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BUREAU OF CONSUMER FINANCIAL PROTECTION

12 CFR Part 1026

[Docket No. CFPB-2020-0020]

RIN 3170-AA98

Qualified Mortgage Definition under the Truth in Lending Act (Regulation Z): General QM Loan Definition

AGENCY: Bureau of Consumer Financial Protection.

ACTION: Proposed rule with request for public comment.

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" (QMs) obtain certain protections from liability. One category of QMs is the General QM loan category. For General QM loans, the ratio of the consumer's total monthly debt to total monthly income (DTI ratio) must not exceed 43 percent. In this notice of proposed rulemaking, the Bureau proposes certain amendments to the General QM loan definition in Regulation Z. Among other things, the Bureau proposes to remove the General QM loan definition's 43 percent DTI limit and replace it with a price-based threshold. Another category of 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) (government-sponsored enterprises, or GSEs), while operating under the conservatorship or receivership of the Federal Housing Finance Agency (FHFA). The GSEs are currently under Federal conservatorship. The Bureau established this category of QMs (Temporary GSE QM loans) as a temporary measure that is set

to expire no later than January 10, 2021 or when the GSEs exit conservatorship. In a separate proposal released simultaneously with this proposal, the Bureau proposes to extend the Temporary GSE QM loan definition to expire upon the effective date of final amendments to the General QM loan definition in Regulation Z (or when the GSEs cease to operate under the conservatorship of the FHFA, if that happens earlier). In this present proposed rule, the Bureau proposes the amendments to the General QM loan definition that are referenced in that separate proposal. The Bureau's objective with these proposals is to facilitate a smooth and orderly transition away from the Temporary GSE QM loan definition and to ensure access to responsible, affordable mortgage credit upon its expiration.

DATES: Comments must be received on or before [INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

ADDRESSES: You may submit comments, identified by Docket No. CFPB-2020-0020 or RIN 3170-AA98, by any of the following methods:

- *Federal eRulemaking Portal*: https://www.regulations.gov. Follow the instructions for submitting comments.
- *Email*: *2020-NPRM-ATRQM-GeneralQM@cfpb.gov*. Include Docket No. CFPB-2020-0020 or RIN 3170-AA98 in the subject line of the message.
- *Mail/Hand Delivery/Courier*: Comment Intake—General QM Amendments, Bureau of Consumer Financial Protection, 1700 G Street, NW, Washington, DC 20552. Please note that due to circumstances associated with the COVID-19 pandemic, the Bureau discourages the submission of comments by mail, hand delivery, or courier.

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, and in light of difficulties associated with mail and hand deliveries during the COVID-19 pandemic, commenters are encouraged to submit comments electronically. In general, all comments received will be posted without change to *https://www.regulations.gov*. In addition, once the Bureau's headquarters reopens, 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 a.m. and 5 p.m. Eastern Time. At that time, you can make an appointment to inspect the documents by telephoning 202-435-9169.

All comments, including attachments and other supporting materials, will become part of the public record and subject to public disclosure. Proprietary information or sensitive personal information, such as account numbers or 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: Benjamin Cady or Waeiz Syed, Counsels, or Sarita Frattaroli, David Friend, Joan Kayagil, Mark Morelli, Amanda Quester, Alexa Reimelt, Marta Tanenhaus, Priscilla Walton-Fein, or Steven Wrone, 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:

I. Summary of the Proposed Rule

The Ability-to-Repay/Qualified Mortgage Rule (ATR/QM Rule or Rule) requires a creditor to make a reasonable, good faith determination of a consumer's ability to repay a residential mortgage loan according to its terms. Loans that meet the Rule's requirements for qualified mortgages (QMs) obtain certain protections from liability. The Rule defines several categories of QMs.

One QM category defined in the Rule is the General QM loan category. General QM loans must comply with the Rule's prohibitions on certain loan features, its points-and-fees limits, and its underwriting requirements. For General QM loans, the ratio of the consumer's total monthly debt to total monthly income (DTI) ratio must not exceed 43 percent. The Rule requires that creditors must calculate, consider, and verify debt and income for purposes of determining the consumer's DTI ratio using the standards contained in appendix Q of Regulation Z.

A second, temporary category of QM loans defined in the Rule consists of mortgages that (1) comply with the same loan-feature prohibitions and points-and-fees limits as General QM loans and (2) are eligible to be purchased or guaranteed by the GSEs while under the conservatorship of the FHFA. This proposal refers to these loans as Temporary GSE QM loans, and the provision that created this loan category is commonly known as the GSE Patch. Unlike for General QM loans, the Rule 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 consumer's DTI ratio exceeds 43 percent, so long as the loan is eligible to be purchased or guaranteed by either of the GSEs. In addition, for Temporary GSE QM loans, the Rule does not require creditors to use appendix Q to determine the consumer's income, debt, or DTI ratio.

Under the Rule, the Temporary GSE QM loan definition expires with respect to each GSE when that GSE exits conservatorship or on January 10, 2021, whichever comes first. The GSEs are currently in conservatorship. Despite the Bureau's expectations when the Rule was published in 2013, Temporary GSE QM loan originations continue to represent a large and persistent share of the residential mortgage loan market. A significant number of Temporary GSE QM loans would not qualify as General QM loans under the current regulations after the Temporary GSE QM loan definition expires. These loans would not qualify as General QM loans either because the consumer's DTI ratio is above 43 percent or because the creditor's method of documenting and verifying income or debt does not comply with appendix Q. Although alternative loan options, including some other types of QM loans, would still be available to many consumers who could not qualify for General QM loans, the Bureau's analysis of available data indicates that many loans that are currently Temporary GSE QM loans would cost materially more for consumers and many would not be made at all.

In a separate proposal (Extension Proposal) released simultaneously with this proposal, the Bureau proposes to extend the Temporary GSE QM loan definition to expire upon the effective date of final amendments to the General QM loan definition or when the GSEs exit conservatorship, whichever comes first. In this proposal, the Bureau proposes the amendments to the General QM loan definition that are referenced in the Extension Proposal.

The Bureau is issuing this proposal to amend the General QM loan definition because it is concerned that retaining the existing General QM loan definition with the 43 percent DTI limit after the Temporary GSE QM loan definition expires would significantly reduce the size of QM and could significantly reduce access to responsible, affordable credit. The Bureau is proposing a price-based General QM loan definition to replace the DTI-based approach because it preliminarily concludes that a loan's price, as measured by comparing a loan's annual percentage rate (APR) to the average prime offer rate (APOR) for a comparable transaction, is a strong indicator of a consumer's ability to repay and is a more holistic and flexible measure of a consumer's ability to repay than DTI alone.

Under the proposal, a loan would meet the General QM loan definition in § 1026.43(e)(2) only if the APR exceeds APOR for a comparable transaction by less than two percentage points as of the date the interest rate is set. The proposal would provide higher thresholds for loans with smaller loan amounts and for subordinate-lien transactions. The proposal would retain the existing product-feature and underwriting requirements and limits on points and fees. Although the proposal would remove the 43 percent DTI limit from the General QM loan definition, the proposal would require that the creditor consider the consumer's income or assets, debt obligations, and DTI ratio or residual income and verify the consumer's current or reasonably expected income or assets other than the value of the dwelling (including any real property attached to the dwelling) that secures the loan and the consumer's current debt obligations, alimony, and child support. The proposal would remove appendix Q. To prevent uncertainty that may result from appendix Q's removal, the proposal would clarify the requirements to consider and verify a consumer's income, assets, debt obligations, alimony, and child support. The proposal would preserve the current threshold separating safe harbor from rebuttable presumption QMs, under which a loan is a safe harbor QM if its APR exceeds APOR for a comparable transaction by less than 1.5 percentage points as of the date the interest rate is set (or by less than 3.5 percentage points for subordinate-lien transactions).

The Bureau is proposing a price-based approach to replace the specific DTI limit because it is concerned that imposing a DTI limit as a condition for QM status under the General QM loan definition may be overly burdensome and complex in practice and may unduly restrict access to credit because it provides an incomplete picture of the consumer's financial capacity. In particular, the Bureau is concerned that conditioning QM status on a specific DTI limit may impair access to responsible, affordable credit for some consumers for whom it might be appropriate to presume ability to repay for their loans at consummation. For the reasons set forth below, the Bureau preliminarily concludes that a price-based General QM loan definition is appropriate because a loan's price, as measured by comparing a loan's APR to APOR for a comparable transaction, is a strong indicator of a consumer's ability to repay and is a more holistic and flexible measure of a consumer's ability to repay than DTI alone.

In addition, although the Bureau is proposing to remove the 43 percent DTI limit and adopt a price-based approach for the General QM loan definition, the Bureau requests comment on certain alternative approaches that would retain a DTI limit but would raise it above the current limit of 43 percent and provide a more flexible set of standards for verifying debt and income in place of appendix Q.

The Bureau proposes that the effective date of a final rule relating to this proposal would be six months after publication in the *Federal Register*. The revised regulations would apply to covered transactions for which creditors receive an application on or after this effective date. The Bureau tentatively determines that a six-month period between *Federal Register* publication of a final rule and the final rule's effective date would give creditors enough time to bring their systems into compliance with the revised regulations. The Bureau does not intend to issue a final rule amending the General QM loan definition early enough for it to take effect before April 1, 2021. The Bureau requests comment on this proposed effective date. The Bureau specifically seeks comment on whether there is a day of the week or time of month that would most facilitate implementation of the proposed changes.

II. Background

A. Dodd-Frank Act 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.[1] 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."[2] 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.[3]

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, DTI 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

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[1] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, sections 1411-12, 1414, 124 Stat. 1376 (2010); 15 U.S.C. 1639c.

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

[3] 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." 15 U.S.C. 1602(dd)(5). TILA section 129C also exempts certain residential mortgage loans from the ATR 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).

the loan.[4] 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 an agency, including the Bureau, later concludes that the ATR determination was not reasonable.

TILA addresses this uncertainty by defining a category of loans—called QMs—for which a creditor "may presume that the loan has met" the ATR requirements.[5] The statute generally defines a QM 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
- 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.[6]

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).[7] The January 2013 Final Rule became

[4] 15 U.S.C. 1639c(a)(3).

[5] 15 U.S.C. 1639c(b)(1).

[6] 15 U.S.C. 1639c(b)(2)(A).

[7] 78 FR 6408 (Jan. 30, 2013).

effective on January 10, 2014, and the Bureau amended it several times through 2016.[8] This proposal 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.[9]

1. General QM Loans

One category of QM loans defined by the Rule consists of "General QM loans."[10] A loan is a General QM loan if:

- 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;[11]

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[8] *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).

[9] 12 CFR 1026.43(c), (e).

[10] The QM definition is related to the definition of Qualified Residential Mortgage (QRM). Section 15G of the Securities Exchange Act of 1934, added by section 941(b) of the Dodd-Frank Act, generally requires the securitizer of asset-backed securities (ABS) to retain not less than five percent of the credit risk of the assets collateralizing the ABS. 15 U.S.C. 78o-11. Six Federal agencies (not including the Bureau) are tasked with implementing this requirement. Those agencies are the Board of Governors of the Federal Reserve System (Board), the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), the Securities and Exchange Commission, the FHFA, and the U.S. Department of Housing and Urban Development (HUD) (collectively, the QRM agencies). Section 15G of the Securities Exchange Act of 1934 provides that the credit risk retention requirements shall not apply to an issuance of ABS if all of the assets that collateralize the ABS are QRMs. *See* 15 U.S.C. 78o-11(c)(1)(C)(iii), (4)(A) and (B). Section 15G requires the QRM agencies to jointly define what constitutes a QRM, taking into consideration underwriting and product features that historical loan performance data indicate result in a lower risk of default. *See* 15 U.S.C. 78o-11(e)(4). Section 15G also provides that the definition of a QRM shall be "no broader than" the definition of a "qualified mortgage," as the term is defined under TILA section 129C(b)(2), as amended by the Dodd-Frank Act, and regulations adopted thereunder. 15 U.S.C. 78o-11(e)(4)(C). In 2014, the QRM agencies issued a final rule adopting the risk retention requirements. 79 FR 77601 (Dec. 24, 2014). The final rule aligns the QRM definition with the QM definition defined by the Bureau in the ATR/QM Rule, effectively exempting securities comprised of loans that meet the QM definition from the risk retention requirement. The final rule also requires the agencies to review the definition of QRM no later than four years after the effective date of the final risk retention rules. In 2019, the QRM agencies initiated a review of certain provisions of the risk retention rule, including the QRM definition. 84 FR 70073 (Dec. 20, 2019). Among other things, the review allows the QRM agencies to consider the QRM definition in light of any changes to the QM definition adopted by the Bureau.

[11] 12 CFR 1026.43(e)(2)(i)-(iii).

- The creditor underwrites the loan based on a fully amortizing schedule using the maximum rate permitted during the first five years;[12]
- The creditor considers and verifies the consumer's income and debt obligations in accordance with appendix Q;[13] and
- The consumer's DTI ratio is no more than 43 percent, determined in accordance with appendix Q.[14]

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 Federal Housing Administration (FHA) of HUD when the January 2013 Final Rule was issued.[15] 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.[16]

2. Temporary GSE QM Loans

A second, temporary category of QM loans defined by the Rule, Temporary GSE QM loans, consists of mortgages that (1) comply with the Rule's prohibitions on certain loan features,

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

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

[14] 12 CFR 1026.43(e)(2)(vi).

[15] 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).

[16] 12 CFR 1026, appendix Q.

its underwriting requirements, and its limitations on points and fees;[17] and (2) are eligible to be purchased or guaranteed by either GSE while under the conservatorship of the FHFA.[18] 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 applicable GSE's 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 with respect to each GSE when that GSE exits conservatorship or on January 10, 2021, whichever comes first.[19]

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.[20] The 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

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[17] 12 CFR 1026.43(e)(2)(i) through (iii).

[18] 12 CFR 1026.43(e)(4).

[19] 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 HUD (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 QM 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).

[20] 78 FR 6408, 6527 (Jan. 30, 2013).

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."[21]

At the same time, the Bureau noted that the mortgage market was especially fragile following the financial crisis, and GSE-eligible loans and federally insured or guaranteed loans made up a significant majority of the market.[22] 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.[23] 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.[24]

In making the Temporary GSE QM loan definition 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."[25] The Bureau believed that the Temporary GSE QM loan definition would benefit consumers by preserving access to credit while the mortgage industry adjusted to the ATR/QM Rule.[26] The Bureau also

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

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

[23] *Id.* at 6534.

[24] *Id.* at 6533.

[25] *Id.* at 6534.

[26] *Id.* at 6536.

explained that it structured the Temporary GSE QM loan definition to cover loans eligible to be purchased or guaranteed by either of the GSEs—regardless of whether the loans are actually purchased or guaranteed—to leave room for non-GSE private investors to return to the market and secure the same legal protections as the GSEs.[27] 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.[28] The Bureau's view was that a shift towards non-QM loans could be supported by the non-GSE 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 definition.[29]

3. *Presumption of Compliance for QM Loans*

In the January 2013 Final Rule, the Bureau considered whether QM loans should receive a conclusive presumption (*i.e.*, a safe harbor) or a rebuttable presumption of compliance with the ATR requirements. The Bureau concluded that the statute is ambiguous as to whether a creditor originating a QM loan receives a safe harbor or a rebuttable presumption that it has complied with the ATR requirements.[30] The Bureau noted that its analysis of the statutory construction

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[27] *Id.* at 6534.

[28] *Id.*

[29] *Id.*

[30] *Id*. at 6511.

and policy implications demonstrated that there are sound reasons for adopting either interpretation.[31] The Bureau concluded that the statutory language does not mandate either interpretation and that the presumptions should be tailored to promote the policy goals of the statute.[32] The Bureau ultimately interpreted the statute to provide for a rebuttable presumption of compliance with the ATR requirements but used its adjustment authority to establish a conclusive presumption of compliance for loans that are not "higher priced."[33]

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." The Rule generally defines a "higher-priced" loan to mean a first-lien mortgage with an APR that exceeded 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 APOR for a comparable transaction as of the date the interest rate was set by 3.5 or more percentage points.[34] 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 from liability.[35] A creditor that makes a loan that meets the standards for a QM loan but is "higher priced" is entitled to a rebuttable presumption that it has complied with the Rule.[36]

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[31] *Id*. at 6507.

[32] *Id*. at 6511.

[33] *Id*. at 6514.

[34] 12 CFR 1026.43(b)(4).

[35] 12 CFR 1026.43(e)(1)(i).

[36] 12 CFR 1026.43(e)(1)(ii).

The Bureau explained in the January 2013 Final Rule why it was adopting different presumptions of compliance based on the pricing of QMs.[37] The Bureau noted that the line it was drawing is one that has long been recognized as a rule of thumb to separate prime loans from subprime loans.[38] The Bureau noted that loan pricing is calibrated to the risk of the loan and that the historical performance of prime and subprime loans indicates greater risk for subprime loans.[39] The Bureau also noted that consumers taking out subprime loans tend to be less sophisticated and have fewer options and that the most abuses prior to the financial crisis occurred in the subprime market.[40] The Bureau concluded that these factors warrant imposing heightened standards for higher-priced loans.[41] For prime loans, however, the Bureau found that lower rates are indicative of ability to repay and noted that prime loans have performed significantly better than subprime loans.[42] The Bureau concluded that if a loan met the product and underwriting requirements for QM and was not a higher-priced loan, there are sufficient grounds for concluding that the creditor satisfied the ATR requirements.[43] The Bureau noted that the conclusive presumption may reduce uncertainty and litigation risk and may promote enhanced competition in the prime market.[44] The Bureau also noted that the litigation risk for

[37] 78 FR 6408 at 6506, 6510-14.

[38] *Id*. at 6408.

[39] *Id*. at 6511.

[40] *Id*.

[41] *Id*.

[42] *Id*.

[43] *Id*.

[44] *Id*.

rebuttable presumption QMs likely would be quite modest and would have a limited impact on access to credit.[45]

The Bureau also noted in the January 2013 Final Rule that policymakers have long relied on pricing to determine which loans should be subject to additional regulatory requirements.[46] That history of reliance on pricing continues to provide support for a price-based approach to the General QM loan definition. For example, in 1994 Congress amended TILA by enacting the Home Ownership and Equity Protection Act (HOEPA) as part of the Riegle Community Development and Regulatory Improvement Act of 1994.[47] HOEPA was enacted as an amendment to TILA to address abusive practices in refinancing and home-equity mortgage loans with high interest rates or high fees.[48] The statute applied generally to closed-end mortgage credit but excluded purchase money mortgage loans and reverse mortgages. Coverage was triggered if a loan's APR exceeded comparable Treasury securities by specified thresholds for particular loan types, or if points and fees exceeded eight percent of the total loan amount or a dollar threshold.[49] For high-cost loans meeting either of those thresholds, HOEPA required creditors to provide special pre-closing disclosures, restricted prepayment penalties and certain other loan terms, and regulated various creditor practices, such as extending credit without

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[45] *Id*. at 6511-12.

[46] *Id*. at 6413-14, 6510-11.

[47] Riegle Community Development and Regulatory Improvement Act, Pub. L. 103-325, 108 Stat. 2160 (1994).

[48] As originally enacted, HOEPA defined a class of "high-cost mortgages," which were generally closed-end home-equity loans (excluding home-purchase loans) with APRs or total points and fees exceeding prescribed thresholds. Mortgages covered by HOEPA have been referred to as "HOEPA loans," "Section 32 loans," or "high-cost mortgages."

[49] The Dodd-Frank Act adjusted the baseline for the APR comparison, lowered the points-and-fees threshold, and added a prepayment trigger.

regard to a consumer's ability to repay the loan. HOEPA also created special substantive protections for high-cost mortgages, such as prohibiting a creditor from engaging in a pattern or practice of extending a high-cost mortgage to a consumer based on the consumer's collateral without regard to the consumer's repayment ability, including the consumer's current and expected income, current obligations, and employment.[50] The Board implemented the HOEPA amendments at §§ 226.31, 226.32, and 226.33[51] of Regulation Z.[52]

In 2001, the Board issued rules expanding HOEPA's protections to more loans by revising the APR threshold for first-lien mortgage loans and revising the ATR provisions to provide for a presumption of a violation of the rule if the creditor engages in a pattern or practice of making high-cost mortgages without verifying and documenting the consumer's repayment ability.

In 2008, the Board exercised its authority under HOEPA to extend certain consumer protections concerning a consumer's ability to repay and prepayment penalties to a new category of "higher-priced mortgage loans" (HPMLs)[53] with APRs that are lower than those prescribed for high-cost loans but that nevertheless exceed the APOR by prescribed amounts. This new

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[50] TILA section 129(h); 15 U.S.C. 1639(h). In addition to the disclosures and limitations specified in the statute, HOEPA expanded the Board's rulemaking authority, among other things, to prohibit acts or practices the Board found to be unfair and deceptive in connection with mortgage loans.

[51] Subsequently renumbered as sections 1026.31, 1026.32, and 1026.33 of Regulation Z.

[52] *See* 60 FR 15463 (Mar. 24, 1995).

[53] Under the Board's 2008 HOEPA Final Rule, a higher-priced mortgage loan is a consumer credit transaction secured by the consumer's principal dwelling with an APR that exceeds APOR for a comparable transaction, as of the date the interest rate is set, by 1.5 or more percentage points for loans secured by a first lien on the dwelling, or by 3.5 or more percentage points for loans secured by a subordinate lien on the dwelling. 73 FR 44522 (July 30, 2008) (2008 HOEPA Final Rule). The definition of a "higher-priced mortgage loan" includes practically all "high-cost mortgages" because the latter transactions are determined by higher loan pricing threshold tests. *See* 12 CFR 226.35(a)(1).

category of loans was designed to include subprime credit, including subprime purchase money mortgage loans. Specifically, the Board exercised its authority to revise HOEPA's restrictions on high-cost loans based on a conclusion that the revisions were necessary to prevent unfair and deceptive acts or practices in connection with mortgage loans.[54] The Board concluded that a prohibition on making individual loans without regard for repayment ability was necessary to ensure a remedy for consumers who are given unaffordable loans and to deter irresponsible lending, which injures individual consumers. The 2008 HOEPA Final Rule provided a presumption of compliance with the higher-priced mortgage ability-to-repay requirements if the creditor follows certain procedures regarding underwriting the loan payment, assessing the DTI ratio or residual income, and limiting the features of the loan, in addition to following certain procedures mandated for all creditors.[55] However, the 2008 HOEPA Final Rule made clear that even if the creditor follows the required and optional criteria, the creditor obtained a presumption (not a safe harbor) of compliance with the repayment ability requirement. The consumer therefore could still rebut or overcome that presumption by showing that, despite following the required and optional procedures, the creditor nonetheless disregarded the consumer's ability the loan.

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

[54] 73 FR 44522 (July 30, 2008).

[55] *See* 12 CFR 1026.34(a)(4)(iii), (iv).

effective date of the rule or order.[56] In June 2017, the Bureau published a request for information in connection with its assessment of the ATR/QM Rule (Assessment RFI).[57] These comments are summarized in general terms in part III below.

In January 2019, the Bureau published its ATR/QM Rule Assessment Report.[58] The Report included 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 have been associated with higher levels of "early delinquency" (*i.e.*, delinquency within two years of origination), which can serve as a proxy for measuring consumer repayment ability at consummation across a wide pool of loans.[59] The Report also found that the Rule did not eliminate access to credit for high-DTI consumers—*i.e.*, consumers with DTI ratios above 43 percent—who qualify for loans eligible for purchase or guarantee by either of the GSEs, that is, Temporary GSE QM loans.[60] On the other hand, based on application-level data obtained from nine large lenders, the Report found that the Rule eliminated between 63 and 70 percent of high-DTI home purchase loans that were not Temporary GSE QM loans.[61]

One main finding about Temporary GSE QM loans was that such loans continued to represent a "large and persistent" share of originations in the conforming segment of the

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[56] 12 U.S.C. 5512(d).

[57] 82 FR 25246 (June 1, 2017).

[58] *See generally* Bureau of Consumer Fin. Prot., *Ability to Repay and Qualified Mortgage Assessment Report* (Jan. 2019) (Assessment Report), https://files.consumerfinance.gov/f/documents/cfpb_ability-to-repay-qualified-mortgage_assessment-report.pdf.

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

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

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

mortgage market.[62] 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.[63] 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.[64]

The continued prevalence of Temporary GSE QM loan originations is contrary to the Bureau's expectation at the time it issued the ATR/QM Rule in 2013.[65] The Assessment Report discussed several possible reasons for the continued prevalence of Temporary GSE QM loan originations. The Report first 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" for Temporary GSE QM loans instead of originating loans under the General QM loan definition.[66] In addition, the Bureau has not revised appendix Q since 2013, while other standards for calculating and verifying debt and income have been updated more frequently.[67] ANPR commenters also expressed concern with appendix Q and stated that the Temporary GSE QM loan definition has benefited creditors and consumers by enabling creditors to originate QMs without having to use appendix Q.

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

[63] *Id.* at 191.

[64] *Id.* at 192.

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

[66] *Id.* at 193.

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

The Assessment Report noted that a second possible reason for the continued prevalence of Temporary GSE QM loans is that the GSEs were able to accommodate the demand for mortgages above the General QM loan definition's DTI limit of 43 percent as the DTI ratio distribution in the market shifted upward.[68] According to the Assessment 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 ratio distribution to shift upward.[69] The Assessment Report noted that the share of GSE home purchase loans with DTI ratios above 43 percent has increased since the ATR/QM Rule took effect in 2014.[70] The available data suggest that such high-DTI lending has declined in the non-GSE market relative to the GSE market.[71] The non-GSE market has constricted even with respect to highly qualified consumers; those with higher incomes and higher credit scores are representing a greater share of denials.[72]

The Assessment Report found that a third possible reason for the persistence of Temporary GSE QM loans is the structure of the secondary market.[73] If creditors adhere to the GSEs' guidelines, they gain access to a robust, highly liquid secondary market.[74] In contrast, while private market securitizations have grown somewhat in recent years, their volume is still a

[68] *Id.* at 194.

[69] *Id.*

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

[71] *Id.* at 119-20.

[72] *Id.* at 153.

[73] *Id.* at 196.

[74] *Id.*

fraction of their pre-crisis levels.[75] There were less than $20 billion in new origination PLS issuances in 2017, compared with $1 trillion in 2005,[76] and only 21 percent of new origination PLS issuances in 2017 were non-QM issuances.[77] To the extent that private securitizations have occurred since the ATR/QM Rule took effect in 2014, the majority of new origination PLS issuances have consisted of prime jumbo loans made to consumers with strong credit characteristics, and these securities have a low share of non-QM loans.[78] The Assessment Report notes that the Temporary GSE QM loan definition may itself be inhibiting the growth of the non-QM market.[79] However, the Report also notes that it is possible that this market might not exist even with a narrower Temporary GSE QM loan definition, if consumers were unwilling to pay the premium charged to cover the potential litigation risk associated with non-QMs, which do not have a presumption of compliance with the ATR requirements, or if creditors were unwilling or lack the funding to make the loans.[80]

The Bureau expects that each of these features of the mortgage market that concentrate lending within the Temporary GSE QM loan definition will largely persist through the current January 10, 2021 sunset date.

D. Effects of the COVID-19 Pandemic on Mortgage Markets

The COVID-19 pandemic has had a significant effect on the U.S. economy. Economic activity has contracted, some businesses have partially or completely closed, and millions of

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[75] *Id.*

[76] *Id.*

[77] *Id.* at 197.

[78] *Id.* at 196.

[79] *Id.* at 205.

[80] *Id.*

workers have become unemployed. The pandemic has also affected mortgage markets and has resulted in a contraction of mortgage credit availability for many consumers, including those that would be dependent on the non-QM market for financing. The pandemic's impact on both the secondary market for new originations and on the servicing of existing mortgages has contributed to this contraction, as described below.

1. Secondary Market Impacts and Implications for Mortgage Origination Markets

The economic disruptions associated with the COVID-19 pandemic have restricted the flow of credit in the U.S. economy, including the mortgage market. During periods of economic distress, many investors seek to purchase safer instruments and as tensions and uncertainty rose in mid-March of 2020, investors moved rapidly towards cash and government securities.[81] Indeed, the yield on the 10-year Treasury note, which moves in the opposite direction as the note's price, declined while mortgage rates increased between February 2020 and March 2020.[82] This widening spread was exacerbated by a large supply of mortgage-backed securities (MBS) entering the market, as investors in MBS sold large portfolios of agency MBS.[83] As a result, in March of 2020, the lack of investor demand to purchase mortgages made it difficult for creditors to originate loans, as many creditors rely on the ability to profitably sell loans in the secondary market to generate the liquidity to originate new loans. This resulted in mortgages becoming more expensive for both homebuyers and homeowners looking to refinance.

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[81] *The Quarterly CARES Act Report to Congress: Hearing Before the S. Comm. on Banking, Housing, and Urban Affairs*, 116th Cong. 2-3 (2020) (statement of Jerome H. Powell, Chairman, Board of Governors of the Federal Reserve System).

[82] Laurie Goodman *et al*., Urban Institute, *Housing Finance at a Glance, Monthly Chartbook,* (Mar. 26, 2020), https://www.urban.org/research/publication/housing-finance-glance-monthly-chartbook-march-2020.

[83] Agency MBS are backed by loans guaranteed by Fannie Mae, Freddie Mac, and the Government National Mortgage Association (Ginnie Mae).

On March 15, 2020, the Board announced that it would increase its holdings of agency MBS by at least $200 billion.[84] On March 23, 2020, the Board announced that it would remove this limit and purchase agency MBS "in the amounts needed to support smooth market functioning and effective transmission of monetary policy to broader financial conditions and the economy."[85] The Board took these actions to stabilize the secondary market and support the continued flow of mortgage credit. With these purchases, market conditions have improved substantially, and the Board has since slowed its pace of purchases.[86] This has helped to stabilize mortgage rates, resulting in a decline in mortgage rates since the Board's intervention.

Non-agency MBS[87] are generally perceived by investors as riskier than agency MBS, and non-QM lending has declined as a result. Issuance of non-agency MBS declined by 8.2 percent in the first quarter of 2020, with nearly all the transactions completed in January and February, before the COVID-19 pandemic began to affect the economy significantly.[88] Nearly all major non-QM creditors ceased making loans in March and April. In May of 2020, issuers of non-agency MBS began to test the market with deals collateralized by non-QM loans largely originated prior to the crisis. Moreover, several non-QM creditors—which largely depend on the

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[84] Press Release, Bd. of Governors of the Fed. Reserve Sys., *Federal Reserve issues FOMC statement* (Mar. 15, 2020), https://www.federalreserve.gov/newsevents/pressreleases/monetary20200315a.htm.

[85] Press Release, Bd. of Governors of the Fed. Reserve Sys., *Federal Reserve announces extensive new measures to support the economy* (Mar. 23, 2020), https://www.federalreserve.gov/newsevents/pressreleases/monetary20200323b.htm.

[86] *The Quarterly CARES Act Report to Congress: Hearing Before the S. Comm. on Banking, Housing, and Urban Affairs*, 116th Cong. 3 (2020) (statement of Jerome H. Powell, Chairman, Board of Governors of the Federal Reserve System).

[87] Non-agency MBS are not backed by loans guaranteed by Fannie Mae, Freddie Mac or the Ginnie Mae. This includes securities collateralized by non-QM loans.

[88] Brandon Ivey, *Non-Agency MBS Issuance Slowed in First Quarter* (2020), https://www.insidemortgagefinance.com/articles/217623-non-agency-mbs-issuance-slowed-in-first-quarter.

ability to sell loans in the secondary market in order to fund new loans—have begun to resume originations, albeit with a tighter credit box.[89] Prime jumbo financing dropped nearly 22 percent in the first quarter of 2020. Banks increased interest rates and narrowed the product offering to consumers with pristine credit profiles, as these loans must be held on portfolio when the secondary market for non-agency MBS contracts.[90]

2. *Servicing Market Impacts and Implications for Origination Markets*

Anticipating that a number of homeowners would struggle to pay their mortgages due to the pandemic and related economic impacts, Congress passed and the President signed the Coronavirus Aid, Relief, and Economic Security Act (the CARES Act) in March 2020. The CARES Act provides additional protections for borrowers whose mortgages are purchased or securitized by a GSE and certain federally-backed mortgages.[91] The CARES Act mandates a 60-day foreclosure moratorium for such mortgages. The CARES Act also allows borrowers to request up to 180 days of forbearance due to a COVID-19-related financial hardship, with an option to extend the forbearance period for an additional 180 days.

Following the passage of the CARES Act, some mortgage servicers remain obligated to make some principal and interest payments to investors in GSE and Ginnie Mae securities, even

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[89] Brandon Ivey, *Non-Agency Mortgage Securitization Opening Up After Pause* (2020), https://www.insidemortgagefinance.com/articles/218034-non-agency-mortgage-securitization-opening-up-after-pause.

[90] Brandon Ivey, *Jumbo Originations Drop Nearly 22% in First Quarter* (2020) https://www.insidemortgagefinance.com/articles/218028-jumbo-originations-drop-nearly-22-in-first-quarter.

[91] Coronavirus Aid, Relief, and Economic Security Act, Public Law 116-136 (2020). (Includes loans backed by HUD, the U.S. Department of the Agriculture, the U.S. Department of Veterans Affairs (VA), Fannie Mae, and Freddie Mac).

if consumers are not making payments.[92] Servicers also remain obligated to make escrowed real estate tax and insurance payments to local taxing authorities and insurance companies. Significant liquidity is needed to fulfill servicer obligations to security holders. While servicers are required to hold liquid reserves to cover anticipated advances, significantly higher-than-expected forbearance rates over an extended period of time may lead to liquidity shortages particularly among many non-bank servicers. According to a weekly survey from the Mortgage Bankers Association, from March 2, 2020 to June 7, 2020, the total number of loans in forbearance grew from 0.25 percent to 8.55 percent, with Ginnie Mae loans having the largest growth from 0.19 percent to 11.83 percent.[93]

To address the anticipated liquidity shortage, on April 10, 2020, Ginnie Mae released guidance on a Pass-Through Assistance Program whereby Ginnie Mae will provide financial assistance at a fixed interest rate to servicers facing a principal and interest shortfall as a last resort. On April 7, 2020, Ginnie Mae also announced approval of a servicing advance financing facility, whereby mortgage servicing rights are securitized and sold to private investors. This change may alleviate some of the liquidity pressures that may cause a servicer to draw on the Pass-Through Assistance Program.

Because many mortgage servicers also originate the loans they service, many creditors have responded to the risk of elevated forbearances and higher-than-expected monthly advances

[92] The GSEs typically repurchase loans out of the trust after they fall 120 days delinquent, after which the servicer is no longer required to advance principal and interest, but Ginnie Mae requires servicers to advance principal and interest until the default is resolved. On April 21, 2020, the FHFA confirmed that servicers of GSE loans will only be required to advance four months of mortgage payments, regardless of whether the GSEs repurchase the loans from the trust after 120 days of delinquency.

[93] Press Release, Mortgage Banker Association, *Share of Mortgage Loans in Forbearance Increases to 8.55%* , (June 15, 2020), https://www.mba.org/2020-press-releases/june/share-of-mortgage-loans-in-forbearance-increases-to-855.

by imposing additional underwriting standards for new originations. These new underwriting standards include more stringent requirements for non-QM, jumbo, and government loans.[94] For example, one major bank announced on April 13, 2020, that it would require prospective home purchasers to have a minimum 700 FICO score and 20 percent down payment. By lending only to consumers with high credit scores, lower DTI ratios, or significant liquid reserves, creditors are managing their risk by reducing the likelihood that a newly-originated loan will require a forbearance plan.

Moreover, several large warehouse providers—*i.e.*, creditors that provide financing to mortgage originators and servicers—have restricted the ability of non-banks to fund loans on their warehouse line by prohibiting the funding of loans to consumers with lower credit scores. These types of restrictions mitigate the warehouse lender's exposure in the event a non-bank fails or is unable to sell the loan prior to the consumer requesting a forbearance.[95]

As of mid-June, historically low interest rates combined with a leveling off in forbearance rates have resulted in an increase in refinance activity that has been primarily concentrated in the agency sector, helping to mitigate some of the servicing liquidity concerns. However, it is unclear how quickly non-banks will return to the non-QM market even after the mortgage market in general recovers.

[94] Maria Volkova, *FHA/VA Lenders Raise Credit Score Requirements* (2020), https://www.insidemortgagefinance.com/articles/217636-fhava-lenders-raise-fico-credit-score-requirements.

[95] On April 22, 2020, the FHFA announced the GSEs would be permitted to purchase certain loans whereby the borrower requested a forbearance prior to the sale of the loan for a limited period of time and at a higher cost.

III. The Rulemaking Process

The Bureau has solicited and received substantial public and stakeholder input on issues related to this proposed rule. In addition to the Bureau's discussions with and communications from industry stakeholders, consumer advocates, other Federal agencies,[96] and members of Congress, the Bureau issued requests for information (RFIs) in 2017 and 2018 and in July 2019 issued an advance notice of proposed rulemaking regarding the ATR/QM Rule (ANPR). The input from these RFIs and from the ANPR is briefly summarized below.

A. The Requests for Information

In June 2017, the Bureau published a request for information in connection with the Assessment Report (Assessment RFI).[97] In response to the Assessment RFI, the Bureau received approximately 480 comments from creditors, industry groups, consumer advocacy groups, and individuals.[98] The comments addressed a variety of topics, including the General QM loan definition and the 43 percent DTI limit; perceived problems with, and potential changes and alternatives to, appendix Q; and how the Bureau should address the expiration of the Temporary GSE QM loan definition. The comments expressed a range of ideas for addressing the expiration of the Temporary GSE QM loan definition, from making the definition permanent, to applying the definition to other mortgage products, to extending it for various periods of time, or some combination of those suggestions. Other comments stated that the Temporary GSE QM loan definition should be eliminated or permitted to expire.

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[96] The Bureau has consulted with agencies including the FHFA, the Board, FHA, the FDIC, the OCC, the Federal Trade Commission, the National Credit Union Administration, and the Department of the Treasury.

[97] 82 FR 25246 (June 1, 2017).

[98] *See* Assessment Report, *supra* note 58, appendix B (summarizing comments received in response to the Assessment RFI).

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.[99] As part of the call for evidence, the Bureau published requests for information relating to, among other things, the Bureau's rulemaking process,[100] the Bureau's adopted regulations and new rulemaking authorities,[101] and the Bureau's inherited regulations and inherited rulemaking authorities.[102] In response to the call for evidence, the Bureau received comments on the ATR/QM Rule from stakeholders, including consumer advocacy groups and industry groups. The comments addressed a variety of topics, including the General QM loan definition, appendix Q, and the Temporary GSE QM loan definition. The comments also raised concerns about, among other things, the risks of allowing the Temporary GSE QM loan definition 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.

B. The Advance Notice of Proposed Rulemaking

On July 25, 2019, the Bureau issued an advance notice of proposed rulemaking regarding the ATR/QM Rule (ANPR). The ANPR stated the Bureau's tentative plans to allow the Temporary GSE QM loan definition 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 definition. The Bureau also stated that it was considering whether

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[99] *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).

[100] 83 FR 10437 (Mar. 9, 2018).

[101] 83 FR 12286 (Mar. 21, 2018).

[102] 83 FR 12881 (Mar. 26, 2018).

to propose revisions to the General QM loan definition in light of the potential expiration of the Temporary GSE QM loan definition and requested comments on several topics related to the General QM loan definition. These topics included: (1) whether and how the Bureau should revise the DTI limit in the General QM loan definition; (2) whether the Bureau should supplement or replace the DTI limit with another method for directly measuring a consumer's personal finances; (3) whether the Bureau should revise appendix Q or replace it with other standards for calculating and verifying a consumer's debt and income; and (4) whether, instead of a DTI limit, the Bureau should adopt standards that do not directly measure a consumer's personal finances.[103] The Bureau requested comment on how much time industry would need to change its practices in response to any changes the Bureau makes to the General QM loan definition.[104] The Bureau received 85 comments on the ANPR from businesses in the mortgage industry (including creditors), consumer advocacy groups, elected officials, individuals, and research centers.

1. Direct Measures of a Consumer's Personal Finances

Commenters largely supported moving away from using the 43 percent DTI limit as a stand-alone General QM underwriting criterion. While a few commenters supported maintaining the current General QM loan definition's 43 percent DTI limit as a stand-alone criterion along with clarifying revisions to appendix Q, the large majority of commenters—representing the mortgage industry, consumer advocacy groups, and research centers—supported either eliminating a DTI limit, replacing it with other methods of measuring a consumer's ability to

[103] 84 FR 37155, 37155, 37160-62 (July 31, 2019).

[104] The Bureau stated that if the amount of time industry would need to change its practices in response to the rule depends on how the Bureau revises the General QM loan definition, the Bureau requested time estimates based on alternative possible definitions.

repay, such as cash flow underwriting or residual income, or supplementing it with additional compensating factors. These commenters asserted that, as a stand-alone factor, DTI has limited predictiveness of a consumer's ability to repay and has an adverse impact on responsible access to credit for low-to-moderate income and minority homeowners.

Many commenters suggested the Bureau consider replacing DTI with an alternative measure of a consumer's ability to repay, such as residual income or cash flow underwriting. While some commenters indicated these alternative measures are more accurate predictors of ability to repay, others suggested the Bureau conduct additional studies of these alternative measures and the effectiveness of existing standards, such as the VA's residual income test.

Other commenters suggested the Bureau promulgate a General QM loan definition that allows certain compensating factors to supplement a specific DTI limit. Under this approach, the rule would set a specific DTI limit (*e.g.*, 43 percent) but would permit loans with higher DTI ratios to be originated as QMs if the creditor determined that certain compensating factors were present. Commenters identified several potential compensating factors, including cash reserves or past payment performance history. Advocates for this approach pointed to the GSEs' underwriting standards, which permit loans with DTI ratios between 43 and 50 percent if compensating factors are present, as evidence that higher DTI loans with appropriate consideration of compensating factors can result in affordable loans. Some of the commenters suggested the current General QM loan definition's 43 percent DTI limit could be responsibly increased. Some commenters recommended that the Bureau incorporate compensating factors into the General QM loan definition but also adopt an overall DTI limit above which loans could not be originated as General QMs, regardless of any compensating factors. Under this approach, similar to the GSEs' current underwriting standards, creditors could originate loans under the

General QM loan definition with DTI ratios under a certain threshold (*e.g.*, 43 percent) without compensating factors, could originate loans under the General QM loan definition with DTI ratios between that threshold and a higher threshold (*e.g.*, 50 percent) if the creditor identifies certain compensating factors, but could not originate loans under the General QM loan definition with DTI ratios above the higher threshold.

The Bureau also solicited comment on whether the rule should retain appendix Q as the standard for calculating and verifying debt and income if the rule retains a direct measure of a consumer's personal finances for General QM. Nearly all commenters agreed that appendix Q in its existing form is insufficient—specifically, that the requirements lack clarity in certain areas, which leaves creditors uncertain of the QM status of their loans. Commenters also criticized appendix Q for being overly prescriptive and outdated in other areas and therefore lacking the flexibility to adapt to changing market conditions. Proponents of eliminating the DTI limit entirely stated that appendix Q could be eliminated without replacement and that the Bureau could instead publish supervisory guidance or best practices to assist creditors in satisfying the ATR requirements. Other commenters suggested that the rule supplement appendix Q or replace it with reasonable alternatives that allow for more flexibility, such as the GSE or FHA standards for verifying income and debt. Although most commenters advocated for elimination of appendix Q, the commenters that advocated for retaining appendix Q generally suggested the Bureau should revise appendix Q to modernize the standards and ease industry compliance.

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

Many commenters argued that there are alternatives that are more predictive of loan performance and a consumer's ability to repay than stand-alone direct measures of a consumer's personal finances such as DTI or residual income. Most commenters noting these alternatives advocated for eliminating the DTI limit entirely and suggested that loan product features and loan pricing should serve as the primary factors that determine a loan's QM status. Commenters that opposed incorporating alternatives to direct measures of a consumer's personal finances into the General QM loan definition generally argued that a creditor's ATR determination is separate and distinct from a creditor's decision on whether to originate a loan. For example, they argued that because creditors consider factors unrelated to ability to repay in determining their cumulative loss exposure—such as the amount of equity in a property—creditors can originate loans that may not be affordable for consumers in the long-term. Commenters cited asset-based lending prior to the crisis, when some creditors originated unaffordable loans with the intention of refinancing the loan prior to default or otherwise believed they were protected from loss in the event of default due to the consumer's equity in the property. Commenters critical of price-based approaches to the General QM loan definition also stated that loan pricing includes a wide variety of factors unrelated to credit quality, such as the value of the mortgage servicing rights. These commenters also raised concerns about the pro-cyclical nature of loan pricing. They argued that mortgage interest rate spreads tend to contract during economic expansions, such that a price-based approach to the General QM loan definition could grant QM status to loans that exceed consumers' ability to repay and increase housing prices. In contrast, they claimed that mortgage interest rate spreads tend to expand during economic contractions, inhibiting access to credit. Commenters critical of price-based approaches also raised concerns that these approaches are vulnerable to lender manipulation.

Most commenters that advocated for removing the DTI limit entirely from the General QM loan definition suggested the existing General QM protections are sufficient—including the prohibited product features, the points-and-fees cap, and the ATR requirements to consider and verify a consumer's debt, income or assets, DTI, or residual income. They argued that the rule should continue to rely on the interest rate spread between the APR and the APOR to distinguish those QM loans eligible for a safe harbor from those eligible for a rebuttable presumption of compliance. Proponents of this approach argued that creditors use a wide variety of factors in the lending decision and consumers with higher-risk lending attributes receive higher interest rates to compensate creditors and investors for the added risk. Accordingly, these commenters argued that the APR spread above the benchmark APOR is more predictive of the general creditworthiness of a loan and a consumer's ability to repay than stand-alone measures such as DTI. While some commenters suggested that the rule should retain the existing price threshold separating safe harbor QM loans from rebuttable presumption QM loans, which is 1.5 percentage points above APOR for most loans, others suggested that it would be appropriate to increase the threshold. Other commenters suggested there could be an additional pricing threshold, above which loans would be designated as non-QM.

Commenters also provided input on the distinction between a safe harbor presumption of compliance and a rebuttable presumption of compliance with the ATR requirements. While commenters offered different views about whether 1.5 percentage points over APOR is appropriate for distinguishing between safe harbor and rebuttable presumption QMs, or if it should be increased, most commenters advocated for maintaining a safe harbor. However, several consumer advocacy groups suggested all QM loans should be subject to a rebuttable presumption of compliance. Several commenters noted that the 1.5 percentage point over APOR threshold would disproportionately prevent smaller loans and loans for manufactured housing from being originated as QMs. They noted that creditors typically charge more to recover fixed costs on small loans than on larger loans with equivalent risk attributes.

Some commenters advocated for an approach whereby the QM determination would be based primarily on the likelihood of default or loss given default as determined by an underwriting model. One commenter recommended that QM status be determined by expected default rates in stressed economic conditions, given certain origination characteristics. Other commenters suggested a Bureau-approved automated underwriting model could determine a loan's QM status. Proponents of these approaches argued that an underwriting model would reflect a more holistic consideration of relevant factors but remove the risk that creditors misprice or underprice loans due to competitive pressures. While many commenters acknowledged the operational complexity associated with the Bureau developing and maintaining an automated underwriting model, they argued that this approach would provide creditors with the certainty of a loan's QM status while most accurately assessing the consumer's ability to sustain the mortgage payment.

Commenters also argued that consumer performance over an extended period should be considered sufficient evidence that the creditor adequately assessed a consumer's ability to repay at origination. They recommended that a loan that is originated as a non-QM or rebuttable presumption QM loan should be eligible to "season" into a QM safe harbor loan if the consumer makes timely payments for a pre-determined length of time. Commenters pointed to the GSE representation and warranty framework as precedent for this concept and argued that a creditor's legal exposure to the ATR requirement should also sunset accordingly. However, several commenters opposed allowing loans to season into QMs. They argued that a period of successful repayment is insufficient to presume conclusively that the creditor reasonably determined ability to repay at origination, that creditors would engage in gaming to minimize defaults during the seasoning period, and that seasoning would inappropriately prevent consumers from raising lack of ability to repay as a defense to foreclosure.

The Bureau is considering adding a seasoning approach to the ATR/QM Rule. A seasoning approach would create an alternative pathway to QM safe harbor status for certain mortgages if the consumer has consistently made timely payments for a specified period of time. The Bureau in the near future will issue a separate proposal that addresses adding such an approach to the ATR/QM Rule.

3. Other Temporary GSE QM Loan Issues

As discussed in the ANPR, absent any changes, the Temporary GSE QM loan definition will remain in effect until January 10, 2021 or the date the GSEs exit conservatorship, whichever occurs first. The Bureau sought comment on whether a short extension would be necessary to minimize market disruption and to potentially facilitate an orderly transition to a new General QM loan definition. While some industry and consumer advocates commented that the Temporary GSE QM loan definition should be made permanent, many commenters supported its expiration following a short extension to revise the General QM loan definition. Industry commenters stated that the length of time to implement a new General QM loan definition would largely be determined by the scale and complexity of the revisions to the General QM loan definition. Commenters supporting the price-based approach indicated that a relatively short implementation period likely would be necessary, given the approach would largely be a simplification of the existing General QM construct. Other commenters suggested linking the date of the Temporary GSE QM loan definition expiration to a period following the publication date of the final General QM rule, such as one year. As noted above, the Bureau is issuing a separate NPRM to address the timing of the expiration of the Temporary GSE QM Loan definition.

IV. Legal Authority

The Bureau is proposing to amend Regulation Z pursuant to its authority under TILA and the Dodd-Frank Act. Section 1061 of the Dodd-Frank Act transferred to the Bureau the "consumer financial protection functions" previously vested in certain other Federal agencies, including the Board. The Dodd-Frank Act defines the term "consumer financial protection function" to include "all authority to prescribe rules or issue orders or guidelines pursuant to any Federal consumer financial law, including performing appropriate functions to promulgate and review such rules, orders, and guidelines."[105] Title X of the Dodd-Frank Act (including section 1061), along with TILA and certain subtitles and provisions of title XIV of the Dodd-Frank Act, are Federal consumer financial laws.[106]

A. TILA

TILA section 105(a). Section 105(a) of TILA directs the Bureau to prescribe regulations to carry out the purposes of TILA and states that such regulations may contain such additional requirements, classifications, differentiations, or other provisions and may further provide for such adjustments and exceptions for all or any class of transactions that the Bureau judges are necessary or proper to effectuate the purposes of TILA, to prevent circumvention or evasion thereof, or to facilitate compliance therewith.[107] A purpose of TILA is "to assure a meaningful

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[105] 12 U.S.C. 5581(a)(1)(A).

[106] Dodd-Frank Act section 1002(14), 12 U.S.C. 5481(14) (defining "Federal consumer financial law" to include the "enumerated consumer laws" and the provisions of title X of the Dodd-Frank Act), Dodd-Frank Act section 1002(12)(O), 12 U.S.C. 5481(12)(O) (defining "enumerated consumer laws" to include TILA).

[107] 15 U.S.C. 1604(a).

disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit."[108] Additionally, a purpose of TILA sections 129B and 129C is 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.[109] As discussed in the section-by-section analysis below, the Bureau is proposing to issue certain provisions of this proposed rule pursuant to its rulemaking, adjustment, and exception authority under TILA section 105(a).

TILA section 129C(b)(2)(A). TILA section 129C(b)(2)(A)(vi) provides the Bureau with authority to establish guidelines or regulations relating to ratios of total monthly debt to monthly income or alternative measures of ability to pay regular expenses after payment of total monthly debt, taking into account the income levels of the borrower and such other factors as the Bureau may determine relevant and consistent with the purposes described in TILA section 129C(b)(3)(B)(i).[110] As discussed in the section-by-section analysis below, the Bureau is proposing to issue certain provisions of this proposed rule pursuant to its authority under TILA section 129C(b)(2)(A)(vi).

TILA section 129C(b)(3)A), (B)(i). TILA section 129C(b)(3)(B)(i) authorizes the Bureau to prescribe regulations that revise, add to, or subtract from the criteria that define a QM upon a finding that such regulations are necessary or proper to ensure that responsible, affordable mortgage credit remains available to consumers in a manner consistent with the purposes of

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[108] 15 U.S.C. 1601(a).

[109] 15 U.S.C. 1639b(a)(2).

[110] 15 U.S.C. 1639c(b)(2)(A).

TILA section 129C; or are necessary and appropriate to effectuate the purposes of TILA sections 129B and 129C, to prevent circumvention or evasion thereof, or to facilitate compliance with such sections.[111] In addition, TILA section 129C(b)(3)(A) directs the Bureau to prescribe regulations to carry out the purposes of section 129C.[112] As discussed in the section-by-section analysis below, the Bureau is proposing to issue certain provisions of this proposed rule pursuant to its authority under TILA section 129C(b)(3)(B)(i).

B. Dodd-Frank Act

Dodd-Frank Act section 1022(b). Section 1022(b)(1) of the Dodd-Frank Act authorizes the Bureau to prescribe rules to enable the Bureau to administer and carry out the purposes and objectives of the Federal consumer financial laws, and to prevent evasions thereof.[113] TILA and title X of the Dodd-Frank Act are Federal consumer financial laws. Accordingly, the Bureau is proposing to exercise its authority under Dodd-Frank Act section 1022(b) to prescribe rules that carry out the purposes and objectives of TILA and title X and prevent evasion of those laws.

V. Why the Bureau Is Issuing this Proposal

The Bureau is issuing this proposal to amend the General QM loan definition because it is concerned that retaining the existing General QM loan definition with the 43 percent DTI limit after the Temporary GSE QM loan definition expires would significantly reduce the size of QM and could significantly reduce access to responsible, affordable credit. The Bureau is proposing a price-based General QM loan definition to replace the DTI-based approach because it preliminarily concludes that a loan's price, as measured by comparing a loan's APR to APOR for

[111] 15 U.S.C. 1639c(b)(3)(B)(i).

[112] 15 U.S.C. 1639c(b)(3)(A).

[113] 12 U.S.C. 5512(b)(1).

a comparable transaction, is a strong indicator of a consumer's ability to repay and is a more holistic and flexible measure of a consumer's ability to repay than DTI alone.

Under the proposal, a loan would meet the General QM loan definition in § 1026.43(e)(2) only if the APR exceeds APOR for a comparable transaction by less than two percentage points as of the date the interest rate is set. The proposal would provide higher thresholds for loans with smaller loan amounts and for subordinate-lien transactions. The proposal would retain the existing product-feature and underwriting requirements and limits on points and fees. Although the proposal would remove the 43 percent DTI limit from the General QM loan definition, the proposal would require that the creditor consider and verify the consumer's current or reasonably expected income or assets other than the value of the dwelling (including any real property attached to the dwelling) that secures the loan and the consumer's current debt obligations, alimony, and child support. The proposal would remove appendix Q. To prevent uncertainty that may result from appendix Q's removal, the proposal would clarify the requirements to consider and verify a consumer's income, assets, debt obligations, alimony, and child support. The proposal would preserve the current threshold separating safe harbor from rebuttable presumption QMs, under which a loan is a safe harbor QM if its APR exceeds APOR for a comparable transaction by less than 1.5 percentage points as of the date the interest rate is set (or by less than 3.5 percentage points for subordinate-lien transactions).

The Bureau is proposing a price-based approach to replace the specific DTI limit because it is concerned that imposing a DTI limit as a condition for QM status under the General QM loan definition may be overly burdensome and complex in practice and may unduly restrict access to credit because it provides an incomplete picture of the consumer's financial capacity. In particular, the Bureau is concerned that conditioning QM status on a specific DTI limit may impair access to credit for some consumers for whom it might be appropriate to presume ability to repay for their loans at consummation. For the reasons set forth below, the Bureau preliminarily concludes that a price-based General QM loan definition is appropriate because a loan's price, as measured by comparing a loan's APR to APOR for a comparable transaction, is a strong indicator of a consumer's ability to repay and is a more holistic and flexible measure of a consumer's ability to repay than DTI alone.

A. Overview of the General QM Loan Definition DTI Limit

As discussed above, TILA section 129C(b)(2) defines QM by limiting certain loan terms and features. The statute generally prohibits a QM from permitting an increase of the principal balance on the loan (negative amortization), interest-only payments, most balloon payments, a term greater than 30 years, and points and fees that exceed a specified threshold. In addition, the statute incorporates limited underwriting criteria that overlap with some elements of the general ATR standard, including prohibiting "no-doc" loans where the creditor does not verify income or assets. TILA does not require DTI ratios to be included in the definition of a QM. Rather, the statute authorizes, but does not require, the Bureau to establish additional criteria relating to monthly DTI ratios, or alternative measures of ability to pay regular expenses after payment of total monthly debt, taking into account the income levels of the consumer and other factors the Bureau determines relevant and consistent with the purposes described in TILA section 129C(b)(3)(B)(i).

The Board's 2011 ATR/QM Proposal. In the 2011 ATR/QM Proposal, the Board proposed two alternative approaches to the General QM loan definition to implement the statutory QM requirements.[114] The proposed alternatives differed in the extent to which, in addition to the statutory QM requirements, they included factors from the ATR standard, including consideration of the consumer's monthly DTI ratio.

Alternative 1 under the Board's proposal would have included only the statutory QM requirements and would not have incorporated the consumer's DTI ratio, residual income, or other factors from the general ATR standard.[115] Among the reasons the Board cited in support of proposed Alternative 1 was a concern that DTI ratios (and residual income) are not objective and would not provide certainty that a loan is in fact a QM.[116] The Board also cited data showing that a consumer's DTI ratio generally does not have a significant predictive power of loan performance, once the effects of credit history, loan type, and loan-to-value (LTV) ratio are considered.[117] The Board was also concerned that the benefit of including DTI ratio (or residual income) requirements in the definition of QM may not outweigh the risk of reduced credit availability for certain consumers who may not meet widely accepted DTI ratio standards but may have other compensating factors, such as sufficient residual income or other resources, to be able to reasonably afford the mortgage.[118] Proposed Alternative 1 would have provided creditors with a safe harbor to establish compliance with the ATR requirements.

Proposed Alternative 2 would have included the statutory QM requirements and additional factors from the general ATR standard, including a requirement to consider and verify

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[114] 76 FR 27390, 27453 (May 11, 2011).

[115] *Id.* at 27453.

[116] *Id.* at 27454.

[117] *Id.*

[118] *Id.*

the consumer's DTI ratio or residual income.[119] The Board expressed concern that, absent a DTI ratio or residual income requirement, a creditor could originate a QM without considering the effect of the new loan payment on the consumer's overall financial picture.[120] The Board did not propose a specific limit for the DTI ratio in the QM definition as part of Alternative 2.[121] The Board cited several reasons for not proposing a specific DTI limit. First, the Board was concerned that setting a specific DTI ratio threshold could limit credit availability without providing adequate off-setting benefits.[122] Second, outreach conducted by the Board revealed a range of underwriting guidelines for DTI ratios based on product type, whether creditors used manual or automated underwriting, and special considerations for high- and low-income consumers.[123] The Board was concerned that setting a specific limit would require addressing the operational issues related to the calculation of the DTI ratio, including defining debt and income.[124] The Board was also concerned that a specific limit would require tolerance provisions to account for mistakes made in calculating the DTI ratio.[125] At the same time, the Board recognized that creditors and consumers may benefit from a higher degree of certainty surrounding the QM definition.[126] Therefore, the Board solicited comment on whether and how it should prescribe a specific limit for the DTI ratio or residual income for the QM definition.[127]

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[119] *Id.*

[120] *Id.* at 27455.

[121] *Id.* at 27460.

[122] *Id.*

[123] *Id.* at 27461.

[124] *Id.*

[125] *Id.*

[126] *Id.*

[127] *Id.*

The Board's Alternative 2 would have provided a rebuttable presumption of compliance with the ATR requirements.

The Bureau's January 2013 Final Rule. The Bureau's January 2013 Final Rule included the statutory QM factors and additional factors from the general ATR standard in the General QM loan definition in § 1026.43(e)(2). However, instead of incorporating the approach to DTI from the ATR standard, which requires a creditor to consider the consumer's DTI ratio or residual income, the Bureau prescribed for the General QM loan definition a specific DTI limit of 43 percent in § 1026.43(e)(2)(vi). In adopting this approach, the Bureau explained that it believed the QM criteria should include a standard for evaluating the consumer's ability to repay, in addition to the product feature restrictions and other requirements that are specified in TILA.[128] The Bureau stated that the TILA ATR/QM provisions are fundamentally about assuring that the mortgage loan that consumers receive is affordable, and that the protection from liability afforded to QMs would not be reasonable if the creditor made the loan without considering and verifying certain core aspects of the consumer's financial picture.[129]

With respect to DTI, the Bureau noted that DTI ratios are widely used for evaluating a consumer's ability to repay over time because, as the available data showed, DTI ratio correlates with loan performance as measured by delinquency rate.[130] The January 2013 Final Rule noted that, at a basic level, the lower the DTI ratio, the greater the consumer's ability to pay back a mortgage loan.[131] The Bureau believed this relationship between the DTI ratio and the

[128] 78 FR 6408, 6516 (Jan. 30, 2013).

[129] *Id.* at 6516.

[130] *Id.* at 6526-27.

[131] *Id.* at 6526.

consumer's ability to repay applied both under conditions as they exist at consummation, as well as under future changed circumstances, such as increases in payments for adjustable-rate mortgages (ARMs), future reductions in income, and unanticipated expenses and new debts.[132] The Bureau's findings regarding DTI ratios relied primarily on analysis of the FHFA's Historical Loan Performance (HLP) dataset, data provided by FHA, and data provided by commenters.[133] The Bureau believed these data indicated that DTI ratios correlate with loan performance, as measured by delinquency rate (where delinquency is defined as being over 60 days late), in any credit cycle.[134] Within a typical range of DTI ratios creditors use in underwriting (*e.g.*, under 32 percent DTI to 46 percent DTI), the Bureau noted that generally, there is a gradual increase in delinquency with higher DTI ratio.[135] The Bureau also noted that DTI ratios are widely used as an important part of the underwriting processes for both governmental programs and private lenders.[136]

To provide certainty for creditors regarding the loan's QM status, the January 2013 Final Rule contained a specific DTI limit of 43 percent as part of the General QM loan definition. The Bureau stated that a specific DTI limit also provides certainty to assignees and investors in the secondary market, which the Bureau believed would help reduce concerns regarding legal risk and promote credit availability.[137] The Bureau noted that numerous commenters had highlighted

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[132] *Id.* at 6526-27.

[133] *Id.* at 6527.

[134] *Id.*

[135] *Id.* (citing 77 FR 33120, 33122-23 (June 5, 2012) (Table 2: Ever 60+ Delinquency Rates, summarizing the HLP dataset by volume of loans and percentage that were ever 60 days or more delinquent, tabulated by the total DTI on the loans and year of origination)).

[136] *Id.*

[137] *Id.*

the value of providing objective requirements determined based on information contained in loan files.[138] To that end, the Bureau provided definitions of debt and income for purposes of the General QM loan definition in appendix Q, to address concerns that creditors may not have adequate certainty about whether a particular loan satisfies the requirements of the General QM loan definition.[139]

The Bureau selected 43 percent as the DTI limit for the General QM loan definition because, based on analysis of data available at the time and comments, the Bureau believed that the 43 percent limit would advance TILA's goals of creditors not extending credit that consumers cannot repay while still preserving consumers' access to credit.[140] The Bureau acknowledged that there is no specific threshold that separates affordable from unaffordable mortgages; rather, there is a gradual increase in delinquency rates as DTI ratios increase.[141] Additionally, the Bureau noted that a 43 percent DTI ratio was within the range used by many creditors, generally comported with industry standards and practices for prudent underwriting, and was the threshold used by FHA as its general boundary at the time the Bureau issued the January 2013 Final Rule.[142] The Bureau noted concerns about setting a higher DTI limit, including concerns that it could allow QM status for mortgages for which there is not a sound reason to presume that the creditor had a reasonable belief in the consumer's ability to repay.[143]

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[138] *Id.*

[139] *Id.*

[140] *Id.*

[141] *Id.*

[142] *Id.*

[143] *Id.* at 6528.

The Bureau was especially concerned about this in the context of QMs that receive a safe harbor from the ATR requirements.[144] The Bureau was also concerned that a higher DTI limit would result in a QM boundary that substantially covered the entire mortgage market. If that were the case, creditors might be unwilling to make non-QM loans, and the Bureau was concerned that the QM rule would define the limit of credit availability.[145] The Bureau also suggested that a higher DTI limit might require a corresponding weakening of the strength of the presumption of compliance, which the Bureau believed would largely defeat the point of adopting a higher DTI limit.[146]

Despite the Bureau's inclusion of a specific DTI limit in the General QM loan definition, the Bureau also acknowledged concerns about the requirement. The Bureau acknowledged that the Board, in issuing the 2011 ATR/QM Proposal, found that DTI ratios may not have significant predictive power, once the effects of credit history, loan type, and LTV ratio are considered.[147] Similarly, the Bureau noted that some commenters responding to the 2011 ATR/QM Proposal suggested that the Bureau should include compensating factors in addition to a specific DTI ratio threshold due to concerns about restricting access to credit.[148] The Bureau acknowledged that a standard that takes into account multiple factors may produce more accurate ability-to-repay determinations, at least in specific cases, but was concerned that incorporating a multi-factor test or compensating factors into the QM definition would undermine the certainty for creditors and

[144] *Id.*

[145] *Id.*

[146] *Id.*

[147] *Id.* at 6527.

[148] *Id.*

the secondary market of whether loans were eligible for QM status.[149] The Bureau also 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.[150] However, the Bureau noted that it lacked sufficient data to mandate a bright-line rule based on residual income.[151] The Bureau anticipated further study of the issue as part of the five-year assessment of the rule.[152]

The Bureau acknowledged in the January 2013 Final Rule that the 43 percent DTI limit in the General QM loan definition could restrict access to credit given market conditions at the time the rule was issued. Among other things, the Bureau expressed concern that, as the mortgage market recovered from the financial crisis, there would be a limited non-QM market, which, in conjunction with the 43 percent DTI limit, could impair access to credit for consumers with DTI ratios over 43 percent.[153] To preserve access to credit for such consumers while the market recovered, the Bureau adopted the Temporary GSE QM loan definition, which did not include a specific DTI limit. As discussed below, the Temporary GSE QM loan definition continues to play a significant role in ensuring access to credit for consumers.

B. Considerations Related to the General QM Loan Definition DTI Limit

The Bureau's own experience and the feedback it has received from stakeholders since issuing the January 2013 Final Rule suggest that imposing a DTI limit as a condition for QM status under the General QM loan definition may be overly burdensome and complex in practice

[149] *Id*.

[150] *Id.* at 6528.

[151] *Id.*

[152] *Id.*

[153] *Id*. at 6533.

and may unduly restrict access to credit because it provides an incomplete picture of the consumer's financial capacity. While the Bureau acknowledges that DTI ratios generally correlate with loan performance, as the Bureau found in the January 2013 Final Rule and as shown in recent Bureau analysis described below, the Bureau also notes that a consumer's DTI ratio is only one way to measure financial capacity and is not a holistic measure of the consumer's ability to repay.

In particular, the Bureau is concerned that imposing a DTI limit as a condition for QM status under the General QM loan definition may deny QM status for loans to some consumers for whom it might be appropriate to presume ability to repay at consummation, and that denying QM status to such loans risks denying consumers access to responsible, affordable credit. Numerous stakeholders, including commenters responding to the ANPR, have argued that the current approach to DTI ratios as part of the General QM loan definition is not appropriate because it creates problems for some consumers' ability to access credit when their DTI ratio is above a bright-line threshold. These access to credit concerns are especially acute for lower-income and minority consumers.

The Bureau acknowledges that the current approach to DTI ratios under the General QM loan definition may also stifle innovation in underwriting because it focuses on a single metric, with strict verification rules. The current approach to DTI ratios under the General QM loan definition may constrain new approaches to assessing repayment ability, including the use of technology as part of the underwriting process. Such innovations include certain new uses of cash flow data and analytics to underwrite mortgage applicants. This emerging technology has the potential to accurately assess consumers' ability to repay using, for example, bank account data that can identify the source and frequency of recurring deposits and payments and identify remaining disposable income. Identifying the remaining disposable income could be a method of assessing the consumer's residual income and could potentially satisfy a requirement to consider either DTI or residual income, absent a specific DTI limit. This innovation could potentially expand access to responsible, affordable mortgage credit, particularly for applicants with non-traditional income and limited credit history. The potential negative effect of the rule on innovation in underwriting may be heightened while the market is largely concentrated in the QM lending space and may limit access to credit for some consumers with DTI ratios above 43 percent.

The Bureau's 2019 ATR/QM Assessment Report highlights the tradeoffs of conditioning the General QM loan definition on a DTI limit. The Assessment Report included specific findings about the General QM loan definition's DTI limit, including certain findings related to DTI ratios as probative of a consumer's ability to repay. The Assessment Report found that loans with higher DTI ratios have been associated with higher levels of "early delinquency" (*i.e.*, delinquency within two years of origination), which, as explained below, may serve as a proxy for measuring whether a consumer had a reasonable ability to repay at the time the loan was consummated.[154] For example, the Assessment Report notes that for all periods and samples studied, a positive relationship between DTI ratios and early delinquency is present and economically meaningful.[155] The Assessment Report states that higher DTI ratios independently increase expected early delinquency, regardless of other underwriting criteria.[156]

[154] *See* Assessment Report, *supra* note 58, at 83-84, 100-05.

[155] Assessment Report at 104-05.

[156] *Id.* at 105.

At the same time, findings from the Assessment Report indicate that the specific 43 percent DTI limit in the current rule has restricted access to credit, particularly in the absence of a robust non-QM market. The report found that, for high-DTI consumers—*i.e.*, consumers 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.[157] However, the Assessment Report attributes the fact that the 43 percent DTI limit has not reduced access to credit for such consumers to the existence of the Temporary GSE QM loan definition. The findings in the Assessment Report indicate that there would be some reduction in access to credit for high-DTI consumers when the Temporary GSE QM loan definition expires, absent changes to the General QM loan definition. For example, based on application-level data obtained from nine large lenders, the Assessment Report found that the January 2013 Final Rule eliminated between 63 and 70 percent of non-GSE eligible, high-DTI home purchase loans.[158] The Bureau is concerned about a similar effect for loans with DTI ratios above 43 percent when the Temporary GSE QM loan definition expires. The Bureau acknowledges that the Assessment Report's finding, without other information, does not prove or disprove the effectiveness of the DTI limit in achieving the purposes of the January 2013 Final Rule in ensuring consumers' ability to repay the loan. If the denied applicants in fact lacked the ability to repay, then the reduction in approval rates is an appropriate consequence of the Rule. However, if the denied applicants did have the ability to repay, then these data suggest an unintended consequence of the Rule. This possibility is supported by the fact that other findings in the Assessment Report suggest that applicants for

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

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

high-DTI ratio, non-GSE eligible loans are being denied, even though other compensating factors indicate that some of them may have the ability to repay their loans.[159]

The current state of the non-QM market heightens the access to credit concerns related to the specific 43 percent DTI limit, particularly if such conditions persist after the expiration of the Temporary GSE QM loan definition. The Bureau stated in the January 2013 Final Rule that it believed mortgages that could be responsibly originated with DTI ratios that exceed 43 percent, which historically includes over 20 percent of mortgages, would be made under the general ATR standard.[160] However, the Assessment Report found that a robust market for non-QM loans above the 43 percent DTI limit has not materialized as the Bureau had predicted. Therefore, there is limited capacity in the non-QM market to provide access to credit after the expiration of the Temporary GSE QM loan definition.[161] As described above, the non-QM market has been further reduced by the recent economic disruptions associated with the COVID-19 pandemic, with most mortgage credit now available in the QM lending space. The Bureau acknowledges that the slow development of the non-QM market, and the recent economic disruptions associated with the COVID-19 pandemic that may significantly hinder its development in the near term, may further reduce access to credit outside the QM space.

The Bureau also has particular concerns about the effects of the appendix Q definitions of debt and income on access to credit. The Bureau intended for appendix Q to provide creditors with certainty about the DTI ratio calculation to foster compliance with the General QM loan

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[159] *See, e.g.,* Assessment Report *supra* note 58, at 150, 153, Table 20. Table 20 illustrates how the pool of denied non-GSE eligible high-DTI applicants has changed between 2013 and 2014. After the introduction of the Rule, the pool of denied applicants contains more consumers with higher incomes, higher FICO scores, and higher down payments.

[160] 78 FR 6408, 6527 (Jan. 30, 2013).

[161] Assessment Report, *supra* note 58, at 198.

definition. However, based on extensive stakeholder feedback and its own experience, the Bureau recognizes that appendix Q's definitions of debt and income are rigid and difficult to apply and do not provide the level of compliance certainty that the Bureau anticipated. Stakeholders have reported that these concerns are particularly acute for transactions involving self-employed consumers, consumers with part-time employment, and consumers with irregular or unusual income streams. The standards in appendix Q could negatively impact access to credit for these consumers, particularly after expiration of the Temporary GSE QM loan definition. The Assessment Report also noted 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" for Temporary GSE QM loans.[162] Appendix Q, unlike other standards for calculating and verifying debt and income, has not been revised since 2013.[163] The current definitions of debt and income in appendix Q have proven to be complex in practice, and, as discussed below, the Bureau has concerns about other potential approaches to defining debt and income in connection with conditioning QM status on a specific DTI limit.

At the time of the January 2013 Final Rule, the Bureau sought to provide a period for economic, market, and regulatory conditions to stabilize and for a reasonable transition period to the General QM loan definition and non-QM loans above a 43 percent DTI ratio. However, contrary to the Bureau's expectations, lending largely has remained in the Temporary GSE QM loan space, and a robust and sizable market to support non-QM lending has not yet emerged.[164] As noted above, the Bureau acknowledges that the recent economic disruptions associated with

[162] *Id.* at 193.

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

[164] *Id.* at 198.

the COVID-19 pandemic may further hinder development of the non-QM market, at least in the near term. The Bureau expects that a significant number of Temporary GSE QM loans would not qualify as General QM loans under the current rule after the Temporary GSE QM loan definition expires, either because they have DTI ratios above 43 percent or because their method of documenting and verifying income or debt is incompatible with appendix Q. Although alternative loan options would still be available to many consumers after expiration of the Temporary GSE QM loan definition, the Bureau anticipates that, with respect to loans that are currently Temporary GSE QM loans and would not otherwise qualify as General QM loans under the current definition, some would cost materially more for consumers and some would not be made at all.

Specifically, the Bureau's Dodd-Frank Act 1022(b) Analysis, below, 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—would be affected by the expiration of the Temporary GSE QM loan definition.[165] An additional, smaller number of loans that currently qualify as Temporary GSE QM loans may not fall within the General QM loan definition after expiration of the Temporary GSE QM loan definition because the method used for verifying income or debt would not comply with appendix Q.[166] The Temporary GSE QM loan definition is currently set to expire upon the earlier of January 10, 2021 or when GSE conservatorship ends, and the Bureau believes that many loans currently originated under the Temporary GSE QM loan definition may cost materially more or may not

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[165] Dodd-Frank Act section 1022(b) (analysis cites the Bureau's prior estimate of affected loans in the ANPR); *see* 84 FR 37155, 37159 (July 31, 2019).

[166] *Id.* at 37159 n.58.

be made at all, absent changes to the General QM loan definition. After the Temporary GSE QM loan definition expires, the Bureau expects that many consumers with DTI ratios above 43 percent who would have received a Temporary GSE QM loan would instead obtain FHA-insured loans since FHA currently insures loans with DTI ratios up to 57 percent.[167] The number of loans that move to FHA would depend on FHA's willingness and ability to insure such loans, whether FHA continues to treat all loans that it insures as QMs under its own QM rule, and how many loans that would have been originated as Temporary GSE QM loans with DTI ratios above 43 percent exceed FHA's loan-amount limit.[168] For example, the Bureau estimates that, in 2018, 11 percent of Temporary GSE QM loans with DTI ratios above 43 percent exceeded FHA's loan-amount limit.[169] Thus, the Bureau considers that at most 89 percent of loans that would have been Temporary GSE QM loans with DTI ratios above 43 percent could move to FHA.[170] The Bureau expects that loans that are originated as FHA loans instead of under the Temporary GSE QM loan definition generally would cost materially more for many consumers.[171] The

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[167] In fiscal year 2019, approximately 57 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 2019*, at 33 using data from App. B Tabl. B9 (Nov. 14, 2018), https://www.hud.gov/sites/dfiles/Housing/documents/2019FHAAnnualReportMMIFund.pdf.

[168] 84 FR 37155, 37159 (July 31, 2019).

[169] *Id.* In 2018, FHA's county-level maximum loan limits ranged from $294,515 to $679,650 in the continental United States. *See* U.S. Dep't of Hous. & Urban Dev., *FHA Mortgage Limits*, https://entp.hud.gov/idapp/html/hicostlook.cfm (last visited June 21, 2020).

[170] 84 FR 37155, 37159 (July 31, 2019).

[171] Interest rates and insurance premiums on FHA loans generally feature less risk-based pricing than conventional loans, charging more similar rates and premiums to all consumers. As a result, they are likely to cost more than conventional loans for consumers with stronger credit scores and larger down payments. Consistent with this pricing differential, consumers with higher credit scores and larger down payments chose FHA loans relatively rarely in 2018 HMDA data on mortgage originations. *See* Bureau of Consumer Fin. Prot., *Introducing New and Revised Data Points in HMDA*, August 2019, https://files.consumerfinance.gov/f/documents/cfpb_new-revised-data-points-in-hmda_report.pdf.

Bureau expects that some consumers offered FHA loans may choose not to take out a mortgage because of these higher costs.

It is also possible that some consumers with DTI ratios above 43 percent would be able to obtain loans in the private market.[172] The ANPR noted that the number of loans absorbed by the private market would likely depend, in part, on whether actors in the private market are willing to assume the legal or credit risk associated with funding—as non-QM loans or small-creditor portfolio QM loans—loans that would have been Temporary GSE QM loans (with DTI ratios above 43 percent)[173] and, if so, whether actors in the private market would offer more competitive pricing or terms.[174] For example, the Bureau estimates that 55 percent of loans that would have been Temporary GSE QM loans (with DTI ratios above 43 percent) in 2018 had credit scores at or above 680 and LTV ratios at or below 80 percent—credit characteristics traditionally considered attractive to actors in the private market.[175] The ANPR also noted 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.[176] At the same time, the Assessment Report found there has been limited momentum toward a greater role for private market non-QM loans. It is uncertain how great this role will be

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[172] 84 FR 37155, 37159 (July 31, 2019).

[173] *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, Pub. L. 115-174, 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).

[174] 84 FR 37155, 37159 (July 31, 2019).

[175] *Id.*

[176] *Id.*

in the future,[177] particularly in the short term due to the economic effects of the COVID-19 pandemic. Finally, the ANPR noted that some consumers with DTI ratios above 43 percent who would have sought Temporary GSE QM loans may adapt to changing options and make different choices, such as adjusting their borrowing to result in a lower DTI ratio.[178] However, some consumers who would have sought Temporary GSE QM loans (with DTI ratios above 43 percent) may not obtain loans at all.[179] For example, based on application-level data obtained from nine large lenders, the Assessment Report found that the January 2013 Final Rule eliminated between 63 and 70 percent of non-GSE eligible, high-DTI home purchase loans.[180]

In the separate Extension Proposal, the Bureau is proposing to replace the January 10, 2021 sunset date with a provision that would amend the Temporary GSE QM loan definition so that it would expire upon the earlier of the effective date of final amendments to the General QM loan definition, or when GSE conservatorship ends.[181] The Bureau is issuing that separate proposal to ensure that responsible, affordable credit remains available to consumers who may be affected if the Temporary GSE QM loan definition expires before amendments to the General QM loan definition take effect.

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[177] *Id.*

[178] *Id.*

[179] *Id.*

[180] *See* Assessment Report *supra* note 58, at 10-11, 117, 131-47.

[181] As the Bureau notes in the separate Extension Proposal, the Bureau does not intend for the effective date of final amendments to the General QM loan definition to be prior to April 1, 2021. Thus, the Bureau does not intend for the Temporary GSE QM loan definition to expire prior to April 1, 2021.

C. Why the Bureau is Proposing a Price-Based QM Definition to Replace the General QM Loan Definition DTI Limit

Given the significant issues associated with the 43 percent DTI limit, the Bureau is proposing to remove that requirement from the General QM loan definition in § 1026.43(e)(2)(vi) and replace it with a requirement based on the price of the loan. Specifically, in addition to the statutory product features and underwriting restrictions that apply under the current rule, a loan would meet the General QM loan definition only if the APR exceeds APOR for a comparable transaction by less than two percentage points as of the date the interest rate is set. The proposal would provide higher thresholds for loans with smaller loan amounts and for subordinate-lien transactions. Although the proposal would remove the 43 percent DTI limit from the General QM loan definition, it would require that the creditor: (1) consider the consumer's income or assets, debt obligations, alimony, and child support, and monthly DTI ratio or residual income, and (2) verify the consumer's current or reasonably expected income or assets other than the value of the dwelling (including any real property attached to the dwelling) that secures the loan and the consumer's current debt obligations, alimony, and child support. The proposal would remove appendix Q but would clarify the requirements to consider and verify a consumer's income, assets, debt obligations, alimony, and child support, to help prevent compliance uncertainty that could otherwise result from the removal of appendix Q. Consistent with the current rule, the proposal would preserve the current threshold separating safe harbor from rebuttable presumption QMs, under which a loan is a safe harbor QM if its APR exceeds

APOR for a comparable transaction by less than 1.5 percentage points as of the date the interest rate is set.[182]

The Bureau acknowledges there is significant debate over whether loan pricing, a consumer's DTI ratio, or another direct or indirect measure of a consumer's personal finances is a better predictor of loan performance, particularly when analyzed across various points in the economic cycle.[183] Some commenters responding to the ANPR advocated for retaining a DTI requirement as part of the General QM loan definition, arguing that it is a strong indicator of a consumer's ability to repay. Other commenters suggested a range of options to replace the current DTI requirement in the General QM loan definition, including by prescribing a residual income test; allowing compensating factors (such as LTV ratios and credit scores) in conjunction with a DTI ratio; and defining QM by reference to widely used underwriting standards. In seeking comments on this proposal, the Bureau is not determining whether DTI ratios, a loan's price, or some other measure is the best predictor of loan performance. As discussed below, analysis provided by stakeholders and the Bureau's own analysis show that pricing is strongly correlated with loan performance, based on early delinquency rates, across a variety of loans and economic conditions. However, the Bureau acknowledges that DTI is also predictive of loan

[182] The current rule provides a higher safe harbor threshold of 3.5 percentage points over APOR for small creditor portfolio QMs and balloon-payment QMs made by certain small creditors pursuant to § 1026.43(e)(5), (e)(6) and (f). *See* § 1026.43(b)(4). This proposal would not alter those thresholds.

[183] *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; Eric Kaplan *et al.*, 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); Morris Davis *et al.*, *A Quarter Century of Mortgage Risk* (FHFA, Working Paper 19-02, 2019), https://www.fhfa.gov/PolicyProgramsResearch/Research/Pages/wp1902.aspx (examining various loan characteristics and a summary measure of risk—the stressed default rate—for predictiveness of loan performance).

performance and that other direct and indirect measures of consumer finances may also be predictive of loan performance. The Bureau does not make a finding here on whether or to what extent one measure clearly outperforms others in predicting loan performance. Rather, the Bureau has weighed several policy considerations in selecting an approach for the proposal based on the purposes of the ATR/QM provisions of TILA.

In particular, the Bureau has balanced considerations related to ensuring consumers' ability to repay and maintaining access to credit in deciding to seek comment on replacing the current 43 percent DTI limit with a price-based approach. The Bureau continues to view the statute as fundamentally about assuring that consumers receive mortgage credit that they are able to repay. However, the Bureau is also concerned about maintaining access to responsible, affordable mortgage credit. The Bureau is concerned that the current General QM loan definition, with a 43 percent DTI limit, would result in a significant reduction in the scope of QM and could reduce access to responsible, affordable mortgage credit after the Temporary GSE QM loan definition expires. The lack of a robust non-QM market enhances those concerns. Although the Bureau noted in the January 2013 Final Rule that it expected access to credit outside of the QM lending space to develop over time, the Assessment Report found that a robust and sizable market to support non-QM lending has not emerged since the Rule took effect.[184] The Bureau also acknowledges that the non-QM market has been further reduced by the recent economic disruptions associated with the COVID-19 pandemic, with most mortgage credit now available in the QM lending space. Although it remains possible that, over time, a substantial market for non-QM loans will emerge, that market has developed slowly, and the recent

[184] Assessment Report, *supra* note 58, at 198.

economic disruptions associated with the COVID-19 pandemic may significantly hinder its development, at least in the near term.

With respect to ability to repay, the Bureau has focused on analysis of early delinquency rates to evaluate whether a loan's price, as measured by the spread of APR over APOR (herein referred to as the loan's rate spread), may be an appropriate measure of whether a loan should be presumed to comply with the ATR provisions. Because the affordability of a given mortgage will vary from consumer to consumer based upon a range of factors, there is no single recognized metric, or set of metrics, that can directly measure whether the terms of mortgage loans are reasonably within consumers' ability to repay.[185] As such, consistent with the Bureau's prior analyses in the Assessment Report, the Bureau uses early distress as a proxy for the lack of the consumer's ability to repay at consummation across a wide pool of loans. Consistent with the Assessment Report, for the analyses of early delinquency rates below, the Bureau measures early distress as whether a consumer was ever 60 or more days past due within the first 2 years after origination (referred to herein as the early delinquency rate).[186] The Bureau's analysis focuses on early delinquency rates to capture consumers' difficulties in making payments soon after consummation of the loan (*i.e.*, within the first 2 years), even if these delinquencies do not lead to consumers potentially losing their homes (*i.e.*, 60 or more days past due, as opposed to 90 or more days or in foreclosure), as early difficulties in making payments indicates higher likelihood that the consumer may have lacked ability to repay at consummation. As in the Assessment Report, the Bureau assumes that the average early delinquency rate across a wide pool of mortgages—whether safe harbor QM, rebuttable presumption QM, or non-QM—is

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[185] *Id.* at 83.

[186] *Id.*

probative of whether such loans are reasonably within consumers' repayment ability, and that the dependence of these early delinquency rates on the defining characteristics of such loans is probative of how those characteristics may influence repayment ability. The Bureau acknowledges that alternative measures of delinquency, including those used in analyses submitted as comments on the ANPR, may also be probative of repayment ability.

The Bureau has reviewed the available evidence to assess whether rate spreads can distinguish loans that are likely to have low early delinquency rates—and thus may be presumed to reasonably reflect the consumer's ability to repay—from loans that are likely to have higher rates of delinquency—for which it would not be appropriate to presume the consumer's ability to repay. The Bureau's own analysis and recent analyses published in response to the Bureau's ANPR and RFIs provide strong evidence of increasing early delinquency rates with higher rate spreads across a range of datasets, time periods, loan types, measures of rate spread, and measures of delinquency. The Bureau's delinquency analysis uses data from the National Mortgage Database (NMDB),[187] including a matched sample of NMDB and HMDA loans.[188] As described below, analysis of these datasets shows that early delinquency rates rise with rate spread.

[187] *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. (The NMDB, jointly developed by the FHFA and the Bureau, provides de-identified loan characteristics and performance information for a five 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.)

[188] HMDA was originally enacted by Congress in 1975 and is implemented by Regulation C, 12 CFR part 1003. *See* Bureau of Consumer Fin. Prot., *Mortgage data (HMDA),* https://www.consumerfinance.gov/data-research/hmda/. HMDA requires many financial institutions to maintain, report, and publicly disclose loan-level information about mortgages. These data are housed here to help show whether lenders are serving the housing needs of their communities; they give public officials information that helps them make decisions and policies; and they shed light on lending patterns that could be discriminatory. The public data are modified to protect applicant and borrower privacy.

Table 1 shows early delinquency rates for 2002-2008 first-lien purchase originations in the NMDB, with loans categorized according to their approximate rate spread. The Bureau analyzed 2002 through 2008 origination years because the relatively fixed private mortgage insurance (PMI) pricing during these years allows for reliable approximation of this important component of rate spreads.[189] The sample is restricted to loans without product features that would make them non-QM under the current rule. Table 1 shows that early delinquency rates increase consistently with rate spreads, from a low of 2 percent among loans with rate spreads below or near zero, up to 14 percent for loans with rate spreads of 2.25 percentage points or more over APOR.[190] The Bureau notes that this sample includes loans originated during the peak of the housing boom and delinquencies that occurred during the ensuing recession, contributing to the high overall levels of early delinquency.

Table 1: 2002-2008 Originations, Early Delinquency Rate by Rate Spread

Rate Spread (interest rate + PMI approximation - PMMS[191]) in percentage points	Early Delinquency Rate
< 0	2%
0-0.24	2%

[189] *See* Neil Bhutta and Benjamin J. Keys, *Eyes Wide Shut? The Moral Hazard of Mortgage Insurers during the Housing Boom*, NBER Working Paper No. 24844, https://www.nber.org/papers/w24844.pdf. APOR is approximated with weekly Freddie Mac Primary Mortgage Market Survey (PMMS) data, retrieved from Fed. Reserve Bank of St. Louis, Fed. Reserve Econ. Data,; https://fred.stlouisfed.org/, March 4, 2020. Each loan's APR is approximated by the sum of the interest rate in the NMDB data and an assumed PMI payment of 0.32, 0.52, or 0.78 percentage points for loans with LTVs above 80 but at or below 85, above 85 but at or below 90, and above 90, respectively. These PMI are based on standard industry rates during this time period. The 30-year Fixed Rate PMMS average is used for fixed-rate loans with terms over 15 years, and 15-year Fixed Rate PMMS is used for loans with terms of 15 years or less. The 5/1-year Adjustable-Rate PMMS average is used (for available years) for ARMs with a first interest rate reset occurring 5 or more years after origination, while the 1-year adjustable-rate PMMS average is used for all other ARMs.

[190] Loans with rate spreads of 2.25 percentage points or more are grouped in Tables 1 and 5 to ensure sufficient sample size for reliable analysis of the 2002-2008 data. This grouping ensures that all cells shown in Table 5 contain at least 500 loans.

[191] Freddie Mac's PMMS is the source of data underlying APOR rate for most mortgages. See *supra* note 189 for additional details.

Rate Spread (interest rate + PMI approximation - PMMS[191]) in percentage points	Early Delinquency Rate
0.25-0.49	4%
0.50-0.74	5%
0.75-0.99	6%
1.00-1.24	8%
1.25-1.49	10%
1.50-1.74	12%
1.75-1.99	13%
2.00-2.24	14%
2.25 and above	14%

Analysis of additional data, as reflected in Table 2, also shows early delinquency rates rising with rate spread. Table 2 shows early delinquency statistics for 2018 NMDB first-lien purchase originations that have been matched to 2018 HMDA data, enabling the Bureau to use actual rate spreads over APOR rather than approximated rate spreads in its analysis.[192] As with the data reflected in Table 1, loans with product features that would make them non-QM under the current rule are excluded from Table 2. However, only delinquencies occurring through December 2019 are observed in Table 2, meaning most loans are not observed for a full two years after origination. This more recent sample provides insight into early delinquency rates under post-crisis lending standards, and for an origination cohort that had not undergone (as of December 2019) a large economic downturn. The 2018 data are divided into wider bins (as compared to Table 1) to ensure enough loans per bin. As with Table 1, Table 2 shows that early delinquency rates increase consistently with rate spreads, from a low of 0.2 percent for loans

[192] Where possible, the FHFA provided an anonymized match of HMDA loan identifiers for 2018 NMDB originations, allowing the Bureau to analyze more detailed HMDA loan characteristics (*e.g.*, rate spread over APOR) for approximately half of 2018 NMDB originations.

with rate spreads near APOR or below APOR, up to 4.2 percent for loans with rate spreads of 2 percentage points or more over APOR.[193]

Table 2: 2018 Originations, Early Delinquency Rate by Rate Spread

Rate Spread over APOR in percentage points	Early Delinquency Rate (as of Dec. 2019)
< 0	0.2%
0-0.49	0.2%
0.50-0.99	0.6%
1.00-1.49	1.7%
1.50-1.99	2.7%
2.00 and above	4.2%

Given the specific DTI limit under the current rule, the Bureau also analyzed the relationship between DTI ratios and early delinquency for the same samples of loans in Tables 3 and 4. The Bureau's analyses show that early delinquency rates increase consistently with DTI ratio in both samples. In the 2002-2008 sample, early delinquency rates increase from a low of 3 percent among loans with DTI ratios at or below 25 percent, up to 9 percent for loans with DTI ratios between 61 and 70 percent.[194] In the 2018 sample, early delinquency rates increase from 0.4 percent among loans with DTI ratios at or below 25 percent, up to 0.9 percent among loans with DTI ratios between 44 and 50.[195] The difference in early delinquency rates between loans

[193] Loans with rate spreads of 2 percentage points or more are grouped in Tables 2 and 6 to ensure sufficient sample size for reliable analysis of the 2018 data. This grouping ensures that all cells shown in Table 6 contain at least 500 loans.

[194] Fewer than 0.7 percent of loans have reported DTI ratios over 70 percent in the 2002-2008 data. These loans are excluded from Tables 3 and 5 due to reliability concerns and to ensure that all cells shown in Table 5 contain at least 500 loans.

[195] Fewer than 0.5 percent of loans have reported DTI ratios over 50 percent in the 2018 data. These loans are excluded from Tables 4 and 6 due to reliability concerns and to ensure that all cells shown in Table 6 contain at least 500 loans.

with the highest and lowest DTI ratios is smaller than the difference in early delinquency rates between the highest and lowest rate spreads during both periods. For these samples and bins of rate spread and DTI ratios, this pattern is consistent with a stronger correlation between rate spread and early delinquency than between DTI ratios and early delinquency.

Table 3: 2002-2008 Originations, Early Delinquency Rate by DTI Ratio

DTI	Early Delinquency Rate
0-20	3%
21-25	3%
26-30	4%
31-35	5%
36-40	6%
41-43	6%
44-45	7%
46-48	7%
49-50	8%
51-60	8%
61-70	9%

Table 4: 2018 Originations, Early Delinquency Rate by DTI

DTI	Early Delinquency Rate (as of Dec. 2019)
0-25	0.4%
26-35	0.5%
36-43	0.7%
44-48	0.9%
49-50	0.9%

To further analyze the strengths of DTI ratios and pricing in predicting early delinquency rates, Tables 5 and 6 show the early delinquency rates of these same samples categorized according to both their DTI ratios and their rate spreads. Table 5 shows early delinquency rates for 2002-2008 first-lien purchase originations in the NMDB, with loans categorized according to both their DTI ratio and their approximate rate spread. For loans within a given DTI ratio range, those with higher rate spreads consistently had higher early delinquency rates. Loans with low rate spreads had relatively low early delinquency rates even at high DTI ratio levels, as seen in the 2 percent early delinquency rate for loans priced below APOR but with DTI ratios of 46 to 48 percent, 51 to 60 percent, and 61 to 70 percent. However, the highest early delinquency rates occurred for loans with high rate spreads and high DTI ratios, reaching 26 percent for loans priced 2 to 2.24 percentage points above APOR with DTI ratios of 61 to 70 percent. Across DTI bins, loans priced 2 percentage points or more above APOR had early delinquency much higher than loans priced below APOR.

Table 5: 2002-2008 Originations, Early Delinquency Rate by Rate Spread and DTI Ratio

Rate Spread (interest rate + PMI approx. - PMMS) in percentage points	DTI 0-20	DTI 21-25	DTI 26-30	DTI 31-35	DTI 36-40	DTI 41-43	DTI 44-45	DTI 46-48	DTI 49-50	DTI 51-60	DTI 61-70
< 0	2%	1%	1%	2%	2%	2%	2%	2%	3%	2%	2%
0-0.24	2%	2%	2%	2%	2%	3%	3%	3%	3%	3%	3%
0.25-0.49	3%	3%	3%	3%	4%	5%	4%	5%	5%	5%	5%
0.50-0.74	4%	4%	4%	4%	5%	6%	6%	6%	7%	7%	7%
0.75-0.99	4%	5%	5%	6%	6%	7%	7%	7%	8%	8%	10%
1.00-1.24	6%	6%	6%	7%	7%	9%	9%	9%	10%	11%	13%
1.25-1.49	6%	7%	8%	8%	10%	11%	12%	12%	12%	14%	15%
1.50-1.74	7%	8%	9%	10%	13%	13%	15%	14%	16%	15%	20%
1.75-1.99	7%	8%	10%	12%	14%	15%	16%	16%	16%	18%	22%
2.00-2.24	6%	10%	10%	12%	15%	15%	17%	19%	18%	20%	26%
2.25 and above	7%	9%	10%	13%	15%	16%	16%	18%	19%	20%	25%

Similarly, Table 6 shows average early delinquency statistics, with loans categorized according to both DTI and rate spread, for the sample of 2018 NMDB first-lien purchase originations that have been matched to 2018 HMDA data.[196] For Table 6, the higher early delinquency rate for loans with higher rate spreads over APOR matches the pattern shown in the data from Table 5. Overall early delinquency rates are substantially lower, reflecting the importance of economic conditions in the likelihood of delinquency for any given consumer. However, the 2018 loans priced 2 percentage points or more above APOR also had early delinquency rates much higher than loans priced below APOR.

Table 6: 2018 Originations, Early Delinquency Rate by Rate Spread and DTI Ratio

Rate Spread over APOR in percentage points	DTI 0-25	DTI 26-35	DTI 36-43	DTI 44-50
< 0	0.1%	0.1%	0.2%	0.3%
0-0.49	0.2%	0.1%	0.3%	0.3%
0.50-0.99	0.1%	0.4%	0.8%	0.8%
1.00-1.49	1.0%	1.4%	1.5%	2.3%
1.50-1.99	-	3.2%	2.5%	2.3%
2.00 and above	-	4.4%	3.9%	4.2%

The Bureau notes that the high relative risk of early delinquency for higher-priced loans holds across samples, demonstrating that rate spreads distinguish early delinquency risk under a range of economic conditions and creditor practices. Analyses published in response to the Bureau's ANPR and RFIs are consistent with the Bureau's analysis showing that early delinquency rates rise consistently with rate spread. For example, CoreLogic analyzes a set of 2018 HMDA conventional mortgage originations merged to loan performance data collected

[196] As in Tables 2 and 4, above, the 2018 data are divided into larger bins to ensure enough loans per bin. Loans with a DTI ratio greater than 50 percent are excluded, as well as loans with a DTI ratio at or below 25 percent and rate spreads of 1.5 percentage points and above, because these bins contained fewer than 500 loans in the matched 2018 NMDB-HMDA sample.

from mortgage servicers.[197] The CoreLogic analysis finds: (1) the lowest delinquency rates among loans with rate spreads that are below APOR, and (2) increased early delinquency rates for each sequentially higher bin of rate spreads up to two percentage points. In assessing the CoreLogic analysis, the Bureau notes that loans priced at or above two percentage points over APOR in the 2018 HMDA data are relatively rare and are disproportionately made for manufactured housing and smaller loan amounts and therefore may not be well represented in mortgage servicing datasets. However, these loans also have relatively high rates of delinquency.[198] CoreLogic finds a similar, but more variable, positive relationship between rate spreads over APOR and delinquency in earlier cohorts (2010-2017) of merged HMDA-CoreLogic originations, a period in which rate spreads were only reported for loans priced at least 1.5 percentage points over APOR.[199]

Further, using loan performance data from Black Knight, analyses by the Urban Institute show a comparable positive relationship between rate spreads—measured there as the note rate over Freddie Mac's Primary Mortgage Market Survey—and delinquency.[200] The analysis finds that the relationship holds across a range of loan types (conventional loans held in portfolio, in

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[197] *See* Archana Pradhan & Pete Carroll, *Expiration of the CFPB's Qualified Mortgage (QM) GSE Patch – Part V*, LogicCore Insights Blog, (Jan. 13, 2020), https://www.corelogic.com/blog/2020/1/expiration-of-the-cfpbs-qualified-mortgage-qm-gse-patch-part-v.aspx. Delinquency was measured as of October 2019, so loans do not have two full years of payment history.

[198] The Bureau analyzes the performance and pricing for smaller loans in the section-by-section analysis for § 1026.43(e)(2)(vi).

[199] *See* Archana Pradhan & Pete Carroll, *Expiration of the CFPB's Qualified Mortgage (QM) GSE Patch* – Part *IV*, LogicCore Insights Blog, (Jan. 11, 2020), https://www.corelogic.com/blog/2020/1/expiration-of-the-cfpbs-qualified-mortgage-qm-gse-patch-part-iv.aspx. Delinquency measured as of October 2019.

[200] *See* Karan Kaul & Laurie Goodman, Urban Inst., *Updated: What, If Anything, Should Replace QM GSE Patch,* (Oct. 2020), at 9, https://www.urban.org/sites/default/files/publication/99268/2018_10_30_qualified_mortgage_rule_update_finalized_4.pdf.

GSE securitizations, and in private securitizations; FHA loans; VA loans) and years (1995-2018). Additional analyses by the Urban Institute show the same positive relationship between rate spread and loan performance in Fannie Mae loan-level performance data.[201]

Collectively, this evidence suggests that higher rate spreads—including the specific measure of APR over APOR—are strongly correlated with early delinquency rates. Given that early delinquency captures consumers' difficulty making required payments, these rate spreads provide a proxy measure for whether the terms of mortgage loans reasonably reflect consumers' ability to repay at the time of origination. The Bureau acknowledges that a test that combines rate spread and DTI may better predict early delinquency rates than either metric on its own. However, any rule with a specific DTI limit would need to provide standards for calculating the income that may be counted and the debt that must be counted so that creditors and investors can ensure with reasonable certainty that they have accurately calculated DTI within the specific DTI limit. As noted above and discussed further below, the current definitions of debt and income in appendix Q have proven to be complex in practice and may unduly restrict access to credit. The Bureau has concerns about whether other potential approaches could define debt and income with sufficient clarify while at the same time providing flexibility to accommodate new approaches to verification and underwriting. As noted in part V.E below, the Bureau is requesting comment on whether the rule should retain a specific DTI limit and, if so, whether the Bureau's proposed approach to verification of income and debt in § 1026.43(e)(2)(v) would provide a workable method for defining debt and income for a specific DTI limit. Part V.E

[201] *See* Karan Kaul *et al*., Urban Inst., *Comment Letter to the Consumer Financial Protection Bureau on the Qualified Mortgage Rule,* (Sept. 2019), at 9-10, https://www.urban.org/sites/default/files/publication/101048/comment_letter_to_the_consumer_financial_protection_bureau_0.pdf.

below requests comment on whether certain aspects of proposed § 1026.43(e)(2)(v) could be applied to a General QM loan definition that includes a specific DTI limit.

In addition to strongly correlating with loan performance, the Bureau tentatively concludes that a price-based QM definition, rather than conditioning QM status on a specific DTI limit, is a more holistic and flexible measure of a consumer's ability to repay. Mortgage underwriting, and by extension, a loan's price, generally includes consideration of a consumer's DTI. However, loan pricing also includes assessment of additional factors, including LTV ratios, credit scores, and cash reserves, that might compensate for a higher DTI ratio and that might also be probative of a consumer's ability to repay. One of the primary criticisms of the current 43 percent DTI ratio is that it is too limited in assessing a consumer's finances and, as such, may unduly restrict access to credit for some consumers for whom it might be appropriate to presume ability to repay at consummation. Therefore, a potential benefit of a price-based QM definition is that a mortgage loan's price reflects credit risk based on many factors, including DTI ratios, and may be a more holistic measure of ability to repay than DTI ratios alone. Further, there is inherent flexibility for creditors in a rate-spread-based QM definition, which could facilitate innovation in underwriting, including emerging research into alternative mechanisms to assess a consumer's ability to repay, such as cash flow underwriting. Although the Bureau is proposing to remove the 43 percent DTI limit in § 1026.43(e)(2)(vi), the Bureau continues to believe that DTI is an important factor for creditors to consider in evaluating consumers' ability to repay. As discussed further in the section-by-section analysis of § 1026.43(e)(2)(v), below, the Bureau is proposing to require creditors to consider a consumer's DTI ratio or residual income to satisfy the General QM loan definition.

The Bureau also notes that there is significant precedent for using the price of a mortgage loan to determine whether to apply additional consumer protections, in recognition of the lower risk generally posed by lower-priced mortgages. A price-based General QM loan definition would be consistent with these existing provisions that provide greater protections to consumers with more expensive loans. For example, TILA and Regulation Z use a loan's APR in comparison to APOR and as one trigger for heightened consumer protections for certain "high-cost mortgages" pursuant to HOEPA.[202] Loans that meet HOEPA's high-cost trigger are subject to special disclosure requirements and restrictions on loan terms, and consumers with high-cost mortgages have enhanced remedies for violations of the law. Further, in 2008, the Board exercised its authority under HOEPA to require certain consumer protections concerning a consumer's ability to repay, prepayment penalties, and escrow accounts for taxes and insurance for a category of "higher-priced mortgage loans," which have APR spreads lower than those prescribed for high-cost mortgages but that nevertheless exceed APOR by a specified threshold.[203] Although the ATR/QM Rule replaced the ability-to-repay requirements promulgated pursuant to HOEPA and the Board's 2008 rule,[204] higher-priced mortgage loans remain subject to additional requirements related to escrow accounts for taxes and homeowners insurance and to appraisal requirements.[205] The ATR/QM Rule itself provides additional protection to QMs that are higher-priced covered transactions, as defined in § 1026.43(b)(4), in

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[202] *See* TILA section 103(aa)(i); Regulation Z § 1026.32(a)(1)(i). TILA and Regulation Z also provide a separate price-based coverage trigger based on the points and fees charged on a loan. *See* TILA section 130(aa)(ii); Regulation Z § 1026.32(a)(1)(ii).

[203] 73 FR 44522 (July 30, 2008).

[204] The Board's 2008 rule was superseded by the January 2013 Final Rule, which imposed ability to repay requirements on a broader range of closed-end consumer credit transactions secured by a dwelling. *See generally* 78 FR 6407 (Jan. 30, 2013).

[205] *See* § 1026.35(b) and (c).

the form of a rebuttable presumption of compliance with the ATR provisions, instead of a conclusive safe harbor.

Finally, the Bureau preliminarily concludes that a price-based General QM loan definition would provide compliance certainty to creditors, since creditors would be able to readily determine whether a loan is a General QM loan. Creditors have experience with APR calculations due to the existing price-based regulatory requirements described above, and for various other disclosure and compliance reasons under Regulation Z. Creditors also have experience determining the appropriate APOR for use in calculating rate spreads. As such, the Bureau believes this approach would provide certainty to creditors regarding a loan's status as a QM.[206]

Although the proposal would require creditors to consider the consumer's income, debt, and DTI ratio or residual income, the proposal would not provide a specific DTI limit. For the reasons discussed below in the section-by-section analysis of § 1026.43(e)(2)(v)(A), the Bureau preliminarily concludes that it is appropriate to remove current appendix Q and instead provide creditors additional flexibility for defining "debt" and "income." Therefore, the Bureau is not proposing to provide a single, specific set of standards equivalent to appendix Q for what must be counted as debt and what may be counted as income for purposes of proposed § 1026.43(e)(2)(v)(A). For purposes of this proposed requirement, income and debt would be determined in accordance with proposed § 1026.43(e)(2)(v)(B), which requires the creditor to verify the consumer's current or reasonably expected income or assets other than the value of the

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[206] The Bureau understands from feedback that creditors are concerned about errors in DTI calculations and have previously requested that the Bureau permit a cure of DTI overages that are discovered after consummation. *See* 79 FR 25730, 25743-45 (May 6, 2014) (requesting comment on potential cure or correction provisions for DTI overages).

dwelling (including any real property attached to the dwelling) that secures the loan, and the consumer's current debt obligations, alimony, and child support. The proposed rule would provide a safe harbor to creditors using verification standards the Bureau specifies. This could potentially include relevant provisions from Fannie Mae's Single Family Selling Guide, Freddie Mac's Single-Family Seller/Servicer Guide, FHA's Single Family Housing Policy Handbook, the VA's Lenders Handbook, and the Field Office Handbook for the Direct Single Family Housing Program and Handbook for the Single Family Guaranteed Loan Program of the U.S. Department of Agriculture (USDA), current as of the proposal's public release. However, under the proposal, creditors would not be required to verify income and debt according to the standards the Bureau specifies. Rather, the proposed rule would also provide creditors with the flexibility to develop other methods of compliance with the verification requirements.

Under the proposal, a loan would meet the General QM loan definition in § 1026.43(e)(2) only if the APR exceeds APOR for a comparable transaction by less than two percentage points as of the date the interest rate is set. As described below in the section-by-section analysis of § 1026.43(e)(2)(vi), the Bureau tentatively concludes that this threshold would strike an appropriate balance between ensuring that loans receiving QM status may be presumed to comply with the ATR provisions and ensuring that access to responsible, affordable mortgage credit remains available to consumers. For these same reasons, the Bureau is proposing higher thresholds for smaller loans and subordinate-lien transactions, as the Bureau is concerned that loans with lower loan amounts may be priced higher than larger loans, even when the consumers have similar credit characteristics and a similar ability to repay. For all loans, regardless of loan size, the Bureau is not proposing to alter the current threshold separating safe harbor from rebuttable presumption QMs in § 1026.43(b)(4), under which a loan is a safe harbor QM if its

APR exceeds APOR for a comparable transaction by less than 1.5 percentage points as of the date the interest rate is set. As such, loans that otherwise meet the General QM loan definition and for which the APR exceeds APOR by 1.5 or more percentage points (but by less than 2 percentage points) as of the date the interest rate is set would receive a rebuttable presumption of compliance with the ATR provisions. This approach is discussed further, below.

Finally, the Bureau notes its analysis of the potential effects on access to credit of a price-based approach to defining a General QM loan. As indicated by the various combinations in Table 7 below, 2018 HMDA data show that under the current rule—including the Temporary GSE QM loan definition, the General QM loan definition with a 43 percent DTI limit, and the Small Creditor QM loan definition in § 1026.43(e)(5)—90.6 percent of conventional purchase loans were safe harbor QM loans and 95.8 percent were safe harbor QM or rebuttable presumption QM loans. Under the proposed General QM rate spread thresholds of 1.5 (safe harbor) and 2 (rebuttable presumption) percentage points over APOR, which are described further, below, 91.6 percent of conventional purchase loans would have been safe harbor QM loans and 96.1 percent would have been safe harbor QM or rebuttable presumption QM loans.[207] Based on these 2018 data, rate spread thresholds of 1-2 percentage points over APOR for safe harbor QM loans would have covered 83.3 to 94.1 percent of the conventional purchase market (as safe harbor QM loans), while rate spread thresholds of 1.5-2.5 percentage points over APOR for rebuttable presumption QM loans would have covered 94.3 to 96.8 percent of the conventional purchase market (as safe harbor and rebuttable presumption QM loans).

[207] All estimates in Table 7 include loans that meet the Small Creditor QM loan definition in § 1026.43(e)(5). In particular, loans originated by small creditors that meet the criteria in § 1026.43(e)(5) are safe harbor QM loans if priced below 3.5 percentage points over APOR or are rebuttable presumption QM loans if priced 3.5 percentage points or more over APOR.

Table 7: Share of 2018 conventional first-lien purchase loans within various price-based safe harbor (SH) QM and rebuttable presumption (RP) QM definitions (HMDA data)

Approach	Safe Harbor QM (share of conventional purchase market)	QM Overall (share of conventional purchase market)
Temporary GSE QM + DTI 43	90.6	95.8
Proposal (SH 1.50, RP 2.00)	91.6	96.1
SH 0.75, RP 1.50	74.6	94.3
SH 1.00, RP 1.50	83.3	94.3
SH 1.25, RP 1.75	88.4	95.3
SH 1.35, RP 2.00	89.8	96.1
SH 1.40, RP 2.00	90.5	96.1
SH 1.75, RP 2.25	93.1	96.6
SH 2.00, RP 2.50	94.1	96.8

Despite the expected benefits of a price-based General QM loan definition, the Bureau acknowledges concerns about the approach. First, while the Bureau believes a loan's price may be a more holistic and flexible measure of a consumer's ability to repay than DTI alone, the Bureau recognizes that there is a distinction between credit risk, which largely determines pricing relative to the prime rate, and a particular consumer's ability to repay, which is one component of credit risk. Pricing is based on creditors' expected net revenues (*i.e.*, whether a creditor will earn interest payments and recover the outstanding principal balance in the event of default). While a consumer's ability to afford loan payments is an important component of pricing, the loan's price will reflect additional factors related to the loan that may not in all cases be probative of the consumer's repayment ability. As noted above, the proposal includes a requirement to consider the consumer's DTI ratio or residual income as part of the General QM loan definition, and to verify the debt and income used to calculate DTI or residual income, because the Bureau believes these are important factors in assessing a consumer's ability to repay. These requirements are discussed further below and in the section-by-section analysis of § 1026.43(e)(2)(v).

The Bureau also acknowledges that factors unrelated to the individual loan can influence its price. Institutional factors, such as the competing policy considerations inherent in setting guarantee fees on GSE loans, can influence mortgage pricing independently of credit risk or ability to repay and would have some effect on which loans would be priced under the proposed General QM loan pricing threshold. The price-based approach also shifts the QM determination from a DTI calculation, which is relatively consistent across creditors and over time, to one which is more variable. An identical loan to a consumer with the same risk profile might satisfy the requirements of the General QM loan definition at one point in time but not at another since APOR will change over time. The Bureau also anticipates that a price-based approach would incentivize some creditors to price some loans just below the threshold so that the loans will receive the presumption of compliance that comes with QM status. While the Bureau acknowledges these criticisms of a price-based approach, the Bureau's delinquency analyses and the analyses by external parties discussed above provide evidence that rate spreads are correlated with delinquency.

Finally, the Bureau is aware of concerns about the sensitivity of a price-based QM definition to macroeconomic cycles. In particular, the Bureau is aware of concerns that the price-based approach would be a dynamic, trailing indicator of risk and could be pro-cyclical. For example, during periods of economic expansion, increasing house prices and strong demand from consumers with weaker credit characteristics often lead to greater availability of credit, as secondary market investors expect minimal losses, regardless of whether the consumer defaults, due to increasing collateral values. This may result in an underpricing of credit risk. To the extent that occurs, rate spreads over APOR would compress and additional higher-priced, higher-risk loans would fit within the proposed General QM loan definition. Further, during periods of economic downturn, investors' demand for mortgage credit may fall as they seek safer investments to limit losses in the event of a broader economic decline. This may result in creditors reducing the availability of mortgage credit to riskier borrowers, through credit overlays and price increases, to protect against the risk that creditors may be unable to sell the loans profitably in the secondary markets, or even sell the loans at all. While APOR would also increase during periods of economic stress and low secondary market liquidity, consumers with riskier credit characteristics may see disproportionate pricing increases relative to the increases in a more normal economic environment. These effects would likely make price-based QM standards pro-cyclical, with a more expansive QM market when the economy is expanding, and a more restrictive QM market when credit is tight. As a result, a rate spread-based QM threshold would likely be less effective in limiting risky loans during periods of strong housing price growth or encouraging safe loans during periods of weak housing price growth. The Bureau is particularly concerned about these potential effects given the recent economic disruptions associated with the COVID-19 pandemic. As described in part V.E below, the Bureau is requesting comment on an alternative, DTI-based approach. Unlike a price-based approach, a DTI-based approach would be counter-cyclical, because of the positive correlation between interest rates and DTI ratios. The alternative proposal is discussed in detail in part V.E.

As noted above, stakeholders have suggested a range of options to replace the 43 percent DTI limit in the General QM loan definition. The Bureau has considered these options in developing this proposed rule but is not providing specific proposals for these alternatives because the Bureau has preliminarily concluded that the price-based approach in proposed

§ 1026.43(e)(2) would best achieve the statutory goals of ensuring consumers' ability to repay and maintaining access to responsible, affordable, mortgage credit. For example, some stakeholders have suggested that the Bureau rely only on the statutory QM loan restrictions (*i.e.*, prohibitions on certain loan features, requirements for underwriting, and a limitation on points and fees) to define a General QM loan. The Bureau is not proposing this approach because it is concerned that such an approach, which would define a General QM loan without either a direct or indirect measure of the consumer's finances, may not adequately ensure that consumers have a reasonable ability to repay their loans according to the loan terms.

Other stakeholders have suggested that the Bureau retain DTI as part of the General QM loan definition, but with modifications to the current rule. Some stakeholders have advocated for increasing the DTI limit to some other percentage to address concerns that the 43 percent DTI limit is too restrictive and may exclude consumers for whom it might be appropriate to presume ability to repay for their loans at consummation. Another stakeholder suggested a hybrid approach that would eliminate the DTI limit only for loans below a set pricing threshold, such that less expensive loans could obtain General QM loan status by meeting the statutory QM factors and more expensive loans could be General QM loans only if the consumer's DTI ratio is below a set threshold. This stakeholder suggests that more expensive loans pose greater risks to consumers, so it is critical to include a DTI limit for such loans. The Bureau recognizes these concerns and, as explained in part V.E, below, is requesting comment on whether an alternative approach that adopts a higher DTI limit or a hybrid approach that combines pricing and a DTI limit, along with a more flexible standard for defining debt and income, could provide a superior alternative to the price-based approach. In particular, the Bureau is requesting comment on whether such an approach would adequately balance considerations related to ensuring consumers' ability to repay and maintaining access to credit, which are described above.

Other stakeholders have advocated for granting QM status to loans with DTI ratios above a prescribed limit if certain compensating factors are present, such as credit score, LTV ratio, and cash reserves. Similarly, another stakeholder suggested the Bureau define General QM loans by reference to a multi-factor approach that combines DTI ratio, LTV ratio, and credit score. The Bureau is concerned about the complexity of these approaches. In particular, these approaches would present the same challenges with defining debt and income described above and would also require the Bureau to define compensating factors and set applicable thresholds for those factors. The Bureau is concerned that incorporating compensating factors into the General QM loan definition would not provide creditors adequate certainty about whether a loan satisfies the requirements of the General QM loan definition, given that it would be difficult to create a bright-line rule that incorporates a range of compensating factors. Further, the Bureau is concerned that a rule that incorporates only a few compensating factors might cause the market to over-emphasize those factors over others that might be equally predictive of a consumer's ability to repay, potentially stifling innovation and limiting access to credit. The Bureau has decided not to propose an approach that would combine a specific DTI limit with compensating factors.

The Bureau also acknowledges that some stakeholders have requested that the Bureau make the Temporary GSE QM loan definition permanent. The Bureau is not proposing this alternative because it is concerned that there is not a basis to presume for an indefinite period 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. Making the Temporary GSE QM loan definition permanent could stifle innovation and the development of competitive private-sector approaches to underwriting. The Bureau is also concerned that, as long as the Temporary GSE QM loan definition continues in effect, the non-GSE private market is less likely to rebound, and that the existence of the Temporary GSE QM loan definition may be contributing to the continuing limited non-GSE private market.

The Bureau requests comment on all aspects of the proposal to remove the General QM loan definition's specific DTI limit in § 1026.43(e)(2)(vi) and replace it with a with a price-based threshold. In particular, the Bureau requests comment, including data or other analysis, on whether pricing is predictive of loan performance and whether the Bureau should consider other requirements, in addition to a price-based threshold, as part of the General QM loan definition. The Bureau also requests comment on whether and to what extent the private market would provide access to credit by originating responsible, affordable mortgages that would no longer receive QM status when the Temporary GSE QM loan definition expires, including loans with DTI ratios above 43 percent. In addition, in light of the concerns about the sensitivity of a price-based QM definition to macroeconomic cycles, the Bureau requests comment on whether it should consider adjusting the pricing thresholds in emergency situations and, if so, how the Bureau should do so. The Bureau also requests comment on how revisions to the General QM loan definition can support innovations in underwriting that would facilitate access to credit, while ensuring that loans granted QM status are those that should be presumed to comply with the ATR provisions.

As noted, the Bureau is proposing to require a creditor to consider a consumer's monthly DTI ratio or residual income, which the Bureau believes would help ensure that QMs remain within a consumer's ability to repay without the need to set a specific DTI limit. However, as discussed in more detail in part V.E below, the Bureau also specifically requests comment on whether, instead of or in addition to a price-based threshold, the rule should retain a DTI limit as part of the General QM loan definition or to determine which loans receive a safe harbor or a rebuttable presumption of compliance.

D. The QM Presumption of Compliance Under a Price-Based QM Definition

The Bureau is not proposing to alter the approach in the current ATR/QM Rule of providing a conclusive presumption of compliance (*i.e.*, a safe harbor) to loans that meet the General QM loan requirements in § 1026.43(e)(2) and for which the APR exceeds APOR for a comparable transaction by less than 1.5 percentage points as of the date the interest rate is set. Loans that meet the General QM loan requirements in § 1026.43(e)(2), including the pricing thresholds in § 1026.43(e)(2)(vi), and for which the APR exceeds APOR for a comparable transaction by 1.5 percentage points or more as of the date the interest rate is set would receive a rebuttable presumption of compliance. Therefore, a loan that otherwise meets the General QM loan definition would receive a rebuttable presumption of compliance with the ATR provisions if the APR exceeds APOR between 1.5 percentage points and less than 2 percentage points as of the interest rate is set. The proposal would provide a rebuttable presumption of compliance up to a higher pricing threshold for smaller loans, depending on the loan amount, and for subordinate-lien transactions, as described further in the section-by-section analysis of § 1026.43(e)(2)(vi).

Under the ATR/QM Rule, a creditor that makes a QM loan receives either a rebuttable or conclusive presumption of compliance with the ATR provisions, depending on whether the loan is a higher-priced covered transaction. The Rule generally defines higher-priced covered transaction in § 1026.43(b)(4) to mean a first-lien mortgage with an APR that exceeds APOR for a comparable transaction as of the date the interest rate is set by 1.5 or more percentage points; or a subordinate-lien transaction with an APR that exceeds APOR for a comparable transaction as of the date the interest rate is set by 3.5 or more percentage points.[208] The Rule provides in § 1026.43(e)(1)(i) that a creditor that makes a QM loan that is not a higher-priced covered transaction is entitled to a safe harbor from liability under the ATR provisions. Under § 1026.43(e)(1)(ii), a creditor that makes a QM loan that is a higher-priced covered transaction is entitled to a rebuttable presumption that the creditor has complied with the ATR provisions.

In developing the approach to the presumptions of compliance for QMs in the January 2013 Final Rule, the Bureau first considered whether the statute prescribes if QM loans receive a conclusive or rebuttable presumption of compliance with the ATR provisions. As discussed above, TILA section 129C(b) provides that loans that meet certain requirements are "qualified mortgages" and that creditors making QMs "may presume" that such loans have met the ATR requirements. However, the statute does not specify whether the presumption of compliance means that the creditor receives a conclusive presumption or a rebuttable presumption of compliance with the ATR provisions. The Bureau noted that its analysis of the statutory construction and policy implications demonstrates that there are sound reasons for adopting either interpretation.[209] The Bureau concluded that the statutory language is ambiguous and does not mandate either interpretation and that the presumptions should be tailored to promote the policy goals of the statute.[210] The Bureau interpreted the statute to provide for a rebuttable

[208] Section 1026.43(b)(4) also provides that a first-lien covered transaction that is a QM under § 1026.43(e)(5), (e)(6), or § 1026.43(f) is "higher priced" if its APR is 3.5 percentage points or more above APOR.

[209] 78 FR 6408, 6507 (Jan. 30, 2013).

[210] *Id*. at 6511.

presumption of compliance with the ATR provisions but used its adjustment and exception authority to establish a conclusive presumption of compliance for loans that are not "higher-priced covered transactions."[211]

In the January 2013 Final Rule, the Bureau identified several reasons why loans that are not higher-priced loans (generally prime loans) should receive a safe harbor. The Bureau noted that the fact that a consumer receives a prime rate is itself indicative of the absence of any indicia that would warrant a loan level price adjustment, and thus is suggestive of the consumer's ability to repay.[212] The Bureau noted that prime rate loans have performed significantly better historically than subprime loans and that the prime segment of the market has been subject to fewer abuses.[213] The Bureau noted that the QM requirements will ensure that the loans do not contain certain risky product features and are underwritten with careful attention to consumers' DTI ratios.[214] The Bureau also noted that a safe harbor provides greater legal certainty for creditors and secondary market participants and may promote enhanced competition and expand access to credit.[215] The Bureau determined that if a loan met the product and underwriting requirements for QM and was not a higher-priced covered transaction, there are sufficient grounds for concluding that the creditor satisfied the ATR provisions.[216]

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[211] *Id*. at 6514.

[212] *Id*. at 6511.

[213] *Id*.

[214] *Id*.

[215] *Id*.

[216] *Id*.

The Bureau in the January 2013 Final Rule pointed to factors to support its decision to adopt a rebuttable presumption for QMs that are higher-priced covered transactions. The Bureau noted that QM requirements, including the restrictions on product features and the 43 percent DTI limit, would help prevent the return of the lax lending practices prevalent in the years before the financial crisis, but that it is not possible to define by a bright-line rule a class of mortgages for which each consumer will have ability to repay, particularly for subprime loans.[217] The Bureau noted that subprime pricing is often the result of loan level price adjustments established by the secondary market and calibrated to default risk.[218] The Bureau also noted that consumers in the subprime market tend to be less sophisticated and have fewer options and thus are more susceptible to predatory lending practices.[219] The Bureau noted that subprime loans have performed considerably worse than prime loans.[220] The Bureau therefore concluded that QMs that are higher-priced covered transactions would receive a rebuttable presumption of compliance with the ATR provisions. The Bureau recognized that this approach could modestly increase the litigation risk for subprime QMs but did not expect that imposing a rebuttable presumption for higher-priced QMs would have a significant impact on access to credit.[221]

The Bureau is not proposing to alter this general approach to the presumption of compliance. Specifically, the Bureau is not proposing to amend the approach under the current rule, in which General QM loans that are higher-priced covered transactions (up to the pricing thresholds set out in proposed § 1026.43(e)(2)(vi)) receive a rebuttable presumption of

[217] *Id*.

[218] *Id*.

[219] *Id*.

[220] *Id*.

[221] *Id*. at 6511-13.

compliance with the ATR requirements and General QM loans that are not higher-priced covered transactions receive a safe harbor. As discussed above, the Bureau has preliminarily concluded that pricing is strongly correlated with loan performance and that pricing thresholds should be included in the General QM loan definition in § 1026.43(e)(2). The Bureau preliminarily concludes that for prime loans, the pricing, in conjunction with the revised QM requirements in proposed § 1026.43(e)(2), provides sufficient grounds for supporting a conclusive presumption that the creditor complied with the ATR requirements. The Bureau recognizes that the January 2013 Final Rule relied in part on the 43 percent DTI limit to support its conclusion that a safe harbor is appropriate for QMs that are not higher-priced covered transactions. However, the Bureau believes that a specific DTI limit may not be necessary to support a decision to preserve the conclusive presumption, provided that the pricing threshold identified for the conclusive presumption is sufficiently low. As noted above, pricing is strongly correlated with loan performance, and the specific 43 percent DTI limit has been problematic, both because of the difficulties of calculating DTI with appendix Q and because, while DTI ratios in general may also be correlated with loan performance, the bright-line 43 percent threshold may unduly restrict access to credit for some consumers for whom it might be appropriate to presume ability to repay at consummation. Further, under the proposed price-based approach, creditors would be required to consider DTI or residual income for a loan to satisfy the requirements of the General QM loan definition. Moreover, the other factors noted above appear to continue supporting a safe harbor for prime QMs, including the better performance of prime loans compared to subprime loans, and the potential benefits of greater competition and access to credit from the greater certainty and reduced litigation risk arising from a safe harbor.

The Bureau is not proposing to alter the current safe harbor thresholds for General QM loans under § 1026.43(e)(2). Under current § 1026.43(b)(4) and (e)(1)(i), a first-lien transaction that is a General QM loan under § 1026.43(e)(2) receives a safe harbor from liability under the ATR provisions if a loan's APR exceeds APOR for a comparable transaction by less than 1.5 percentage points as of the date the interest rate is set. Current paragraphs (b)(4) and (e)(1)(i) of § 1026.43 provide a separate safe harbor threshold of 3.5 percentage points for subordinate-lien transactions. The Bureau is also not proposing to amend that threshold.[222]

As explained above, the Bureau's January 2013 Final Rule generally viewed loans with APRs that did not exceed APOR by more than 1.5 percentage points (and 3.5 percentage points for subordinate-lien transactions) to be prime loans which, if the loan satisfies the criteria to be a QM, may be conclusively presumed to comply with the ATR provisions. In support of providing a conclusive presumption of compliance to prime loans, the Bureau cited the absence of loan level price adjustments for those loans (which the Bureau viewed as indicative of the consumer's ability to repay), the historical performance of prime rate loans compared to subprime loans, and historically fewer abusive practices in the prime market.[223] With respect to the specific thresholds chosen to separate safe harbor from rebuttable presumption QM loans, the Bureau in the January 2013 Final Rule noted that the line it was drawing had long been recognized as a rule of thumb to separate prime loans from subprime loans.[224] The 1.5 percentage point above APOR threshold is the same as that used in the Board's 2008 HOEPA Final Rule, described above,

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[222] As noted above, the Bureau is not proposing to alter the higher threshold of 3.5 percentage points over APOR for small creditor portfolio QMs and balloon-payment QMs made by certain small creditors pursuant to § 1026.43(e)(5), (e)(6) and (f). *See* § 1026.43(b)(4).

[223] 78 FR 6408, 6511 (Jan. 30, 2013).

[224] *Id.* at 6408.

which was amended by the Board's 2011 Jumbo Loans Escrows Final Rule to include a separate threshold for jumbo loans for purposes of certain escrows requirements.[225] Subsequently, the Dodd-Frank Act adopted these same thresholds in TILA section 129C(a)(6)(D)(ii)(II), which provides that a creditor making a balloon-payment loan with an APR at or above certain thresholds must determine ability to repay using the contract's repayment schedule.[226] The Bureau concluded that a 1.5 percentage point threshold for first-lien QMs and 3.5 percentage point threshold for subordinate-lien QMs balanced competing consumer protection and access to credit considerations.[227] The Bureau also concluded that it was not appropriate to extend the safe harbor to first-lien loans above those thresholds because that approach would provide insufficient protection to consumers in loans with higher interest rates who may require greater protection than consumers in prime rate loans.[228]

For the reasons set forth below, the Bureau is not proposing to alter the safe harbor threshold of 1.5 percentage points for first-lien General QM loans under the price-based approach in proposed § 1026.43(e)(2). The Bureau tentatively concludes that the current safe harbor threshold of 1.5 percentage points for first liens is appropriate to restrict safe harbor QMs to lower-priced, generally less risky, loans while ensuring that responsible, affordable credit remains available to consumers. The Bureau generally believes these same considerations support not changing the current safe harbor threshold of 3.5 percentage points for subordinate-lien transactions, which generally perform better and have stronger credit characteristics than

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[225] *Id.* at 6451; *see also* 76 FR 11319 (Mar. 2, 2011) (2011 Jumbo Loans Escrows Final Rule).

[226] 78 FR 6408, 6451 (Jan. 30, 2013).

[227] *Id.* at 6514.

[228] *Id*.

first-lien transactions. The Bureau's proposal to address subordinate-lien transactions is discussed further below in the section-by-section analysis of § 1026.43(e)(2)(vi).

As explained above, the Bureau uses early delinquency rates as a proxy for measuring whether a consumer had ability to repay at the time the mortgage loan was originated. Here, the Bureau analyzed early delinquency rates in considering whether it should propose to revise the threshold for first-lien safe harbor General QM loans under the proposed price-based approach; that is, which first-lien General QM loans should be conclusively presumed to comply with the ATR provisions in the absence of a specific DTI limit. As noted above, the January 2013 Final Rule relied in part on the 43 percent DTI limit to support its conclusion that a safe harbor is appropriate for QMs that are not higher-priced covered transactions. Under the proposal to replace the current 43 percent DTI limit with a price-based approach, some loans with DTI ratios above 43 percent will receive safe harbor QM status.

The Bureau compared projected early delinquency rates under the General QM loan definition with and without a 43 percent DTI limit under a range of potential rate-spread based safe harbor thresholds. Under the current 43 percent DTI limit for first-lien General QM loans, Table 5 (2002-2008), above, indicates early delinquency rates for loans with rate spreads just below 1.5 percentage points increase with DTI, from 6 percent for loans with a DTI ratio of 20 percent or below to 11 percent for loans with DTI ratios from 41 to 43 percent. For loans with rate spreads just below 1.5 percentage points and DTI ratios above 43 percent, Table 5 indicates early delinquency rates between 12 percent (for loans with 44 to 45 percent DTI ratios) and 15 percent (for loans with DTI ratios of 61 to 70 percent). The loans at that rate spread with DTI ratios above 43 percent in Table 5 are loans that are not QMs under the current General QM loan definition in § 1026.43(e)(2) because of the 43 percent DTI limit, but that would be QMs under the proposed General QM loan definition in § 1026.43(e)(2) in the absence of the 43 percent DTI limit. Therefore, the loans that would be newly granted safe harbor status under the proposed price-based approach at a safe harbor threshold of 1.5 percentage points are likely to have a somewhat higher early delinquency rate than those just at or below 43 percent DTI ratios, 12 to 15 percent versus 11 percent. The comparable early delinquency rates for 2018 loans from Table 6 also show a slightly higher early delinquency rate for DTI ratios above 43 percent compared to loans with DTI ratios of 36 to 43 percent: 2.3 percent versus 1.5 percent.

The Bureau acknowledges that removing the 43 percent DTI limit while retaining a 1.5 percentage point safe harbor threshold would lead to somewhat higher-risk loans obtaining safe harbor QM status relative to loans within the current General QM loan definition. However, Bureau analysis shows the early delinquency rate for this set of loans is on par with loans that have received safe harbor QM status under the Temporary GSE QM loan definition. Restricting the sample of 2018 NMDB-HMDA matched first-lien conventional purchase originations to only those purchased and guaranteed by the GSEs, loans with DTI ratios above 43 and rate spreads between 1 and 1.49 percentage points had an early delinquency rate of 2.4 percent.[229] Consequently, the Bureau does not believe that the price-based alternative would result in substantially higher delinquency rates than the standard included in the current rule.

The Bureau also considered continued access to responsible, affordable mortgage credit in deciding not to propose revisions to the current 1.5 percentage point safe harbor threshold.

[229] This comparison uses 2018 data on GSE originations because such loans were originated while the Temporary GSE QM loan definition was in effect and the GSEs were in conservatorship. GSE loans from the 2002 to 2008 period were originated under a different regulatory regime and with different underwriting practices (*e.g.*, GSE loans more commonly had DTI ratios over 50 percent during the 2002 to 2008 period), and thus may not be directly comparable to loans made under the Temporary GSE QM loan definition.

The Bureau is concerned that a safe harbor threshold lower than 1.5 percentage points could reduce access to credit, as some loans that are General QM loans under current § 1026.43(e)(2) and receive a safe harbor would instead receive a rebuttable presumption of compliance under proposed § 1026.43(e)(2). HMDA data analyzed by the Bureau in the Assessment Report suggest that the safe harbor threshold of 1.5 percentage points has not constrained lenders, as the share of originations above the threshold remained steady after the implementation of the ATR/QM Rule.[230] However, the Report noted that these results are likely explained by the fact that, since the Board's issuance of a rule in 2008, an ability-to-repay requirement has applied to a category of mortgage loans that is substantially the same as rebuttable presumption QMs under the January 2013 Final Rule.[231] The Bureau is concerned about the potential effects on access to credit if the threshold is lowered, as loans that are newly subject to the rebuttable presumption rather than the safe harbor may cost materially more to consumers. For example, the Bureau is concerned that some loans that would have been originated as conventional mortgages may instead be originated as FHA loans, which the Bureau expects would cost materially more for many consumers. The Bureau expects that a safe harbor threshold of 1.5 percentage points over APOR for first liens under a price-based General QM loan definition would not have an adverse effect on access to credit. In particular, the Bureau estimates that the size of the safe harbor QM market would be comparable to the size of that market with the Temporary GSE QM loan

[230] Assessment Report, *supra* note 58, section 5.5, at 187.

[231] *Id.* at 182. The Assessment Report explained that because of their nearly identical definitions, higher-priced mortgage loans (HPMLs) may serve as a proxy for higher-priced covered transactions under the ATR/QM Rule in analysis of HMDA data.

definition in place and may expand slightly under the proposed amendments to the General QM loan definition in § 1026.43(e)(2), if the rule retains the current safe harbor threshold.[232]

As discussed above and in the January 2013 Final Rule, TILA does not plainly mandate either a safe harbor or a rebuttable presumption approach to a QM presumption of compliance.[233] With respect to General QM prime loans (General QM loans with an APR that does not exceed APOR by 1.5 or more percentage points for first liens), the Bureau preliminarily concludes that it is appropriate to use its adjustment authority under TILA section 105(a) to retain a conclusive presumption (*i.e.*, a safe harbor). The Bureau preliminarily concludes that this approach would balance the competing consumer protection and access to credit considerations described above. The Bureau acknowledges that, under the price-based approach in proposed § 1026.43(e)(2), General QM loans would not be limited to those with DTI ratios that do not exceed 43 percent, as is the case under the current rule. However, the Bureau preliminarily concludes that it remains appropriate to provide a safe harbor to these loans. The Bureau has recognized that receipt of a prime rate is suggestive of a consumer's ability to repay.[234] Further, the Bureau notes that proposed § 1026.43(e)(2)(v) would impose new requirements for the creditor to consider the consumer's income, debt, and monthly debt-to-income ratio or residual income to satisfy the General QM loan definition, thus retaining a requirement that the creditor consider

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[232] The Bureau estimates that 90.9 percent of conventional purchase loans in 2018 HMDA data fell within safe harbor QM status under the current rule with the Temporary GSE QM loan definition. The Bureau estimates that under the proposed changes to the General QM loan definition in § 1026.43(e)(2), 91.9 percent of those conventional purchase loans would have had safe harbor QM status if the current safe harbor threshold of 1.5 percentage points remains in place. Therefore, the Bureau expects that the proposed changes would result in a comparable, or somewhat increased, portion of the QM share of the market that would be protected by the safe harbor.

[233] 78 FR 6408, 6513 (Jan. 30, 2013).

[234] *Id*. at 6511.

key aspects of the consumer's financial capacity. The Bureau is not proposing to extend the safe harbor to higher-priced loans because the Bureau preliminarily concludes that such an approach would provide insufficient protection to consumers in loans with higher interest rates who may require greater protection than consumers in prime rate loans. The Bureau preliminarily concludes that providing a safe harbor for prime loans is necessary and proper to facilitate compliance with and to effectuate the purposes of section 129C and TILA, including to assure that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay the loans.

The Bureau requests comment on whether the rule should retain the current thresholds separating safe harbor from rebuttable presumption General QM loans and specifically requests feedback on whether the Bureau should adopt higher or lower safe harbor thresholds. The Bureau encourages commenters to suggest specific rate spread thresholds for the safe harbor. In particular, the Bureau requests comment on whether it may be appropriate to set the safe harbor threshold for first-lien transactions lower than 1.5 percentage points over APOR in light of the comparatively lower delinquency rates associated with high-DTI loans at lower rate spreads, as reflected in Tables 5 and 6.

The Bureau acknowledges that adopting a threshold below 1.5 percentage points over APOR could have some negative impact on access to credit, as some loans that are General QM loans under current § 1026.43(e)(2) and receive a safe harbor would instead receive a rebuttable presumption of compliance under proposed § 1026.43(e)(2). The Bureau similarly requests comment on whether it may be appropriate to set the safe harbor threshold for first liens higher than 1.5 percentage points over APOR. The Bureau acknowledges that some commenters to the ANPR suggested that the current safe harbor threshold is too low and may have an adverse impact on access to credit, including for minority consumers. At the same time, the Bureau notes its concern about higher early delinquency rates at higher safe harbor thresholds and is concerned that such an approach might result in safe harbors for loans for which it would not be appropriate to presume conclusively that consumers have a reasonable ability to repay their loans according to the loan terms. The Bureau requests comment on whether a safe harbor threshold of 2 percentage points over APOR would balance considerations regarding access to credit and ability to repay. For commenters that recommend a safe harbor threshold higher than 1.5 percentage points over APOR (such as a 2-percentage point threshold), the Bureau requests comment on an appropriate threshold to separate QM loans from non-QM loans. As discussed in the section-by-section analysis of § 1026.43(e)(2)(vi), below, the Bureau is proposing that loans with rate spreads between 1.5 and less than 2 percentage points over APOR receive a rebuttable presumption of compliance with the ATR provisions, and that loans with rate spreads of 2 percentage points over APOR or higher would not meet the General QM loan definition. Commenters are encouraged to provide data or other material to support their recommendations, as well as suggestions for commentary that would assist in understanding the application of the thresholds.

With respect to General QM loans that are higher-priced covered transactions the Bureau preliminarily concludes that such loans should receive a rebuttable presumption of compliance with the ATR requirements. Such loans would have to satisfy the revised QM requirements of § 1026.43(e)(2), and so would be prevented from including risky features and would be priced only moderately above prime loans. Accordingly, the Bureau preliminarily concludes that a rebuttable presumption of compliance is warranted for such loans. This approach may strike an appropriate balance between the access to credit benefits that arise from providing a greater degree of certainty that such loans comply with the ATR requirements and the consumer protections that stem from permitting consumers the opportunity to rebut the presumption of compliance.

The Bureau is not proposing to revise § 1026.43(e)(1)(ii)(B), which defines the grounds on which the presumption of compliance that applies to higher-priced QMs can be rebutted. Section 1026.43(e)(1)(ii)(B) provides that a consumer may rebut the presumption by showing that, at the time the loan was originated, the consumer's income and debt obligations left insufficient residual income or assets to meet living expenses. The analysis considers the consumer's monthly payments on the loan, mortgage-related obligations, and any simultaneous loans of which the creditor was aware, as well as any recurring, material living expenses of which the creditor was aware.

The Bureau stated in the January 2013 Final Rule that this standard was sufficiently broad to provide consumers a reasonable opportunity to demonstrate that the creditor did not have a good faith and reasonable belief in the consumer's repayment ability, despite meeting the prerequisites of a QM. At the same time, the Bureau stated that it believed the standard was sufficiently clear to provide certainty to creditors, investors, and regulators about the standards by which the presumption can successfully be challenged in cases where creditors have correctly followed the QM requirements. The Bureau also noted that the standard was consistent with the standard in the 2008 HOEPA Final Rule.[235] Commentary to that rule provides, as an example of how its presumption may be rebutted, that the consumer could show "a very high debt-to-income

[235] *Id.* at 6512.

ratio and a very limited residual income . . . depending on all of the facts and circumstances."[236] The Bureau noted that, under the definition of QM that the Bureau was adopting, the creditor was generally not entitled to a presumption if the consumer's DTI ratio was "very high." The Bureau stated that, as a result, the Bureau was focusing the standard for rebutting the presumption in the January 2013 Final Rule on whether, despite meeting a DTI test, the consumer nonetheless had insufficient residual income to cover the consumer's living expenses.[237]

The Bureau is not proposing to change the standard for rebutting the presumption of compliance because it believes the existing standard continues to balance the consumer protection and access to credit considerations described above appropriately. For example, the Bureau is not amending the presumption of compliance to provide that the consumer may use the DTI ratio to rebut the presumption of compliance by establishing that the DTI ratio is very high, or by establishing that the DTI ratio is very high *and* that the residual income is not sufficient. First, the Bureau tentatively determines that permitting the consumer to rebut the presumption by establishing that the DTI ratio is very high is not necessary because the existing rebuttal standard already incorporates an examination of the consumer's actual income and debt obligations (*i.e.*, the components of the DTI ratio) by providing the consumer the option to show that the consumer's residual income—which is calculated using the same components—was insufficient at consummation. Accordingly, the Bureau anticipates that the addition of DTI ratio to the

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[236] *See* Regulation Z comment 34(a)(4)(iii)-1.

[237] 78 FR 6408, 6511-12 (Jan. 30, 2013). The Bureau in the January 2013 Final Rule stated that it interpreted TILA section 129C(b)(1) to create a rebuttable presumption of compliance, but exercised its adjustment authority under TILA section 105(a) to limit the ability to rebut the presumption because the Bureau found that an open-ended rebuttable presumption would unduly restrict access to credit without a corresponding benefit to consumers. *Id.* at 6514.

rebuttal standard would not add probative value beyond the current residual income test in § 1026.43(e)(1)(ii)(B). Second, the Bureau anticipates that the addition of DTI ratio as a ground to rebut the presumption of compliance would undermine compliance certainty to creditors and the secondary market without providing any clear benefit to consumers. The Bureau tentatively determines that the rebuttable presumption standard would continue to be sufficiently broad to provide consumers a reasonable opportunity to demonstrate that the creditor did not have a good faith and reasonable belief in the consumer's repayment ability, despite meeting the prerequisites of a QM. The Bureau requests comment on its tentative determination not to amend the grounds on which the presumption of compliance can be rebutted. The Bureau also requests comment on whether to amend the grounds on which the presumption of compliance can be rebutted, such as where the consumer has a very high DTI and low residual income. To the extent commenters suggest that the Bureau should amend the grounds on which to rebut the presumption to add instances of a consumer having very high DTI, the Bureau requests comment on whether and how to define "very high DTI."

The Bureau requests comment on all aspects of the proposed approach for the presumption of compliance. In particular, the Bureau requests comment, including data or other analysis, on whether a safe harbor for QMs that are not higher priced is appropriate and, if so, on whether other requirements should be imposed for such QMs to receive a safe harbor.

E. Alternative to the Proposed Price-Based QM Definition: Retaining a DTI Limit

Although the Bureau is proposing to remove the 43 percent DTI limit and adopt a price-based approach for the General QM loan definition, the Bureau requests comment on an alternative approach that retains a DTI limit, but raises it above the current limit of 43 percent and provides a more flexible set of standards for verifying debt and income in place of appendix Q.

As discussed above, the Bureau is proposing to remove the 43 percent DTI limit because it is concerned that, after the expiration of the Temporary GSE QM loan definition, the 43 percent DTI limit would result in a significant reduction in the size of QM and potentially could result in a significant reduction in access to credit. The Bureau proposes to move away from a DTI-based approach because it is concerned that imposing a DTI limit as a condition for QM status under the General QM loan definition may be overly burdensome and complex in practice and may unduly restrict access to credit because it provides an incomplete picture of the consumer's financial capacity. The Bureau is proposing to remove appendix Q because its definitions of debt and income are rigid and difficult to apply and do not provide the level of compliance certainty that the Bureau anticipated at the time of the January 2013 Final Rule. As noted above, the Bureau is proposing a price-based General QM loan definition because it preliminarily concludes that a loan's price, as measured by comparing a loan's APR to APOR for a comparable transaction, is a strong indicator of a consumer's ability to repay and is a more holistic and flexible measure of a consumer's ability to repay than DTI alone.

At the same time, the Bureau acknowledges concerns about a price-based approach, as described in part V, above. In particular, the Bureau acknowledges the sensitivity of a price-based QM definition to macroeconomic cycles, including concerns that the price-based approach could be pro-cyclical, with a more expansive QM market when the economy is expanding, and a more restrictive QM market when credit is tight. The Bureau is especially concerned about these potential effects given the recent economic disruptions associated with the COVID-19 pandemic. If the QM market were to contract, the Bureau would be concerned about a reduction in access to credit because of the modest amount of non-QM lending identified in the Bureau's Assessment Report, which the Bureau understands has declined further in recent months. The Bureau also acknowledges that a small share of loans that satisfy the current General QM loan definition would lose QM status under the proposed price-based approach due to the loan's rate spread exceeding the applicable threshold.

For these reasons, the Bureau requests comment on whether an approach that increases the DTI limit to a specific threshold within a range of 45 to 48 percent and that includes more flexible definitions of debt and income would be a superior alternative to a price-based approach.[238] As discussed above, the January 2013 Final Rule incorporated DTI as part of the General QM loan definition because the Bureau believed the QM criteria should include a standard for evaluating the consumer's ability to repay, in addition to the product-feature restrictions and other requirements that are specified in TILA. The Bureau has acknowledged that DTI is predictive of loan performance, and some commenters responding to the ANPR advocated for retaining a DTI limit as part of the General QM loan definition, arguing that it is a strong indicator of a consumer's ability to repay. The Bureau adopted a specific DTI limit as part of the General QM loan definition to provide certainty to creditors that a loan is in fact a QM.[239] The Bureau also provided a specific DTI limit to give certainty to assignees and investors in the secondary market, because the Bureau believed such certainty would help reduce possible concerns regarding risk of liability and promote credit availability.[240] Numerous

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[238] The Bureau acknowledges that some loans currently originated as Temporary GSE QM loans have higher DTI ratios. However, the Bureau is concerned about adopting a DTI limit above a range of 45 to 48 percent without a requirement to consider compensating factors. The Bureau is concerned about the complexity of approaches to the General QM loan definition that incorporate compensating factors, as explained in part V.C, above.

[239] 78 FR 6408 at 6526-27.

[240] *Id.*

commenters on the 2011 Proposed Rule and comments submitted subsequent to publication of the January 2013 Final Rule have highlighted the value of providing objective requirements that creditors can identify and apply based on information contained in loan files. Unlike a price-based approach, a DTI-based approach would be counter-cyclical, because of the positive correlation between interest rates and DTI ratios. Consumers' monthly payments on their debts—the numerator in DTI—will be higher when interest rates and home prices are high, leading to a more restrictive QM market. By contrast, DTI ratios will be lower when interest rates and home prices are lower, leading to a more expansive QM market.

The Bureau is proposing to remove the 43 percent DTI limit and appendix Q, based in substantial part on concerns about access to credit and the challenges associated with using appendix Q to define income and debt, and to adopt a price-based approach for the General QM loan definition. However, the Bureau requests comment on whether an alternative approach that adopts a higher DTI limit and a more flexible standard for defining debt and income could mitigate these concerns and provide a superior alternative to the price-based approach. In particular, the Bureau requests comment on whether such an approach would adequately balance considerations related to ensuring consumers' ability to repay and maintaining access to credit.

As described above, the Bureau uses early delinquency (measured by whether a consumer was ever 60 or more days past due within the first 2 years after origination) as a proxy for the likelihood of a lack of consumer ability to repay at consummation across a wide pool of loans. The Bureau's analyzed the relationship between DTI ratios and early delinquency, using data on first-lien conventional purchase originations from the NMDB, including a matched sample of NMDB and HMDA loans. That analysis, as shown in Tables 3 and 4 above, shows that early delinquency rates increase consistently with DTI ratio. This relationship is like the pattern shown in the Bureau's analysis of early delinquency rates by rate spread. For 2002-2008 originations, as shown in Table 3, there was a 7 percent early delinquency rate for loans with DTI ratios between 44 and 48 percent. For the sample of 2018 originations in the NMDB matched to HMDA data, as shown in Table 4, there was a 0.9 percent early delinquency rate for loans with DTI ratios between 44 and 50 percent.

Tables 5 and 6 show the early delinquency rates of these same samples categorized according to both their DTI and their rate spreads. Table 5, which shows early delinquency rates for the 2002-2008 data, shows early delinquency rates as high as 19 percent for loans with DTI ratios between 46 and 48 percent that are priced between 2 and 2.24 percentage points over APOR. This approximates the loans with the highest DTI and pricing that would be QMs under this alternative. For comparison, as discussed in the section-by-section analysis of § 1026.43(e)(2)(vi), the highest early delinquency rates for loans within the current General QM loan definition is 16 percent (DTI ratios of 41 to 43 percent and priced 2 percentage points or more over APOR) and the highest early delinquency rates for loans within the General QM loan definition under the proposed price-based approach is 22 percent (DTI ratios of 61 to 70 percent priced between 1.75 and 1.99 percentage points over APOR).

Table 6, which shows early delinquency rates for the 2018 sample, allows a similar comparison for 2018 originations. Table 6 shows early delinquency rates of 4.2 percent for loans with DTI ratios between 44 and 50 percent that are priced 2 percentage points or more above APOR. However, the highest early delinquency rates for loans within the current General QM loan definition or the alternative is 4.4 percent (DTI ratios of 26 to 35 percent and priced 2 percentage points or more over APOR). The highest early delinquency rates for loans within the

General QM loan definition under the proposed price-based approach is 3.2 percent (DTI ratios of 26 to 35 percent priced between 1.5 and 1.99 percentage points over APOR).

The Bureau has also analyzed the potential effects of a DTI-based approach on the size of QM and potentially on access to credit. As indicated in Table 8 below, 2018 HMDA data show that with the Temporary GSE QM loan definition and the General QM loan definition with a 43 percent DTI limit, 90.6 percent of conventional purchase loans were safe harbor QM loans and 95.8 percent were safe harbor QM or rebuttable presumption QM loans. If, instead, the Temporary GSE QM loan definition were not in place along with the General QM loan definition (with the 43 percent DTI limit), and assuming no change in consumer or creditor behavior from the 2018 HMDA data, then only 69.3 percent of loans would have been safe harbor QM loans and 73.6 percent of loans would have been safe harbor QM loans or rebuttable presumption QM loans. Raising the DTI limit above 43 percent would increase the size of the QM market and, as a result, potentially increase access to credit relative to the General QM loan definition with a DTI limit of 43 percent. The magnitude of the increase in the size of the QM market and potential increase in access to credit depends on the selected DTI limit. A DTI limit in the range of 45 to 48 percent would likely result in a QM market that is larger than one with a DTI limit of 43 percent but smaller than the status quo (*i.e.*, Temporary GSE QM loan definition and DTI limit of 43 percent). However, the Bureau expects that consumers and creditors would respond to changes in the General QM loan definition, potentially allowing additional loans to be made as safe harbor QM loans or rebuttable presumption QM loans.

Table 8: Share of 2018 conventional purchase loans within various safe harbor QM and rebuttable presumption QM definitions (HMDA data)

Approach	Safe Harbor QM (share of conventional market)	QM Overall (share of conventional market)
Temporary GSE QM + DTI 43	90.6	95.8
Proposal (Pricing at 2.0)	91.6	96.1
DTI limit 43	69.3	73.6
DTI limit 45	76.1	80.9
DTI limit 46	78.8	83.8
DTI limit 47	81.4	86.6
DTI limit 48	84.1	89.4
DTI limit 49	87.0	92.4
DTI limit 50	90.8	96.4

The Bureau seeks comment on whether to retain a specific DTI limit for the General QM loan definition, rather than or in addition to the proposed price-based approach. The Bureau specifically seeks comment on a specific DTI limit between 45 and 48 percent. The Bureau seeks comment and data on whether increasing the DTI limit to a specific percentage between 45 and 48 percent would be a superior alternative to the proposed price-based approach, and, if so, on what specific DTI percentage the Bureau should include in the General QM loan definition. The Bureau seeks comment and data as to how specific DTI percentages would be expected to affect access to credit and would be expected to affect the risk that the General QM loan definition would include loans for which the Bureau should not presume that the consumers who receive them have the ability to repay. The Bureau also requests comment on whether increasing the DTI limit to a specific percentage between 45 to 48 percent would better balance the goals of ensuring access to responsible, affordable credit and ensuring that QMs are limited to loans for which the Bureau should presume that consumers have the ability to repay. The Bureau also requests comment on the macroeconomic effects of a DTI-based approach as well as whether and how the Bureau should weigh such effects in amending the General QM loan definition. In addition, the Bureau requests comment on whether, if the Bureau adopts a higher specific DTI limit as part of the General QM loan definition, the Bureau should retain the price-based threshold of 1.5 percentage points over APOR to separate safe harbor QM loans from rebuttable presumption QM loans for first-lien transactions.

The Bureau also requests comment on whether to adopt a hybrid approach in which a combination of a DTI limit and a price-based threshold would be used in the General QM loan definition. One such approach could impose a DTI limit only for loans above a certain pricing threshold, to reduce the likelihood that the presumption of compliance with the ATR requirement would be provided to loans for which the consumer lacks ability to repay, while avoiding the potential burden and complexity of a DTI limit for many lower-priced loans. The Bureau estimates that 81 percent of conventional purchase loans have rate spreads below 1 percentage point and no product features restricted under the General QM loan definition. For example, the rule could impose a DTI limit of 50 percent for loans with rate spreads at or above 1 percentage point. Using 2018 HMDA data, the Bureau estimates that 91.5 percent of conventional purchase loans would be safe harbor QM loans under this approach, and 96 percent would be QM loans. A similar approach might impose a DTI limit above a certain pricing threshold and also tailor the presumption of compliance with the ATR requirement based on DTI. For example, the rule could provide that (1) for loans with rate spreads under 1 percentage point, the loan is a safe harbor QM regardless of the consumer's DTI ratio; (2) for loans with rate spreads at or above 1 but less than 1.5 percentage points, a loan is a safe harbor QM if the consumer's DTI ratio does not exceed 50 percent and a rebuttable presumption QM if the consumer's DTI is above 50 percent; and (3) if the rate spread is at or above 1.5 but less than 2 percentage points, loans would be rebuttable presumption QM if the consumer's DTI ratio does not exceed 50 percent and non-QM if the DTI ratio is above 50 percent. Using 2018 HMDA data, the Bureau estimates that 91.5 percent of conventional purchase loans would be safe harbor QM loans under this approach, and 96.1 percent would be QM loans. The Bureau requests comment on whether a DTI limit of up to 50 percent would be appropriate under these hybrid approaches that incorporate pricing into the General QM loan definition given that the pricing threshold would generally limit the additional risk factors beyond the higher DTI ratio.

Another hybrid approach would impose a DTI limit on all General QM loans but would allow higher DTI ratios for loans below a set pricing threshold. For example, the rule could generally impose a DTI limit of 47 percent but could permit a loan with a DTI ratio up to 50 percent to be eligible for QM status under the General QM loan definition if the APR is less than 2 percentage points over APOR. This approach might limit the likelihood of providing QM status to loans for which the consumer lacks ability to repay, but also would permit some lower-priced loans with higher DTI ratios to achieve QM status. Using 2018 HDMA data, the Bureau estimates that 90.8 percent of conventional purchase loans would be safe harbor QM loans under this approach, and 96.2 percent would be QM loans. The Bureau requests comment on whether these hybrid approaches or a different hybrid approach would better address concerns about access to credit and ensuring that the General QM criteria support a presumption that consumers have the ability to repay their loans.

With respect to the Bureau's concerns about appendix Q, the Bureau requests comment on an alternative method of defining debt and income the Bureau believes could replace appendix Q in conjunction with a specific DTI limit. As noted, the Bureau is concerned that the appendix Q definitions of debt and income are rigid and difficult to apply and do not provide the level of compliance certainty that the Bureau anticipated at the time of the January 2013 Final Rule. Further, under the current rule, some loans that would otherwise have DTI ratios below 43 percent do not satisfy the General QM loan definition because their method of documenting and verifying income or debt is incompatible with appendix Q. In particular, the Bureau requests comment on whether the approach in proposed § 1026.43(e)(2)(v) could be applied with a General QM loan definition that includes a specific DTI limit. As discussed in more detail in the section-by-section discussion of § 1026.43(e)(2)(v), proposed § 1026.43(e)(2)(v)(A) would require creditors to consider income or assets, debt obligations, alimony, child support, and DTI or residual income for their ability-to-repay determination. Proposed § 1026.43(e)(2)(v)(B) and the associated commentary explain how creditors must verify and count the consumer's current or reasonably expected income or assets other than the value of the dwelling (including any real property attached to the dwelling) that secures the loan and the consumer's current debt obligations, alimony, and child support, relying on the standards set forth in the ATR requirements in § 1026.43(c). Proposed § 1026.43(e)(2)(v)(B) would further provide creditors a safe harbor with standards the Bureau may specify for verifying debt and income. This could potentially include relevant provisions from the Fannie Mae Single Family Selling Guide, the Freddie Mac Single-Family Seller/Servicer Guide, FHA's Single Family Housing Policy Handbook, the VA's Lenders Handbook, and USDA's Field Office Handbook for the Direct Single Family Housing Program and Handbook for the Single Family Guaranteed Loan Program, current as of this proposal's public release. The Bureau also is seeking comments on potentially adding to the safe harbor other standards that external stakeholders develop.

The Bureau requests comment on whether the alternative method of defining debt and income in proposed § 1026.43(e)(2)(v)(B) could replace appendix Q in conjunction with a specific DTI limit. As noted above, the Bureau is concerned that this approach that combines a general standard with safe harbors may not be appropriate for a specific DTI limit. The Bureau requests comment on whether the approach in proposed § 1026.43(e)(2)(v)(B) would address the problems associated with appendix Q and would provide an alternative method of defining debt and income that would be workable with a specific DTI limit. The Bureau seeks comment on whether allowing creditors to use standards the Bureau may specify to verify debt and income—as would be permitted under proposed § 1026.43(e)(2)(v)(B)—as well as potentially other standards external stakeholders develop and the Bureau adopts would provide adequate clarity and flexibility while also ensuring that DTI calculations across creditors and consumers are sufficiently consistent to provide meaningful comparison of a consumer's calculated DTI to any DTI ratio threshold specified in the rule.

The Bureau also requests comment on what changes, if any, would be needed to proposed § 1026.43(e)(2)(v)(B) to accommodate a specific DTI limit. For example, the Bureau requests comment on whether creditors that comply with guidelines that have been revised but are substantially similar to the guides specified above should receive a safe harbor, as the Bureau has proposed. The Bureau also seeks comment on its proposal to allow creditors to "mix and match" verification standards, including whether the Bureau should instead limit or prohibit such "mixing and matching" under an approach that incorporates a specific DTI limit. The Bureau requests comment on whether these aspects of the approach in proposed § 1026.43(e)(2)(v)(B), if used in conjunction with a specific DTI limit, would provide sufficient certainty to creditors, investors, and assignees regarding a loan's QM status and whether it would result in potentially inconsistent application of the rule.

VI. Section-by-Section Analysis

1026.43 Minimum Standards for Transactions Secured by a Dwelling

43(b) Definitions

43(b)(4)

Section 1026.43(b)(4) provides the definition of a higher-priced covered transaction. It provides that a covered transaction is a higher-priced covered transaction if the APR exceeds APOR for a comparable transaction as of the date the interest rate is set by the applicable rate spread specified in the Rule. For purposes of General QM loans under § 1026.43(e)(2), the applicable rate spreads are 1.5 or more percentage points for a first-lien covered transaction and 3.5 or more percentage points for a subordinate-lien covered transaction. Pursuant to § 1026.43(e)(1), a loan that satisfies the requirements of a qualified mortgage and is a higher-priced covered transaction under § 1026.43(b)(4) is eligible for a rebuttable presumption of compliance with the ATR requirements. A qualified mortgage that is not a higher-priced covered transaction is eligible for a conclusive presumption of compliance with the ATR requirements.

The Bureau is proposing to revise § 1026.43(b)(4) to create a special rule for purposes of determining whether certain types of General QM loans under § 1026.43(e)(2) are higher-priced covered transactions. This special rule would apply to loans for which the interest rate may or will change within the first five years after the date on which the first regular periodic payment will be due. For such loans, the creditor would be required to determine the APR, for purposes of determining whether a QM under § 1026.43(e)(2) is a higher-priced covered transaction, by treating the maximum interest rate that may apply during that five-year period as the interest rate for the full term of the loan.

An identical special rule also would apply to loans for which the interest rate may or will change under proposed § 1026.43(e)(2)(vi), which would revise the definition of a General QM loan under § 1026.43(e)(2) to implement the price-based approach described in part V. The section-by-section analysis of proposed § 1026.43(e)(2)(vi) explains the Bureau's reasoning for proposing these rules. The special rules in the proposed revisions to § 1026.43(b)(4) and in proposed § 1026.43(e)(2)(vi) would not modify other provisions in Regulation Z for determining the APR for other purposes, such as the disclosures addressed in or subject to the commentary to § 1026.17(c)(1).

Proposed comment 43(b)(4)-4 explains that provisions in subpart C, including commentary to § 1026.17(c)(1), address how to determine the APR disclosures for closed-end credit transactions and that provisions in § 1026.32(a)(3) address how to determine the APR to determine coverage under § 1026.32(a)(1)(i). It further explains that proposed § 1026.43(b)(4) requires, only for purposes of a QM under paragraph (e)(2), a different determination of the APR for purposes of paragraph (b)(4) for a loan for which the interest rate may or will change within the first five years after the date on which the first regular periodic payment will be due. It also cross-references proposed comment 43(e)(2)(vi)-4 for how to determine the APR of such a loan for purposes of § 1026.43(b)(4) and (e)(2)(vi).

As discussed above in part IV, TILA section 105(a), directs the Bureau to prescribe regulations to carry out the purposes of TILA, and provides that such regulations may contain additional requirements, classifications, differentiations, or other provisions, and may provide for such adjustments and exceptions for all or any class of transactions that the Bureau judges are necessary or proper to effectuate the purposes of TILA, to prevent circumvention or evasion thereof, or to facilitate compliance therewith. In particular, it is the purpose of TILA section

129C, as amended by the Dodd-Frank Act, 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.

As also discussed above in part IV, TILA section 129C(b)(3)(B)(i) authorizes the Bureau to prescribe regulations that revise, add to, or subtract from the criteria that define a QM upon a finding that such regulations are necessary or proper to ensure that responsible, affordable mortgage credit remains available to consumers in a manner consistent with the purposes of section 129C, necessary and appropriate to effectuate the purposes of section 129C and section 129B, to prevent circumvention or evasion thereof, or to facilitate compliance with such section.

The Bureau is proposing the special rule in § 1026.43(b)(4) regarding the APR determination of certain loans for which the interest rate may or will change pursuant to its authority under TILA section 105(a) to make such adjustments and exceptions as are necessary and proper to effectuate the purposes of TILA, including that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay the loans. The Bureau believes that these proposed provisions may ensure that safe harbor QM status would not be accorded to certain loans for which the interest rate may or will change that pose a heightened risk of becoming unaffordable relatively soon after consummation. The Bureau is also proposing these provisions pursuant to its authority under TILA section 129C(b)(3)(B)(i) to revise and add to the statutory language. The Bureau believes that the proposed APR determination provisions in § 1026.43(b)(4) may ensure that responsible, affordable mortgage credit remains available to consumers in a manner consistent with the purpose of TILA section 129C, referenced above, as well as effectuate that purpose.

The Bureau requests comment on all aspects of the proposed special rule that would be required in proposed § 1026.43(b)(4) to determine the APR for certain loans for which the interest rate may or will change. See the section-by-section analysis of proposed § 1026.43(e)(2)(vi) for specific data requests and additional solicitation of comments.

43(c) Repayment Ability

43(c)(4) Verification of Income or Assets

TILA section 129C(a)(4) states that a creditor making a residential mortgage loan shall verify amounts of income or assets that such creditor relies on to determine repayment ability, including expected income or assets, by reviewing the consumer's Internal Revenue Service (IRS) Form W-2, tax returns, payroll receipts, financial institution records, or other third-party documents that provide reasonably reliable evidence of the consumer's income or assets. In the January 2013 Final Rule, the Bureau implemented this requirement in § 1026.43(c)(4), which states that a creditor must verify the amounts of income or assets that the creditor relies on under § 1026.43(c)(2)(i) to determine a consumer's ability to repay a covered transaction using third-party records that provide reasonably reliable evidence of the consumer's income or assets. Section 1026.43(c)(4) further states that a creditor may verify the consumer's income using a tax-return transcript issued by the IRS and lists several examples of other records the creditor may use to verify the consumer's income or assets, including, among others, financial institution records. Additionally, § 1026.43(e)(2)(v)(A) provides that a General QM loan is a covered transaction for which the creditor considers and verifies at or before consummation the consumer's current or reasonably expected income or assets other than the value of the dwelling (including any real property attached to the dwelling) that secures the loan in accordance with § 1026.43(c)(4), as well as § 1026.43(c)(2)(i) and appendix Q.

The Bureau is not proposing to change the text of § 1026.43(c)(4). The Bureau is proposing to add comment 43(c)(4)-4, which would clarify that a creditor does not meet the requirements of § 1026.43(c)(4) if it observes an inflow of funds into the consumer's account without confirming that the funds are income. The proposed comment would also state that, for example, a creditor would not meet the requirements of § 1026.43(c)(4) where it observes an unidentified $5,000 deposit in the consumer's account but fails to take any measures to confirm or lacks any basis to conclude that the deposit represents the consumer's personal income and not, for example, proceeds from the disbursement of a loan. (As described below in the section-by-section analysis of proposed § 1026.43(e)(2)(v), below, the Bureau is also proposing to amend the verification requirements in the General QM loan definition.)

The Bureau is proposing to include this clarification as part of its effort to avoid potential compliance uncertainty that could arise from the removal of appendix Q and from the resulting greater reliance on regulation text and commentary to define a creditor's obligations to consider and verify a consumer's income, assets, debt obligations, alimony, and child support. (Other proposed revisions related to this effort are described below with respect to § 1026.43(e)(2)(v).) The Bureau understands, based on outreach and on its experience supervising creditors, that this clarification could be useful to creditors because the Rule includes "financial institution records" as one of the examples of records that a creditor may use to verify a consumer's income or assets. As part of their underwriting process, creditors may seek to use transactions in electronic or paper financial records such as consumer account statements to examine inflows and outflows from consumers' accounts. In many cases, there may be sufficient basis in transaction data alone, or in combination with other information, to determine that a deposit or other credit to a consumer's account represents income, such that a creditor's use of the data in an underwriting process is distinguishable from the example in the proposed comment. The Bureau's preliminary view is that this clarification would help creditors understand their verification requirements under the General QM loan definition, given that proposed comment 43(e)(2)(v)(B)-1 would explain that a creditor must verify the consumer's current or reasonably expected income or assets in accordance with § 1026.43(c)(4) and its commentary.[241]

The Bureau requests comment on this proposed new comment. The Bureau also requests comment on whether additional clarifications may be helpful with respect to cash flow underwriting and verifying whether inflows are income under the Rule.

43(e) Qualified Mortgages

43(e)(2) Qualified Mortgage Defined - General

43(e)(2)(v)

As discussed above in part V, the Bureau is proposing to remove the specific DTI limit in § 1026.43(e)(2)(vi). Furthermore, as discussed below in this section-by-section analysis of proposed § 1026.43(e)(2)(v), the Bureau is proposing to require that creditors consider the consumer's DTI ratio or residual income and to remove the appendix Q requirements from § 1026.43(e)(2)(v). The Bureau tentatively concludes that these proposed amendments necessitate additional revisions to clarify a creditor's obligation to consider and verify certain information under the General QM loan definition. Consequently, the Bureau is proposing to amend the consider and verify requirements in § 1026.43(e)(2)(v) and its associated commentary.

[241] *See* the section-by-section analysis for proposed § 1026.43(e)(2)(v)(B).

TILA section 129C contains several requirements that creditors consider and verify various types of information. In the statute's general ATR provisions, TILA section 129C(a)(1) requires that a creditor make a reasonable and good faith determination, based on "verified and documented information," that a consumer has a reasonable ability to repay the loan. TILA section 129C(a)(3) states that a creditor's ATR determination shall include "consideration" of the consumer's credit history, current income, expected income the consumer is reasonably assured of receiving, current obligations, DTI ratio or the residual income the consumer will have after paying non-mortgage debt and mortgage-related obligations, employment status, and other financial resources other than the consumer's equity in the dwelling or real property that secures repayment of the loan. TILA section 129C(a)(4) states that a creditor making a residential mortgage loan shall verify amounts of income or assets that such creditor relies on to determine repayment ability, including expected income or assets, by reviewing the consumer's IRS Form W-2, tax returns, payroll receipts, financial institution records, or other third-party documents that provide reasonably reliable evidence of the consumer's income or assets. Finally, in the statutory QM definition, TILA section 129C(b)(2)(A)(iii) provides that, for a loan to be a QM, the income and financial resources relied on to qualify the obligors on the loan must be "verified and documented."

In the January 2013 Final Rule, the Bureau implemented the requirements to consider and verify various factors for the general ATR standard in § 1026.43(c)(2), (c)(3), (c)(4), and (c)(7). Section 1026.43(c)(2) states that—except as provided in certain other provisions (including the General QM loan definition)—a creditor must consider several specified factors in making its ATR determination. These factors include, among others, the consumer's current or reasonably expected income or assets, other than the value of the dwelling, including any real property attached to the dwelling, that secures the loan (under § 1026.43(c)(2)(i)); the consumer's current debt obligations, alimony, and child support (§ 1026.43(c)(2)(vi)); and the consumer's monthly DTI ratio or residual income in accordance with § 1026.43(c)(7). Section 1026.43(c)(3) requires a creditor to verify the information the creditor relies on in determining a consumer's repayment ability using reasonably reliable third-party records, with a few specified exceptions. Section 1026.43(c)(3) further states that a creditor must verify a consumer's income and assets that the creditor relies on in accordance with § 1026.43(c)(4). Section 1026.43(c)(4) requires that a creditor verify the amounts of income or assets that the creditor relies on to determine a consumer's ability to repay a covered transaction using third-party records that provide reasonably reliable evidence of the consumer's income or assets. It also provides examples of records the creditor may use to verify the consumer's income or assets.

As noted in part V, the January 2013 Final Rule incorporated some aspects of the general ATR standards into the General QM loan definition, including the requirement to consider and verify income or assets and debt obligations, alimony, and child support. Section 1026.43(e)(2)(v) states that a General QM loan is a covered transaction for which the creditor considers and verifies at or before consummation: (A) the consumer's current or reasonably expected income or assets other than the value of the dwelling (including any real property attached to the dwelling) that secures the loan, in accordance with appendix Q, § 1026.43(c)(2)(i), and (c)(4); and (B) the consumer's current debt obligations, alimony, and child support in accordance with appendix Q, § 1026.43(c)(2)(vi) and (c)(3). The Bureau used its adjustment and exception authority under TILA section 129C(b)(3)(B)(i) to require creditors to consider and verify the consumer's debt obligations, alimony, and child support pursuant to the General QM loan definition.

The Bureau proposes to revise § 1026.43(e)(2)(v) to separate and clarify the requirements to consider and verify certain information. Proposed § 1026.43(e)(2)(v)(A) would contain the "consider" requirements, and proposed § 1026.43(e)(2)(v)(B) would contain the "verify" requirements. Specifically, proposed § 1026.43(e)(2)(v) would state that a General QM loan is a covered transaction for which the creditor: (A) considers the consumer's income or assets, debt obligations, alimony, child support, and monthly DTI ratio or residual income, using the amounts determined from § 1026.43(e)(2)(v)(B); and (B) verifies the consumer's current or reasonably expected income or assets other than the value of the dwelling (including any real property attached to the dwelling) that secures the loan using third-party records that provide reasonably reliable evidence of the consumer's income or assets, in accordance with § 1026.43(c)(4), and the consumer's current debt obligations, alimony, and child support using reasonably reliable third-party records in accordance with § 1026.43(c)(3). The regulatory text would also state that, for purposes of § 1026.43(e)(2)(v)(A), the consumer's monthly DTI ratio or residual income is determined in accordance with § 1026.43(c)(7), except that the consumer's monthly payment on the covered transaction, including the monthly payment for mortgage-related obligations, is calculated in accordance with § 1026.43(e)(2)(iv).

As noted above, the Bureau is proposing to remove the specific 43 percent DTI limit in § 1026.43(e)(2)(vi) and the appendix Q requirement in § 1026.43(e)(2)(v). Given that these proposed amendments would change how a creditor would satisfy the General QM loan definition, the Bureau is proposing to amend the consider and verify requirements in § 1026.43(e)(2)(v). Under the Bureau's proposal, the General QM loan definition would no longer include a specific DTI limit in § 1026.43(e)(2)(vi), but a creditor would be required to consider DTI or residual income, debt obligations, alimony, child support, and income or assets under § 1026.43(e)(2)(v). The Bureau tentatively concludes that providing additional explanation of the proposed requirement to consider this information may ease compliance uncertainty. To meet the consider requirement in § 1026.43(e)(2)(v)(A), the proposal would require the creditor to use the amounts determined according to § 1026.43(e)(2)(v)(B). For example, if the creditor relied on assets in its ability-to-repay determination, the creditor could consider current and reasonably expected assets other than the value of the dwelling (including any real property attached to the dwelling) that secures the loan as calculated under 1026.43(e)(2)(v)(B). The Bureau tentatively concludes that providing additional explanation of the proposed requirement to consider income or assets, debt obligations, alimony, child support, and DTI or residual income may ease compliance uncertainty.

The Bureau is proposing to remove appendix Q and the requirement to use appendix Q from the rule. The Bureau's principal reason for adopting appendix Q in 2013 was to provide clear and specific standards for calculating a consumer's debt, income, and DTI ratio for purposes of comparison with the 43 percent DTI limit and to provide certainty about whether a loan meets the requirements for being a General QM loan. As discussed in more detail below, appendix Q has not provided clear and specific standards, and the Bureau is proposing to remove the 43 percent DTI limit. Accordingly, the Bureau preliminarily concludes that appendix Q, and the requirement to use appendix Q to calculate DTI for purposes of the General QM loan definition, should be removed from the Rule. However, appendix Q currently serves the additional function of specifying what a creditor must do to comply with the requirements of § 1026.43(e)(2)(v) to consider and verify a consumer's income, assets, debt obligations, alimony, and child support. The Bureau is concerned that the rule would create significant compliance uncertainty if it merely removed appendix Q without clarifying how a creditor can evaluate various types of income, assets, and debt.

The Bureau's objective in proposing to clarify the § 1026.43(e)(2)(v) requirements to consider a consumer's income, assets, debt obligations, alimony, and child support is to ensure that a loan for which a creditor disregards these factors cannot obtain QM status, while ensuring that creditors and investors can readily determine if a loan is a QM. The Bureau's primary objective in clarifying the requirement to verify a consumer's income, assets, debt obligations, alimony, and child support is to provide reasonable assurance that only income and assets that exist or will exist are part of a creditor's ATR determination and that none of the consumer's debt obligations, alimony, and child support are excluded from consideration. The Bureau also aims to ensure that the verification requirement provides substantial flexibility for creditors to adopt innovative verification methods, such as the use of bank account data that identifies the source of deposits to determine personal income, while also specifying examples of compliant verification standards to provide greater certainty that a loan has QM status.

As described above, proposed § 1026.43(e)(2)(v)(B) would provide that creditors must verify income, assets, debt obligations, alimony, and child support in accordance with the general ATR verification provisions. Specifically, § 1026.43(e)(2)(v)(B)(1) requires a creditor to verify the consumer's current or reasonably expected income or assets (including any real property attached to the value of the dwelling) that secures the loan in accordance with § 1026.43(c)(4), which states that a creditor must verify such amounts using third-party records that provide reasonably reliable evidence of the consumer's income or assets. Section 1026.43(e)(2)(v)(B)(2) requires a creditor to verify the consumer's current debt obligations, alimony, and child support in accordance with § 1026.43(c)(3), which states that a creditor must verify such amounts using reasonably reliable third-party records. So long as a creditor complies with the provisions of § 1026.43(c)(3) with respect to debt obligations, alimony, and child support and § 1026.43(c)(4) with respect to income and assets, the creditor is permitted to use any reasonable verification methods and criteria. By incorporating § 1026.43(c)(3) and (c)(4) in § 1026.43(e)(2)(v)(B), the Bureau seeks to maintain in the General QM loan verification requirements the flexibility inherent to these ATR provisions. At the same time, the Bureau seeks to provide greater certainty to creditors regarding the General QM loan verification requirements by explaining that a creditor complies with § 1026.43(e)(2)(v)(B) if it complies with any one of certain verification standards the Bureau would specify.

The Bureau also proposes revisions to the commentary for § 1026.43(e)(2)(v). The Bureau proposes to remove comments 43(e)(2)(v)-2 and -3. In general, these comments currently clarify that creditors must consider and verify any income as well as any debt or liability specified in appendix Q and that, while other income and debt may be considered and verified, such income and debt would not be included in the DTI ratio determination required by § 1026.43(e)(2)(vi). The Bureau preliminarily concludes that these comments would no longer be needed in light of the proposed revisions to § 1026.43(e)(2)(v). The first sentence of each of these two comments merely restates language in the regulatory text. The second sentence would no longer be needed because the Bureau is proposing to remove references to appendix Q in § 1026.43(e)(2)(v). And the third sentence would no longer be needed because the Bureau is proposing to remove the DTI limit in § 1026.43(e)(2)(vi).

43(e)(2)(v)(A)

As explained above, the Bureau proposes to revise § 1026.43(e)(2)(v), which currently includes the requirement to consider and verify the consumer's reasonably expected income or assets, debt obligations, alimony, and child support, as part of the QM definition. The Bureau is proposing to separate the consider and verify requirements in § 1026.43(e)(2)(v) into § 1026.43(e)(2)(v)(A) for the "consider" requirements and § 1026.43(e)(2)(v)(B) for the "verify" requirements. The Bureau proposes to revise § 1026.43(e)(2)(v)(A) to provide that a General QM loan is a covered transaction for which the creditor, at or before consummation, considers the consumer's income or assets, debt obligations, alimony, child support, and monthly DTI ratio or residual income, using the amounts determined from proposed § 1026.43(e)(2)(v)(B).

For purposes of § 1026.43(e)(2)(v)(A), the Bureau proposes to prescribe the same method for the creditor to calculate the consumer's monthly payment that is currently prescribed in § 1026.43(e)(2)(vi), in which the consumer's monthly DTI ratio is determined using the consumer's monthly payment on the covered transaction and any simultaneous loan that the creditor knows or has reason to know will be made. The Bureau is proposing to eliminate appendix Q and the DTI limit in § 1026.43(e)(2)(vi). To make clear that any DTI calculation must incorporate alimony and child support—which is currently facilitated through appendix Q—the Bureau is proposing to cross-reference the § 1026.43(c)(7) requirements. In order to maintain the monthly DTI ratio calculation method from § 1026.43(e)(2)(vi)(B), the Bureau is proposing to move the text prescribing the calculation method from § 1026.43(e)(2)(vi)(B) to § 1026.43(e)(2)(v)(A). The Bureau is proposing to expand the § 1026.43(c)(7) cross-reference and the monthly payment calculation method to residual income given that the proposal allows creditors the option of considering residual income in lieu of DTI. The Bureau tentatively concludes that the reference to simultaneous loans is not necessary because the cross-reference to § 1026.43(c)(7) would require creditors to consider simultaneous loans.

Proposed § 1026.43(e)(2)(v)(A) would revise existing § 1026.43(e)(2)(v) by requiring a creditor to consider DTI or residual income in addition to income or assets, debt obligations, alimony, and child support, as determined under proposed § 1026.43(e)(2)(v)(B). The Bureau tentatively concludes that the amounts considered under § 1026.43(e)(2)(v)(A) should be consistent with the amounts verified according to § 1026.43(e)(2)(v)(B). For example, if the creditor relies on assets in its ability-to-repay determination and seeks to comply with the consider requirement under § 1026.43(e)(2)(v)(A), the creditor could consider current and reasonably expected assets other than the value of the dwelling (including any real property attached to the dwelling) that secures the loan as calculated under 1026.43(e)(2)(v)(B).

The Bureau is proposing the revision to add DTI to ensure that, although the Bureau is proposing to eliminate the DTI limit in § 1026.43(e)(2)(vi), creditors still must consider DTI (or residual income, as discussed below) as part of the General QM loan definition. The Bureau continues to believe that DTI is an important factor in assessing a consumer's ability to repay. Comments responding to the 2019 ANPR indicate that creditors generally use DTI as part of their underwriting process. These comments indicate that requiring as part of the General QM loan definition that creditors consider DTI when determining a consumer's ability to repay—even if the QM definition no longer includes a specific DTI limit—would be consistent with current market practices. In a final rule issued in June 2013 (June 2013 Final Rule), the Bureau created an exception from the DTI limit requirement for small creditors that hold QMs on portfolio.[242] The Bureau determined that, even though the DTI limit was not appropriate for a small creditor that holds loans on their portfolio, DTI (or residual income) was still a

[242] 78 FR 35430 (June 12, 2013).

fundamental part of the creditor's ATR determination.[243] The Bureau tentatively concludes that requiring creditors to consider DTI as part of the QM definition is necessary and appropriate to ensure that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay the loan.

Proposed § 1026.43(e)(2)(v)(A) would require creditors to consider either a consumer's monthly residual income or DTI. The January 2013 Final Rule adopted a bright-line DTI limit for the General QM loan definition under § 1026.43(e)(2)(vi), but the Bureau concluded that it did not have enough information to establish a bright-line residual income limit as an alternative to the DTI limit.[244] In comparison, TILA and the January 2013 Final Rule allow creditors to consider either residual income or DTI as part of the general ATR requirements in § 1026.43(c)(2)(vii), and the June 2013 Final Rule allows small creditors originating QM loans pursuant to § 1026.43(e)(5) to consider DTI or residual income. Given the Bureau's proposal to eliminate the bright-line DTI limit in § 1026.43(e)(2)(vi), comments from stakeholders discussed in the January 2013 Final Rule regarding the value of residual income in determining ability to repay,[245] and the Bureau's determination in the June 2013 Final Rule that residual income can be

[243] *Id.* at 35487 ("The Bureau continues to believe that consideration of debt-to-income ratio or residual income is fundamental to any determination of ability to repay. A consumer is able to repay a loan if he or she has sufficient funds to pay his or her other obligations and expenses and still make the payments required by the terms of the loan. Arithmetically comparing the funds to which a consumer has recourse with the amount of those funds the consumer has already committed to spend or is committing to spend in the future is necessary to determine whether sufficient funds exist.").

[244] 78 FR 6408, 6528 (Jan. 30, 2013) ("Unfortunately, however, the Bureau lacks sufficient data, among other considerations, to mandate a bright-line rule based on residual income at this time.").

[245] *Id.* at 6527 ("Another consumer group commenter argued that residual income should be incorporated into the definition of QM. Several commenters suggested that the Bureau use the general residual income standards of the VA as a model for a residual income test, and one of these commenters recommended that the Bureau coordinate with FHFA to evaluate the experiences of the GSEs in using residual income in determining a consumer's ability to repay."); *id.* at 6528 ("Finally, the Bureau acknowledges arguments that residual income may be a better measure of repayment ability in the long run. A consumer with a relatively low household income may not be able to afford a 43 percent debt-to-income ratio because the remaining income, in absolute dollar terms, is too small to enable the

a valuable measure of ability to repay, the Bureau tentatively concludes that allowing creditors the option to consider (but not requiring them to consider) residual income in lieu of DTI would allow space for creditor flexibility and innovation and is necessary and proper to preserve access to responsible, affordable mortgage credit.

The Bureau is proposing the requirement that the creditor consider the consumer's debt obligations, alimony, child support, income or assets, and monthly DTI or residual income under § 1026.43(e)(2)(A) pursuant to its adjustment and exception authority under TILA section 129C(b)(3)(B)(i). The Bureau preliminarily finds that this addition to the General QM loan criteria is necessary and proper to ensure that responsible, affordable mortgage credit remains available to consumers in a manner that is consistent with the purposes of TILA section 129C and necessary and appropriate to effectuate the purposes of TILA section 129C, which includes assuring that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay the loan. The Bureau also incorporates this requirement pursuant to its authority under TILA section 105(a) to issue regulations that, among other things, contain such additional requirements, other provisions, or that provide for such adjustments for all or any class of transactions, that in the Bureau's judgment are necessary or proper to effectuate the purposes of TILA, which include the above purpose of section 129C. The Bureau preliminarily finds that including consideration of DTI or residual income in the General QM loan criteria is necessary and proper to fulfill the purpose of assuring that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay the loan. The Bureau also believes that § 1026.43(e)(2)(A) is authorized by TILA section

consumer to cover his or her living expenses. Conversely, a consumer with a relatively high household income may be able to afford a higher debt ratio and still live comfortably on what is left over.").

129C(b)(2)(A)(vi), which permits, but does not require, the Bureau to adopt guidelines or regulations relating to debt-to-income ratios or alternative measures of ability to pay regular expenses after payment of total monthly debt.

The Bureau is proposing to revise § 1026.43(e)(2)(v)(A) to incorporate the monthly payment calculation method from current § 1026.43(e)(2)(vi)(B). In order to preserve the incorporation of alimony and child support in this calculation—which currently is facilitated by appendix Q—the Bureau is proposing to cross-reference the requirement in § 1026.43(c)(7). The cross-reference also incorporates simultaneous loans. Additionally, given the proposal to allow creditors to consider residual income in lieu of monthly DTI, the Bureau is proposing to apply this calculation requirement to residual income. This proposed revision would ensure that the mortgage payment and the payment on any simultaneous loans are included in a manner consistent with § 1026.43(e)(2)(iv) both when a creditor considers DTI or residual income. The Bureau tentatively concludes that requiring this pre-existing calculation method for DTI and residual income is appropriate because it would assist creditors in complying with the consider requirement and would assist in enforcement of the rule because it would encourage consistency in DTI and residual income calculations.

To clarify the proposed requirements in § 1026.43(e)(2)(v)(A), the Bureau proposes to add comments 43(e)(2)(v)(A)-1 to -3. The Bureau proposes these new comments because they may be appropriate to ensure that the rule's requirement to consider the consumer's debt obligations, alimony, child support, income or assets, and DTI ratio or residual income is clear and detailed enough to provide creditors with sufficient certainty about whether a loan satisfies the General QM loan definition. Under the proposal, the General QM loan definition would no longer include a specific DTI limit in § 1026.43(e)(2)(vi) and would require instead that creditors consider DTI or residual income, along with debt and income. By requiring calculation of DTI and comparing that calculation to a DTI limit, the existing DTI limit provides creditors with a bright-line rule demonstrating how to consider the consumer's income or assets, debt, and DTI when making its ATR determination. Without providing additional explanation of the proposed requirement to consider DTI or residual income, along with debt and income, eliminating the DTI limit could create compliance uncertainty that could leave some creditors reluctant to originate QM loans to consumers and could allow other creditors to originate risky loans without considering DTI or residual income and still receive QM status. In addition, without additional explanation, it may be difficult to enforce the requirement to consider income or assets, debt obligations, alimony, child support, and monthly DTI or residual income. Several ANPR commenters requested that the Bureau maintain the "consider" requirement in the General QM loan definition and clarify this requirement. Accordingly, the Bureau tentatively concludes that it is appropriate to provide additional explanation for the consider requirement in § 1026.43(e)(2)(v) in proposed comments 43(e)(2)(v)(A)-1 to -3.

Proposed comment 43(e)(2)(v)(A)-1 would explain that, in order to comply with the requirement in § 1026.43(e)(2)(v)(A) to consider income or assets, debt obligations, alimony, child support, and DTI ratio or residual income, a creditor must take into account income or assets, debt obligations, alimony, child support, and monthly DTI ratio or residual income in its ATR determination. In making this determination, creditors must use the amounts determined under the requirement to verify the consumer's current or reasonably expected income or assets and the consumer's current debt obligations, alimony, and child support in § 1026.43(e)(2)(v)(B). The proposed comment would further explain that, according to requirements in § 1026.25(a) to retain records showing compliance with the Rule, a creditor must retain documentation showing how it took into account these factors in its ATR determination. By citing the record retention requirement, this comment would clarify that to comply with § 1026.43(e)(2)(v)(A) and obtain QM status, a creditor must document how the required factors were taken into account in the creditor's ATR determination. If a creditor ignores the required factors of income or assets, debt obligations, alimony, child support, and DTI or residual income—or otherwise did not take them into account as part of its ATR determination—the loan would not be eligible for QM status. While creditors must take these factors into account and retain documentation of how they did so, the Bureau emphasizes that creditors would have great latitude in how they took these factors into account and that they would be able to document how they did so in a simple and non-burdensome manner, such as a creditor documenting that it followed its standard procedures for considering these factors in connection with a specific loan. As an example of the type of documents that a creditor might use to show that income or assets, debt obligations, alimony, child support, and DTI or residual income were taken into account, the proposed comment cites an underwriter worksheet or a final automated underwriting system certification, alone or in combination with the creditor's applicable underwriting standards, that shows how these required factors were taken into account in the creditor's ability-to-repay determination.

To reinforce that the QM definition no longer would include a specific DTI limit, proposed comment 43(e)(2)(v)(A)-2 explains that creditors have flexibility in how they consider these factors and that the proposed rule does not prescribe a specific monthly DTI or residual income threshold. To assist creditors, the Bureau is proposing two examples of how to comply with the requirement to consider DTI. Proposed comment 43(e)(2)(v)(A)-2 provides an example in which a creditor considers monthly DTI or residual income by establishing monthly DTI or residual income thresholds for its own underwriting standards and documenting how those thresholds were applied to determine the consumer's ability to repay. Given that some creditors use several thresholds that depend on any relevant compensating factors, the Bureau is also proposing a second example. The second example in the comment would provide that a creditor may also consider DTI or residual income by establishing monthly DTI or residual income thresholds and exceptions to those thresholds based on other compensating factors, and documenting application of the thresholds along with any applicable exceptions. The Bureau tentatively concludes that both examples are consistent with current market practices and therefore providing these examples would clarify a loan's QM status without imposing a significant burden on the market.

The Bureau is aware that some creditors look to factors in addition to income or assets, debt obligations, alimony, child support, and DTI or residual income in determining a consumer's ability to repay. For example, the Bureau is aware that some creditors may look to net cash flow into a consumer's deposit account as a method of residual income analysis. As the Bureau understands it, a net cash flow calculation typically consists of residual income, further reduced by consumer expenditures other than those already subtracted from income in calculating the consumer's residual income. Accordingly, the result of a net cash flow calculation may be useful in to assessing the adequacy of a particular consumer's residual income.

Proposed comment 43(e)(2)(v)(A)-3 would explain that the requirement in § 1026.43(e)(2)(v)(A) to consider income or assets, debt obligations, alimony, child support, and monthly DTI or residual income does not preclude the creditor from taking into account additional factors that are relevant in making its ability-to-repay determination. The proposed comment further provides that creditors may look to comment 43(c)(7)-3 for guidance on considering additional factors in determining the consumer's ATR. Comment 43(c)(7)-3 explains that creditors may consider additional factors when determining a consumer's ability to repay and provides an example of looking to consumer assets other than the value of the dwelling, such as a savings account.

The Bureau seeks comment on proposed § 1026.43(e)(2)(v)(A) and the related commentary. The Bureau specifically seeks comment on whether the proposed commentary provides sufficient clarity as to what creditors must do to comply with the requirement to consider income or assets, debt obligations, alimony, child support, and DTI or residual income, and whether it creates impediments to consideration of other factors or data in making an ATR determination. The Bureau also seeks comment on whether it should retain the monthly payment calculation method for DTI, which it is proposing to move from § 1026.43(e)(2)(vi)(B) to proposed § 1026.43(e)(2)(v)(A).

The Bureau is proposing revisions to § 1026.43(e)(2)(v)(A) and related commentary as part of the proposal to eliminate the specific DTI limit. In amending the General QM loan definition under § 1026.43(e)(2), Bureau is concerned about balancing various factors, including the need for clarity regarding QM status and for flexibility as market underwriting practices evolve, while also trying to ensure that creditors making loans that receive QM status have considered the consumers' financial capacity and thus should receive a presumption of compliance with the ATR requirements. In particular, the Bureau is concerned about the potential that the price-based approach may permit some loans to receive QM status, even if creditors may have originated those loans without meaningfully considering the consumer's financial capacity because they believe their risk of loss may be limited by factors like a rising housing price environment or the consumer's existing equity in the home. As discussed in the January 2013 Final Rule, the Bureau is aware of concerns about creditors relying on factors related to the value of the dwelling, like LTV ratio, and how such reliance may have contributed to the mortgage crisis.[246] Given these concerns, the Bureau also seeks comment on whether proposed § 1026.43(e)(2)(v)(A) and its associated commentary sufficiently address the risk that loans with a DTI that is so high or residual income that is so low that a consumer may lack ability to repay can obtain QM status. In particular, the Bureau seeks comment on whether the Rule should provide examples in which a creditor has not considered the required factors and, if so, what may be appropriate examples. The Bureau also requests comment on whether the Rule should provide that a creditor does not appropriately consider DTI or residual income if a very high DTI ratio or low residual income indicates that the consumer lacks ability to repay but the creditor disregards this information and instead relies on the consumer's expected or present equity in the dwelling, such as might be identified through the consumer's LTV ratio. The Bureau also requests comment on whether the Rule should specify which compensating factors

[246] *See id.* at 6561 (Jan. 30, 2013) ("In some cases, lenders and borrowers entered into loan contracts on the misplaced belief that the home's value would provide sufficient protection. These cases included subprime borrowers who were offered loans because the lender believed that the house value either at the time of origination or in the near future could cover any default. Some of these borrowers were also counting on increased housing values and a future opportunity to refinance; others likely understood less about the transaction and were at an informational disadvantage relative to the lender."); *id.* at 6564 ("During those periods there were likely some lenders, as evidenced by the existence of no-income, no-asset (NINA) loans, that used underwriting systems that did not look at or verify income, debts, or assets, but rather relied primarily on credit score and LTV."); *id.* at 6559 ("If the lender is assured (or believes he is assured) of recovering the value of the loan by gaining possession of the asset, the lender may not pay sufficient attention to the ability of the borrower to repay the loan or to the impact of default on third parties. For very low LTV mortgages, *i.e.*, those where the value of the property more than covers the value of the loan, the lender may not care at all if the borrower can afford the payments. Even for higher LTV mortgages, if prices are rising sharply, borrowers with even limited equity in the home may be able to gain financing since lenders can expect a profitable sale or refinancing of the property as long as prices continue to rise…. In all these cases, the common problem is the failure of the originator or creditor to internalize particular costs, often magnified by information failures and systematic biases that lead to underestimation of the risks involved. The first such costs are simply the pecuniary costs from a defaulted loan—if the loan originator or the creditor does not bear the ultimate credit risk, he or she will not invest sufficiently in verifying the consumer's ability to repay.").

creditors may or may not rely on for purposes of determining the consumer's ability to repay. The Bureau also seeks comment on the tradeoffs of addressing these ability-to-repay concerns with undermining the clarity of a loan's QM status. The Bureau also seeks comment on the impact of the COVID-19 pandemic on how creditors consider income or assets, debt obligations, alimony, child support, and monthly DTI ratio or residual income.

43(e)(2)(v)(B)

For the reasons discussed below, the Bureau proposes to revise § 1026.43(e)(2)(v)(B) to provide that a General QM loan is a covered transaction for which the creditor, at or before consummation, verifies the consumer's current or reasonably expected income or assets other than the value of the dwelling (including any real property attached to the dwelling) that secures the loan using third-party records that provide reasonably reliable evidence of the consumer's income or assets, in accordance with § 1026.43(c)(4) and verifies the consumer's current debt obligations, alimony, and child support using reasonably reliable third-party records in accordance with § 1026.43(c)(3).

To clarify this requirement, the Bureau proposes to add comments 43(e)(2)(v)(B)-1 through -3. Proposed comment 43(e)(2)(v)(B)-1 would explain that § 1026.43(e)(2)(v)(B) does not prescribe specific methods of underwriting that creditors must use. It would provide that § 1026.43(e)(2)(v)(B)(*1*) requires a creditor to verify the consumer's current or reasonably expected income or assets (including any real property attached to the value of the dwelling) that secures the loan in accordance with § 1026.43(c)(4), which states that a creditor must verify such amounts using third-party records that provide reasonably reliable evidence of the consumer's income or assets. The proposed comment would provide further that § 1026.43(e)(2)(v)(B)(*2*) requires a creditor to verify the consumer's current debt obligations, alimony, and child support in accordance with § 1026.43(c)(3), which states that a creditor must verify such amounts using reasonably reliable third-party records. Proposed comment 43(e)(2)(v)(B)-1 would then clarify that, so long as a creditor complies with the provisions of § 1026.43(c)(3) with respect to debt obligations, alimony, and child support and § 1026.43(c)(4) with respect to income and assets, the creditor is permitted to use any reasonable verification methods and criteria.

Proposed comment 43(e)(2)(v)(B)-2 would clarify that "current and reasonably expected income or assets other than the value of the dwelling (including any real property attached to the dwelling) that secures the loan" is determined in accordance with § 1026.43(c)(2)(i) and its commentary and that "current debt obligations, alimony, and child support" has the same meaning as under § 1026.43(c)(2)(vi) and its commentary. The proposed comment would further clarify that § 1026.43(c)(2)(i) and (vi) and the associated commentary apply to a creditor's determination with respect to what inflows and property it may classify and count as income or assets and what obligations it must classify and count as debt obligations, alimony, and child support, pursuant to its compliance with § 1026.43(e)(2)(v)(B).

The Bureau notes that proposed comments 43(e)(2)(v)(B)-1 and -2 would enable creditors to take into account the effects of public emergencies that affect consumers' incomes when verifying a particular consumer's income. These proposed comments would clarify that § 1026.43(e)(2)(v)(B) does not prescribe precisely how creditors must verify the consumer's income or assets, debt obligations, alimony, and child support—merely that they must do so using third-party records that are reasonably reliable. As such, creditors would have the flexibility to adjust their verification methods in the event of an emergency, such as the COVID-19 pandemic, that affects consumer incomes.

Proposed comment 43(e)(2)(v)(B)-3.i would explain further that a creditor also complies with § 1026.43(e)(2)(v)(B) if it satisfies one of the specific verification standards the Bureau would set forth in the rule. These standards may include relevant provisions in specified versions of the Fannie Mae Single Family Selling Guide,[247] the Freddie Mac Single-Family Seller/Servicer Guide,[248] the FHA's Single Family Housing Policy Handbook,[249] the VA's Lenders Handbook,[250] and the USDA's Field Office Handbook for the Direct Single Family Housing Program[251] and the Handbook for the Single Family Guaranteed Loan Program, current as of the date of this proposal's public release.[252] The Bureau seeks comment on whether these or other verification standards should be incorporated into proposed comment 43(e)(2)(v)(B)-3.i.

Proposed comment 43(e)(2)(v)(B)-3.ii would clarify that a creditor complies with § 1026.43(e)(2)(v)(B) if it complies with requirements in the standards listed in comment 43(e)(2)(v)(B)-3 for creditors to verify income or assets, debt obligations, alimony and child support using specified guides or to include or exclude particular inflows, property, and obligations as income, assets, debt obligations, alimony, and child support. For example, such requirements would include a specified standard's definition of the term "self-employment income," description of when the creditor may use self-employment income as qualifying

[247] Fed. Nat'l Mortgage Assoc., Single Family Selling Guide (2020), https://selling-guide.fanniemae.com/.

[248] Fed. Home Loan Mort. Corp., The Single-Family Seller/Servicer Guide (2020), https://guide.freddiemac.com/app/guide/.

[249] U.S. Dep't of Hous. & Urban Dev., Single Family Housing Policy Handbook 4000.1 (2019), https://www.hud.gov/program_offices/housing/sfh/handbook_4000-1.

[250] U.S. Dept. of Veterans Affairs, Lenders Handbook-VA Pamphlet 26-7 (2019), https://www.benefits.va.gov/WARMS/pam26_7.asp.

[251] U.S. Dep't of Agric. Rural Hous. Serv., Direct Single Family Housing Loans and Grants-Field Office Handbook HB-1-3550 (2019), https://www.rd.usda.gov/resources/directives/handbooks#hb13555.

[252] U.S. Dep't of Agric. Rural Hous. Serv., Guaranteed Loan Program Technical Handbook HB-1-3555 (2020), https://www.rd.usda.gov/resources/directives/handbooks#hb13555.

income for a mortgage, and explanation of how the creditor must document self-employment income.

Proposed comment 43(e)(2)(v)(B)-3.iii would clarify that, for purposes of compliance with § 1026.43(e)(2)(v)(B), a creditor need not comply with requirements in the standards listed in comment 43(e)(2)(v)(B)-3.i other than those that require creditors to verify income, assets, debt obligations, alimony, and child support using specified documents or to classify particular inflows, property, and obligations as income, assets, debt obligations, alimony, and child support. For example, a standard the Bureau would specify may include information on the use of DTI ratios. Because such information is not a requirement to verify income, assets, debt obligations, alimony and child support using specified documents or to classify particular inflows, property, and obligations as income, assets, debt obligations, alimony, and child support, a creditor would need not comply with this requirement to be eligible to receive a safe harbor as described in comment 43(e)(2)(v)(B)-3.i.

Proposed comment 43(e)(2)(v)(B)-3.iv would clarify that a creditor also complies with § 1026.43(e)(2)(v)(B) if it complies with revised versions of standards that the Bureau would specify in comment 43(e)(2)(v)(B)-3, provided that the two versions are substantially similar. This provision is intended to allow creditors to use new versions of standards without the Bureau needing to amend the commentary unless the new versions of the standards deviate in important respects from the older versions of the standards.

Finally, proposed comment 43(e)(2)(v)(B)-3.v would clarify that a creditor complies with § 1026.43(e)(2)(v)(B) if it complies with the verification requirements in one or more of the standards the Bureau would specify in comment 43(e)(2)(v)(B)-3.i. The proposed comment would provide further that a creditor may, but need not, comply with § 1026.43(e)(2)(v)(B) by complying with the verification requirements from more than one standard (in other words, by "mixing and matching" verification requirements). For example, if a creditor complies with the requirements in one of the standards the Bureau would specify for when the creditor may use "self-employment income," and also complies with the requirements in a different standard the Bureau would specify regarding certain vested assets, the creditor complies with § 1026.43(e)(2)(v)(B) and receives a safe harbor as described in comment 43(e)(2)(v)(B)-3.i with respect to those determinations. A creditor that chooses to comply with the verification requirements from more than one standard need not satisfy all of the verification requirements in each of the standards it uses.

The Bureau proposes these revisions because it preliminarily concludes that they may help ensure that the Rule's verification requirements are clear and detailed enough to provide creditors with sufficient certainty about whether a loan satisfies the General QM loan definition. Without such certainty, creditors may be less likely to provide General QM loans to consumers, reducing the availability of responsible, affordable mortgage credit to consumers. The Bureau also seeks to ensure that the Rule's verification requirements are flexible enough to adapt to emerging issues with respect to the treatment of certain types of debt or income, advancing the provision of responsible, affordable credit to consumers.

To further these objectives, the Bureau is proposing to remove the requirement that creditors verify the consumer's income or assets, debt obligations, alimony, and child support in accordance with appendix Q and to add commentary clarifying that a creditor complies with § 1026.43(e)(2)(v)(B) if it complies with verification standards the Bureau would specify. The Bureau encourages stakeholders to develop additional verification standards that the Bureau could incorporate into the safe harbor set forth in proposed comment 43(e)(2)(v)(B)-3.

Stakeholder standards also could incorporate, in whole or in part, any standards that the Bureau specifies as providing a safe harbor, including mixing and matching these standards. The Bureau thus welcomes the submission of stakeholder-developed verification standards and would review any such standards for potential inclusion in the safe harbor.

In the January 2013 Final Rule, the Bureau adopted the requirement that creditors verify the consumer's income or assets, debt obligations, alimony, and child support in accordance with appendix Q. The Bureau believed this requirement would provide certainty to creditors as to whether a loan meets the General QM loan definition and would not deter creditors from providing QMs to consumers.[253] However, appendix Q has not achieved this goal. The Assessment Report highlighted three concerns with appendix Q. First, the Report stated that appendix Q lacks the high degree of specific detail that is provided by, for example, Fannie Mae's Seller Guide and Freddie Mac's Seller/Servicer Guide.[254] Second, the Report noted that there is a perceived lack of clarity in appendix Q. As the Report noted, commenters on the Assessment RFI stated that appendix Q "is ambiguous and leads to uncertainty" and is "confusing and unworkable," and that "additional guidance…is needed."[255] Third, the Report noted that appendix Q has been static since its adoption, while the GSEs regularly update and adjust their guidelines in response to, among other things, emerging issues with respect to the treatment of certain types of debt or income.[256] The Assessment Report found that such concerns "may have contributed to investors'—and at least derivatively, creditors'—preference"

[253] 78 FR 6408, 6523 (Jan. 30, 2013).

[254] *See* Assessment Report, *supra* note 58, at 193.

[255] *Id*.

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

for Temporary GSE QM loans instead of originating loans under the General QM loan definition.[257] Commenters responding to the ANPR also raised similar concerns, but some commenters also recommended maintaining appendix Q as an option for compliance.

As described above in part III, the ANPR solicited comment on whether the rule should retain appendix Q as the standard for calculating and verifying debt and income.[258] Nearly all commenters agreed that appendix Q in its existing form is insufficient—specifically, that the requirements lacked clarity in certain areas, particularly with respect to the application of the standards to consumers who are self-employed or otherwise have non-traditional income. These commenters stated that this lack of clarity leaves creditors uncertain of the QM status of some loans. Commenters also criticized appendix Q for being overly prescriptive and outdated in other areas and therefore lacking the flexibility to adapt to changing market conditions. Commenters suggested that the Bureau supplement appendix Q or replace it with reasonable alternatives that allow for more flexibility, such as a general reasonability standard for verifying income and debt or verification standards issued by the GSEs, FHA, USDA, or VA. Commenters also stated that appendix Q hampers innovation because it is incompatible with practices such as digital underwriting. Although most commenters advocated for elimination of appendix Q, the commenters that advocated for retaining appendix Q generally suggested the Bureau should revise appendix Q to modernize the standards and ease industry compliance.

[257] *Id*. at 193.

[258] Specifically, the Bureau sought comment on whether the rule should retain appendix Q as the standard for verification if the rule retains a direct measure of a consumer's personal finances for General QM. Even though the Bureau is proposing to remove the DTI ratio requirement, the question about retention of appendix Q remains relevant because the proposal would require creditors to verify income, assets, debt obligations, alimony, and child support.

The Bureau tentatively determines that, due to the well-founded and consistent concerns described above, appendix Q does not provide sufficient compliance certainty to creditors and does not provide flexibility to adapt to emerging issues with respect to the treatment of certain types of debt or income categories. The Bureau recognizes that some findings in the Assessment Report suggest that the issues raised by creditors with respect to appendix Q do not appear to have had a substantial impact for certain loans. For example, although creditors have stated that it may be difficult to comply with certain appendix Q requirements for self-employed borrowers, the Assessment Report noted that application data indicated that the approval rates for non-high DTI, non-GSE eligible self-employed borrowers have decreased by only two percentage points since the January 2013 Final Rule became effective.[259] The Bureau tentatively concludes, however, that this limited decrease in approvals for such applications does not undermine creditors' concerns that appendix Q's definitions of debt and income are rigid and difficult to apply and do not provide the level of compliance certainty that the Bureau anticipated in the January 2013 Final Rule. Additionally, the Assessment Report showed that about 40 percent of respondents to a lender survey indicated that they "often" or "sometimes" originate non-QM loans where the borrower could not provide documentation required by appendix Q. The Bureau concluded that these results left open the possibility that appendix Q requirements may have had an impact on access to credit.[260]

The Bureau thus proposes to remove the appendix Q requirements from § 1026.43(e)(2)(v), and to remove appendix Q from Regulation Z entirely. The Bureau proposes to remove appendix Q entirely in light of concerns from creditors and investors that its perceived

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[259] *See* Assessment Report, *supra* note 58, at 11.

[260] *See id.* at 155.

inflexibility, ambiguity, and static nature result in standards that are both confusing and outdated. The Bureau understands it would be time- and resource-intensive to revise appendix Q in a manner that would resolve these concerns. The Bureau tentatively concludes that a more efficient and practicable solution is to propose to remove appendix Q entirely.

As described above, the proposal would instead provide that creditors must verify income, assets, debt obligations, alimony, and child support in accordance with the general ATR verification provisions. The proposal would also provide a safe harbor for compliance with § 1026.43(e)(2)(v)(B) if a creditor complies with verification requirements in standards the Bureau would specify in comment 43(e)(2)(v)(B)-3. Because the Bureau believes that the general ATR verification provisions and external standards the Bureau would specify would provide a workable approach, and because the Bureau preliminarily agrees that the existing concerns with appendix Q discussed above have merit, the Bureau is not proposing to retain appendix Q as an option for creditors to comply with the requirements of § 1026.43(e)(2)(v) to consider and verify a consumer's income, assets, debt obligations, alimony, and child support. As proposed comment 43(e)(2)(v)(B)-1 makes clear, creditors would still be required to verify the consumer's income or assets in accordance with § 1026.43(c)(4) and its commentary and verify the consumer's current debt obligations, alimony, and child support in accordance with § 1026.43(c)(3) and its commentary.

As noted above, the proposal would also provide a safe harbor for compliance with § 1026.43(e)(2)(v)(B) where a creditor complies with verification requirements in standards the Bureau specifies. These may include relevant provisions from Fannie Mae's Single Family Selling Guide, Freddie Mac's Single-Family Seller/Servicer Guide, FHA's Single Family Housing Policy Handbook, the VA's Lenders Handbook, and the USDA's Field Office

Handbook for the Direct Single Family Housing Program as well as its Handbook for the Single Family Guaranteed Loan Program, current as of this proposal's public release. All of these verification standards are available to the public for free online.[261] As discussed above, the Bureau is also open to including stakeholder-developed verification standards among this list of guides such that a creditor's compliance with such verification standards would provide conclusive evidence of compliance with § 1026.43(e)(2)(v)(B).

The Bureau tentatively determines, based on extensive public feedback and its own experience and review, that external standards appear reasonable and would provide creditors with substantially greater certainty about whether many loans satisfy the General QM loan definition—particularly with respect to verifying income for self-employed consumers, consumers with part-time employment, and consumers with irregular or unusual income streams. The Bureau tentatively determines that these types of income would be addressed more fully by certain external standards than by appendix Q. The Bureau tentatively determines that, as a result, this proposal would increase access to responsible, affordable credit for consumers.

The Bureau emphasizes that a creditor would not be required to comply with any of the verification requirements in the standards the Bureau would specify in comment 43(e)(2)(v)(B)-3.i in order to comply with § 1026.43(e)(2)(v)(B). Rather, the Bureau is proposing to clarify that compliance with these standards constitutes compliance with the verification requirements of

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[261] The current versions of the guides (as of June 17, 2020) are available on the respective Federal agency and GSE websites. The current versions of the Federal agency guides noted above will be posted with the proposed rule on https://www.regulations.gov. In the event that the GSEs replace the current versions of the guides noted above with new versions of the guides on their websites during the comment period, the version current as of June 17, 2020 of Fannie Mae's Single Family Selling Guide will be available at http://www.allregs.com/tpl/public/fnma_freesiteconv_tll.aspx, and the version current as of June 17, 2020 of Freddie Mac's Single-Family Seller/Servicer Guide will be available at https://www.allregs.com/tpl/public/fhlmc_freesite_tll.aspx.

§ 1026.43(c)(3) and (c)(4) and their commentary, which generally require creditors to verify income, assets, debt obligations, alimony, and child support using reasonably reliable third-party records. The Bureau tentatively determines that this would help address the concerns of many creditors and commenters that appendix Q has not facilitated adequate compliance certainty.

The Bureau also tentatively determines that the proposal would provide creditors with the flexibility to develop other methods of compliance with the verification requirements of § 1026.43(e)(2)(v)(B), consistent with § 1026.43(c)(3) and (c)(4) and their commentary, an option that the Bureau intends to address the concerns of creditors and commenters that found appendix Q to be too rigid or prescriptive. As explained in proposed comment 43(e)(2)(v)(B)-1, § 1026.43(e)(2)(v)(B) does not prescribe specific methods of underwriting, and so long as a creditor complies with § 1026.43(c)(3) and (c)(4), the creditor is permitted to use any reasonable verification methods and criteria. Furthermore, as proposed comment 43(e)(2)(v)(B)-3.v would clarify, creditors would have the flexibility to "mix and match" the verification requirements in the standards the Bureau would specify in comment 43(e)(2)(v)(B)-3.i, and receive a safe harbor with respect to verification that is made consistent with those standards.

The Bureau also proposes to explain in proposed comment 43(e)(2)(v)(B)-3.iv that a creditor complies with § 1026.43(e)(2)(v)(B) if it complies with revised versions of the standards the Bureau would specify in comment 43(e)(2)(v)(B)-3.i, provided that the two versions are substantially similar. Many of the standards that the Bureau could specify in comment 43(e)(2)(V)(B)-3.i, such as GSE and Federal agency standards, are regularly updated in response to emerging issues with respect to the treatment of certain types of debt or income. This proposed comment would explain that the safe harbor described in comment 43(e)(2)(v)(B)-3.i applies not only to verification requirements in the specific versions of the standards listed, but also revised versions of these standards, as long as the revised version is substantially similar.

The Bureau is aware, based on comments received on the ANPR, that some creditors would prefer that compliance with *any* future version of the standards the Bureau specifies, rather than just the versions of those standards the Bureau would specify in comment 43(e)(2)(v)(B)-3.i (as well as any substantially similar version, under proposed comment 43(e)(2)(v)(B)-3.iv), be automatically deemed to constitute compliance with the verification requirements of § 1026.43(c)(3) and (c)(4). However, such an approach would mean that any future revisions to those standards by the third parties that issue them could cause significant changes in the creditor obligations and consumer protections under the Rule without review by the Bureau. For this reason, the Bureau is not proposing such an approach.

As in the January 2013 Final Rule, the Bureau is proposing to incorporate the requirement that the creditor verify the consumer's current debt obligations, alimony, and child support into the definition of a General QM loan in § 1026.43(e)(2) pursuant to its authority under TILA section 129C(b)(3)(B)(i). The Bureau is also proposing the revisions to the commentary to § 1026.43(e)(2)(v)(B)—including the clarification that a creditor complies with the General QM loan verification requirement where it complies with certain verification standards issued by third parties that the Bureau would specify—pursuant to its authority under TILA section 129C(b)(3)(B)(i). The Bureau tentatively finds that these provisions would be necessary and proper to ensure that responsible, affordable mortgage credit remains available to consumers in a manner that is consistent with the purposes of TILA section 129C and necessary and appropriate to effectuate the purposes of TILA section 129C, which includes assuring that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay the loan.

The Bureau also proposes these provisions pursuant to its authority under TILA section 105(a) to issue regulations that, among other things, contain such additional requirements, other provisions, or that provide for such adjustments for all or any class of transactions, that in the Bureau's judgment are necessary or proper to effectuate the purposes of TILA, which include the above purpose of section 129C, among other things. The Bureau tentatively finds that these provisions would be necessary and proper to achieve this purpose. In particular, the Bureau tentatively finds that incorporating the requirement that a creditor verify a consumer's current debt obligations, alimony, and child support into the General QM loan criteria—as well as clarifying that a creditor complies with the General QM verification requirement where it complies with certain verification standards issued by third parties that the Bureau would specify—would ensure that creditors verify whether a consumer has the ability to repay a General QM loan. Finally, the Bureau concludes that these regulatory amendments are authorized by TILA section 129C(b)(2)(A)(vi), which permits, but does not require, the Bureau to adopt guidelines or regulations relating to debt-to-income ratios or alternative measures of ability to pay regular expenses after payment of total monthly debt.

The Bureau seeks comment on proposed § 1026.43(e)(2)(v)(B) and related commentary, including on whether it should retain appendix Q as an option for complying with the Rule's verification standards. In addition, the Bureau requests comment on whether proposed § 1026.43(e)(2)(v)(B) and related commentary would facilitate or create obstacles to verification of income, assets, debt obligations, alimony, and child support through automated analysis of electronic transaction data from consumer account records. The Bureau also requests comment on whether the Rule should include a safe harbor for compliance with certain verification standards, as the Bureau proposes in proposed comment 43(e)(2)(v)(B)-3, and, if so, what verification standards the Bureau should specify for the safe harbor. The Bureau also requests comment about the advantages and disadvantages of the verification requirements in each possible standard the Bureau could specify for the safe harbor, including: (1) chapters B3-3 through B3-6 of the Fannie Mae Single Family Selling Guide, published June 3, 2020; (2) sections 5102 through 5500 of the Freddie Mac Single-Family Seller/Servicer Guide, published June 10, 2020; (3) sections II.A.1 and II.A.4-5 of the FHA's Single Family Housing Policy Handbook, issued October 24, 2019; (4) chapter 4 of the VA's Lenders Handbook, revised February 22, 2019; (5) chapter 4 of the USDA's Field Office Handbook for the Direct Single Family Housing Program, revised March 15, 2019; and (6) chapters 9 through 11 of the USDA's Handbook for the Single Family Guaranteed Loan Program, revised March 19, 2020. In addition, the Bureau requests comment on whether creditors that comply with standards that have been revised but are substantially similar should receive a safe harbor, as the Bureau proposes. The Bureau further seeks comment on whether the Rule should include examples of revisions that might qualify as substantially similar, and if so, what types of examples would provide helpful clarification to creditors and other stakeholders. For example, the Bureau seeks comment on whether it would be helpful to clarify that a revision might qualify as substantially similar where it is a clarification, explanation, logical extension, or application of a pre-existing proposition in the standard. The Bureau also seeks comment on its proposal to allow creditors to "mix and match" requirements from verification standards, including whether examples of such "mixing and matching" would be helpful and whether the Bureau should instead limit or prohibit such "mixing and matching," and why.

Finally, the Bureau requests comment on whether the Bureau should specify in the safe harbor existing stakeholder standards or standards that stakeholders develop that define debt and income. The Bureau seeks comment on whether the potential inclusion or non-inclusion of Federal agency or GSE verification standards in the safe harbor in the future would further encourage stakeholders to develop such standards.

43(e)(2)(vi)

TILA section 129C(b)(2)(vi) states that the term "qualified mortgage" includes any mortgage loan that complies with any guidelines or regulations established by the Bureau relating to ratios of total monthly debt to monthly income or alternative measure of ability to pay regular expenses after payment of total monthly debt, taking into account the income levels of the consumer and such other factors as the Bureau may determine relevant and consistent with the purposes described in TILA section 129C(b)(3)(B)(i). TILA section 129C(b)(3)(B)(i) authorizes the Bureau to revise, add to, or subtract from the criteria that define a QM upon a finding that the changes are necessary or proper to ensure that responsible, affordable mortgage credit remains available to consumers in a manner consistent with the purposes of TILA section 129C, necessary and appropriate to effectuate the purposes of TILA sections 129C and 129B, to prevent circumvention or evasion thereof, or to facilitate compliance with TILA sections 129C and 129B. Current § 1026.43(e)(2)(vi) implements TILA section 129C(b)(2)(vi), consistent with TILA section 129C(b)(3)(B)(i), and provides that, as a condition to be a General QM loan under § 1026.43(e)(2), the consumer's total monthly DTI ratio may not exceed 43 percent. Section 1026.43(e)(2)(vi) further provides that the consumer's total monthly DTI ratio is generally determined in accordance with appendix Q.

For the reasons described in part V above, the Bureau is proposing to remove the 43 percent DTI limit in current § 1026.43(e)(2)(vi) and replace it with a price-based approach. The proposal also would require a creditor to consider and verify the consumer's debt, income, and monthly DTI ratio or residual income. Specifically, the Bureau proposes to remove the text of current § 1026.43(e)(2)(vi) and to provide instead that, to be a General QM loan under § 1026.43(e)(2), the APR may not exceed APOR for a comparable transaction as of the date the interest rate is set by the amounts specified in § 1026.43(e)(2)(vi)(A) through (E).[262] Proposed § 1026.43(e)(2)(vi)(A) through (E) would provide specific rate spread thresholds for purposes of § 1026.43(e)(2), including higher thresholds for small loan amounts and subordinate-lien transactions. Proposed § 1026.43(e)(2)(vi)(A) would provide that for a first-lien covered transaction with a loan amount greater than or equal to $109,898 (indexed for inflation), the APR may not exceed APOR for a comparable transaction as of the date the interest rate is set by two or more percentage points. Proposed § 1026.43(e)(2)(vi)(B) and (C) would provide higher thresholds for smaller first-lien covered transactions. Proposed § 1026.43(e)(2)(vi)(D) and (E) would provide higher thresholds for subordinate-lien covered transactions. Loans priced at or above the thresholds in proposed § 1026.43(e)(2)(vi)(A) through (E) would not be eligible for QM status under § 1026.43(e)(2). The proposal would also provide that the loan amounts specified in § 1026.43(e)(2)(vi)(A) through (E) be adjusted annually for inflation based on changes in the Consumer Price Index for All Urban Consumers (CPI-U).

[262] As explained above in the section-by-section discussion of § 1026.43(e)(2)(v)(A), the Bureau is proposing to move to § 1026.43(e)(2)(v)(A) the provisions in existing § 1026.43(e)(2)(vi)(B), which specify that the consumer's monthly DTI ratio is determined using the consumer's monthly payment on the covered transaction and any simultaneous loan that the creditor knows or has reason to know will be made.

Proposed § 1026.43(e)(2)(vi) would also provide a special rule for determining the APR for purposes of determining a loan's status as a General QM loan under § 1026.43(e)(2) for certain ARMs and other loans for which the interest rate may or will change in the first five years of the loan. Specifically, proposed § 1026.43(e)(2)(vi) would provide that, for purposes of § 1026.43(e)(2)(vi), the creditor must determine the APR for a loan for which the interest rate may or will change within the first five years after the date on which the first regular periodic payment will be due by treating the maximum interest rate that may apply during that five-year period as the interest rate for the full term of the loan.

The Bureau is proposing these revisions to § 1026.43(e)(2)(vi) for the reasons set forth above in part V. As explained above, the Bureau is proposing to remove the 43 percent DTI limit in current § 1026.43(e)(2)(vi) and replace it with a price-based approach because the Bureau is concerned that retaining the existing General QM loan definition with the 43 percent DTI limit after the expiration of Temporary GSE QM loan definition expires would significantly reduce the size of QM and could significantly reduce access to responsible, affordable credit. The Bureau is proposing a price-based approach to replace the specific DTI limit approach because it is concerned that imposing a DTI limit as a condition for QM status under the General QM loan definition may be overly burdensome and complex in practice and may unduly restrict access to credit because it provides an incomplete picture of the consumer's financial capacity. The Bureau preliminarily concludes that a price-based General QM loan definition is appropriate because a loan's price, as measured by comparing a loan's APR to APOR for a comparable transaction, is a strong indicator of a consumer's ability to repay and is a more holistic and flexible measure of a consumer's ability to repay than DTI alone.

The Bureau also proposes to remove current comment 43(e)(2)(vi)-1, which relates to the calculation of monthly payments on a covered transaction and for simultaneous loans for purposes of calculating the consumer's DTI ratio under current § 1026.43(e)(2)(vi). The Bureau believes this comment would be unnecessary under the proposal to move the text of current § 1026.43(e)(2)(vi) and revise it to remove the references to appendix Q. The Bureau proposes to replace current comment 43(e)(2)(vi)-1 with a cross-reference to comments 43(b)(4)-1 through -3 for guidance on determining APOR for a comparable transaction as of the date the interest rate is set. The Bureau also proposes new comment 43(e)(2)(vi)-2, which provides that a creditor must determine the applicable rate spread threshold based on the face amount of the note, which is the "loan amount" as defined in § 1026.43(b)(5). In addition, the Bureau proposes comment 43(e)(2)(vi)-3 in which it will publish the annually adjusted loan amounts to reflect changes in the CPI-U. The Bureau also proposes new comment 43(e)(2)(vi)-4, which explains the proposed special rule that, for purposes of § 1026.43(e)(2)(vi), the creditor must determine the APR for a loan for which the interest rate may or will change within the first five years after the date on which the first regular periodic payment will be due by treating the maximum interest rate that may apply during that five-year period as the interest rate for the full term of the loan. The guidance provided in proposed comment 43(e)(2)(vi)-4 is discussed further, below.

The Bureau proposes to adopt a price-based approach to defining General QM loans in § 1026.43(e)(2)(vi) pursuant to its authority under TILA section 129C(b)(3)(B)(i). The Bureau preliminarily concludes that a price-based approach to the General QM loan definition is necessary and proper to ensure that responsible, affordable mortgage credit remains available to consumers in a manner that is consistent with the purposes of TILA section 129C and is necessary and appropriate to effectuate the purposes of TILA section 129C, which includes assuring that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay the loan. As noted above, the Bureau is concerned that, when the Temporary GSE QM loan definition expires, there would be a significant reduction in access to credit if the Bureau retained the existing General QM loan definition with the 43 percent DTI limit. The Bureau preliminarily concludes that a price-based General QM loan definition is appropriate because a loan's price, as measured by comparing a loan's APR to APOR for a comparable transaction, is a strong indicator of a consumer's ability to repay. Further, the Bureau preliminarily concludes that a price-based approach is a more holistic and flexible measure of a consumer's ability to repay than DTI ratios alone, and therefore would better promote access to credit by providing QM status to consumers with DTI ratios above 43 percent for whom it may be appropriate to presume ability to repay. As such, the Bureau preliminarily concludes that a price-based approach to the General QM loan definition would both ensure that responsible, affordable mortgage credit remains available to consumers and assure that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay the loan. For these same reasons, the Bureau also proposes to adopt a price-based requirement in § 1026.43(e)(2)(vi) pursuant to its authority under TILA section 105(a) to issue regulations that, among other things, contain such additional requirements or other provisions, or that provide for such adjustments for all or any class of transactions, that in the Bureau's judgment are necessary or proper to effectuate the purposes of TILA, which include the above purpose of section 129C, among other things. The Bureau preliminarily concludes that the price-based addition to the QM criteria is necessary and proper to achieve this purpose, for the reasons described above. Finally, the Bureau preliminarily concludes a price-based approach is authorized by TILA section 129C(b)(2)(A)(vi), which permits, but does not require, the Bureau to adopt guidelines or regulations relating to DTI ratios or alternative measures of ability to pay regular expenses after payment of total monthly debt.

The General QM Loan Pricing Thresholds

Proposed § 1026.43(e)(2)(vi)(A) would establish the pricing threshold for most General QM loans. Specifically, proposed § 1026.43(e)(2)(vi)(A) would provide that, for a first-lien covered transaction with a loan amount greater than or equal to $109,898 (indexed for inflation), the APR may not exceed APOR for a comparable transaction as of the date the interest rate is set by two or more percentage points. Loans that are priced at or above the two-percentage point threshold would not be eligible for QM status under § 1026.43(e)(2), except that, as discussed below, the proposal provides higher thresholds for loans with smaller loan amounts and for subordinate-lien transactions. As discussed above, for all loans, the proposal preserves the current thresholds in § 1026.43(e)(1)(i) that separate safe harbor from rebuttable presumption QMs, so that a loan that otherwise meets the General QM loan definition is a safe harbor QM if its APR exceeds APOR for a comparable transaction as of the date the interest rate was set by less than 1.5 percentage points for first-lien transactions, or 3.5 percentage points for subordinate-lien transactions. Under the proposal, all other QM loans would continue to be considered rebuttable presumption QMs under § 1026.43(e)(1)(ii).

In considering pricing thresholds for the General QM loan definition, the Bureau has placed particular emphasis on balancing considerations related to ensuring consumers' ability to repay with maintaining access to responsible, affordable mortgage credit. The Bureau tentatively concludes that, in general, a two-percentage-point-over-APOR threshold would strike the appropriate balance between these two objectives.

As explained above, the Bureau uses early delinquency rates as a proxy for measuring whether a consumer had a reasonable ability to repay at the time the loan was consummated. Here, the Bureau analyzed early delinquency rates in considering the pricing thresholds at which a loan should be presumed to comply with the ATR provisions. The Bureau analyzed NMDB and HMDA data to assess early delinquency rates for first-lien purchase originations, using both DTI and rate spread. The data are summarized in Tables 1 through 6, above. Tables 5 and 6 show the early delinquency rates for samples of loans categorized by both their DTI and their rate spread.

Table 5 shows early delinquency rates for 2002-2008 first-lien purchase originations in the NMDB. The 2002-2008 time period corresponds to a market environment that, in general, demonstrates looser, higher-risk credit conditions.[263] The Bureau's analyses found direct correlations between rate spreads and early delinquency rates across all DTI ranges reviewed. Loans with low rate spreads had relatively low early delinquency rates even at high DTI levels. The highest early delinquency rates corresponded to loans with both high rate spreads and high DTI ratios. For loans with DTI ratios of 41 to 43 percent—the category in Table 5 that includes the current DTI limit of 43 percent—the early delinquency rates reached 16 percent at rate spreads including and above 2.25 percentage points over APOR. At rate spreads inclusive of 1.75 through 1.99 percentage points over APOR—the category that is just below the proposed two-percentage-point rate spread threshold—the early delinquency rate reached 22 percent for DTI ratios of 61 to 70 percent. At DTI ratios of 41 to 43 percent and rate spreads inclusive of 1.75 through 1.99 percentage points over APOR, the early delinquency rate is 15 percent.

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263 Characteristics of a high-risk credit market include very high unemployment and falling home prices.

Table 6 shows average delinquency statistics for 2018 NMDB first-lien purchase originations that have been matched to 2018 HMDA data. In contrast to Table 5, the time period in Table 6 corresponds to a market environment that, in general, demonstrates tighter, lower-risk credit conditions.[264] In the 2018 data in Table 6, early delinquency rates also increased as rate spreads increased across each range of DTI ratios analyzed, although the overall performance of loans in the Table 6 dataset was significantly better than those represented in Table 5. For loans with DTI ratios of 36 to 43 percent—the category in Table 6 that includes the current DTI limit of 43 percent—early delinquency rates reached 3.9 percent (at rate spreads of at least 2 percentage points). The highest early delinquency rate associated with the proposed rate spread threshold (less than 2 percentage points over APOR) is 3.2 percent and corresponds to loans with the DTI ratios of 26 to 35 percent. At the same rate spread threshold, the early delinquency rate for the loans with the highest DTI ratios is 2.3 percent.[265]

Although in Tables 5 and 6 delinquency rates rise with rate spread, there is no clear point at which delinquency rates accelerate. Comparisons between a high-risk credit market (Table 5) and a low-risk credit market (Table 6) show substantial expansion of early delinquency rates during an economic downturn across all rate spreads and DTI ratios. Data show that, for example, prime loans that experience a 0.2 percent early delinquency rate in a low-risk market might experience a 2 percent early delinquency rate in a higher-risk market, while subprime

[264] Characteristics of a low-risk credit market include very low unemployment and rising home prices. As noted above, this more recent sample of data provides insight into early delinquency rates under post-crisis lending standards for a dataset of loans that had not undergone an economic downturn.

[265] The apparent anomalies in the progression of the early delinquency rates across DTI ratios at the higher rate spread categories in Table 6 is likely because there are relatively few loans in the 2018 data with the indicated combinations of higher rate spreads and lower DTI ratios and some creditors require that consumers demonstrate more compensating factors on higher DTI loans.

loans with a 4.2 percent early delinquency rate in a low-risk market might experience a 19 percent early delinquency rate in a higher-risk market.

As discussed above, other analyses reviewed by the Bureau also show a strong positive correlation of delinquency rates with interest rate spreads.[266] Collectively, this evidence suggests that higher rate spreads—including the specific measure of APR over APOR—are strongly correlated with future early delinquency rates. The Bureau expects that, for loans just below the respective thresholds, a pricing threshold of two percentage points over APOR would generally result in similar or somewhat higher early delinquency rates relative to the current DTI limit of 43 percent. However, Bureau analysis shows the early delinquency rate for this set of loans is on par with loans that have received QM status under the Temporary GSE QM loan definition. Restricting the sample of 2018 NMDB-HMDA matched first-lien conventional purchase originations to only those purchased and guaranteed by the GSEs, loans with rate spreads at or above 2 percentage points had an early delinquency rate of 4.2 percent, higher than the maximum early delinquency rates observed for loans with rate spreads below 2 percentage points in either Table 2 (2.7 percent) or Table 6 (3.2 percent).[267] Consequently, the Bureau does not believe that the price-based approach would result in substantially higher delinquency rates than the standard included in the current rule. Although some commenters on the ANPR recommended rate spread thresholds as high as 2.5 percentage points over APOR, the Bureau is not proposing a higher General QM threshold for most loans because of concerns that such loans

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[266] See discussion of data and analyses provided by CoreLogic and the Urban Institute, in part V, above.

[267] This comparison uses 2018 data on GSE originations because such loans were originated while the Temporary GSE QM loan definition was in effect and the GSEs were in conservatorship. GSE loans from the 2002 to 2008 period were originated under a different regulatory regime and with different underwriting practices (*e.g.*, GSE loans more commonly had DTI ratios over 50 percent during the 2002 to 2008 period), and thus may not be directly comparable to loans made under the Temporary GSE QM loan definition.

would have high predicted delinquency rates, which appears inconsistent with the goal of assuring that consumers of loans that receive QM status and the resulting presumption of compliance with the ATR requirements do, in fact, have ability to repay.

The Bureau has used 2018 HMDA data to estimate that 95.8 percent of conventional purchase loans currently meet the criteria to be defined as QMs, including under the Temporary GSE QM loan definition. The Bureau also uses 2018 HMDA data to project that the proposed two-percentage-point-over-APOR threshold would result in a 96.1 percent market share for QMs with an adjustment for small loans, as discussed below.[268] Creditors may also respond to such a threshold by lowering pricing on some loans near the threshold, further increasing the QM market share. Therefore, using the size of the QM market as an indicator of access to credit, the Bureau expects that a pricing threshold of two percentage points over APOR, in combination with the proposed adjustments for small loans, would result in an expansion of access to credit as compared to the current rule including the Temporary GSE QM loan definition, particularly as creditors are likely to adjust pricing in response to the rule, allowing additional loans to obtain QM status.[269] Further, the proposal would result in a substantial expansion of access to credit as compared to the current rule without the Temporary GSE QM loan definition, under which only an estimated 73.6 percent of conventional purchase loans would be QMs.

The Bureau is concerned that rate spread thresholds lower than two percentage points over APOR could result in a significant reduction in access to credit when the Temporary GSE

[268] The Bureau estimates that alternative QM pricing thresholds of 1.5, 1.75, 2.25, and 2.5 percentage points over APOR would result in QM market shares of 94.3, 95.3, 96.6, and 96.8 percent, respectively.

[269] The Bureau acknowledges, however, that some loans that do not meet the current General QM loan definition, but that would be General QMs under the proposed price-based approach, would have been made under other QM definitions (*e.g.*, FHA, small-creditor QM).

QM definition expires. This is especially true given the modest amount of non-QM lending identified in the Bureau's Assessment Report, and the recent sharp reduction in that lending in recent months. The Bureau is also concerned that a rate spread threshold higher than two percentage points over APOR would define a QM boundary that substantially covers the entire mortgage market, except for loans with statutorily prohibited features, including loans for which the early delinquency rate suggests the consumer may not have had a reasonable ability to repay at consummation.

The Bureau preliminarily concludes that, for most first-lien covered transactions, a threshold of two percentage points over APOR is an appropriate criterion to include in the definition of General QM in § 1026.43(e)(2)(vi). This proposed threshold would appropriately balance the certainty provided to the market from ensuring that loans afforded QM status may be presumed to comply with the ATR provisions, with assurances that access to responsible, affordable mortgage credit remains available to consumers.

The Bureau requests comment on whether the final rule should establish in § 1026.43(e)(2)(vi)(A) a different rate spread threshold and, if so, what the threshold should be. The Bureau requests comment on whether the General QM rate spread threshold should be higher than 2 percentage points over APOR. For commenters suggesting a higher rate spread threshold, the Bureau requests commenters provide data or other analysis that would support providing QM status to such loans, which the Bureau expects would have higher risk profiles. The Bureau also requests comment on whether the General QM rate spread threshold should be set lower than 2 percentage points over APOR. For commenters suggesting a lower rate spread threshold, the Bureau requests commenters provide data or other analysis that would show that adopting a lower threshold would not have adverse effects on access to credit. All commenters are encouraged to include data or other analysis to support their recommendations for a particular threshold, including the proposed two-percentage-point-over-APOR threshold. The Bureau also seeks comments on whether creditors may be expected to change lending practices in response to the addition of any rate spread threshold in the definition of General QM (for example, by lowering interest rates to fit within rate spread thresholds), and how that would affect the size of the QM market. In addition, in light of the concerns about the sensitivity of a price-based QM definition to macroeconomic cycles, the Bureau requests comment on whether the Bureau should consider adjusting the pricing thresholds in emergency situations and, if so, how the Bureau should do so.

Thresholds for Smaller Loans and Subordinate-Lien Transactions

Proposed § 1026.43(e)(2)(vi)(B) and (C) would establish higher pricing thresholds for smaller loans, and loans priced at or above the proposed thresholds would not be eligible for QM status under § 1026.43(e)(2). Specifically, proposed § 1026.43(e)(2)(vi)(B) would provide that, for first-lien covered transactions with loan amounts greater than or equal to $65,939 but less than $109,898,[270] the threshold would be 3.5 percentage points over APOR. Proposed § 1026.43(e)(2)(vi)(C) would provide that, for first-lien covered transactions with loan amounts less than $65,939, the threshold would be 6.5 percentage points over APOR.

Proposed § 1026.43(e)(2)(vi)(D) and (E) would establish higher thresholds for subordinate-lien transactions, with different thresholds depending on the size of the transaction.

[270] The Bureau is proposing $65,939, rather than a threshold such as $60,000 or $65,000, and $109,898, rather than a threshold such as $100,000 or $110,000, because the proposed thresholds align with certain thresholds for the limits on points and fees, as updated for inflation, in § 1026.43(e)(3)(i) and the associated commentary. The Bureau will update these loan amounts if the corresponding dollar amounts for § 1026.43(e)(3)(i) and the associated commentary are updated before this final rule becomes effective, in order to ensure that the loan amounts for this provision and § 1026.43(e)(3) remain synchronized.

Subordinate-lien transactions priced at or above the proposed thresholds would not be eligible for QM status under § 1026.43(e)(2). Specifically, proposed § 1026.43(e)(2)(vi)(D) would provide that, for subordinate-lien covered transactions with loan amounts greater than or equal to $65,939, the threshold would be 3.5 percentage points over APOR. Proposed § 1026.43(e)(2)(vi)(E) would provide that, for subordinate-lien covered transactions with loan amounts less than $65,939, the threshold would be 6.5 percentage points over APOR.

The proposal would also provide that the loan amounts specified in § 1026.43(e)(2)(vi)(A) through (E) be adjusted annually for inflation based on changes in CPI-U. Specifically, the Bureau would adjust the loan amounts in § 1026.43(e)(2)(vi) annually on January 1 by the annual percentage change in the CPI-U that was reported on the preceding June 1. The Bureau would publish adjustments in new comment 43(e)(2)(vi)-3 after the June figures become available each year.

The Bureau is proposing higher thresholds for smaller loans because it is concerned that loans with smaller loan amounts are typically priced higher than loans with larger loan amounts, even though a consumer with a smaller loan may have similar credit characteristics and ability to repay. Many of the creditors' costs for a transaction may be the same or similar, regardless of the loan amount. For creditors to recover their costs for smaller loans, they may have to charge higher interest rates or higher points and fees as a percentage of the loan amounts than they would for comparable larger loans. As a result, smaller loans may have higher APRs than larger loans to consumers with similar credit characteristics and who may have a similar ability to repay. As discussed below, the Bureau's analysis indicates that consumers who take out smaller loans with APRs within higher thresholds may have similar credit characteristics as consumers who take out larger loans. The Bureau's analysis also indicates that smaller loans with APRs within higher thresholds may have comparable levels of early delinquencies as larger loans within lower thresholds. However, as explained further below, the Bureau's analysis of delinquency levels for smaller loans, compared to larger loans, does not appear to indicate a threshold at which delinquency levels significantly accelerate.

The Bureau is concerned that adopting the same threshold of two percentage points above APOR for all loans could disproportionately prevent smaller loans from being originated as General QM loans. In particular, the Bureau's analysis indicates that without higher thresholds for smaller loans, loans for manufactured housing and loans to minority consumers could disproportionately be excluded from being originated as General QM loans. The Bureau's analysis of 2018 HMDA data found that 57.9 percent of manufactured housing loans are priced two percentage points or more over APOR. The Bureau's analysis also found that 5.1 percent of site-built loans to minority consumers are priced two percentage points or more over APOR, but 3.5 percent of site-built loans to non-Hispanic white consumers are priced two percentage points or more over APOR. While some loans may be originated under other QM definitions or as non-QM loans, those loans may be meaningfully more expensive, and some loans may not be originated at all. As discussed in part V, the non-QM market has been slow to develop, and the negative impact on the non-QM market from the disruptions caused by the COVID-19 pandemic raises further concerns about the capacity of the non-QM market to provide consumers with access to credit through such loans.

The Bureau also notes that, in the Dodd-Frank Act, Congress provided for additional pricing flexibility for creditors making smaller loans, allowing smaller loans to include higher points and fees while still meeting the QM definition. TILA section 129C(b)(2)(A)(vi) defines a QM as a loan for which, among other things, the total points and fees payable in connection with the loan do not exceed 3 percent of the total loan amount. However, TILA section 129C(b)(2)(D) requires the Bureau to prescribe rules adjusting the points-and-fees limits for smaller loans. In the January 2013 Final Rule, the Bureau implemented this requirement in § 1026.43(e)(3), adopting higher points-and-fees thresholds for different tiers of loan amounts less than or equal to $100,000, adjusted for inflation. The Bureau's preliminary conclusion that creditors originating smaller loans typically impose higher points and fees or higher interest rates to recover their costs, regardless of the consumer's creditworthiness, and that higher thresholds for smaller loans in § 1026.43(e)(2)(vi) may, therefore, be appropriate, is consistent with the statutory directive to adopt higher points-and-fees thresholds for smaller loans.

To develop the proposed thresholds for smaller loans in § 1026.43(e)(2)(vi)(B) and (C), the Bureau analyzed evidence related to credit characteristics and loan performance for first-lien purchase transactions at various rate spreads and loan amounts (adjusted for inflation) using HMDA and NMDB data, as shown in Table 9.[271]

Table 9: Loan Characteristics and Performance for Different Sizes of First-Lien Transactions at Various Rate Spreads

Loan Size Group	**Rate Spread Range** (Percentage points over APOR)	**Mean CLTV,** 2018 HMDA	**Mean DTI,** 2018 HMDA	**Mean Credit Score,** 2018 HMDA	**Percent observed 60+ days delinquent within first 2 years,** 2002-2008 NMDB	**Percent observed 60+ days delinquent within first 2 years,** 2018 NMDB
Under $65,939	1.5 - 2.0	81.9	32.3	717	6.1%	2.8%
Under $65,939	1.5 - 2.5	82.2	32.3	714	6.1%	2.3%
Under $65,939	1.5 - 3.0	82.1	32.2	714	6.2%	2.3%
Under $65,939	1.5 - 3.5	81.9	32.1	715	6.2%	2.5%

[271] *See* Bureau of Labor and Statistics, *Historical Consumer Price Index for All Urban Consumers (CPI-U)*, https://www.bls.gov/cpi/tables/supplemental-files/historical-cpi-u-202004.pdf. (Using the CPI-U price index, nominal loan amounts are inflated to June 2019 dollars from the price level in June of the year prior to origination. This effectively categorizes loans according to the inflation-adjusted thresholds for smaller loans that would have been in effect on the origination date.)

Loan Size Group	**Rate Spread Range** (Percentage points over APOR)	**Mean CLTV**, 2018 HMDA	**Mean DTI**, 2018 HMDA	**Mean Credit Score**, 2018 HMDA	**Percent observed 60+ days delinquent within first 2 years,** 2002-2008 NMDB	**Percent observed 60+ days delinquent within first 2 years,** 2018 NMDB
Under $65,939	1.5 - 4.0	81.7	32.3	714	6.3%	2.5%
Under $65,939	1.5 - 4.5	81.7	32.5	710	6.4%	2.6%
Under $65,939	1.5 - 5.0	81.7	32.6	706	6.4%	2.5%
Under $65,939	1.5 - 5.5	81.6	32.7	699	6.5%	2.4%
Under $65,939	1.5 - 6.0	81.7	32.9	694	6.5%	2.5%
Under $65,939	1.5 - 6.5	81.9	33.1	685	6.5%	3.4%
Under $65,939	1.5 and above	82.0	33.3	676	6.6%	4.1%
$65,939 to $109,897	1.5 - 2.0	89.9	35.5	704	11.1%	3.4%
$65,939 to $109,897	1.5 - 2.5	90.1	35.4	702	12.2%	4.2%
$65,939 to $109,897	1.5 - 3.0	90.0	35.5	702	12.9%	4.2%
$65,939 to $109,897	1.5 - 3.5	89.7	35.5	703	13.0%	4.3%
$65,939 to $109,897	1.5 - 4.0	89.4	35.6	703	13.1%	4.0%
$65,939 to $109,897	1.5 - 4.5	89.3	35.7	701	13.2%	4.2%
$65,939 to $109,897	1.5 - 5.0	89.1	35.8	699	13.3%	4.1%
$65,939 to $109,897	1.5 - 5.5	89.1	35.9	696	13.4%	4.0%
$65,939 to $109,897	1.5 - 6.0	89.2	36.0	692	13.4%	4.2%
$65,939 to $109,897	1.5 - 6.5	89.3	36.1	684	13.4%	4.5%
$65,939 to $109,897	1.5 and above	89.3	36.1	684	13.7%	4.5%
$109,898 and above	1.5 - 2.0 (for comparison)	92.7	39.4	698	14.9%	2.5%

The Bureau's analysis indicates that consumers with smaller loans with APRs within higher potential thresholds, such as 6.5 or 3.5 percentage points above APOR, have similar credit characteristics as consumers with larger loans between 1.5 and 2 percentage points above APOR.[272] More specifically, the Bureau analyzed 2018 HMDA data on first-lien conventional purchase loans and found that loans below $65,939 that are priced between 1.5 and 6.5 percentage points above APOR have a mean DTI ratio of 33.1 percent, a mean combined LTV

[272] Portfolio loans made by small creditors, as defined in § 1026.35(b)(2)(iii)(B) and (C), are excluded, as such loans are likely Small Creditor QMs pursuant to § 1026.43(e)(5) regardless of pricing.

ratio of 81.9 percent, and a mean credit score of 685. Loans equal to or greater than $65,939 but less than $109,898 that are priced between 1.5 and 3.5 percentage points above APOR have a mean DTI ratio of 35.5 percent, a mean combined LTV of 89.7 percent, and a mean credit score of 703. Loans equal to or greater than $109,898 that are priced between 1.5 and 2 percentage points above APOR have a mean DTI ratio of 39.4 percent, a mean combined LTV of 92.7 percent, and a mean credit score of 698. These all suggest that the credit characteristics, and potentially the ability to repay, of consumers taking out smaller loans with higher APRs, may be at least comparable to those of consumers taking out larger loans with lower APRs.

With respect to early delinquencies, the evidence summarized in Table 9 generally provides support for higher thresholds for smaller loans. Loans less than $65,939 had lower delinquency rates than loans between $65,939 and $109,897 across all rate spread ranges and had delinquency rates lower than or comparable to larger loans (equal to or greater than $109,898) priced between 1.5 and 2 percentage points above APOR. Loans between $65,939 and $109,897 had lower delinquency rates than larger loans between 2002 and 2008, but higher delinquency rates for 2018 loans.

More specifically, the Bureau analyzed NMDB data from 2002 through 2008 on first-lien conventional purchase loans and found that loans below $65,939 that were priced between 1.5 and 6.5 percentage points above APOR had an early delinquency rate of 6.5 percent. Loans equal to or greater than $65,939 but less than $109,898 that were priced between 1.5 and 3.5 percentage points above APOR had an early delinquency rate of 13 percent. Loans equal to or greater than $109,898 that were priced between 1.5 and 2 percentage points above APOR had an early delinquency rate of 14.9 percent. These rates suggest that the historical loan performance of smaller loans with higher APRs may be comparable, if not better, than larger loans with lower APRs.

However, the Bureau's analysis found that early delinquency rates for 2018 loans are somewhat higher for smaller loans with higher APRs than larger loans with lower APRs. More specifically, NMDB data from 2018 on first-lien conventional purchase loans show that loans below $65,939 that were priced between 1.5 and 6.5 percentage points above APOR had an early delinquency rate of 3.4 percent. Loans equal to or greater than $65,939 but less than $109,898 that were priced between 1.5 and 3.5 percentage points above APOR had an early delinquency rate of 4.3 percent. Loans equal to or greater than $109,898 that were priced between 1.5 and 2 percentage points above APOR had an early delinquency rate of 2.5 percent.

Although the current data do not appear to indicate a particular threshold at which the credit characteristics or loan performance for smaller loans with higher APRs decline significantly, the Bureau preliminarily concludes that the proposed thresholds in § 1026.43(e)(2)(vi)(B) and (C) for smaller, first-lien covered transactions would strike the right balance in delineating which loans should be eligible for a rebuttable presumption of compliance with the ATR requirements. The Bureau believes the proposed thresholds may help ensure that responsible, affordable credit remains available to consumers taking out smaller loans, in particular loans for manufactured housing and loans to minority consumers, while also helping to ensure that the risks are limited so that it would be appropriate for those loans to receive a rebuttable presumption of compliance with the ATR requirements.

The Bureau is proposing higher thresholds in § 1026.43(e)(2)(vi)(D) and (E) for subordinate-lien transactions because it is concerned that subordinate-lien transactions may be priced higher than comparable first-lien transactions for reasons other than consumers' ability to repay. In general, the creditor of a subordinate lien will recover its principal, in the event of default and foreclosure, only to the extent funds remain after the first-lien creditor recovers its principal. Thus, to compensate for this risk, creditors typically price subordinate-lien transactions higher than first-lien transactions, even though the consumer in the subordinate-lien transaction may have similar credit characteristics and ability to repay. In addition, subordinate-lien transactions are often for smaller loan amounts, so the pricing factors discussed above for smaller loan amounts may further increase the price of subordinate-lien transaction, regardless of the consumer's ability to repay. The Bureau is concerned that, to the extent the higher pricing for subordinate-lien transaction is not related to consumers' ability to repay, subordinate-lien transactions may be inappropriately excluded from QM status under § 1026.43(e)(2) if the pricing thresholds for subordinate-lien transactions are not increased.

In the January 2013 Final Rule, the Bureau adopted higher thresholds for determining when subordinate-lien QMs received a rebuttable presumption or a conclusive presumption of compliance with the ATR requirements. For subordinate-lien transactions, the definition of "higher-priced covered transaction" in § 1026.43(b)(4) is used in § 1026.43(e)(1) to set a threshold of 3.5 percentage points above APOR to determine which subordinate-lien QMs receive a safe harbor and which receive a rebuttable presumption of compliance. As discussed above in part V, the Bureau is not proposing to alter the threshold for subordinate-lien transactions in § 1026.43(b)(4). To avoid the odd result that a subordinate-lien transaction would otherwise be eligible to receive a safe harbor under § 1026.43(b)(4) and (e)(1) but would not be eligible for QM status under § 1026.43(e)(2)(vi), the Bureau considered which threshold or thresholds at or above 3.5 percentage points above APOR may be appropriate to propose for subordinate-lien transactions in § 1026.43(e)(2)(vi).

To develop the proposed thresholds for subordinate-lien transactions in § 1026.43(e)(2)(vi)(D) and (E), the Bureau considered evidence related to credit characteristics and loan performance for subordinate-lien transactions at various rate spreads and loan amounts (adjusted for inflation) using HMDA and Y-14M data, as shown in Table 10.

Table 10: Loan Characteristics and Performance for Different Sizes of Subordinate-Lien Transactions at Various Rate Spreads

Loan Size Group	**Rate Spread Range** (Percentage points over APOR)	**Mean CLTV**, 2018 HMDA	**Mean DTI**, 2018 HMDA	**Mean Credit Score**, 2018 HMDA	**Percent observed 90+ days delinquent within first 2 years**, 2013-2016 Y-14M data (subset)
Under $65,939	2.0 - 2.5	76.9	36.1	728	2.1%
Under $65,939	2.0 - 3.0	78.4	36.5	724	1.6%
Under $65,939	2.0 - 3.5	79.7	36.8	721	1.4%
Under $65,939	2.0 - 4.0	80.1	36.9	720	1.4%
Under $65,939	2.0 - 4.5	80.2	36.9	719	1.3%
Under $65,939	2.0 - 5.0	80.3	37.0	718	1.3%
Under $65,939	2.0 - 5.5	80.3	37.1	718	1.3%
Under $65,939	2.0 - 6.0	80.3	37.1	717	1.3%
Under $65,939	2.0 - 6.5	80.4	37.2	717	1.3%
Under $65,939	2.0 and above	80.7	37.3	715	1.4%
$65,939 and above	2.0 - 2.5	79.5	37.2	738	1.9%
$65,939 and above	2.0 - 3.0	80.5	37.3	735	1.7%
$65,939 and above	2.0 - 3.5	81.0	37.4	732	1.6%
$65,939 and above	2.0 - 4.0	81.3	37.5	732	1.7%
$65,939 and above	2.0 - 4.5	81.3	37.6	731	1.7%
$65,939 and above	2.0 - 5.0	81.5	37.7	731	1.8%
$65,939 and above	2.0 - 5.5	81.6	37.7	730	1.8%
$65,939 and above	2.0 - 6.0	81.6	37.8	729	1.8%
$65,939 and above	2.0 - 6.5	81.7	37.9	729	1.8%
$65,939 and above	2.0 and above	81.8	37.9	728	1.9%

In general, the Bureau's analysis found strong credit characteristics and loan performance for subordinate-lien loans at various thresholds above two percentage points above APOR. The current data do not appear to indicate a particular threshold at which the credit characteristics or loan performance decline significantly.

With respect to larger subordinate-lien transactions, the Bureau's analysis of 2018 HMDA data on subordinate-lien conventional loans found that, for consumers with subordinate-lien transactions greater than or equal to $65,939 that were priced 2 to 3.5 percentage points above APOR, the mean DTI ratio was 37.4 percent, the mean combined LTV was 81 percent, and the mean credit score was 732. The Bureau also analyzed Y-14M loan data for 2013 to 2016 and estimated that subordinate-lien transactions greater than or equal to $65,939 that were priced 2 to 3.5 percentage points above APOR had an early delinquency rate of approximately 1.6 percent.[273] These factors appear to provide a strong indication of ability to repay, so the Bureau preliminarily concludes that it may be appropriate to set the threshold at 3.5 percentage points above APOR for subordinate-lien transactions to be eligible for QM status under § 1026.43(e)(2). The Bureau recognizes that, because the proposed price-based approach would leave the threshold in § 1026.43(b)(4) for higher-priced QMs at 3.5 percentage points above APOR for subordinate-lien transactions (and that such transactions that are not higher priced would, therefore, receive a safe harbor under § 1026.43(e)(1)(i)), this approach, if adopted, would result in subordinate-lien transactions for amounts over $65,939 either being a safe harbor QM or not being eligible for QM status under § 1026.43(e)(2). No such loans would be eligible to be a rebuttable presumption QM. Nevertheless, the Bureau believes that the proposed threshold may appropriately balance the relatively strong credit characteristics and loan performance of these transactions historically, which is indicative of ability to repay, against the concern that the supporting data are limited to recent years with strong economic performance and conservative underwriting.

[273] The loan data were a subset of the supervisory loan-level data collected as part of the Board's Comprehensive Capital Analysis and Review, known as Y-14M data. The early delinquency rate measured the percentage of loans that were 90 or more days late in the first two years. The Bureau used loans with payments that were 90 or more days late to measure delinquency, rather than the 60 or more days used with the data discussed above for first-lien transactions, because the Y-14M data do not include a measure for payments 60 or more days late. Data from a small number of creditors were not included due to incompatible formatting.

For smaller subordinate-lien transactions, the Bureau's analysis of 2018 HMDA data on subordinate-lien conventional loans found that for consumers with subordinate-lien transactions less than $65,939 with that were priced between 2 and 6.5 percentage points above APOR, the mean DTI ratio was 37.2 percent, the mean combined LTV was 80.4 percent, and the mean credit score was 717. The Bureau also analyzed Y-14M loan data for 2013 to 2016 and estimated that subordinate-lien transactions less than $65,939 that were priced between 2 and 6.5 percentage points above APOR, the early delinquency rate was approximately 1.3 percent. Based on these relatively strong credit characteristics and low delinquency rates, the Bureau preliminarily concludes that it may be appropriate to set the threshold at 6.5 percentage points above APOR for subordinate-lien transactions less than $65,939 to be eligible for QM status under § 1026.43(e)(2). The Bureau notes that under this proposal, subordinate-lien transactions less than $65,939 priced greater than or equal to 3.5 but less than 6.5 percentage points above APOR would be eligible only for a rebuttable presumption of compliance under § 1026.43(e)(1)(ii) and that consumers, therefore, would have the opportunity to rebut the presumption under § 1026.43(e)(1)(ii)(B).

The Bureau requests comment, including data or other analysis, on whether the final rule in § 1026.43(e)(2)(vi)(B) through (C) should include different rate spread thresholds at which smaller loans would be considered General QM loans, and, if so, what those thresholds should be. Specifically, the Bureau requests comment on whether the General QM rate spread threshold for first-lien loans should be higher or lower than the rate spread ranges set forth in Table 9 for such loans with loan amounts less than $109,987 and greater than or equal to $65,939 and for such loans with loan amounts less than $65,939. For example, the Bureau solicits comments on whether a rate spread threshold of less than 6.5 percentage points above APOR for loan amounts less than $65,939 would strike a better balance between ability to repay and access to credit, in particular with respect to loans for manufactured housing and loans to minority borrowers. For commenters suggesting a different rate spread threshold, the Bureau requests commenters provide data or other analysis that would support providing General QM status to such loans taking into account concerns regarding the consumer's ability to repay and adverse effects on access to credit.

The Bureau also requests comment, including data or other analysis, on whether the final rule in § 1026.43(e)(2)(vi)(D) through (E) should include different rate spread thresholds at which subordinate-lien loans would be considered General QM loans, and, if so, what those thresholds should be. Specifically, the Bureau requests comment on whether the General QM rate spread threshold for subordinate-lien loans should be higher or lower than the rate spread ranges set forth in Table 10 for such loans with loan amounts greater than or equal to $65,939 and for such loans with loan amounts less than $65,939. For example, the Bureau solicits comments on whether a rate spread threshold of less than 6.5 percentage points above APOR for subordinate-lien loans with loan amounts less than $65,939 would strike a better balance between ability to repay and access to credit. For commenters suggesting a different rate spread threshold, the Bureau requests commenters provide data or other analysis that would support providing General QM status to such loans taking into account concerns regarding the consumer's ability to repay and adverse effects on access to credit.

The Bureau also requests comment, including data and other analysis, on whether the rule should include a DTI limit for smaller loans and subordinate-lien loans; for example, a DTI limit between 45 and 48 percent, instead of a pricing threshold or together with a pricing threshold, and, if so, what those limits should be. This includes comment on whether the approach to smaller loans and subordinate-lien loans should differ from the approach to other loans if the Bureau adopts one of the alternatives outlined in part V.E above.

Determining the APR for Certain Loans for which the Interest Rate May or Will Change

The Bureau is also proposing to revise § 1026.43(e)(2)(vi) to include a special rule for determining the APR for certain types of loans for purposes of whether a loan meets the General QM loan definition under § 1026.43(e)(2). This special rule would apply to loans for which the interest rate may or will change within the first five years after the date on which the first regular periodic payment will be due. For such loans, for purposes of determining whether the loan is a General QM loan under § 1026.43(e)(2)(vi), the creditor would be required to determine the APR by treating the maximum interest rate that may apply during that five-year period as the interest rate for the full term of the loan.[274] The special rule in the proposed revisions to § 1026.43(e)(2)(vi) would not modify other provisions in Regulation Z for determining the APR for other purposes, such as the disclosures addressed in or subject to the commentary to § 1026.17(c)(1).

The Bureau anticipates that the proposed price-based approach to defining General QM loans would in general be effective in identifying which loans consumers have the ability to repay and should therefore be eligible for QM status under § 1026.43(e)(2). However, the Bureau is concerned that, absent the special rule, the proposed price-based approach may less effectively capture specific unaffordability risks of certain loans for which the interest rate may or will change relatively soon after consummation. Therefore, for loans for which the interest

[274] As discussed above in the section-by-section analysis of proposed § 1026.43(b)(4), an identical special rule for determining the APR for certain loans for which the interest rate may or will change also would apply under that paragraph for purposes of determining whether a QM under § 1026.43(e)(2) is a higher-priced covered transaction.

rate may or will change within the first five years after the date on which the first regular periodic payment will be due, a modified approach to determining the APR for purposes of the rate-spread thresholds under proposed § 1026.43(e)(2) may be warranted.

Structure and pricing particular to ARMs. The special rule in proposed § 1026.43(e)(2)(vi) would apply principally to ARMs with initial fixed-rate periods of five years or less (referred to herein as "short-reset ARMs").[275] These loans may be affordable for the initial fixed-rate period but may become unaffordable relatively soon after consummation if the payments increase appreciably after reset, causing payment shock. The APR for short-reset ARMs may be less predictive of ability to repay than for fixed-rate mortgages because of how ARMs are structured and priced and how the APR for ARMs is determined under various provisions in Regulation Z. Several different provisions in Regulation Z address the calculation of the APR for ARMs. For disclosure purposes, if the initial interest rate is determined by the index or formula to make later interest rate adjustments, Regulation Z generally requires the creditor to base the APR disclosure on the initial interest rate at consummation and to not assume that the rate will increase during the remainder of the loan.[276] In some transactions, including many ARMs, the creditor may set an initial interest rate that is lower (or less commonly, higher) than the rate would be if it were determined by the index or formula used to make later interest

[275] In addition to short-reset ARMs, the proposed special rule would apply to step-rate mortgages that have an initial fixed-rate period of five years or less. The Bureau recognizes that the interest rates in step-rate mortgages are known at consummation. However, unlike fixed-rate mortgages and akin to ARMs, the interest rate of step-rate mortgages changes, thereby raising the concern that interest-rate increases relatively soon after consummation may present affordability risks due to higher loan payments. Moreover, applying the proposed APR determination requirement to such loans is consistent with the treatment of step-rate mortgages pursuant to the requirement in the current General QM loan definition to underwrite loans using the maximum interest rate during the first five years after the date on which the first regular periodic payment will be due. *See* comment 43(e)(2)(iv)-3.iii.

[276] *See* comment 17(c)(1)-8.

rate adjustments. For these ARMs, Regulation Z requires the creditor to disclose a composite APR based on the initial rate for as long as it is charged and, for the remainder of the term, on the fully indexed rate.[277] The fully indexed rate at consummation is the sum of the value of the index at the time of consummation plus the margin, based on the contract. The Dodd-Frank Act requires a different APR calculation for ARMs for the purpose of determining whether ARMs are subject to certain HOEPA requirements.[278] As implemented in § 1026.32(a)(3)(ii), the creditor is required to determine the APR for HOEPA coverage for transactions in which the interest rate may vary during the term of the loan in accordance with an index, such as with an ARM, by using the fully indexed rate or the introductory rate, whichever is greater.[279]

The requirements in Regulation Z for determining the APR for disclosure purposes and for HOEPA coverage purposes do not account for any potential increase or decrease in interest rates based on changes to the underlying index. If interest rates rise after consummation, and therefore the value of the index rises to a higher level, the loan can reset to a higher interest rate than the fully indexed rate at the time of consummation. The result would be a higher payment than the one implied by the rates used in determining the APR, and a higher effective rate spread (and increased likelihood of delinquency) than the spread that would be taken into account for determining General QM status at consummation under the price-based approach in the absence of a special rule.

ARMs may present more risk for consumers than fixed-rate mortgages, depending on the direction and magnitude of changes in interest rates. In the case of a 30-year fixed-rate loan,

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[277] *See* comment 17(c)(1)-10.

[278] *See* TILA section 103(bb)(1)(B)(ii).

[279] *See* comment 32(a)(3)-3.

creditors or mortgage investors assume both the credit risk and the interest-rate risk (*i.e.*, the risk that interest rates rise above the fixed rate the consumer is obligated to pay), and the price of the loan, which is fully captured by the APR, reflects both risks. In the case of an ARM, the creditor or investor is assuming the credit risk of the loan, but the consumer assumes most of the interest-rate risk, as the interest rate will adjust along with the market. The extent to which the consumer assumes the interest-rate risk is established by caps in the note on how high the interest rate charged to the consumer may rise. To compensate for the added interest-rate risk assumed by the consumer (as opposed to the investor), ARMs are generally priced lower—in absolute terms—than a 30-year fixed-rate mortgage with comparable credit risk.[280] Yet with rising interest rates, the risks that ARMs could become unaffordable, and therefore lead to delinquency or default, are more pronounced. As noted above, the requirements for determining the APR for ARMs in Regulation Z do not reflect this risk because they do not take into account potential increases in the interest rate over the term of the loan based on changes to the underlying index. This APR may therefore understate the risk that the loan may become unaffordable to the consumer if interest rates increase.

Unaffordability risk more acute for short-reset ARMs. While all ARMs run the risk of increases in interest rates and payments over time, longer-reset ARMs (*i.e.*, ARMs with initial fixed-rate periods of longer than five years) present a less acute risk of unaffordability than short-reset ARMs. Longer-reset ARMs permit consumers to take advantage of lower interest rates for more than five years and thus, akin to fixed-rate mortgages, provide consumers significant time to pay off or refinance, or to otherwise adjust to anticipated changes in payment

[280] The lower absolute pricing of ARMs with comparable credit risk is reflected in the lower ARM APOR, which is typically 50 to 150 basis points lower than the fixed-rate APOR.

during that relatively long period while the interest rate is fixed and before payments may increase.

Short-reset ARMs can also contribute to speculative lending because they permit creditors to originate loans that could be affordable in the short term, with the expectation that property values will increase and thereby permit consumers to refinance before payments may become unaffordable. Further, creditors can minimize their credit risk on such ARMs by, for example, requiring lower LTV ratios, as was common in the run-up to the 2008 financial crisis.[281] Additionally, creditors may be more willing to market these ARMs in areas of strong housing-price appreciation, irrespective of a consumer's ability to absorb the potentially higher payments after reset, because they may expect that consumers will have the equity to refinance if necessary.

In the Dodd-Frank Act, Congress addressed affordability concerns specific to short-reset ARMs and their eligibility for QM status by providing in TILA section 129C(b)(2)(A)(v) that, to receive QM status, ARMs must be underwritten using the maximum interest rate that may apply during the first five years.[282] The ATR/QM Rule implemented this requirement in Regulation Z at § 1026.43(e)(2)(iv). For many short-reset ARMs, this requirement resulted in a higher DTI that would have to be compared to the Rule's 43 percent DTI limit to determine whether the loans were eligible to receive General QM status. Particularly in a higher-rate environment in which short-reset ARMs could become more attractive, the five-year maximum interest-rate

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[281] Bureau analysis of NMDB data shows crisis-era short-reset ARMs had lower LTVs at consummation relative to comparably priced fixed-rate loans.

[282] This approach for ARMs is different from the approach in § 1026.43(c)(5) for underwriting ARMs under the ATR requirements, which, like the APR determination for HOEPA coverage for ARMs under § 1026.32(a)(3), is based on the greater of the fully indexed rate or the initial rate.

requirement combined with the Rule's 43 percent DTI limit would have likely prevented some of the riskiest short-reset ARMs (*i.e.*, those that adjust sharply upward in the first five years and cause payment shock) from obtaining General QM status. As discussed above, the proposed price-based approach would remove the DTI limit from the General QM loan definition in § 1026.43(e)(2)(vi). As a result, the Bureau is concerned that, without the special rule, a price-based approach may not adequately address the risk that consumers taking out short-reset ARMs may not have the ability to repay those loans but that such loans would nonetheless be eligible for General QM status under § 1026.43(e)(2).[283]

How the price-based approach would address affordability concerns. Bureau analysis of historical ARM pricing and performance indicates that the General QM product restrictions combined with the proposed price-based approach would have effectively excluded many—but not all—of the riskiest short-reset ARMs from obtaining General QM status. As a result, the Bureau believes an additional mechanism may be merited to exclude from the General QM loan definition any short-reset ARMs for which the pricing and structure indicate a risk of

[283] As discussed, the Bureau proposes to exercise its adjustment and revision authorities to amend § 1026.43(e)(2)(vi) to provide that, to determine the APR for short-reset ARMs for purposes of General QM status, the creditor must treat the maximum interest rate that may apply during that five-year period as the interest rate for the full term of the loan. The Bureau observes that the requirement in TILA section 129C(b)(2)(A)(v) to underwrite ARMs for QM purposes using the maximum interest rate that may apply during the first five years is at least ambiguous with respect to whether it independently obligates the creditor to determine the APR for short-reset ARMs in the same manner as the proposed special rule, at least where the Bureau relies on pricing thresholds as the primary indicator of likely repayment ability in the proposed General QM loan definition. Furthermore, the Bureau tentatively concludes that it would be reasonable, in light of the proposed definition of a General QM loan and in light of the policy concerns already described, to construe TILA section 129C(b)(2)(A)(v) as imposing the same obligations as the proposed special rule in § 1026.43(e)(2)(vi). Thus, in addition to relying on its adjustment and revision authorities to amend § 1026.43(e)(2)(vi), the Bureau tentatively concludes that it may do so under its general authority to interpret TILA in the course of prescribing regulations under TILA section 105(a) to carry out the purposes of TILA.

delinquency that is inconsistent with the presumption of compliance with ATR that comes with QM status.

Bureau analysis of NMDB data shows that short-reset ARMs originated from 2002 through 2008 had, on average, substantially higher early delinquency rates (14.9 percent) than other ARMs (10.1 percent) or fixed-rate mortgages (5.4 percent). Many of these short-reset ARMs were also substantially higher-priced relative to APOR and more likely to have product features that TILA and the Rule now prohibits for QMs, such as interest-only payments or negative amortization. When considering only loans without such restricted features and with rate spreads within 2 percentage points of APOR, short-reset ARMs still have the highest average early delinquency rate (5.5 percent), but the difference relative to other ARMs (4.3 percent) and fixed-rate mortgages (4.2 percent) is smaller. Many ARMs in the data during this period do not report the time between consummation and the first interest-rate reset, and so are excluded from this analysis.

While the data indicates that short-reset ARMs pose a greater risk of early delinquency than other ARMs and fixed-rate mortgages, the Bureau requests additional data or evidence comparing loan performance of short-reset ARMs, other ARMs, and fixed-rate mortgages. Moreover, as discussed above, the proposed special rule is designed to address the risk that, for consumers with short-reset ARMs, a rising-rate environment can lead to significantly higher payments and delinquencies in the first five years of the loan term. Therefore, the Bureau also requests data comparing the performance of such loans during periods of rising interest rates. The Bureau recognizes that rising rates may pose some risk of unaffordability for longer-reset ARMs later in the loan term. However, as discussed above, the Bureau is proposing the special rule to address the specific concern that short-reset ARMs pose a higher risk vis-a-vis other

ARMs of becoming unaffordable in the first five years, before consumers have sufficient time to refinance or adjust to the larger payments—a concern Congress also identified in the Dodd-Frank Act.

During the peak of the mid-2000s housing boom, ARMs accounted for as much as 52 percent of all new originations. In contrast, the current market share of ARMs is relatively small. Post-crisis, the ARM share had declined to 12 percent by December 2013 and to 2 percent by November 2019, only slightly above the historical low of 1 percent in 2009.[284] A number of factors contributed to the overall decline in ARM volume, particularly the low-interest-rate environment since the end of the financial crisis. Typically, ARMs are more popular when conventional interest rates are high, since the rate (and monthly payment) during the initial fixed period is typically lower than the rate of a comparable conventional fixed-rate mortgage.

Consistent with TILA section 129C(b)(2)(A), the January 2013 Final Rule prohibited ARMs with higher-risk features such as interest-only payments or negative amortization from receiving General QM status. According to the Assessment Report, short-reset ARMs comprised 17 percent of ARMs in 2012, prior to the January 2013 Final Rule, and fell to 12.3 percent in 2015, after the effective date of the Rule.[285] The Assessment Report also found that short-reset ARMs originated after the effective date of the Rule were restricted to highly creditworthy borrowers.[286]

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[284] Laurie Goodman *et. al*., Urban Inst., *Housing Finance at a Glance* (Feb. 2020), at 9, https://www.urban.org/research/publication/housing-finance-glance-monthly-chartbook-february-2020/view/full_report.

[285] Assessment Report, *supra* note 58, at 94 (fig. 25).

[286] *Id.* at 93-95.

This combination of factors post-crisis—the sharp drop in ARM originations and the restriction of such originations to highly creditworthy borrowers, as well as the prevalence of low interest rates—likely has muted the overall risks of short-reset ARMs. For example, the Assessment Report found that conventional, non-GSE short-reset ARMs originated after the effective date of the Rule had early delinquency rates of only 0.2 percent.[287] Thus, these recent originations may not accurately reflect the potential unaffordability of short-reset ARMs under different market conditions than those that currently prevail.

Proposed special rule for APR determination for short-reset ARMs.[288] Given the potential that rising interest rates could cause short-reset ARMs to become unaffordable for consumers following consummation and the fact that the price-based approach may not account for some of those risks because of how APRs are determined for ARMs, the Bureau is proposing a special rule to determine the APR for short-reset ARMs for purposes of defining General QM under § 1026.43(e)(2). As noted above, in defining QM in TILA, Congress adopted a special requirement to address affordability concerns for short-reset ARMs. Specifically, the statute provides that, for an ARM to be a QM, the underwriting must be based on the maximum interest rate permitted under the terms of the loan during the first five years. With the 43 percent DTI limit in the current rule, implementing the five-year underwriting requirement is straightforward: the rule requires a creditor to calculate DTI using the mortgage payment that results from the maximum possible interest rate that could apply during the first five years.[289] This ensures that

[287] *Id.* at 95 (fig. 26).

[288] As noted above, the proposed special rule would also apply to step-rate mortgages in which the interest rate changes in the first five years.

[289] 12 CFR 1026.43(e)(2)(iv).

the creditor calculates the DTI using the highest interest rate that the consumer may experience in the first five years, and the loan is not eligible for QM status under § 1026.43(e)(2) if the DTI calculated using that interest rate exceeds 43 percent. The Bureau is concerned that using the fully indexed rate to determine the APR for purposes of the rate spread thresholds in proposed § 1026.43(e)(2)(vi) would not provide a sufficiently meaningful safeguard against the elevated likelihood of delinquency for short-reset ARMs. For that reason, the Bureau is proposing the special rule for determining the APR for such loans.

The Bureau believes the statutory five-year underwriting requirement provides a basis for the special rule for determining the APR for short-reset ARMs for purposes of General QM rate-spread thresholds under § 1026.43(e)(2). Specifically, the Bureau is proposing that the creditor must determine the APR by treating the maximum interest rate that may apply during the first five years, as described in proposed § 1026.43(e)(2)(vi), as the interest rate for the full term of the loan. That APR determination would then be compared to the APOR[290] to determine General QM status. This approach would address in a targeted manner the primary concern about short-reset ARMs—payment shock—by accounting for the risk of delinquency and default associated with payment increases under these loans. And it would do so in a manner that is consistent with the five-year framework embedded in the statutory provision for such ARMs and implemented in the current rule.

In sum, the proposed special rule is consistent with both the statutory mandate for short-reset ARMs and the proposed price-based approach. As discussed above in part V, the rate

[290] This refers to the standard APOR for ARMs. The proposed requirement would modify the determination for the APR of ARMs but would not affect the determination of the APOR. The Bureau notes that the APOR used for step-rate mortgages would be the ARM APOR because, as with ARMs, the interest rate in step-rate mortgages adjusts and is not fixed. Thus, the APOR for fixed-rate mortgages would be inapt.

spread of APR over APOR is strongly correlated with early delinquency rates. As a result, such rate spreads may generally serve as an effective proxy for a consumer's ability to repay. However, the structure and pricing of ARMs can result in early interest rate increases that are not fully accounted for in Regulation Z provisions for determining the APR for ARMs. Such increases would diminish the effectiveness of the rate spread as a proxy, and lead to heightened risk of early delinquency for short-reset ARMs relative to other loans with comparable APRs over APOR rate spreads. The proposed special rule, by requiring creditors to more fully incorporate this interest-rate risk in determining the APR for short-reset ARMs, would help ensure that the resulting pricing would account for that risk for such loans.

The proposed special rule would require that the maximum interest rate in the first five years be treated as the interest rate for the full term of the loan to determine the APR. The Bureau is concerned that a composite APR determination based on the maximum interest rate in the first five years and the fully indexed rate for the remaining loan term could understate the APR for short-reset ARMs by failing to sufficiently account for the risk that consumers with such loans could face payment shock early in the loan term. Accordingly, to account for that risk, and due to concerns about whether it would be appropriate to presume ATR for short-reset ARMs without such a safeguard, the Bureau is proposing that the APR for short-reset ARMs be based on the maximum interest rate during the first five years.

The Bureau considered several alternatives to the proposed special rule for certain loans for which the interest rate may or will change within the first five years after the date on which the first regular periodic payment will due. In response to the ANPR, several consumer advocates submitted comments suggesting prohibiting altogether short-reset ARMs from consideration as General QMs. These commenters pointed to the high default and foreclosure rates of such ARMs, the complex nature of the product, and consumers' insufficient comprehension of the product as justification to deny General QM status for ARMs with a fixed-rate period of less than five years. The Bureau believes the risks associated with short-reset ARMs can be effectively managed without prohibiting them from receiving General QM status, given that the Dodd-Frank Act explicitly permits short-reset ARMs to be considered as General QMs and includes a specific provision for addressing the potential for payment shock from such loans.

One of the above-referenced commenters alternatively recommended the Bureau impose specific limits on annual adjustments for short-reset ARMs. The Bureau considered this and similar alternatives, including applying a different rate spread over APOR for short-reset ARMs. The Bureau anticipates that the proposed approach would address in a more streamlined and targeted manner the core problem, *i.e.*, that short-reset ARMs could reset to significantly higher interest rates shortly after consummation resulting in a risk of default from unaffordable payments not adequately reflected under the standard determination of APR for ARMs. Further, the Bureau believes that including different rate spreads or similar schemes for short-reset ARMs and additional subtypes of loans would impose unnecessary operational and compliance complexity.

Proposed comment 43(e)(2)(vi)-4.i explains that provisions in subpart C, including the existing commentary to § 1026.17(c)(1), address the determination of the APR disclosures for closed-end credit transactions and that provisions in § 1026.32(a)(3) address how to determine the APR to determine coverage under § 1026.32(a)(1)(i). It further explains that proposed § 1026.43(e)(2)(vi) requires, for the purposes of that paragraph, a different determination of the APR for a QM under proposed § 1026.43(e)(2) for which the interest rate may or will change within the first five years after the date on which the first regular periodic payment will be due. In addition, proposed comment 43(e)(2)(vi)-4.i explains that an identical special rule for determining the APR for such a loan also applies for purposes of proposed § 1026.43(b)(4).

Proposed comment 43(e)(2)(vi)-4.ii explains the application of the special rule in proposed § 1026.43(e)(2)(vi) for determining the APR for a loan for which the interest rate may or will change within the first five years after the date on which the first regular periodic payment will be due. Specifically, it explains that the special rule applies to ARMs that have a fixed-rate period of five years or less and to step-rate mortgages for which the interest rate changes within that five-year period.

Proposed comment 43(e)(2)(vi)-4.iii explains that, to determine the APR for purposes of proposed 43(e)(2)(vi), a creditor must treat the maximum interest rate that could apply at any time during the five-year period after the date on which the first regular periodic payment will be due as the interest rate for the full term of the loan, regardless of whether the maximum interest rate is reached at the first or subsequent adjustment during the five-year period. Further, the proposed comment cross-references existing comments 43(e)(2)(iv)-3 and -4 for additional instruction on how to determine the maximum interest rate during the first five years after the date on which the first regular periodic payment will be due.

Proposed comment 43(e)(2)(vi)-4.iv explains how to use the maximum interest rate to determine the APR for purposes of proposed § 1026.43(e)(2)(vi). Specifically, the proposed comment explains that the creditor must determine the APR by treating the maximum interest rate described in proposed § 1026.43(e)(2)(vi) as the interest rate for the full term of the loan. It further provides an example of how to determine the APR by treating the maximum interest rate as the interest rate for the full term of the loan.

As discussed above in part IV, TILA section 105(a), directs the Bureau to prescribe regulations to carry out the purposes of TILA, and provides that such regulations may contain additional requirements, classifications, differentiations, or other provisions, and may provide for such adjustments and exceptions for all or any class of transactions that the Bureau judges are necessary or proper to effectuate the purposes of TILA, to prevent circumvention or evasion thereof, or to facilitate compliance therewith. In particular, a purpose of TILA section 129C, as amended by the Dodd-Frank Act, to assure that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay the loans.

As also discussed above in part IV, TILA section 129C(b)(3)(B)(i) authorizes the Bureau to prescribe regulations that revise, add to, or subtract from the criteria that define a QM upon a finding that such regulations are necessary or proper to ensure that responsible, affordable mortgage credit remains available to consumers in a manner consistent with the purposes of section 129C, necessary and appropriate to effectuate the purposes of section 129C and section 129B, to prevent circumvention or evasion thereof, or to facilitate compliance with such section.

The Bureau is proposing the special rule in § 1026.43(e)(2)(vi) regarding the APR determination of certain loans for which the interest rate may or will change pursuant to its authority under TILA section 105(a) to make such adjustments and exceptions as are necessary and proper to effectuate the purposes of TILA, including that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay the loans. The Bureau believes that these proposed provisions may ensure that General QM status would not be accorded to short-reset ARMs and certain other loans that pose a heightened risk of becoming unaffordable relatively soon after consummation. The Bureau is also proposing these provisions pursuant to its authority under TILA section 129C(b)(3)(B)(i) to revise and add to the criteria that define a QM. The Bureau believes that the proposed APR determination provisions in § 1026.43(e)(2)(vi) may ensure that responsible, affordable mortgage credit remains available to consumers in a manner consistent with the purpose of TILA section 129C, referenced above, as well as effectuate that purpose.

The Bureau requests comment on all aspects of the proposed special rule in proposed § 1026.43(e)(2)(vi). In particular, the Bureau requests data regarding short-reset ARMs and those step-rate mortgages that would be subject to the proposed special rule, including default and delinquency rates and the relationship of those rates to price. The Bureau also requests comment on alternative approaches for such loans, including the ones discussed above, such as imposing specific limits on annual rate adjustments for short-reset ARMs, applying a different rate spread, and excluding such loans from General QM eligibility altogether.

43(e)(4)

TILA section 129C(b)(3)(B)(ii) directs HUD, VA, USDA, and the Rural Housing Service (RHS) to prescribe rules defining the types of loans they insure, guarantee, or administer, as the case may be, that are QMs. Pending the other agencies' implementation of this provision, the Bureau included in the ATR/QM Rule a temporary category of QM loans in the special rules in § 1026.43(e)(4)(ii)(B) through (E) consisting of mortgages eligible to be insured or guaranteed (as applicable) by HUD, VA, USDA, and RHS. The Bureau also created the Temporary GSE QM loan definition, in § 1026.43(e)(4)(ii)(A).

Section 1026.43(e)(4)(i) states that, notwithstanding § 1026.43(e)(2), a QM is a covered transaction that satisfies the requirements of § 1026.43(e)(2)(i) through (iii)—the General QM loan-feature prohibitions and points-and-fees limits—as well as one or more of the criteria in § 1026.43(e)(4)(ii). Section 1026.43(e)(4)(ii) states that a QM under § 1026.43(e)(4) must be a loan that is eligible under enumerated "special rules" to be (A) purchased or guaranteed by the GSEs while under the conservatorship of the FHFA (the Temporary GSE QM loan definition), (B) insured by HUD under the National Housing Act, (C) guaranteed by VA, (D) guaranteed by USDA pursuant to 42 U.S.C. 1472(h), or (E) insured by RHS. Section 1026.43(e)(4)(iii)(A) states that § 1026.43(e)(4)(ii)(B) through (E) shall expire on the effective date of a rule issued by each respective agency pursuant to its authority under TILA section 129C(b)(3)(ii) to define a QM. Section 1026.43(e)(4)(iii)(B) states that, unless otherwise expired under § 1026.43(e)(4)(iii)(A), the special rules in § 1026.43(e)(4) are available only for covered transactions consummated on or before January 10, 2021.

The Bureau proposes to amend § 1026.43(e)(4) to state that, notwithstanding § 1026.43(e)(2), a QM is a covered transaction that is defined as a QM by HUD under 24 CFR 201.7 or 24 CFR 203.19, VA under 38 CFR 36.4300 or 38 CFR 36.4500, or USDA under 7 CFR 3555.109. There are two reasons for this proposed amendment.

First, if the Bureau issues a final rule in connection with this present proposal, the Bureau anticipates that the Temporary GSE QM loan definition described in § 1026.43(e)(4)(ii)(A) may expire upon the effective date of such a final rule. This is because, in a separate proposed rule released simultaneously with this proposal, the Bureau proposes to revise § 1026.43(e)(4)(iii)(B) to state that, unless otherwise expired under § 1026.43(e)(4)(iii)(A), the special rules in § 1026.43(e)(4) are available only for covered transactions consummated on or before the effective date of a final rule issued by the Bureau amending the General QM loan definition. The Bureau may issue a final rule concerning its proposal to extend the sunset date in § 1026.43(e)(4)(iii)(B) before it issues a final rule concerning this present proposal (which would amend the General QM loan definition). Thus, if the Bureau issues a final rule in connection with this present proposal, such a final rule would remove the Temporary GSE QM loan definition from § 1026.43(e)(4)(ii)(A).

Second, after promulgation of the January 2013 Final Rule, each of the agencies described in § 1026.43(e)(4)(ii)(B) through (E) adopted separate definitions of qualified mortgages.[291] Under current § 1026.43(e)(4)(iii)(A), the special rules in § 1026.43(e)(4)(ii)(B) through (E) are already superseded by the actions of HUD, VA, and USDA. The Bureau proposes to amend § 1026.43(e)(4) to provide cross-references to each of these other agencies' definitions so that creditors and practitioners have a single point of reference for all QM definitions.

The Bureau also proposes to amend comment 43(e)(4)-1 to reflect the cross-references to the QM definitions of other agencies and to clarify that a covered transaction that meets another agency's definition is a QM for purposes of § 1026.43(e). Comment 43(e)(4)-2 would be amended to clarify that covered transactions that met the requirements of § 1026.43(e)(2)(i) through (iii), were eligible for purchase or guarantee by Fannie Mae or Freddie Mac, and were consummated prior to the effective date of any final rule promulgated as a result of the proposal would still be considered a QM for purposes of § 1026.43(e) after the adoption of such potential final rule. Comments 43(e)(4)-3, -4, and -5 would be amended to indicate that such comments are reserved for future use. The Bureau requests comment on the proposed amendments to § 1026.43(e)(4) and related commentary.

[291] 78 FR 75215 (Dec. 11, 2013) (HUD); 79 FR 26620 (May 9, 2014) and 83 FR 50506 (Oct. 9, 2018) (VA); and 81 FR 26461 (May 3, 2016) (USDA).

Conforming Changes

As discussed above, the Bureau is proposing revisions to § 1026.43(e)(2)(v) and (e)(2)(vi) that would, among other things, remove references to appendix Q and remove the DTI ratio limit in § 1026.43(e)(2)(vi). The Bureau is also proposing to remove appendix Q. Accordingly, the Bureau is proposing nonsubstantive conforming changes in certain provisions to reflect the proposed changes to § 1026.43(e)(2)(v) and (e)(2)(vi) and the proposed removal of appendix Q. Specifically, the Bureau proposes to update comment 43(c)(7)-1 by removing the reference to the DTI limit in § 1026.43(e). The Bureau also proposes conforming changes to provisions related to small creditor QMs in § 1026.43(e)(5)(i) and to balloon-payment QMs in § 1026.43(f)(1). Both § 1026.43(e)(5) and (f)(1) provide that as part of the respective QM definitions, loans must comply with the requirements to consider and verify debts and income in existing § 1026.43(e)(2)(v). As discussed above, the Bureau is proposing to reorganize and revise § 1026.43(e)(2)(v) in order to provide that creditors must consider DTI or residual income and to clarify the requirements for creditors to consider and verify income, debt and other information. The proposed conforming changes to § 1026.43(e)(5) and (f)(1) would generally insert the substantive requirements of existing § 1026.43(e)(2)(v) into § 1026.43(e)(5)(i) and (f)(1), respectively, and would provide that loans under § 1026.43(e)(5) and § 1026.43(f) do not have to comply with proposed § 1026.43(e)(2)(v) or (e)(2)(vi). The proposed conforming changes would not insert the requirement that lenders consider and verify income, debt, and other information in accordance with appendix Q because, as described elsewhere in this proposal, the Bureau is proposing to remove appendix Q from Regulation Z. The Bureau is also proposing conforming changes to the related commentary.

Appendix Q to Part 1026—Standards for Determining Monthly Debt and Income

Appendix Q to part 1026 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. As explained in the section-by-section analysis of § 1026.43(e)(2)(v)(B) above, the Bureau proposes to remove appendix Q entirely in light of concerns from creditors and investors that its perceived rigidity, ambiguity, and static nature result in standards that are both confusing and outdated. As noted above, the Bureau seeks comment on its proposal to remove appendix Q entirely and not to retain it as an option for creditors to verify the consumer's income, assets, debt obligations, alimony, and child support.

VII. Dodd-Frank Act Section 1022(b) Analysis

A. Overview

As discussed above, this proposal would amend the General QM loan definition to, among other things, remove the specific DTI limit and add a pricing threshold. In developing this proposal, the Bureau has considered the potential benefits, costs, and impacts as required by section 1022(b)(2)(A) of the Dodd-Frank Act. Specifically, section 1022(b)(2)(A) of the Dodd-Frank Act requires the Bureau to consider the potential benefits and costs of a regulation to consumers and covered persons, including the potential reduction of access by consumers to consumer financial products or services, the impact on depository institutions and credit unions with $10 billion or less in total assets as described in section 1026 of the Dodd-Frank Act, and the impact on consumers in rural areas. The Bureau consulted with appropriate prudential regulators and other Federal agencies regarding the consistency of the proposed rule with prudential, market, or systemic objectives administered by such agencies as required by section 1022(b)(2)(B) of the Dodd-Frank Act. The Bureau requests comment on the preliminary analysis presented below as well as submissions of additional data that could inform the Bureau's analysis of the benefits, costs, and impacts.

1. Data and evidence

The discussion in these impact analyses relies on data from a range of sources. These include data collected or developed by the Bureau, including HMDA[292] and NMDB[293] data, as well as data obtained from industry, other regulatory agencies, and other publicly available sources. The Bureau also conducted the Assessment and issued the Assessment Report as required under section 1022(d) of the Dodd-Frank Act. The Assessment Report provides quantitative and qualitative information on questions relevant to the proposed rule, including the extent to which DTI ratios are probative of a consumer's ability to repay, the effect of rebuttable presumption status relative to safe harbor status on access to credit, and the effect of QM status relative to non-QM status on access to credit. Consultations with other regulatory agencies, industry, and research organizations inform the Bureau's impact analyses.

The data the Bureau relied upon provide detailed information on the number, characteristics, pricing, and performance of mortgage loans originated in recent years. However, it would be useful to supplement these data with more information relevant to pricing and APR

[292] HMDA requires many financial institutions to maintain, report, and publicly disclose loan-level information about mortgages. These data help show whether creditors are serving the housing needs of their communities; they give public officials information that helps them make decisions and policies; and they shed light on lending patterns that could be discriminatory. HMDA was originally enacted by Congress in 1975 and is implemented by Regulation C. *See* Bureau of Consumer Fin. Prot., https://www.consumerfinance.gov/data-research/hmda/.

[293] The NMDB, jointly developed by the FHFA and the Bureau, provides de-identified loan characteristics and performance information for a five 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 HMDA data are attributable to differences in coverage and data construction methodology.

calculations (particularly PMI costs) for originations before 2018. PMI costs are an important component of APRs, particularly for loans with smaller down payments, and thus should be included or estimated in calculations of rate spreads relative to APOR. The Bureau seeks additional information or data which could inform quantitative estimates of PMI costs or APRs for these loans.

The data also do not provide information on creditor costs. As a result, analyses of any impacts of the proposal on creditor costs, particularly realized costs of complying with underwriting criteria or potential costs from legal liability, are based on more qualitative information. Similarly, estimates of any changes in burden on consumers resulting from increased or decreased verification requirements are based on qualitative information.

The Bureau seeks additional information or data which could inform quantitative estimates of the number of borrowers whose documentation cannot satisfy appendix Q, or the costs to borrowers or covered persons of complying with appendix Q verification requirements (or the potential costs of complying with appendix Q for Temporary GSE QM loans) or the proposed verification requirements. The Bureau also seeks comment or additional information which could inform quantitative estimates of the availability, underwriting, and pricing of non-QM alternatives to loans made under the Temporary GSE QM loan definition.

2. *Description of the baseline*

The Bureau considers the benefits, costs, and impacts of the proposal against the baseline in which the Bureau takes no action and the Temporary GSE QM loan definition expires on January 10, 2021, or when the GSEs exit conservatorship, whichever occurs first. Under the proposal, the amendments to the General QM loan definition would take effect either at the time or after the Temporary GSE QM loan definition expires, depending on whether the GSEs remain in conservatorship on the effective date of a final rule issued by the Bureau amending the General QM loan definition. As a result, the proposal's direct market impacts are considered relative to a baseline in which the Temporary GSE QM has expired and no changes have been made to the General QM loan definition. Unless described otherwise, estimated loan counts under the baseline, proposal, and alternatives are annual estimates.

Under the baseline, conventional loans could receive QM status under the Bureau's rules only by underwriting according to the General QM requirements, Small Creditor QM requirements, Balloon Payment QM requirements, or the expanded portfolio QM amendments created by the 2018 Economic Growth, Regulatory Relief, and Consumer Protection Act. The General QM loan definition, which would be the only type of QM available to larger creditors for conventional loans, requires that consumers' DTI ratio not exceed 43 percent and requires creditors to determine debt and income in accordance with the standards in appendix Q.

The Bureau anticipates that there are two main types of conventional loans that would be affected by the expiration of the Temporary GSE QM loan definition: High-DTI GSE loans (those with DTI ratios above 43 percent) and GSE-eligible loans without appendix Q-required documentation. These loans are currently originated as QM loans due to the Temporary GSE QM loan definition but may not be originated as General QM loans, or may not be originated at all, without the proposed amendments to the General QM loan definition. This section 1022 analysis refers to these loans as potentially displaced loans.

High-DTI GSE Loans. The ANPR provided an estimate of the number of loans potentially affected by the expiration of the Temporary GSE QM loan definition.[294] In providing

[294] 84 FR 37155, 37158-59 (July 31, 2019).

the estimate, the ANPR focused on loans that fall within the Temporary GSE QM loan definition but not the General QM loan definition because they have a DTI ratio above 43 percent. This proposal refers to these loans as High-DTI GSE loans. Based on NMDB data, the Bureau estimated that there were approximately 6.01 million closed-end first-lien residential mortgage originations in the United States in 2018.[295] Based on supplemental data provided by the FHFA, the Bureau estimated that the GSEs purchased or guaranteed 52 percent—roughly 3.12 million—of those loans.[296] Of those 3.12 million loans, the Bureau estimated that 31 percent—approximately 957,000 loans—had DTI ratios greater than 43 percent.[297] Thus, the Bureau estimated 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—were High-DTI GSE loans.[298] This estimate does not include Temporary GSE QM loans that were eligible for purchase by the GSEs but were not sold to the GSEs.

Loans Without Appendix Q-Required Documentation That Are Otherwise GSE-Eligible. In addition to High-DTI GSE loans, the Bureau noted that an additional, smaller number of Temporary GSE QM loans with DTI ratios of 43 percent or less, when calculated using GSE underwriting guides, may not fall within the General QM loan definition because their method of

[295] 84 FR at 37158-59.

[296] *Id.* at 37159.

[297] *Id.* 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.

[298] *Id.* at 37159.

verifying income or debt is incompatible with appendix Q.[299] These loans would also likely be affected when the Temporary GSE QM loan definition expires. The Bureau understands, from extensive public feedback and its own experience, that appendix Q does not specifically address whether and how to verify certain forms of income. The Bureau understands these concerns are particularly acute for self-employed consumers, consumers with part-time employment, and consumers with irregular or unusual income streams.[300] As a result, these consumers' access to credit may be affected if the Temporary GSE QM loan definition were to expire without amendments to the General QM loan definition.

The Bureau's analysis of the market under the baseline focuses on High-DTI GSE loans because the Bureau estimates that most potentially displaced loans are High-DTI GSE loans. The Bureau also lacks the loan-level documentation and underwriting data necessary to estimate with precision the number of potentially displaced loans that do not fall within the other General QM loan requirements and are not High-DTI GSE loans. However, the Assessment did not find evidence of substantial numbers of loans in the non-GSE-eligible jumbo market being displaced when appendix Q verification requirements became effective in 2014.[301] Further, the Assessment Report found evidence of only a limited reduction in the approval rate of self-

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[299] *Id.* at 37159 n.58. Where these types of loans have DTI ratios above 43 percent, they would be captured in the estimate above relating to High-DTI GSE loans.

[300] For example, in qualitative responses to the Bureau's Lender Survey conducted as part of the Assessment, underwriting for self-employed borrowers was one of the most frequently reported sources of difficulty in originating mortgages using appendix Q. These concerns were also raised in comments submitted in response to the Assessment RFI, noting that appendix Q is ambiguous with respect to how to treat income for consumers who are self-employed, have irregular income, or want to use asset depletion as income. *See* Assessment Report, *supra* note 58, at 200.

[301] *Id.* at 107 ("For context, total jumbo purchase originations increased from an estimated 108,700 to 130,200 between 2013 and 2014, based on nationally representative NMDB data.").

employed applicants for non-GSE eligible mortgages.[302] Based on this evidence, along with qualitative comparisons of GSE and appendix Q verification requirements and available data on the prevalence of borrowers with non-traditional or difficult-to-document income (*e.g.*, self-employed borrowers, retired borrowers, those with irregular income streams), the Bureau estimates this second category of potentially displaced loans is considerably less numerous than the category of High-DTI GSE loans.

Additional Effects on Loans Not Displaced. While the most significant market effects under the baseline are displaced loans, loans that continue to be originated as QM loans after the expiration of the Temporary GSE QM loan definition would also be affected. After the expiration date, all loans with DTI ratios at or below 43 percent which are or would have been purchased and guaranteed as GSE loans under the Temporary GSE QM loan definition—approximately 2.16 million loans in 2018—and that continue to be originated as General QM loans after the provision expires would be required to verify income and debts according to appendix Q, rather than only according to GSE guidelines. Given the concerns raised about appendix Q's ambiguity and lack of flexibility, this would likely entail both increased documentation burden for some consumers as well as increased costs or time-to-origination for creditors on some loans.[303]

[302] *Id.* at 118 ("The Application Data indicates that, notwithstanding concerns that have been expressed about the challenge of documenting and verifying income for self-employed borrowers under the General QM standard and the documentation requirements contained in appendix Q to the Rule, approval rates for non-High DTI, non-GSE eligible self-employed borrowers have decreased only slightly, by two percentage points….").

[303] *See* part V.B. for additional discussion of concerns raised about appendix Q.

B. Potential Benefits and Costs to Covered Persons and Consumers

1. *Benefits to consumers*

The primary benefit to consumers of the proposal is increased access to credit, largely through the expanded availability of High-DTI conventional QM loans. Given the large number of consumers who obtain High-DTI GSE loans rather than available alternatives, including loans from the private non-QM market and FHA loans, such High-DTI conventional QM loans may be preferred due to their pricing, underwriting requirements, or other features. Based on HMDA data, the Bureau estimates that 943,000 High-DTI conventional loans in 2018 would fall outside the QM definitions under the baseline, but fall within the proposal's amended General QM loan definition.[304] In addition, some consumers who would have been limited in the amount they could borrow due to the DTI limit under the baseline would likely be able to obtain larger mortgages at higher DTI levels.

Under the baseline, a sizeable share of potentially displaced High-DTI GSE loans may instead be originated as FHA loans. Thus, under the proposal, any price advantage of GSE or other conventional QM loans over FHA loans would be a realized benefit to consumers. Based on the Bureau's analysis of 2018 HMDA data, FHA loans comparable to the loans received by High-DTI GSE borrowers, based on loan purpose, credit score, and combined LTV ratio, on average have \$3,000 to \$5,000 higher upfront total loan costs at origination. APRs provide an alternative, annualized measure of costs over the life of a loan. FHA borrowers typically pay different APRs, which can be higher or lower than APRs for GSE loans depending on a borrower's credit score and LTV. Borrowers with credit scores at or above 720 pay an APR 30

[304] This estimate includes only HMDA loans which have a reported DTI and rate spread over APOR, and thus may underestimate the true number of loans gaining QM status under the proposal.

to 60 basis points higher than borrowers of comparable GSE loans, leading to higher monthly payments over the life of the loan. However, FHA borrowers with credit scores below 680 and combined LTVs exceeding 85 percent pay an APR 20 to 40 basis points lower than borrowers of comparable GSE loans, leading to lower monthly payments over the life of the loan.[305] For a loan size of $250,000, these APR differences amount to $2,800 to $5,600 in additional total monthly payments over the first five years of mortgage payments for borrowers with credit scores above 720, and $1,900 to $3,800 in reduced total monthly payments over five years for borrowers with credit scores below 680 and LTVs exceeding 85 percent.[306] Thus, all FHA borrowers are likely to pay higher costs at origination, while some pay higher monthly mortgage payments, and others pay lower monthly mortgage payments. Assuming for comparison that all 943,000 additional loans falling within the amended General QM loan definition would be made as FHA loans in the absence of the proposal, the average of the upfront pricing estimates implies total savings for consumers of roughly $4 billion per year on upfront costs.[307] The total savings or costs over the life of the loan implied by APR differences would vary substantially across borrowers depending on credit scores, LTVs, and length of time holding the mortgage. While this comparison assumed all potentially displaced loans would be made as FHA loans, higher

[305] The Bureau expects consumers could continue to obtain FHA loans where such loans were cheaper or preferred for other reasons.

[306] Based on NMDB data, the Bureau estimates that the average loan amount among High-DTI GSE borrowers in 2018 was $250,000. While the time to repayment for mortgages varies with economic conditions, the Bureau estimates that half of mortgages are typically closed or paid off five to seven years into repayment. Payment comparisons based on typical 2018 HMDA APRs for GSE loans, 5 percent for borrowers with credit scores over 720, and 6 percent for borrowers with credit scores below 680 and LTVs exceeding 85.

[307] This approximation assumes $4,000 in savings from total loan costs for all 943,000 consumers. Actual expected savings would vary substantially based on loan and credit characteristics, consumer choices, and market conditions.

costs (either upfront or in monthly payments) are likely to prevent some borrowers from obtaining loans at all.

In the absence of the proposed amendment to the regulation, some of these potentially displaced consumers, particularly those with higher credit scores and the resources to make larger down payments, likely would be able to obtain credit in the non-GSE private market at a cost comparable to or slightly higher than the costs for GSE loans, but below the cost of an FHA loan. As a result, the above cost comparisons between GSE and FHA loans provide an estimated upper bound on pricing benefits to consumers of the proposal. However, under the baseline, some potentially displaced consumers may not obtain loans, and thus would experience benefits of credit access under the proposal. As discussed above, the Assessment Report found that the January 2013 Final Rule eliminated between 63 and 70 percent of high-DTI home purchase loans that were not Temporary GSE QM loans.[308] The Bureau requests information or data which would inform quantitative estimates of the number of consumers who may not obtain loans and the costs to such consumers.

The proposal would also benefit those consumers with incomes difficult to verify using appendix Q to obtain General QM status, as the proposed General QM amendments would no longer require the use of appendix Q for verification of income. Under the proposal—as under the current rule—creditors would be required to verify income and assets in accordance with § 1026.43(c)(4) and debt obligations, alimony, and child support in accordance with § 1026.43(c)(3). The proposal would also state that a creditor complies with the General QM requirement to verify income, assets, debt obligations, alimony, and child support where it

[308] *See* Assessment Report *supra* note 58, at 10-11, 117, 131-47.

complies with verification requirements in standards the Bureau specifies. The greater flexibility of verification standards allowed under the proposal is likely to reduce effort and costs for these consumers, and in the most difficult cases in which consumers' documentation cannot satisfy appendix Q, the proposal may allow consumers to obtain General QM loans rather than potential FHA or non-QM alternatives. These consumers—likely including self-employed borrowers and those with non-traditional forms of income—would likely benefit from cost savings under the proposal, similar to those for High-DTI consumers discussed above.

Finally, as noted below under "Costs to consumers," the Bureau estimates that 28,000 low-DTI conventional loans which are QM under the baseline would fall outside the amended QM definition under the proposal, due to exceeding the pricing thresholds in proposed § 1026.43(e)(2)(vi). If consumers of such loans are able to obtain non-QM loans with the amended General QM loan definition in place, they would gain the benefit of the ability-to-repay causes of action and defenses against foreclosure. However, some of these consumers may instead obtain FHA loans with QM status.

2. *Benefits to covered persons*

The proposal's primary benefit to covered persons, specifically mortgage creditors, is the expanded profits from originating High-DTI conventional QM loans. Under the baseline, creditors would be unable to originate such loans under the Temporary GSE QM loan definition and would instead have to originate loans with comparable DTI ratios as FHA, Small Creditor QM, or non-QM loans, or originate at lower DTI ratios as conventional General QM loans. Creditors' current preference for originating large numbers of High-DTI Temporary GSE QMs likely reflects advantages in a combination of costs or guarantee fees (particularly relative to FHA loans), liquidity (particularly relative to Small Creditor QM), or litigation and credit risk (particularly relative to non-QM). Moreover, QM loans—including Temporary GSE QMs—are exempt from the Dodd-Frank Act risk retention requirement whereby creditors that securitize mortgage loans are required to retain at least five percent of the credit risk of the security, which adds significant cost. As a result, the proposal conveys benefits to mortgage creditors originating High-DTI conventional QMs on each of these dimensions.

In addition, for those lower-DTI GSE loans which could satisfy General QM requirements, creditors may realize cost savings from underwriting loans using the more flexible verification standards allowed under the proposal compared with using appendix Q. Under the proposal, creditors would be required to consider DTI or residual income in addition to income and debt but would not need to comply with the appendix Q standards required for General QM loans under the baseline. For conventional consumers unable to provide documentation compatible with appendix Q, the proposal may allow such loans to continue receiving QM status, providing comparable benefits to creditors as described for High-DTI GSE loans above.

Finally, those creditors whose business models rely most heavily on originating High-DTI GSE loans would likely see a competitive benefit from the continued ability to originate such loans as General QMs. This is effectively a transfer in market share to these creditors from those who primarily originate FHA or private non-QM loans, who likely would have gained market share under the baseline.

3. *Costs to consumers*

As discussed above, relative to the baseline, the Bureau estimates that 943,000 additional High-DTI loans could be originated as General QM loans under the proposal. Some of these loans would have been non-QM loans (if originated) under the baseline. As a result, the proposal is likely to increase the number of consumers who become delinquent on QM loans, meaning an increase in consumers with delinquent loans who do not have the benefit of the ability-to-repay causes of action and defenses against foreclosure.

Tables 5 and 6 in part V.C provide historical early delinquency rates for loans under different combinations of DTI ratio and rate spread. Under the proposal, conventional loans originated with rate spreads below 2 percentage points and DTI above 43 percent would newly fall within the amended General QM loan definition relative to the baseline. Based on the number and characteristics of 2018 HMDA originations, the Bureau estimates 8,000 to 59,000 additional General QM loans annually could become delinquent within two years of origination, based on the observed early delinquencies from Table 6 (2018) and Table 5 (2002-2008), respectively. Further, consumers who would have been limited in the amount they could borrow due to the DTI limit under the baseline may obtain larger mortgages at higher DTI levels, further increasing the expected number of delinquencies. However, given that many of these loans may have been originated as FHA (or other non-General QM) loans under the baseline, the increase in delinquent loans held by consumers without the ability-to-repay causes of action and defenses against foreclosure is likely smaller than the upper bound estimates cited above.

For the estimated 28,000 consumers obtaining low-DTI General QM or Temporary GSE QM loans priced 2 percentage points or more above APOR under the baseline, the amended General QM loan definition may restrict access to conventional QM credit. There are several possible outcomes for these consumers. Many may instead obtain FHA loans, likely paying higher total loan costs as discussed in part VII.B.1. Others may be able to obtain General QM loans priced below 2 percentage points over APOR due to creditor responses to the proposal or obtain loans under the Small Creditor QM definition. However, some consumers may not be able to obtain a mortgage at all. The Bureau requests data or evidence that could inform estimates for the likelihood of these outcomes among consumers with low-DTI General QM or Temporary GSE QM loans priced 2 percentage points or more above APOR.

In addition, the proposal could slow the development of the non-QM market, particularly new mortgage products which may have become available under the baseline. To the extent that some consumers would prefer some of these products to conventional QM loans due to pricing, verification flexibility, or other advantages, the delay of their development would be a cost to consumers of the proposal.

4. *Costs to covered persons*

For creditors retaining the credit risk of their General QM mortgages (*e.g.*, portfolio loans and private securitizations), an increase in High-DTI General QM originations may lead to increased risk of credit losses. There is reason to believe, however, that on average the effects on portfolio lenders may be small. Creditors that hold loans on portfolio have an incentive to verify ability to repay regardless of liability under the ATR provisions, because they hold the credit risk. While portfolio lenders (or those who manage the portfolios) may recognize and respond to this incentive to different degrees, the proposed rule is likely on average to cause a small increase in the willingness of these creditors to originate loans with a greater risk of default and credit losses, such as certain loans with high DTI ratios. The credit losses to investors in private securitizations are harder to predict. In general, these losses would depend on the scrutiny that investors are willing and able to give to the non-QM loans under the baseline that become QM loans (with high DTI ratios) under the proposed rule. It is possible, however, that the reduction in liability under the ATR provisions would lead to securitizations with more loans that have a greater risk of default and credit losses.

In addition, creditors would generally no longer be able to originate low-DTI conventional loans priced 2 percentage points or higher above APOR as General QMs under the proposal.[309] Creditors may be able to originate some of these loans at prices below 2 percentage points above APOR or as non-QM or other types of QM loans, but in any of these cases may pay higher costs or receive lower revenues relative to under the baseline. If creditors are unable to originate such loans at all, they would see a larger reduction in revenue.

The proposal also generates what are effectively transfers between creditors relative to the baseline, reflecting reduced loan origination volume for creditors who primarily originate FHA or private non-QM loans and increased origination volume for creditors who primarily originate conventional QM loans. Business models vary substantially within market segments, with portfolio lenders and lenders originating non-QM loans most likely to forgo market share gains possible under the baseline, while GSE-focused bank and non-bank creditors are likely to maintain market share that might be lost in the absence of the proposal.

5. Other benefits and costs

The proposal may limit the development of the secondary market for non-QM mortgage loan securities. Under the baseline, those loans that do not fit within General QM requirements represent a potential new market for non-QM securitizations. Thus, the proposal would reduce the scope of the potential non-QM market, likely lowering profits and revenues for participants in the private secondary market. This would effectively be a transfer from these non-QM secondary market participants to participants in the agency or other QM loan secondary markets.

[309] The comparable thresholds are 6.5 percentage points over APOR for loans priced under $65,939 and 3.5 percentage points over APOR for loans priced under $109,898 but at or above $65,939.

6. Alternatives

A potential alternative to the proposed rule is maintaining the General QM loan definition's DTI limit but at a higher level, for example, 45 or 50 percent. The Bureau estimates the effects of such alternatives relative to the proposed rule, assuming no change in consumer or creditor behavior. For an alternative General QM loan definition with a DTI limit of 45 percent, the Bureau estimates that 662,000 fewer loans would be General QM due to DTI ratios over 45 percent, while 32,000 additional loans with rate spreads above the proposed rule's QM pricing thresholds would newly fit within the General QM loan definition due to DTI ratios at or below 45 percent. For an alternative DTI limit of 50 percent, the Bureau estimates 48,000 fewer loans would fit within the General QM loan definition due to DTI ratios over 50 percent, while 41,000 additional loans with rate spreads above the proposed rule's QM pricing thresholds would newly fit within the General QM loan definition due to DTI ratios at or below 50 percent.

In addition to these effects on the composition of loans within the General QM loan definition, the Bureau uses the historical delinquency rates from Tables 5 and 6 in part V.C to estimate the number of loans expected to become delinquent within the General QM loan definition relative to the proposal. The Bureau estimates that under an alternative DTI limit of 45 percent, 4,000 to 35,000 fewer General QM loans would become delinquent relative to the proposal, based on delinquency rates for 2018 and 2002-2008 originations respectively. Under an alternative DTI limit of 50 percent, the Bureau estimates approximately 1,000 additional General QM loans would become delinquent relative to the proposal, due to loans priced 2 percentage points or more above APOR gaining QM status.

For an alternative DTI limit of 45 percent, these estimates collectively indicate that substantially fewer loans would fit within the General QM loan definition relative to the proposal, which would also reduce the number of General QM loans becoming delinquent. By contrast, the estimates indicate that an alternative DTI limit of 50 percent would lead to a comparable number of General QM loans relative to the proposal, both overall and among those that would become delinquent. However, consumer and creditor responses to such alternatives, such as reducing loan amounts to lower DTI ratios, could increase the number of loans that fit within the General QM loan definition relative to the proposal.

Other potential alternatives to the proposed rule could impose a DTI limit only for loans above a certain pricing threshold, for example a DTI limit of 50 percent for loans with rate spreads at or above 1 percentage point.[310] Such an alternative would function as a hybrid of the proposal and an alternative which maintains a DTI limit at a higher level, 50 percent in the case of this example. As a result, the number of loans fitting within the General QM loan definition would generally be between the Bureau's estimates for the proposal and its estimates for the corresponding alternative which maintains the higher DTI limit. Thus, this hybrid approach would bring fewer loans within the General QM loan definition compared to the proposal but more loans within the General QM loan definition compared to the alternative DTI limit of 50 percent, both overall and among loans that would become delinquent.

[310] As discussed in part V.E, a similar approach could impose a DTI limit above a certain pricing threshold and also tailor the presumption of compliance with the ATR requirement based on DTI. For example, the rule could provide that (1) for loans with rate spreads under 1 percentage point, the loan is a safe harbor QM regardless of the consumer's DTI ratio; (2) for loans with rate spreads at or above 1 but less than 1.5 percentage points, a loan is a safe harbor QM if the consumer's DTI ratio does not exceed 50 percent and a rebuttable presumption QM if the consumer's DTI is above 50 percent; and (3) if the rate spread is at or above 1.5 but less than 2 percentage points, loans would be rebuttable presumption QM if the consumer's DTI ratio does not exceed 50 percent and non-QM if the DTI ratio is above 50 percent.

C. Potential Impact on Depository Institutions and Credit Unions With $10 Billion or Less in Total Assets, as Described in Section 1026

The proposal's expected impact on depository institutions and credit unions that are also creditors making covered loans (depository creditors) with $10 billion or less in total assets is similar to the expected impact on larger depository creditors and on non-depository creditors. As discussed in part VII.B.4 (Costs to Covered Persons), depository creditors originating portfolio loans may forgo potential market share gains that would occur in the absence of the proposal. In addition, depository creditors with $10 billion or less in total assets that originate portfolio loans can originate High-DTI Small Creditor QM loans under the rule. These depository creditors may currently rely less on the Temporary GSE QM loan definition for originating High-DTI loans. If the expiration of the Temporary GSE QM loan definition would confer a competitive advantage to these small creditors in their origination of High-DTI loans, the proposal would offset this outcome.

Conversely, those small depository creditors that primarily rely on the GSEs as a secondary market outlet because they do not have the capacity to hold numerous loans on portfolio or the infrastructure or scale to securitize loans may continue to benefit from the ability to make High-DTI GSE loans as QM loans. In the absence of the proposal, these creditors would be limited to originating GSE loans as QMs only with DTI at or below 43 percent under the current General QM loan definition. These creditors may also originate FHA, VA, or USDA loans or non-QM loans for private securitizations, likely at a higher cost relative to originating Temporary GSE QM loans. The proposed rule would allow these creditors to originate more

GSE loans under the General QM loan definition and have a lower cost of origination relative to the baseline.[311]

D. Potential Impact on Rural Areas

The proposal's expected impact on rural areas is similar to the expected impact on non-rural areas. Based on 2018 HMDA data, the Bureau estimates that High-DTI conventional purchase mortgages originated for homes in rural areas are approximately as likely to be reported as initially sold to the GSEs (52.5 percent) as loans in non-rural areas (52 percent).[312] In addition, the Bureau estimates that in 2018, 95.6 percent of conventional purchase loans originated for homes in rural areas would have been QM loans under the proposal, similar to the Bureau's estimate for all conventional purchase loans in rural and non-rural areas (96.1 percent).[313]

VIII. Regulatory Flexibility Act Analysis

The Regulatory Flexibility Act (RFA), as amended by the Small Business Regulatory Enforcement Fairness Act of 1996, requires each agency to consider the potential impact of its regulations on small entities, including small businesses, small governmental units, and small not-for-profit organizations. The RFA defines a "small business" as a business that meets the

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[311] Alternative approaches, such as retaining a DTI limit of 45 or 50 percent, would have similar effects of allowing small depository creditors originate more GSE loans under an expanded General QM loan definition relative to the baseline, while offsetting potential competitive advantages for small depository creditors that originate Small Creditor QM loans.

[312] These statistics are estimated based on originations from the first nine months of the year, to allow time for loans to be sold before HMDA reporting deadlines. In addition, a higher share of High-DTI conventional purchase non-rural loans (33.3 percent) report being sold to other non-GSE purchasers compared to rural loans (22.3 percent).

[313] For alternative approaches, the Bureau estimates 84.7 percent of conventional purchase loans for homes in rural areas would have been QMs under a DTI limit of 45 percent, and 95.7 percent of conventional purchase loans for homes in rural areas would have been QMs under a DTI limit of 50 percent.

size standard developed by the Small Business Administration pursuant to the Small Business Act.[314]

The RFA generally requires an agency to conduct an initial regulatory flexibility analysis (IRFA) and a final regulatory flexibility analysis (FRFA) of any rule subject to notice-and-comment rulemaking requirements, unless the agency certifies that the rule would not have a significant economic impact on a substantial number of small entities (SISNOSE).[315] The Bureau also is subject to certain additional procedures under the RFA involving the convening of a panel to consult with small business representatives before proposing a rule for which an IRFA is required.[316]

An IRFA is not required for this proposal because the proposal, if adopted, would not have a SISNOSE. As the below analysis makes clear, relative to the baseline, the proposed rule has only one sizeable adverse effect. Certain loans with DTI ratios under 43 percent that would otherwise be originated as rebuttable presumption QM loans under the baseline would be non-QM loans under the proposal. The proposal would also have a number of more minor effects on small entities which are not quantified in this analysis, including adjustments to the APR calculation used for certain ARMs when determining QM status; amendments to the Rule's requirements to consider and verify income, assets, debt obligations, alimony, and child support; and the addition of DTI as a factor consumers may use to rebut the QM presumption of

[314] 5 U.S.C. 601(3) (the Bureau may establish an alternative definition after consultation with the Small Business Administration and an opportunity for public comment).

[315] 5 U.S.C. 603-605.

[316] 5 U.S.C. 609.

compliance for loans priced 1.5 percentage points or more over APOR. The Bureau expects only small increases or decreases in burden from these more minor effects.

The analysis divides potential originations into different categories and considers whether the proposed rule has any adverse impact on originations relative to the baseline. Note that under the baseline, the category of Temporary GSE QM loans no longer exists. The Bureau has identified five categories of small entities that may be subject to the proposed provisions: Commercial banks, savings institutions and credit unions (NAICS 522110, 522120, and 522130) with assets at or below $600 million; mortgage brokers (NAICS 522310) with average annual receipts at or below $8 million; and mortgage companies (NAICS 522292 and 522298) with average annual receipts at or below $41.5 million. As discussed further below, the Bureau relies primarily on 2018 HMDA data for the analysis.[317]

Type I: First liens that are not small loans, DTI is over 43 percent.

Under the baseline, small entities cannot originate Type I loans as safe harbor or rebuttable presumption QM loans unless they are also small creditors and comply with the additional requirements of the small creditor QM category. Neither the removal of DTI requirements nor the addition of the pricing conditions have an adverse impact on the ability of small entities to originate these loans.

Type II: First liens that are not small loans, DTI is 43 percent or under

[317] Non-depositories are classified as small entities if they had fewer than 5,188 total originations in 2018. The classification for non-depositories is based on the SBA small entity definition for mortgage companies (less than $41.5 million in annual revenues) and an estimate of $8,000 for revenue-per-origination from the Assessment Report, *supra* note 58, at 78. The HMDA data do not directly distinguish mortgage brokers from mortgage companies, so the more inclusive revenue threshold is used.

Under the baseline, small entities can originate these loans as either safe harbor QM or rebuttable presumption QM, depending on pricing. The removal of DTI requirements has no adverse impact on the ability of small entities to originate these loans. The addition of the pricing conditions has no adverse impact on the ability of small creditors to originate these loans as safe harbor QM loans: a loan with APR within 1.5 percentage points of APOR that can be originated as a safe harbor QM loan under the baseline can be originated as a safe harbor QM loan under the pricing conditions of the proposed rule. Similarly, the addition of the pricing conditions has no adverse impact on the ability of small creditors to originate rebuttable presumption QM loans with APR between 1.5 percentage points and 2 percentage points over APOR. The addition of the pricing conditions would, however, prevent small creditors from originating rebuttable presumption QM loans with APR 2 percentage points or more over APOR. In the SISNOSE analysis below, the Bureau conservatively assumes that none of these loans would be originated.

Type III: First-liens that are small loans

Under the baseline, small entities can originate these loans as General QM loans if they have DTI ratios at or below the DTI limit of 43 percent. The proposal's amended General QM loan definition preserves QM status for some smaller, low-DTI loans priced 2 percentage points or more over APOR. Specifically, loans under $65,939 with APR less than 6.5 percentage points over APOR and loans under $109,898 with APR less than 3.5 percentage points over APOR can be originated as General QM loans, assuming they meet all other General QM requirements. The proposal would prevent small creditors from originating smaller, low-DTI loans with APR at or above these higher thresholds as General QM loans. For the SISNOSE analysis below, the Bureau conservatively assumes that none of these loans would be originated.

Type IV: Closed-end subordinate-liens

Under the baseline, small entities can originate these loans as General QM loans if they have DTI ratios at or below the DTI limit of 43 percent. The proposal's amended General QM loan definition creates new pricing thresholds for subordinate-lien originations. Subordinate-lien loans under $65,939 with APR less than 6.5 percentage points over APOR and larger subordinate-lien loans with APR less than 3.5 percentage points over APOR can be originated as General QM loans, assuming they meet all other General QM requirements. The proposal would prevent small creditors from originating low-DTI, subordinate-lien loans with APR at or above these thresholds as General QM loans. For the SISNOSE analysis below, the Bureau conservatively assumes that none of these loans would be originated.

Analysis

For purposes of this analysis, the Bureau assumes that average annual receipts for small entities is proportional to mortgage loan origination volume. The Bureau further assumes that a small entity experiences a significant negative effect from the proposed rule if the proposed rule would cause a reduction in origination volume of over 2 percent. Using the 2018 HMDA data, the Bureau estimates that if none of the Type II, III, or IV loans adversely affected were originated, 149 small entities would experience a loss of over 2 percent in mortgage loan origination volume. Thus, there are at most 149 small entities that experience a significant adverse economic impact. The Bureau estimates that there are 2,027 small entities in the HMDA data. 149 is not a substantial number relative to 2,027.

The Bureau recognizes that there are small entities that originate mortgage credit that do not report HMDA data. The Bureau has no reason to expect, however, that small entities that originate mortgage credit that do not report HMDA data would be affected differently from small

HMDA reporters by the proposed rule. In other words, the Bureau expects that including HMDA non-reporters in the analysis would increase the number of small entities that would experience a loss of over 2 percent in mortgage loan origination volume and the number of relevant small entities by the same proportion. Thus, the overall number of small entities that would experience a significant adverse economic impact would not be a substantial number of the overall number of small entities that originate mortgage credit.

Accordingly, the Director certifies that this proposal, if adopted, would not have a significant economic impact on a substantial number of small entities. The Bureau requests comment on its analysis of the impact of the proposal on small entities and requests any relevant data.

IX. Paperwork Reduction Act

Under the Paperwork Reduction Act of 1995 (PRA),[318] Federal agencies are generally required to seek, prior to implementation, approval from the Office of Management and Budget (OMB) for information collection requirements. Under the PRA, the Bureau may not conduct or sponsor, and, notwithstanding any other provision of law, a person is not required to respond to, an information collection unless the information collection displays a valid control number assigned by OMB.

The Bureau has determined that this proposal does not contain any new or substantively revised information collection requirements other than those previously approved by OMB under OMB control number 3170-0015. The proposal would amend 12 CFR part 1026 (Regulation Z),

[318] 44 U.S.C. 3501 *et seq.*

which implements TILA. OMB control number 3170-0015 is the Bureau's OMB control number for Regulation Z.

The Bureau welcomes comments on these determinations or any other aspect of the proposal for purposes of the PRA.

X. Signing Authority

The Director of the Bureau, having reviewed and approved this document, is delegating the authority to electronically sign this document to Laura Galban, a Bureau Federal Register Liaison, for purposes of publication in the *Federal Register*.

List of Subjects in 12 CFR Part 1026

Advertising, Banks, Banking, Consumer protection, Credit, Credit unions, Mortgages, National banks, Reporting and recordkeeping requirements, Savings associations, Truth-in-lending.

Authority and Issuance

For the reasons set forth above, the Bureau proposes to amend Regulation Z, 12 CFR part 1026, as set forth below:

PART 1026—TRUTH IN LENDING (REGULATION Z)

1. The authority citation for part 1026 continues to read as follows:

Authority: 12 U.S.C. 2601, 2603-2605, 2607, 2609, 2617, 3353, 5511, 5512, 5532, 5581; 15 U.S.C. 1601 *et seq.*

Subpart E – Special Rules for Certain Home Mortgage Transactions

2. Amend § 1026.43 by revising paragraphs (b)(4), (e)(2)(v), (e)(2)(vi), (e)(4), (e)(5)(i)(A), (e)(5)(i)(B), and (f)(1)(i) and (iii) to read as follows:

§ 1026.43 Minimum standards for transactions secured by a dwelling.

*   *   *   *   *

(b) * * *

(4) *Higher-priced covered transaction* means a covered transaction with an annual percentage rate that exceeds the average prime offer rate for a comparable transaction as of the date the interest rate is set by 1.5 or more percentage points for a first-lien covered transaction, other than a qualified mortgage under paragraph (e)(5), (e)(6), or (f) of this section; by 3.5 or more percentage points for a first-lien covered transaction that is a qualified mortgage under paragraph (e)(5), (e)(6), or (f) of this section; or by 3.5 or more percentage points for a subordinate-lien covered transaction. For purposes of a qualified mortgage under paragraph (e)(2) of this section, for a loan for which the interest rate may or will change within the first five years after the date on which the first regular periodic payment will be due, the creditor must determine the annual percentage rate for purposes of this paragraph (b)(4) by treating the maximum interest rate that may apply during that five-year period as the interest rate for the full term of the loan.

*   *   *   *   *

(e) * * *

(2) * * *

(v) For which the creditor, at or before consummation:

(A) Considers the consumer's income or assets, debt obligations, alimony, child support, and monthly debt-to-income ratio or residual income, using the amounts determined from paragraph (e)(2)(v)(B) of this section. For purposes of this paragraph (e)(2)(v)(A), the consumer's monthly debt-to-income ratio or residual income is determined in accordance with paragraph (c)(7) of this section, except that the consumer's monthly payment on the covered transaction, including the monthly payment for mortgage-related obligations, is calculated in accordance with paragraph (e)(2)(iv) of this section.

(B)(*1*) Verifies the consumer's current or reasonably expected income or assets other than the value of the dwelling (including any real property attached to the dwelling) that secures the loan using third-party records that provide reasonably reliable evidence of the consumer's income or assets, in accordance with paragraph (c)(4) of this section; and

(*2*) Verifies the consumer's current debt obligations, alimony, and child support using reasonably reliable third-party records in accordance with paragraph (c)(3) of this section.

(vi) For which the annual percentage rate does not exceed the average prime offer rate for a comparable transaction as of the date the interest rate is set by the amounts specified in paragraphs (e)(2)(vi)(A) through (E) of this section. The amounts specified here shall be adjusted annually on January 1 by the annual percentage change in the Consumer Price Index for All Urban Consumers (CPI-U) that was reported on the preceding June 1. For purposes of this paragraph (e)(2)(vi), the creditor must determine the annual percentage rate for a loan for which the interest rate may or will change within the first five years after the date on which the first regular periodic payment will be due by treating the maximum interest rate that may apply during that five-year period as the interest rate for the full term of the loan.

(A) For a first-lien covered transaction with a loan amount greater than or equal to $109,898 (indexed for inflation), 2 or more percentage points;

(B) For a first-lien covered transaction with a loan amount greater than or equal to $65,939 (indexed for inflation) but less than $109,898 (indexed for inflation), 3.5 or more percentage points;

(C) For a first-lien covered transaction with a loan amount less than $65,939 (indexed for inflation), 6.5 or more percentage points;

(D) For a subordinate-lien covered transaction with a loan amount greater than or equal to $65,939 (indexed for inflation), 3.5 or more percentage points;

(E) For a subordinate-lien covered transaction with a loan amount less than $65,939 (indexed for inflation), 6.5 or more percentage points.

*   *   *   *   *

(4) *Qualified mortgage defined—other agencies.* Notwithstanding paragraph (e)(2) of this section, a qualified mortgage is a covered transaction that is defined as a qualified mortgage by the U.S. Department of Housing and Urban Development under 24 CFR 201.7 and 24 CFR 203.19, the U.S. Department of Veterans Affairs under 38 CFR 36.4300 and 38 CFR 36.4500, or the U.S. Department of Agriculture under 7 CFR 3555.109.

(5) * * * (i) * * *

(A) That satisfies the requirements of paragraph (e)(2) of this section other than the requirements of paragraphs (e)(2)(v) and (e)(2)(vi);

(B) For which the creditor:

(*1*) Considers and verifies at or before consummation the consumer's current or reasonably expected income or assets other than the value of the dwelling (including any real property attached to the dwelling) that secures the loan, in accordance with paragraphs (c)(2)(i) and (c)(4) of this section;

(*2*) Considers and verifies at or before consummation the consumer's current debt obligations, alimony, and child support in accordance with paragraphs (c)(2)(vi) and (c)(3) of this section;

(*3*) Considers at or before consummation the consumer’s monthly debt-to-income ratio or residual income and verifies the debt obligations and income used to determine that ratio in accordance with paragraph (c)(7) of this section, except that the calculation of the payment on the covered transaction for purposes of determining the consumer’s total monthly debt obligations in paragraph (c)(7)(i)(A) shall be determined in accordance with paragraph (e)(2)(iv) of this section instead of paragraph (c)(5) of this section;

* * * * *

(f) * * * (1) * * *

(i) The loan satisfies the requirements for a qualified mortgage in paragraphs (e)(2)(i)(A), (e)(2)(ii), and (e)(2)(iii) of this section;

* * * * *

(iii) The creditor:

(A) Considers and verifies at or before consummation the consumer’s current or reasonably expected income or assets other than the value of the dwelling (including any real property attached to the dwelling) that secures the loan, in accordance with paragraphs (c)(2)(i) and (c)(4) of this section;

(B) Considers and verifies at or before consummation the consumer’s current debt obligations, alimony, and child support in accordance with paragraphs (c)(2)(vi) and (c)(3) of this section;

(C) Considers at or before consummation the consumer's monthly debt-to-income ratio or residual income and verifies the debt obligations and income used to determine that ratio in accordance with paragraph (c)(7) of this section, except that the calculation of the payment on the covered transaction for purposes of determining the consumer's total monthly debt obligations in (c)(7)(i)(A) shall be determined in accordance with paragraph (f)(1)(iv)(A) of this section, together with the consumer's monthly payments for all mortgage-related obligations and excluding the balloon payment;

*   *   *   *   *

Appendix Q to Part 1026 [Removed]

3. Remove Appendix Q to Part 1026.

4. In Supplement I to Part 1026—Official Interpretations, under *Section 1026.43—Minimum Standards for Transactions Secured by a Dwelling*:

a. Revise *43(b)(4) Higher-priced covered transaction*; *43(c)(4) Verification of income or assets*; *43(c)(7) Monthly debt-to-income ratio or residual income*; and *Paragraph 43(e)(2)(v)*;

b. Add *Paragraphs 43(e)(2)(v)(A) and 43(e)(2)(v)(B)* after *Paragraph 43(e)(2)(v)*;

c. Revise *Paragraph 43(e)(2)(vi)*;

d. Revise the heading for subsection *43(e)(4)*;

e. Revise *43(e)(4) Qualified mortgage defined—other agencies*;

f. Revise *Paragraph 43(e)(5)*;

g. Revise *Paragraph 43(f)(1)(i)*; and

h. Revise *Paragraph 43(f)(1)(iii)*.

The revisions and additions read as follows:

Supplement I to Part 1026—Official Interpretations

*   *   *   *   *

Section 1026.43—Minimum standards for transactions secured by a dwelling

*   *   *   *   *

43(b)(4) Higher-priced covered transaction.

1. *Average prime offer rate*. The average prime offer rate is defined in § 1026.35(a)(2). For further explanation of the meaning of "average prime offer rate," and additional guidance on determining the average prime offer rate, *see* comments 35(a)(2)-1 through -4.

2. *Comparable transaction*. A higher-priced covered transaction is a consumer credit transaction that is secured by the consumer's dwelling with an annual percentage rate that exceeds by the specified amount the average prime offer rate for a comparable transaction as of the date the interest rate is set. The published tables of average prime offer rates indicate how to identify a comparable transaction. *See* comment 35(a)(2)-2.

3. *Rate set*. A transaction's annual percentage rate is compared to the average prime offer rate as of the date the transaction's interest rate is set (or "locked") before consummation. Sometimes a creditor sets the interest rate initially and then re-sets it at a different level before consummation. The creditor should use the last date the interest rate is set before consummation.

4. *Determining the annual percentage rate for certain loans for which the interest rate may or will change.* Provisions in subpart C of this part, including the commentary to § 1026.17(c)(1), address how to determine the annual percentage rate disclosures for closed-end credit transactions. Provisions in § 1026.32(a)(3) address how to determine the annual percentage rate to determine coverage under § 1026.32(a)(1)(i). Section 1026.43(b)(4) requires, only for the purposes of a qualified mortgage under § 1026.43(e)(2), a different determination of the annual percentage rate for purposes of § 1026.43(b)(4) for a loan for which the interest rate may or will change within the first five years after the date on which the first regular periodic payment will be due. *See* comment 43(e)(2)(vi)-4 for how to determine the annual percentage rate of such a loan.

* * * * *

43(c)(4) Verification of income or assets.

1. *Income or assets relied on*. A creditor need consider, and therefore need verify, only the income or assets the creditor relies on to evaluate the consumer's repayment ability. *See* comment 43(c)(2)(i)-2. For example, if a consumer’s application states that the consumer earns a salary and is paid an annual bonus and the creditor relies on only the consumer’s salary to evaluate the consumer's repayment ability, the creditor need verify only the salary. *See also* comments 43(c)(3)-1 and -2.

2. *Multiple applicants*. If multiple consumers jointly apply for a loan and each lists income or assets on the application, the creditor need verify only the income or assets the creditor relies on in determining repayment ability. *See* comment 43(c)(2)(i)-5.

3. *Tax-return transcript*. Under § 1026.43(c)(4), a creditor may verify a consumer's income using an Internal Revenue Service (IRS) tax-return transcript, which summarizes the information in a consumer's filed tax return, another record that provides reasonably reliable evidence of the consumer's income, or both. A creditor may obtain a copy of a tax-return transcript or a filed tax return directly from the consumer or from a service provider. A creditor need not obtain the copy directly from the IRS or other taxing authority. *See* comment 43(c)(3)-2.

4. *Unidentified funds*. A creditor does not meet the requirements of § 1026.43(c)(4) if it observes an inflow of funds into the consumer’s account without confirming that the funds are income. For example, a creditor would not meet the requirements of § 1026.43(c)(4) where it observes an unidentified $5,000 deposit in the consumer’s account but fails to take any measures to confirm or lacks any basis to conclude that the deposit represents the consumer’s personal income and not, for example, proceeds from the disbursement of a loan.

*   *   *   *   *

43(c)(7) Monthly debt-to-income ratio or residual income.

1. *Monthly debt-to-income ratio or monthly residual income.* Under § 1026.43(c)(2)(vii), the creditor must consider the consumer's monthly debt-to-income ratio, or the consumer's monthly residual income, in accordance with the requirements in § 1026.43(c)(7). Section 1026.43(c) does not prescribe a specific monthly debt-to-income ratio with which creditors must comply. Instead, an appropriate threshold for a consumer's monthly debt-to-income ratio or monthly residual income is for the creditor to determine in making a reasonable and good faith determination of a consumer's ability to repay.

2. *Use of both monthly debt-to-income ratio and monthly residual income.* If a creditor considers the consumer's monthly debt-to-income ratio, the creditor may also consider the consumer's residual income as further validation of the assessment made using the consumer's monthly debt-to-income ratio.

3. *Compensating factors.* The creditor may consider factors in addition to the monthly debt-to-income ratio or residual income in assessing a consumer's repayment ability. For example, the creditor may reasonably and in good faith determine that a consumer has the ability to repay despite a higher debt-to-income ratio or lower residual income in light of the consumer's assets other than the dwelling, including any real property attached to the dwelling, securing the covered transaction, such as a savings account. The creditor may also reasonably and in good faith determine that a consumer has the ability to repay despite a higher debt-to-income ratio in light of the consumer's residual income.

*   *   *   *   *

Paragraph 43(e)(2)(v).

1. *General*. For guidance on satisfying § 1026.43(e)(2)(v), a creditor may rely on commentary to § 1026.43(c)(2)(i) and (vi), (c)(3), and (c)(4).

Paragraph 43(e)(2)(v)(A).

1. *Consider*. In order to comply with the requirement to consider income or assets, debt obligations, alimony, child support, and monthly debt-to-income ratio or residual income under § 1026.43(e)(2)(v)(A), a creditor must take into account income or assets, debt obligations, alimony, child support, and monthly debt-to-income ratio or residual income in its ability-to-repay determination. Under § 1026.25(a), a creditor must retain documentation showing how it took into account income or assets, debt obligations, alimony, child support, and monthly debt-to-income ratio or residual income in its ability-to-repay determination. Examples of such documentation may include, for example, an underwriter worksheet or a final automated underwriting system certification, alone or in combination with the creditor's applicable underwriting standards, that shows how these required factors were taken into account in the creditor's ability-to-repay determination.

2. *Requirement to consider monthly debt-to-income ratio or residual income*. Section 1026.43(e)(2)(v)(A) does not prescribe specifically how a creditor must consider monthly debt-to-income ratio or residual income. Section 1026.43(e)(2)(v)(A) also does not prescribe a particular monthly debt-to-income ratio or residual income threshold with which a creditor must comply. A creditor may, for example, consider monthly debt-to-income ratio or residual income by establishing monthly debt-to-income or residual income thresholds for its own underwriting standards and documenting how it applied those thresholds to determine the consumer's ability to repay. A creditor may also consider these factors by establishing monthly debt-to-income or

residual income thresholds and exceptions to those thresholds based on other compensating factors, and documenting application of the thresholds along with any applicable exceptions.

3. *Flexibility to consider additional factors related to a consumer's ability to repay*. The requirement to consider income or assets, debt obligations, alimony, child support, and monthly debt-to-income ratio or residual income does not preclude the creditor from taking into account additional factors that are relevant in determining a consumer's ability to repay the loan. For guidance on considering additional factors in determining the consumer's ability to repay, see comment 43(c)(7)-3.

Paragraph 43(e)(2)(v)(B).

1. *Verification of income, assets, debt obligations, alimony, and child support.* Section 1026.43(e)(2)(v)(B) does not prescribe specific methods of underwriting that creditors must use. Section 1026.43(e)(2)(v)(B)(*1*) requires a creditor to verify the consumer's current or reasonably expected income or assets (including any real property attached to the value of the dwelling) that secures the loan in accordance with § 1026.43(c)(4), which states that a creditor must verify such amounts using third-party records that provide reasonably reliable evidence of the consumer's income or assets. Section 1026.43(e)(2)(v)(B)(*2*) requires a creditor to verify the consumer's current debt obligations, alimony, and child support in accordance with § 1026.43(c)(3), which states that a creditor must verify such amounts using reasonably reliable third-party records. So long as a creditor complies with the provisions of § 1026.43(c)(3) with respect to debt obligations, alimony, and child support and § 1026.43(c)(4) with respect to income and assets, the creditor is permitted to use any reasonable verification methods and criteria.

2. *Classifying and counting income, assets, debt obligations, alimony, and child support.* "Current and reasonably expected income or assets other than the value of the dwelling

(including any real property attached to the dwelling) that secures the loan" is determined in accordance with § 1026.43(c)(2)(i) and its commentary. "Current debt obligations, alimony, and child support" has the same meaning as under § 1026.43(c)(2)(vi) and its commentary. Section 1026.43(c)(2)(i) and (vi) and the associated commentary apply to a creditor's determination with respect to what inflows and property it may classify and count as income or assets and what obligations it must classify and count as debt obligations, alimony, and child support, pursuant to its compliance with § 1026.43(e)(2)(v)(B).

3. *Safe harbor for compliance with specified external standards.*

i. Meeting the standards in the following documents for verifying current or reasonably expected income or assets using third-party records provides a creditor with reasonably reliable evidence of the consumer's income or assets. Meeting the standards in the following documents for verifying current debt obligations, alimony, and child support obligation using third-party records provides a creditor with reasonably reliable evidence of the consumer's debt obligations, alimony, and child support obligations. Accordingly, a creditor complies with § 1026.43(e)(2)(v)(B) if it complies with verification standards in one or more of the following documents: [List to be Determined, as Discussed in Preamble].

ii. *Applicable provisions in standards.* A creditor complies with § 1026.43(e)(2)(v)(B) if it complies with requirements in the standards listed in comment 43(e)(2)(v)(B)-3 for creditors to verify income, assets, debt obligations, alimony and child support using specified documents or to include or exclude particular inflows, property, and obligations as income, assets, debt obligations, alimony, and child support.

iii. *Inapplicable provisions in standards.* For purposes of compliance with § 1026.43(e)(2)(v)(B), a creditor need not comply with requirements in the standards listed in comment 43(e)(2)(v)(B)-3 other than those that require lenders to verify income, assets, debt obligations, alimony and child support using specified documents or to classify and count particular inflows, property, and obligations as income, assets, debt obligations, alimony, and child support.

iv. *Revised versions of standards.* A creditor also complies with § 1026.43(e)(2)(v)(B) where it complies with revised versions of the standards listed in comment 43(e)(2)(v)(B)-3.i, provided that the two versions are substantially similar.

v. *Use of standards from more than one document*. A creditor complies with § 1026.43(e)(2)(v)(B) if it complies with the verification standards in one or more of the documents specified in comment 43(e)(2)(v)(B)-3.i. Accordingly, a creditor may, but need not, comply with § 1026.43(e)(2)(v)(B) by complying with the verification standards from more than one document (in other words, by "mixing and matching" verification standards).

Paragraph 43(e)(2)(vi).

1. *Determining the average prime offer rate for a comparable transaction as of the date the interest rate is set.* For guidance on determining the average prime offer rate for a comparable transaction as of the date the interest rate is set, see comments 43(b)(4)-1 through -3.

2. *Determination of applicable threshold.* A creditor must determine the applicable threshold by determining which category the loan falls into based on the face amount of the note (the "loan amount" as defined in § 1026.43(b)(5)). For example, for a first-lien covered transaction with a loan amount of $75,000, the loan would fall into the tier for loans greater than or equal to $65,939 (indexed for inflation) but less than $109,898 (indexed for inflation), for which the applicable threshold is 3.5 or more percentage points.

3. *Annual adjustment for inflation*. The dollar amounts in § 1026.43(e)(2)(vi) will be adjusted annually on January 1 by the annual percentage change in the CPI-U that was in effect on the preceding June 1. The Bureau will publish adjustments after the June figures become available each year.

4. *Determining the annual percentage rate for certain loans for which the interest rate may or will change.*

i. *In general*. The commentary to § 1026.17(c)(1) and other provisions in subpart C address how to determine the annual percentage rate disclosures for closed-end credit transactions. Provisions in § 1026.32(a)(3) address how to determine the annual percentage rate to determine coverage under § 1026.32(a)(1)(i). Section 1026.43(e)(2)(vi) requires, for the purposes of § 1026.43(e)(2)(vi), a different determination of the annual percentage rate for a qualified mortgage under § 1026.43(e)(2) for which the interest rate may or will change within the first five years after the date on which the first regular periodic payment will be due. An identical special rule for determining the annual percentage rate for such a loan also applies for purposes of § 1026.43(b)(4).

ii. *Loans for which the interest rate may or will change*. Section 1026.43(e)(2)(vi) includes a special rule for determining the annual percentage rate for a loan for which the interest rate may or will change within the first five years after the date on which the first regular periodic payment will be due. This rule applies to adjustable-rate mortgages that have a fixed-rate period of five years or less and to step-rate mortgages for which the interest rate changes within that five-year period.

iii. *Maximum interest rate during the first five years*. For a loan for which the interest rate may or will change within the first five years after the date on which the first regular periodic payment will be due, a creditor must treat the maximum interest rate that could apply at any time during that five-year period as the interest rate for the full term of the loan to determine the annual percentage rate for purposes of § 1026.43(e)(2)(vi), regardless of whether the maximum interest rate is reached at the first or subsequent adjustment during the five-year period. For additional instruction on how to determine the maximum interest rate during the first five years after the date on which the first regular periodic payment will be due. *See* comments 43(e)(2)(iv)-3 and -4.

iv. *Treatment of the maximum interest rate in determining the annual percentage rate.* For a loan for which the interest rate may or will change within the first five years after the date on which the first regular periodic payment will be due, the creditor must determine the annual percentage rate for purposes of § 1026.43(e)(2)(vi) by treating the maximum interest rate that may apply within the first five years as the interest rate for the full term of the loan. For example, assume an adjustable-rate mortgage with a loan term of 30 years and an initial discounted rate of 5.0 percent that is fixed for the first three years. Assume that the maximum interest rate during the first five years after the date on which the first regular periodic payment will be due is 7.0 percent. Pursuant to § 1026.43(e)(2)(vi), the creditor must determine the annual percentage rate based on an interest rate of 7.0 percent applied for the full 30-year loan term.

* * * * *

43(e)(4) Qualified mortgage defined—other agencies.

1. *General.* The Department of Housing and Urban Development, Department of Veterans Affairs, and the Department of Agriculture have promulgated definitions for qualified mortgages under mortgage programs they insure, guarantee, or provide under applicable law.

Cross-references to those definitions are listed in § 1026.43(e)(4) to acknowledge the covered transactions covered by those definitions are qualified mortgages for purposes of this section.

2. *Mortgages originated prior to [effective date of final rule]*. Covered transactions that met the requirements of § 1026.43(e)(2)(i) thorough (iii), were eligible for purchase or guarantee by the Federal National Mortgage Association (Fannie Mae) or the Federal Home Loan Mortgage Corporation (Freddie Mac) (or any limited-life regulatory entity succeeding the charter of either) operating under the conservatorship or receivership of the Federal Housing Finance Agency pursuant to section 1367 of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. 4617), and were consummated prior to [effective date of final rule] continue to be qualified mortgages for the purposes of this section.

3. [RESERVED].

4. [RESERVED].

5. [RESERVED].

*   *   *   *   *

Paragraph 43(e)(5).

1. *Satisfaction of qualified mortgage requirements*. For a covered transaction to be a qualified mortgage under § 1026.43(e)(5), the mortgage must satisfy the requirements for a qualified mortgage under § 1026.43(e)(2), other than the requirements in § 1026.43(e)(2)(v) and (vi). For example, a qualified mortgage under § 1026.43(e)(5) may not have a loan term in excess of 30 years because longer terms are prohibited for qualified mortgages under § 1026.43(e)(2)(ii). Similarly, a qualified mortgage under § 1026.43(e)(5) may not result in a balloon payment because § 1026.43(e)(2)(i)(C) provides that qualified mortgages may not have

balloon payments except as provided under § 1026.43(f). However, a covered transaction need not comply with § 1026.43(e)(2)(v) and (vi).

2. *Debt-to-income ratio or residual income*. Section 1026.43(e)(5) does not prescribe a specific monthly debt-to-income ratio with which creditors must comply. Instead, creditors must consider a consumer's debt-to-income ratio or residual income calculated generally in accordance with § 1026.43(c)(7) and verify the information used to calculate the debt-to-income ratio or residual income in accordance with § 1026.43(c)(3) and (4). However, § 1026.43(c)(7) refers creditors to § 1026.43(c)(5) for instructions on calculating the payment on the covered transaction. Section 1026.43(c)(5) requires creditors to calculate the payment differently than § 1026.43(e)(2)(iv). For purposes of the qualified mortgage definition in § 1026.43(e)(5), creditors must base their calculation of the consumer's debt-to-income ratio or residual income on the payment on the covered transaction calculated according to § 1026.43(e)(2)(iv) instead of according to § 1026.43(c)(5).

3. *Forward commitments*. A creditor may make a mortgage loan that will be transferred or sold to a purchaser pursuant to an agreement that has been entered into at or before the time the transaction is consummated. Such an agreement is sometimes known as a "forward commitment." A mortgage that will be acquired by a purchaser pursuant to a forward commitment does not satisfy the requirements of § 1026.43(e)(5), whether the forward commitment provides for the purchase and sale of the specific transaction or for the purchase and sale of transactions with certain prescribed criteria that the transaction meets. However, a forward commitment to another person that also meets the requirements of § 1026.43(e)(5)(i)(D) is permitted. For example, assume a creditor that is eligible to make qualified mortgages under § 1026.43(e)(5) makes a mortgage. If that mortgage meets the purchase criteria of an investor

with which the creditor has an agreement to sell loans after consummation, then the loan does not meet the definition of a qualified mortgage under § 1026.43(e)(5). However, if the investor meets the requirements of § 1026.43(e)(5)(i)(D), the mortgage will be a qualified mortgage if all other applicable criteria also are satisfied.

4. *Creditor qualifications*. To be eligible to make qualified mortgages under § 1026.43(e)(5), a creditor must satisfy the requirements stated in § 1026.35(b)(2)(iii)(B) and (C). Section 1026.35(b)(2)(iii)(B) requires that, during the preceding calendar year, or, if the application for the transaction was received before April 1 of the current calendar year, during either of the two preceding calendar years, the creditor and its affiliates together extended no more than 2,000 covered transactions, as defined by § 1026.43(b)(1), secured by first liens, that were sold, assigned, or otherwise transferred to another person, or that were subject at the time of consummation to a commitment to be acquired by another person. Section 1026.35(b)(2)(iii)(C) requires that, as of the preceding December 31st, or, if the application for the transaction was received before April 1 of the current calendar year, as of either of the two preceding December 31sts, the creditor and its affiliates that regularly extended, during the applicable period, covered transactions, as defined by § 1026.43(b)(1), secured by first liens, together, had total assets of less than $2 billion, adjusted annually by the Bureau for inflation.

5. *Requirement to hold in portfolio*. Creditors generally must hold a loan in portfolio to maintain the transaction's status as a qualified mortgage under § 1026.43(e)(5), subject to four exceptions. Unless one of these exceptions applies, a loan is no longer a qualified mortgage under § 1026.43(e)(5) once legal title to the debt obligation is sold, assigned, or otherwise transferred to another person. Accordingly, unless one of the exceptions applies, the transferee could not benefit from the presumption of compliance for qualified mortgages under

§ 1026.43(e)(1) unless the loan also met the requirements of another qualified mortgage definition.

6. *Application to subsequent transferees*. The exceptions contained in § 1026.43(e)(5)(ii) apply not only to an initial sale, assignment, or other transfer by the originating creditor but to subsequent sales, assignments, and other transfers as well. For example, assume Creditor A originates a qualified mortgage under § 1026.43(e)(5). Six months after consummation, Creditor A sells the qualified mortgage to Creditor B pursuant to § 1026.43(e)(5)(ii)(B) and the loan retains its qualified mortgage status because Creditor B complies with the limits on asset size and number of transactions. If Creditor B sells the qualified mortgage, it will lose its qualified mortgage status under § 1026.43(e)(5) unless the sale qualifies for one of the § 1026.43(e)(5)(ii) exceptions for sales three or more years after consummation, to another qualifying institution, as required by supervisory action, or pursuant to a merger or acquisition.

7. *Transfer three years after consummation*. Under § 1026.43(e)(5)(ii)(A), if a qualified mortgage under § 1026.43(e)(5) is sold, assigned, or otherwise transferred three years or more after consummation, the loan retains its status as a qualified mortgage under § 1026.43(e)(5) following the transfer. The transferee need not be eligible to originate qualified mortgages under § 1026.43(e)(5). The loan will continue to be a qualified mortgage throughout its life, and the transferee, and any subsequent transferees, may invoke the presumption of compliance for qualified mortgages under § 1026.43(e)(1).

8. *Transfer to another qualifying creditor*. Under § 1026.43(e)(5)(ii)(B), a qualified mortgage under § 1026.43(e)(5) may be sold, assigned, or otherwise transferred at any time to another creditor that meets the requirements of § 1026.43(e)(5)(i)(D). That section requires that a creditor together with all its affiliates, extended no more than 2,000 first-lien covered

transactions that were sold, assigned, or otherwise transferred by the creditor or its affiliates to another person, or that were subject at the time of consummation to a commitment to be acquired by another person; and have, together with its affiliates that regularly extended covered transactions secured by first liens, total assets less than $2 billion (as adjusted for inflation). These tests are assessed based on transactions and assets from the calendar year preceding the current calendar year or from either of the two calendar years preceding the current calendar year if the application for the transaction was received before April 1 of the current calendar year. A qualified mortgage under § 1026.43(e)(5) transferred to a creditor that meets these criteria would retain its qualified mortgage status even if it is transferred less than three years after consummation.

9. *Supervisory sales*. Section 1026.43(e)(5)(ii)(C) facilitates sales that are deemed necessary by supervisory agencies to revive troubled creditors and resolve failed creditors. A qualified mortgage under § 1026.43(e)(5) retains its qualified mortgage status if it is sold, assigned, or otherwise transferred to another person pursuant to: A capital restoration plan or other action under 12 U.S.C. 1831o; the actions or instructions of any person acting as conservator, receiver or bankruptcy trustee; an order of a State or Federal government agency with jurisdiction to examine the creditor pursuant to State or Federal law; or an agreement between the creditor and such an agency. A qualified mortgage under § 1026.43(e)(5) that is sold, assigned, or otherwise transferred under these circumstances retains its qualified mortgage status regardless of how long after consummation it is sold and regardless of the size or other characteristics of the transferee. Section 1026.43(e)(5)(ii)(C) does not apply to transfers done to comply with a generally applicable regulation with future effect designed to implement, interpret, or prescribe law or policy in the absence of a specific order by or a specific agreement

with a governmental agency described in § 1026.43(e)(5)(ii)(C) directing the sale of one or more qualified mortgages under § 1026.43(e)(5) held by the creditor or one of the other circumstances listed in § 1026.43(e)(5)(ii)(C). For example, a qualified mortgage under § 1026.43(e)(5) that is sold pursuant to a capital restoration plan under 12 U.S.C. 1831o would retain its status as a qualified mortgage following the sale. However, if the creditor simply chose to sell the same qualified mortgage as one way to comply with general regulatory capital requirements in the absence of supervisory action or agreement it would lose its status as a qualified mortgage following the sale unless it qualifies under another definition of qualified mortgage.

10. *Mergers and acquisitions*. A qualified mortgage under § 1026.43(e)(5) retains its qualified mortgage status if a creditor merges with, is acquired by, or acquires another person regardless of whether the creditor or its successor is eligible to originate new qualified mortgages under § 1026.43(e)(5) after the merger or acquisition. However, the creditor or its successor can originate new qualified mortgages under § 1026.43(e)(5) only if it complies with all of the requirements of § 1026.43(e)(5) after the merger or acquisition. For example, assume a creditor that originates 250 covered transactions each year and originates qualified mortgages under § 1026.43(e)(5) is acquired by a larger creditor that originates 10,000 covered transactions each year. Following the acquisition, the small creditor would no longer be able to originate § 1026.43(e)(5) qualified mortgages because, together with its affiliates, it would originate more than 500 covered transactions each year. However, the § 1026.43(e)(5) qualified mortgages originated by the small creditor before the acquisition would retain their qualified mortgage status.

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Paragraph 43(f)(1)(i).

1. *Satisfaction of qualified mortgage requirements*. Under § 1026.43(f)(1)(i), for a mortgage that provides for a balloon payment to be a qualified mortgage, the mortgage must satisfy the requirements for a qualified mortgage in paragraphs (e)(2)(i)(A), (e)(2)(ii), and (e)(2)(iii). Therefore, a covered transaction with balloon payment terms must provide for regular periodic payments that do not result in an increase of the principal balance, pursuant to § 1026.43(e)(2)(i)(A); must have a loan term that does not exceed 30 years, pursuant to § 1026.43(e)(2)(ii); and must have total points and fees that do not exceed specified thresholds pursuant to § 1026.43(e)(2)(iii).

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Paragraph 43(f)(1)(iii).

1. *Debt-to-income or residual income*. A creditor must consider and verify the consumer's monthly debt-to-income ratio or residual income to meet the requirements of § 1026.43(f)(1)(iii)(C). To calculate the consumer's monthly debt-to-income or residual income for purposes of § 1026.43(f)(1)(iii)(C), the creditor may rely on the definitions and calculation rules in § 1026.43(c)(7) and its accompanying commentary, except for the calculation rules for a consumer's total monthly debt obligations (which is a component of debt-to-income and residual income under § 1026.43(c)(7)). For purposes of calculating the consumer's total monthly debt obligations under § 1026.43(f)(1)(iii), the creditor must calculate the monthly payment on the covered transaction using the payment calculation rules in § 1026.43(f)(1)(iv)(A), together with

all mortgage-related obligations and excluding the balloon payment.

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/s/ Laura Galban

Laura Galban,

Federal Register Liaison, Bureau of Consumer Financial Protection.