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CFPB Takes Major Steps Toward Revising the QM and Replacing the GSE Patch

This week, the Consumer Financial Protection Bureau (CFPB) took major steps toward revising the requirements for the Qualified Mortgage (QM) under the Ability to Repay/Qualified Mortgage Rule (ATR/QM Rule or Rule).[1] On June 22, 2020, the CFPB issued two Notices of Proposed Rulemaking (NPRMs or Proposals). Both are targeted at replacing the General QM and the soon expiring Temporary GSE QM (commonly referred to as the "GSE Patch"), which confers QM status on loans eligible for purchase or guarantee by Fannie Mae or Freddie Mac (the GSEs), with a revised, more workable, set of General QM requirements.

One of the NPRMs details the proposed changes to the QM definition[2] and the other would extend the GSE Patch,[3] currently set to expire in January, 2021, pending establishment of the changes. Comments on both proposals are invited for sixty days from the date of their publication in the Federal Register, expected shortly. When comments on these proposals are considered and a final rule is issued, the new definition of QM is expected to set the criteria to obtain the most affordable and safest credit for years to come. Considering how impactful these proposals are, significant commentary on them is assured.

It is clear that while the CFPB has issued the NPRMs with specific proposed courses of action, it has left the door open to changing its views by encouraging commenters to challenge, contest, rebut and offer alternative proposals. For this reason, it is imperative that all interested parties take the opportunity to submit comments during the comment period individually, through their counsel, and/or through their associations. In fact, if you agree with the proposed changes, it is particularly critical that you submit comments in support of them, in order to avoid having adverse commenters appear to be in the majority and compel the CFPB to revise its views.

The CFPB has consistently maintained throughout its existence that it is and will always be a data-driven regulator. Accordingly, throughout these NPRMs, the CFPB provides extensive and detailed data in support of the positions it takes and the decisions it has made so far. It is, then, particularly important whenever possible to ensure that comments submitted are likewise supported by as much data as may be available or at least supportive of the data the CFPB provides. We would welcome the opportunity to

[1] The ATR/QM Rule's provisions and standards are found in the Truth in Lending Act's implementing rule, Regulation Z, at 12 C.F.R. § 1026.43 and Appendix Q.
[2] Consumer Financial Protection Bureau, Qualified Mortgage Definition under the Truth in Lending Act (Regulation Z): General QM Loan Definition (June 22, 2020), https://files.consumerfinance.gov/f/documents/cfpb_proposed-rule_general-qm-loan-definition_2020-06.pdf.
[3] Consumer Financial Protection Bureau, Qualified Mortgage Definition under the Truth in Lending Act (Regulation Z): Extension of Sunset Date (June 22, 2020), https://files.consumerfinance.gov/f/documents/cfpb_proposed-rule_qm-patch-extension_2020-06.pdf.

assist in your efforts to write and provide comments on any of these issues of interest to you and your company.

Background

Rulemaking: Last year on July 25, 2019, through an Advance Notice of Proposed Rulemaking (ANPR),[4] the CFPB announced, to the surprise of many, that it planned to allow the GSE Patch to expire at the beginning of 2021. The ANPR invited comments on the possibility of a short extension for an "orderly transition." It also invited comments on whether and how the General QM, which is intended to be available for all mortgage loans meeting its requirements, should be revised in light of the GSE Patch's planned expiration.

Before the ANPR was issued, the CFPB issued a Request for Information (RFI), in June 2017, in connection with its statutorily mandated five-year reassessment of the ATR/QM Rule which considered a range of topics and invited comments. These comments, along with the CFPB's experience with the rule as well as its views concerning the future of the GSEs appear to have informed this rulemaking to date. Importantly, to better understand what is being changed, we start with a brief review of the statute and the current rule.

In January 2014, when the ATR/QM Rule became effective, having been finalized a year before, it implemented the provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Act),[5] generally requiring that for closed-end residential mortgage loans, creditors must make a reasonable and good faith determination, at or before closing, that the consumer will have a reasonable ability to repay the loan.[6] The Rule codified the eight factors the Act prescribed that must be considered in making such a determination.[7]

Consistent with the Act, the Rule also provided the alternative of complying with the ability to repay requirement by originating a QM loan, which contains both bright line standards for a safer mortgage product and a presumption of compliance with the ATR requirements for those loans meeting the standards. To qualify as a QM, a mortgage

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[4] Qualified Mortgage Definition under the Truth in Lending Act (Regulation Z), 84 Fed. Reg. 37,155 (July 31, 2019) (Advance Notice of Proposed Rulemaking (ANPR)).
[5] Public Law 111-203, sec. 1411 – 12, 1414, 124 Stat. 1376 (2010); 15 U.S.C. 1639c.
[6] 12 C.F.R. § 1026.43(c)(1).
[7] 12 C.F.R. § 1026.43(c)(2). The eight factors include the consumer's: (i) current and reasonably expected income or assets, other than the value of the dwelling, including any real property attached to the dwelling, that secured the loan; (ii) employment status if job income is relied on; (iii) monthly payment on the covered transaction; (iv) monthly payment on any simultaneous loan that the creditor knows or has reason to know will be made; (v) monthly payment for mortgage-related obligations; (vi) current debt obligations, alimony, and child support; (vii) monthly debt-to-income ratio or residual income; and (viii) credit history. *Id*.

generally must meet certain statutory restrictions under the Act that prohibit "risky features" including: negative amortization; interest only or balloon payments; a term greater than 30 years; and points and fees exceeding specified limits.[8]

A QM loan is also required to be underwritten based on a fully amortizing schedule using the maximum rate permitted during the first five years, a payment schedule that fully amortizes the loan over the loan term and takes into account all mortgage-related obligations. Underwriting also must include verifying and documenting the income and assets relied upon for repayment and complying with any guidelines or regulations established by the CFPB 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.[9] Regarding the presumption of compliance, mortgages meeting the QM requirements gain either a safe harbor or a rebuttable presumption of compliance based on whether the Annual Percentage Rate (APR) for the loan is within 150 basis points of the Average Prime Offer Rate (APOR). QM mortgages where the spread is less than 150 basis points gain a safe harbor and those above 150 gain a rebuttable presumption of compliance.

For a General QM, the creditor is required to consider and verify the consumer's income and debt obligations in accordance with Appendix Q, which is based on a now obsolete Federal Housing Administration (FHA) underwriting guide effective at the time the ATR/QM Rule was developed. Most significantly, to qualify for a General QM, the borrower's debt to income ratio (DTI) at consummation cannot exceed 43 percent, also as determined in accordance with Appendix Q.

Additionally, because the CFPB in 2013 did not believe that a 43 percent DTI ratio represented the outer boundary of responsible lending, and the market was "especially fragile," the Rule established the GSE Patch, thereby allowing the use of systems and standards with which lenders were familiar. The Rule provides that for seven years, until January 10, 2021, or until the GSEs are no longer under Federal conservatorship, any loan eligible for Fannie Mae's or Freddie Mac's purchase or guarantee—whether or not it is actually purchased or guaranteed—is a QM.[10] Importantly, the Rule does not prescribe a maximum DTI limit for GSE Patch loans. A loan can qualify if the DTI ratio exceeds 43 percent, as long as the loan meets the GSE's criteria including any compensating factors. Also, income and debt for GSE Patch loans and DTI ratios, are verified, considered and calculated using GSE standards, not Appendix Q.

Under the Rule, FHA, the Department of Veterans Affairs (VA), and the Rural Housing Service/Department of Agriculture (RHS) also were authorized to define which loans

[8] 15 U.S.C. § 1639c(b)(2)(A).

[9] *Id*.

[10] 12 C.F.R. § 1026.43(e)(4)(ii)(A).

under their programs are QMs, and each agency has separately done so. None of the agencies requires a maximum DTI ratio to qualify as a QM, or requires the use of Appendix Q. Alternative QMs also have been established for smaller creditors' mortgages. For these QMs, there also are no maximum DTI and Appendix Q requirements, although loans generally must be held in their portfolio for three years.

Any type of creditor can originate a General QM or a GSE Patch QM. Only creditors that meet certain asset, volume and other requirements can originate the Small Creditor Portfolio QM, the Small Creditor Balloon QM, and the new Smaller Institution QM. Additionally, only creditors with loans meeting FHA, VA or RHS requirements can originate QMs under these agencies' programs.

The Market: Since the Rule's implementation, mortgage lending has been overwhelmingly confined to the origination of QM loans. According to the Urban Institute, which admits estimates of the non-QM market are difficult to make, non-QM originations in 2018 were $20 to $30 billion of $1.8 trillion total originations.[11]

Similarly, since the rule became effective, a very large proportion of QM loans were originated under the GSE Patch, including up to nearly a million loans that would not have qualified as QM loans without the GSE Patch. In the ANPR, the CFPB cited estimates that there were approximately 6 million closed-end first-lien residential mortgage loans in the U.S. in 2018, of which 52 percent, or roughly 3.12 million, were purchased or guaranteed by the GSEs. Of these 3.12 million loans, approximately 1/3 of GSE loans, or 1/6 of all QM loans, had DTI ratio greater than 43 percent, exceeding the maximum DTI ratio permitted for General QM loans. Reportedly, a large proportion of these above-43 percent DTI loans are loans to low- and moderate-income and minority borrowers.[12]

Because the CFPB believed that a robust non-QM lending market would develop as lenders and investors became more familiar and comfortable with the ATR requirements, the GSE Patch was established to be temporary, expiring at the earlier of when the GSEs exit from governmental conservatorship or 7 years from its establishment (January 10, 2021). The CFPB itself concedes that the GSE Patch remains a large and persistent share of mortgage originations. Its own research in 2019 indicates that, in 2018, as many as 957,000 loans, or nearly 16% of that year's first-lien, closed-end residential mortgages, were GSE Patch QMs that most likely would have not been made, or made at materially higher costs.

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[11] Karan Kaul and Laurie Goodman, *Updated: What, If Anything, Should Replace the QM GSE Patch*, Urban Institute, Housing Finance Policy Center (Oct. 2018).

[12] *Id*.

So, Why Not Extend the PATCH? Considering that the “Patch” has proven to be an effective and well-trodden path to providing safe, sound, and affordable QM loans to creditworthy borrowers who may not qualify for the General QM, some have urged that the GSE Patch be extended.

The ANPR made clear, as does the current proposal, that the CFPB never intended to make the GSE Patch permanent and that the CFPB did not presume that loans eligible for GSE purchase or guarantee, whether or not the GSEs are under conservatorship, are originated with appropriate consideration of the ability to repay. Beyond that, the CFPB has expressed concern that reliance on the GSEs’ underwriting standards could stifle innovation and the development of competitive private-sector approaches to underwriting, as well as prevent a private securitization market rebound.

The CFPB also expressed the view in the ANPR that in the absence of the Patch, high DTI borrowers would likely choose FHA loans because of their higher DTI limits, non-QM or small creditor loans and, in some cases, smaller loan amounts or no loans at all.

Finally, the U.S. Treasury Housing Reform Plan,[13] issued in September 2019, setting forth the Trump Administration’s vision for a privatized and more competitive future for the GSEs, specifically supported the CFPB’s decision to let the GSE Patch expire. The decision to end the GSE Patch and the Administration’s plans for the GSEs are consistent, and it seems purposely so.

Proposed Changes and Myriad Questions

With the January 10, 2021 date rapidly approaching, the CFPB has focused on what impact the expiration of the GSE Patch might have on the residential mortgage markets. At the same time, it has also focused on what it learned in its mandated five-year lookback assessment of the overall ATR/QM rule, and has apparently concluded that if it addressed problems with the general QM definition, it could permit the GSE Patch to expire without significant impact, as long as the timing of the two events coincided. These two NPRMs achieve exactly that: the first NPRM would change the definition of the general category of QM to retain most of its requirements but remove the DTI limit from the QM requirement and replace it with a pricing test; the second NPRM would change the expiration date of the GSE Patch to be the same as the effective date of those changes in the general QM definition.

Proposed Changes to the General QM: First, let’s examine the NPRM that proposes to revise the general QM definition.

[13] *See* U.S. Dept. of Treasury, Housing Reform Plan Pursuant to the Presidential Memorandum Issued March 27, 2019 (Sept. 2019).

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The 43% DTI limit contained in the general QM definition has been controversial from its inception. Concern whether the DTI by itself provides a reliable indicator of the borrower's ability to repay has only been exacerbated by complaints that the rigidly prescriptive requirements for how income and debt was to be qualified and calculated under Appendix Q simply did not work to qualify borrowers employed in important sectors of the economy. In particular, but certainly not the only problem areas, Appendix Q's requirements were largely unworkable for gig workers, transient labor and self-employed individuals. In the discussions explaining its rationale for its proposed changes to the general QM definition, the CFPB makes clear that it believes that these objections were valid and, citing extensive statistical analytics, support its decision to eliminate the DTI element and its accompanying Appendix Q, and replace it with a pricing-based test.

A pricing test, which compares the loan's Annual Percentage Rate (APR) to the Average Prime Offer Rate (APOR) of a comparable transaction, according to the CFPB comprises a more holistic and flexible indicator of a borrower's overall ability to repay than DTI. Using similarly extensive statistical analytics, the CFPB also supports its view that the pricing of a loan is equally if not more predictive of ability to repay than DTI.

Accordingly, the CFPB proposes to change the definition of the General QM category by:

- Removing the requirements for a 43% DTI limit and the use of Appendix Q.
- Replacing the DTI and Appendix Q requirements with a pricing test where a loan qualifies as a QM if the spread between the loan's APR and APOR meets the following pricing thresholds:
    - For first-lien loans of $109,898 or more, less than 2.00%;
    - For first-lien loans of $65,939 - $109,897, less than 3.5%;
    - For first-lien loans of $65,938 or less, less than 6.5%;
    - For subordinate-lien loans of $65,939 or more, less than 3.5%;
    - For subordinate-lien loans of less than $65,939, less than 6.5%.

  All loan amounts would be annually adjusted for inflation.
- Making clear that the elimination of Appendix Q does not eliminate the need to consider and verify a consumer's income, assets, debt obligations, alimony, and child support but provides lenders the flexibility to decide how to meet these requirements.
- While not strictly requiring any specific method for considering and verifying the information immediately above, providing a safe harbor for compliance with the requirements if the lender follows the appropriate requirements from a list of sources the CFPB will specify in the final rule, potentially including one or more of the following:
    - Fannie Mae's Single Family Selling Guide;
    - Freddie Mac's Single Family Seller/Servicer Guide;
    - FHA's Single Family Housing Policy Handbook;

- VA's Lenders Handbook;
- USDA's Field Office Handbook for the Direct Single Family Housing Program; or
- USDA's Handbook for the Single Family Guaranteed Loan Program.

- Preserving the present standards separating safe harbor from rebuttable presumption QMs at:
    - A spread of 1.5% or less between the APR and APOR for first-lien loans, or
    - A spread of 3.5% or less between the APR and APOR for subordinate-lien loans, but
    - For loans where the interest rate can or will change within 5 years of the first payment due date, requiring calculation of a special APR by treating the maximum interest rate that may apply at any time during the first 5 years as the interest rate for the full term of the loan. This special APR would be used solely to measure the spread over APOR for this purpose, and would not apply to loan disclosures or any other purpose.

As noted above, while the CFPB does present the changes proposed as its "preliminary conclusions" of what will be included in the final rule, it not only encourage comments on all aspects of the proposals, but also specifically invites comments on a number of questions and possible alternative approaches including:

- Whether a private market would develop to provide access to responsible, affordable credit should the GSE Patch simply be permitted to expire without any changes to the General QM definition.
- Whether the proposed price-based standard is an appropriate substitute for a DTI limit in determining QM status.
- Whether the price-based standard is predictive of loan performance.
- Whether additional elements should be used in combination with the price-based standard in determining QM status.
- If a price-based standard is used, whether the proposed levels (outlined above) are appropriate.
- If a price-based standard is used, whether the CFPB should consider adjusting the pricing thresholds in emergency situations, and if so, how the CFPB should do so.
- Whether the present bifurcated levels of liability protection for QMs (safe harbor versus rebuttable presumption) should be retained, or whether the level of liability protection should just be established as a rebuttable presumption across the entire QM spectrum.
- If safe harbor protection is retained, whether the existing price-based threshold for separating safe harbor from rebuttable presumption QMs should be retained unchanged, or if a different value is more appropriate.

- If the safe harbor is retained, whether some method other than or in addition to the price-based threshold should be used to separate safe harbor and rebuttable presumption loans.
- If the safe harbor is retained, and determined using a price-based threshold, whether the proposed specially calculated APR for QMs with interest rates that can or will change within their first 5 years is necessary and appropriate for making the safe harbor determination for such loans.
- Whether a DTI limit should be retained as an element of QM qualification and if so whether it should be kept at 43% or set at some different value.
- If a DTI limit is retained, whether the CFPB's plan to eliminate Appendix Q and permit lenders flexibility in how they verify and calculate income and debt would work together with a specified DTI limit.
- Whether Appendix Q should be eliminated at all, or either be amended to address its shortcomings or have a different, specific set of CFPB-selected instructions substituted for it.
- If Appendix Q is removed without having a specific set of instructions substituted for it, whether the CFPB should provide a list of alternative sets of requirements, the use of any of which would provide a safe harbor of compliance for lenders choosing to use them.
- Whether the existing grounds on which the rebuttable presumption of compliance can be contested should remain unchanged, or whether they should be amended.
- Specifically, whether a ground for contesting the rebuttable presumption should be created for situations where a consumer has a "very high DTI and low residual income." The CFPB asks that commenters supporting this new potential ground also provide suggestions whether and how a "very high DTI" should be defined.
- Whether other changes to the general QM definition would support innovations in underwriting that would facilitate access to credit while ensuring that loans granted QM status would be those that should be presumed to comply with ATR provisions.
- Whether the proposed effective date of 6 months after publication of a final rule in the Federal Register is sufficient time to provide for implementation.

Finally, the CFPB also mentions in the General QM definition NPRM that it is considering whether to implement a process whereby a loan that was originated as a non-QM loan might be able to "season" its way into becoming a QM loan, if the consumer consistently makes timely payments for a specified amount of time. The CFPB indicates it has deliberately excluded consideration of such a process from this NPRM, but advises that it intends to address the subject in a separate proposal in the future.

Extending the Patch: Turning to the companion NPRM that proposes to extend the expiration of the GSE Patch to coincide with the effective date of the changes proposed in the NPRM discussed above, the proposal is straight-forward and the questions far more limited.

The CFPB cites the need to avoid disruption in the marketplace that would likely arise from having the GSE Patch expire without having appropriate changes in the general QM definition in place at the same time. Therefore, it proposes to extend the expiration date for expiration of the GSE Patch from January 10, 2021 to whatever date the final rule establishing changes to the general QM definition becomes effective. The proposal also maintains the other expiration option for the GSE Patch, which is the date the GSEs are released from conservatorship, because GSEs not subject to conservatorship may provide eligibility standards for loans that do not adequately consider the consumer's ability to repay. (Clearly, notwithstanding the serious efforts to find an end to the conservatorship that are underway elsewhere in the current administration, it is also extremely unlikely that such an event will occur before the final rules from these NPRMs become effective.)

Notably, after explaining its proposal, the CFPB examines, and rejects, several alternative approaches. Specifically, it discusses and rejects the option of simply making the GSE Patch permanent for the reasons noted above as well as its uncertainty about how eligibility standards might evolve at released GSEs. Moreover, it believes that the changes it proposes to the General QM definition in the companion NPRM will obviate the need for the GSE Patch. And it also rejects the option of simply establishing a new date certain for expiration of the patch, over concerns that such a new date may provide insufficient time for General QM definition changes and result in market disruptions; it also might come after the release of the GSEs from conservatorship.

Despite all of this, the NPRM still invites comments on whether its intended approach is indeed the best alternative, or whether any of the other alternatives, or another approach altogether, should be pursued. Obviously, again, considering the CFPB's approach, the need to submit comments is critical, and we are certainly available to assist such efforts.

Conclusion

The CFPB has made clear through its actions and pronouncements that dealing with the expiration of the GSE Patch is a high priority, and it should be expected to move expeditiously to complete this work. As the rulemaking process progresses, considering the stakes involved, this issue is also likely to be an increasingly high priority for the public, companies, and organizations of all stripes. WBK will help you stay informed and involved as the discussion moves forward. The availability and affordability of mortgage credit hangs in the balance.