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September 8, 2020

Comment Intake – General QM Amendments
Bureau of Consumer Financial Protection
1700 G Street, NW
Washington, DC 20552

RE: Docket No. CFPB-2020-0020 or RIN 3170-AA98; Qualified Mortgage Definition under the Truth in Lending Act (Regulation Z); General QM Loan Definition

To Whom It May Concern:

The Housing Policy Council[1] ("HPC") appreciates the opportunity to comment on the Consumer Financial Protection Bureau's ("Bureau") proposed modifications to the General Qualified Mortgage ("QM") loan definition in Regulation Z ("Proposal").

I. Overall Comments

The HPC commends the Bureau's proposal to modify the General QM definition to create clear, objective standards that ensure QMs are based on a consumer's ability to repay and that creditworthy borrowers are not denied access to affordable financing. HPC supports the removal of the debt-to-income ("DTI") threshold (and related Appendix Q), which is not required under the Truth in Lending Act ("TILA") and which, as a standalone feature in the QM definition, unreasonably restricts access to credit. We agree with the Bureau's observation that a specific DTI limit provides an incomplete picture of the consumer's financial capacity and is more appropriately applied as an element of comprehensive underwriting, as it is within the Ability-to-Repay (ATR) underwriting portion of the regulation.

Importantly, the Proposal's "consider and verify" standard within the QM definition serves as an appropriate reaffirmation of ATR, requiring evidence that the creditor considered DTI as a component of General QM. Under the proposed QM definition, the creditor must have information in the loan file that demonstrates consideration of the consumer's income or assets, debt obligations, and DTI ratio or residual income and verification of the consumer's current or reasonably expected income or assets other than the value of the dwelling that secures the loan and the consumer's current debt obligations, alimony, and child support. The requirement that a creditor consider and verify these key criteria, including DTI ratio or residual

[1] HPC is a trade association compromised of the nation's leading mortgage lenders, services, mortgage insurers, and title and data companies. HPC advocates for the mortgage and housing finance interests of its members in legislative, regulatory, and judicial forums. Our interest is in the safety and soundness of the housing finance system, the equitable and consistent regulatory treatment of all market participants, and the promoting of lending practices that create sustainable home ownership opportunities leading to long-term wealthy-building and community-building for families.

income, reinforces that creditors must make a responsible determination of a consumer's ability to repay the loan, a foundational Dodd-Frank requirement for all mortgages.

We also support the removal of Appendix Q, which has proven challenging for both the industry and the Bureau, as highlighted in the Bureau's 5-Year Regulatory Assessment Report.[2] As HPC emphasized in previous comments and as the Bureau concluded in that Report, Appendix Q standards are static, outdated, and fundamentally insufficient. Even if the Bureau maintained Appendix Q with modifications, those modifications would quickly become antiquated, as such regulatory requirements cannot keep pace with continual government and industry enhancements to standards for calculating and verifying debt and income. We agree with the Bureau's conclusion that the most efficient and practicable solution to the problems of Appendix Q is to remove the DTI threshold and these related instructions entirely.

These modifications to General QM are appropriate measures to accompany expiration of the GSE Patch, preserving responsible lending practices and access to credit and alleviating the distortions to the market that the Bureau identified in the Assessment Report. As the Bureau notes, the prevalence of GSE Patch loan originations ran contrary to the Bureau's original expectations and intent. As the Bureau's Assessment Report details, possible reasons for the reliance on the GSE Patch include the preference to avoid Appendix Q and the 43 percent DTI limit. Without modification to these provisions, when the GSE Patch expires, responsible credit could be unduly restricted, with a more significant detrimental impact on low-and moderate-income households and communities of color.

In addition to the removal of the problematic elements from the rule, HPC supports the Bureau's introduction of a price-based threshold for General QM, as a supplementary reflection of a consumer's ability to repay. We agree with the Bureau that the price of a loan is a strong indicator of a consumer's ability to repay. This measure has historical precedent in other regulations, as highlighted in the preamble to this proposed rule, and will reinforce the intent of the law, to ensure that QM loans are well-underwritten, safe, and affordable. However, we believe that the safe harbor threshold should be increased to a level that allows more consumers access to affordable, responsible credit. We also are not opposed to an increase in the General QM pricing threshold.

We understand the Bureau's concerns regarding short-reset ARMs, but we do not agree with the Bureau's proposed solution, as it will essentially prohibit these products from being QMs. As discussed in more detail below, we propose an alternative approach, with a distinct pricing cap on the maximum rate in the first five years for short-reset ARMs, without the burden of a new APR calculation.

In summary, HPC supports the Bureau's Proposal with certain necessary modifications, all designed to advance the Bureau's goal of setting a clear, objective standard for General QM,

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[2] *Ability-to-Repay and Qualified Mortgage Rule Assessment Report*, Consumer Financial Protection Bureau (CFPB), January 2019

and to permit responsibly underwritten loan products to be included within the General QM definition. Our comments, as detailed below, are as follows:

(1) We support the Bureau's proposals to require a creditor to "consider" and "verify" certain relevant factors, and we propose two modifications to ensure the standards are clear – one regarding the commentary for the "consider" requirement and the other regarding the referenced standards for the "verify" requirement;
(2) We do not support any of the alternative proposals for the treatment of DTI and Appendix Q raised in the preamble;
(3) While we support a price-based threshold for a General QM, we believe increasing the safe harbor threshold will increase access to credit while still ensuring consumers have the ability-to-repay such loans and we would not oppose an increase in the General QM pricing cap; we also ask the Bureau to engage in periodic evaluations of these thresholds and to ensure that the data it publishes for these thresholds is accurate and reliable; and
(4) We do not support the treatment of short-reset ARMs under the General QM pricing requirement and the related new APR calculation. Instead of the proposed unique APR calculation for short-reset ARMs, we propose that short-reset ARMs be subject to an additional pricing cap that would limit the maximum rate in the first five years, based on the Average Initial Interest Rate ("AIIR"), an approach that would still permit such loans to qualify as QM, but only for those short-reset ARMs that are affordable and do not cause payment shock.

II. The "consider" and "verify" standards are appropriate with minor modifications.

HPC supports the Bureau's proposal to include in the QM definition a requirement that creditors "consider" and "verify" certain key criteria that are core to the evaluation of a borrower's ability to repay. We believe that the Bureau's approach will provide clear evidence that appropriate ATR underwriting is performed for General QM loans, without specific mandates as to how that underwriting is performed. The "consider" and "verify" standards serve as the necessary affirmation and evidence that the creditor assessed the borrower's capacity to repay. We concur that this requirement would meet the Bureau's objective of ensuring that a loan for which a creditor disregards a consumer's income, assets, debt obligations, alimony, and child support cannot obtain QM status, while ensuring that creditors and investors can readily determine if a loan is a QM. For the same reason, HPC supports the addition of the requirement for a creditor to provide documentation that demonstrates consideration of a consumer's DTI ratio or residual income.

a. We recommend adjustments to the commentary for 1026.43(e)(2)(v)(A) to reflect the Bureau's intent.

We appreciate and support the Bureau's thoughtful approach to the "consider" requirement of the General QM, as it requires creditors to evaluate key criteria while providing

an objective standard. As proposed, this standard would ensure that to qualify a loan as QM, a creditor must make an ability to repay determination taking into account key criteria, without dictating the way in which the creditor makes such consideration. If a creditor ignores the required factors (income or assets, debt obligations, alimony, child support, and DTI or residual income) or otherwise does not take them into account as part of its ability-to-repay determination, the loan would not be eligible for QM status. The Bureau's proposal ensures that the creditor performs a proper ability-to-repay evaluation, while providing latitude in how such evaluation is conducted. We appreciate and support the Bureau's proposal.

While we support the Bureau's proposal that a creditor must document that it followed its procedures for considering the listed factors, we recommend minor modifications to the proposed official commentary related to this provision, to reassert the objective nature of this standard. Our proposed revisions are to align the commentary with the rule text and the Bureau's objective that this provision is a simple measure that requires a creditor to demonstrate consideration of the specified factors. Specifically, we propose that the Bureau replace the word "how" with the word "that" in proposed comments 43(e)(2)(v)(A)-1 and -2, as follows:

> "1. C*onsider.* 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~~ that 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~~ that these required factors were taken into account in the creditor's ability-to-repay determination.
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> 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~~ that 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."

These slight modifications to the text will remove any ambiguity regarding the categorical nature of this requirement, leaving no doubt that the creditor must provide evidence of consideration of the key factors of income, debt, and DTI as described in the regulation.

b. We recommend changes to the safe harbor for the "verify" requirement to protect innovation.

The proposed requirement that a creditor verify the borrower's income and debt, as described in more detail in the proposed 1026.43(e)(2)(v)(B), is integrally related to the "consider" standard, and HPC supports this requirement as another affirmation of the ATR underwriting standards. We particularly appreciate that this provision would provide substantial flexibility for creditors to use innovative verification methods. In addition to allowing for this innovation, the rule could also establish a specific set of identified verification standards to provide certainty that the creditor has satisfied this standard. We support the addition of this optional safe harbor, which may confer an additional level of confidence for lenders and investors.

We also recommend that the list of "safe harbor" guidance that could be included in a final regulation must accommodate future revisions and changes; in other words, the regulation must explicitly permit updates to the standards cited in proposed comment 43(e)(2)(v)(B)-3.i, as discussed in proposed comment 43(e)(2)(v)(B)-3.iv. To be clear, we are concerned that the Proposal indicates that the Bureau may define revisions to the specified standards too narrowly; we believe that the term "substantially similar," as described in the preamble, is unduly restrictive. The Bureau seeks input on whether the commentary should define "substantially similar" as a mere "clarification, explanation, logical extension, or application of a pre-existing proposition in the standard." We are concerned that this proposed definition is too limited, narrowly confining a departure from the existing documented standards to be a slight variation, which may not sufficiently encompass substantive updates and revisions to the standards. This proposed explanation could stifle innovation in verification techniques, which runs counter to one of the Bureau's intents. To ensure that updates and revisions that do not materially stray from the original cited standards can still qualify under this provision, we propose the following language for comment 43(e)(2)(v)(B)-3.iv:

> "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 revised version does not materially deviate from the previous version ~~two versions are substantially similar~~."

This standard would give creditors and investors confidence to rely upon published standards that could be altered and enhanced over time, while also meeting the Bureau's objective that such revisions not undermine the creditor obligations and consumer protections established under the rule.

III. HPC does not support alternatives to the proposed removal of the DTI threshold.

As we discussed above in Section I, HPC supports the Bureau's proposal to remove the specific DTI threshold and Appendix Q. We acknowledge that the Bureau included in the preamble to the Proposal a systematic assessment of many alternatives to this approach, including maintaining a DTI threshold, allowing the DTI threshold to increase based on compensating factors, and revising Appendix Q. This is evidence that the Bureau has been very deliberate, thoughtful, and pragmatic in considering modifications to the General QM.

HPC does not support any of the alternatives discussed in the Proposal's preamble. We firmly believe that the Bureau is making the right policy choice in its removal of the DTI threshold and Appendix Q – a choice that closely aligns with the original intent of this section of TILA. A return to a set DTI threshold is not the answer, as that would continue to isolate DTI as a standalone factor. The addition of compensating factors to the DTI threshold would add new challenges, amplifying the regulatory complexity by defining a whole new set of standards, further complicating the clear bright-line QM measures, and creating more difficulty in continuously modifying these standards to keep pace with changes in the marketplace. As we noted above, revising Appendix Q to be useful is not pragmatic. In the preamble, the Bureau presents a number of cogent arguments against both this approach and all of the other variations that would maintain reliance on a DTI threshold, and HPC finds the Bureau's arguments to be compelling and accurate.

QM must be a clear, objective, bright-line standard that ensures that qualified borrowers can access affordable credit from institutions engage in responsible lending practices. None of the alternatives discussed in the preamble achieve these goals.

IV. On the two pricing mechanisms, HPC believes the Safe Harbor QM pricing threshold should be increased and does not oppose an increase in the General QM threshold. HPC also recommends periodic evaluation of these thresholds, and we ask the Bureau to ensure the data it publishes for these thresholds is accurate and reliable.

Before we discuss the pricing thresholds for a General QM and safe harbor status, we want to raise an important issue regarding the role of pricing. The addition of a QM pricing cap to the regulation is a feature that reinforces the importance of a thorough assessment of a borrower's ability to repay the mortgage. Pricing has long served as a clear indication of credit risk in mortgage transactions and the use of the new General QM rate spread cap follows this tradition. That said, it is incumbent upon the industry and government regulators to embrace

and advance the execution and enforcement of critical fair housing and fair lending rules. Housing discrimination in loan pricing – from the intentional to the inadvertent – remains a challenge that must be continuously monitored and addressed and the Bureau has the opportunity in this regulation to reiterate its commitment to this cause. We urge the Bureau to consider articulating explicitly in this rule that the QM designation for mortgages does not deem compliance with the Fair Housing Act and/or the Equal Credit Opportunities Act.

a. **HPC does not oppose increasing the General QM price-based threshold.**

The Proposal would establish a new price-based requirement for a loan to qualify as a General QM. A loan would meet the price-based threshold if the APR exceeds APOR by less than two percentage points, with different limits for loans with loan amounts less than $109,898 and for subordinate-lien transactions.[3] The Bureau is proposing this price-based threshold as its data and analysis show that a loan's price 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 tentatively concludes that the two percentage points threshold strikes an appropriate balance between ensuring that loans receiving QM status may be presumed to comply with the ability-to-repay provisions and ensuring that access to affordable mortgage credit remains available to consumers.

We concur with the Bureau that pricing is predictive of loan performance. We appreciate the Bureau's careful and thoughtful analysis of the interplay of pricing and delinquency rates. While we are not proposing a specific increase in this threshold, we do not oppose increasing this threshold. Such an increase may allow additional, responsible access to credit, particularly for minority consumers.

b. **HPC recommends that the Bureau increase the safe harbor threshold to 2 percentage points above APOR.**

The Proposal does not change the pricing threshold that establishes whether a General QM has a conclusive presumption (safe harbor) or a rebuttable presumption for meeting the ability-to-repay requirements. A loan receives safe harbor protection if the APR exceeds APOR by less than 1.5 percentage points (3.5 percentage points for subordinate liens). 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 a higher or lower safe harbor threshold.

Based on our review of relevant data, we recommend the Bureau increase the safe harbor threshold so that a loan receives safe harbor treatment if the APR exceeds APOR by less

[3] Please see *Section V* for our comments on the proposed calculation for the APR on short-reset ARMs for the General QM pricing threshold and the safe harbor threshold.

than 2 percentage points (4 percentage points for subordinate liens). We believe that by changing this threshold, the Bureau would preserve responsible access to credit without imposing undue risk to borrowers or the market. As detailed in an Urban Institute paper,[4] if the safe harbor threshold is raised from 150 to 200 basis points above APOR, over 75,000 loans would receive safe harbor designation, based on the 2019 Home Mortgage Disclosure Act ("HMDA") data. The analysis shows that such a threshold increase will have a disproportionately more positive impact on purchase lending volumes than on refinance volumes, meaning that this increase will have a meaningful positive impact on homeownership opportunity. Importantly, Blacks and Hispanics would benefit from an increased threshold. These populations are much more likely to have higher rate-spreads on their mortgages than Whites.

To help understand the impact a safe harbor threshold increase would have on defaults, Urban Institute analyzed data from Black Knight McDash and Fannie Mae's single-family historical loan performance data. Urban Institute found that the ever 60 days or more delinquency (D60+) rate for 2013-2018 GSE originations in the 150-200 basis points bucket is 5.3 percent compared to 3.7 percent in the 100-150 basis points bucket, an increase of 1.6 percentage points. In the portfolio space, the D60+ rate increases barely, from 2.7 percent to 2.9 percent, and for PLS, the D60+ rate increase from 2.9 to 3.7 percent. Notably, the default rate for 2013-2018 originations in the 150-200 basis points bucket is the same or less than the default rate for 1999-2004 originations in the up to 50 basis points bucket for all three channels, demonstrating the very low baseline of defaults today. This is likely due to the improvements in underwriting across the industry and the prohibitions on certain product features and practices instituted by the Dodd-Frank Act. While there could be a small increase in defaults, that rate would still be well below reasonable historical levels. Therefore, it makes sense to increase the safe harbor threshold to 200 basis points, to minimally and responsibly expand access to credit, particularly for Blacks and Hispanics.

In addition, raising the safe harbor to 200 basis points over APOR would better align the Bureau's QM safe harbor and FHA's safe harbor. In our previous comment letter in response to the Bureau's ANPR, we also suggested that the Bureau consider some form of alignment between the Bureau's QM safe harbor and that of FHA to help address possible market distortions that shifts more borrowers to FHA.

c. **HPC recommends the Bureau engage in periodic evaluations of these pricing thresholds**

We recommend that the Bureau explicitly establish periodic evaluations of the General QM pricing threshold and the safe harbor threshold and also reserve the authority to perform assessments and adjustments if market conditions warrant additional consideration. This type

[4] *The CFPB's Proposed QM Rule Will Responsibly Ease Credit Availability*, Urban Institute Housing Finance Policy Center, September 2020

of evaluation, both periodic and on an as-needed basis, would provide the opportunity for the Bureau and interested parties, through notice and comment, to consider whether these pricing thresholds are operating as the Bureau intended and permits an efficient, yet public process for adjustment as necessary to maintain access to credit.

d. **We ask the Bureau to ensure the data it publishes for these thresholds is accurate and reliable.**

The Bureau's proposed General QM pricing threshold, as well as the existing safe harbor threshold, and our proposed test specific to short-reset ARMs, discussed below, rely on data published by the Bureau. In particular, through the Federal Financial Institutions Examination Council's (FFIEC) website, the Bureau publishes the APOR which is necessary to evaluate whether a loan is a QM and whether it qualifies for a safe harbor, and the Average Initial Interest Rate, which is necessary for the HPC proposed short-reset ARM test. Without these reliable data points, creditors, insurers, and investors will be unable to make such determinations. It is therefore critical that the data published by the Bureau be accurate and that creditors can reasonably and safely rely on such data. The Bureau should make clear that if the creditor relied on data published by the Bureau in determining the rate spreads for the various thresholds in the rule, the creditor cannot be held liable if such data later proves to be incorrect. If the Bureau discovers and corrects an error after initial publication of the data, the Bureau must ensure that creditors are aware of such correction and state that such correction does not affect a creditor's reasonable reliance on the initial data published by the Bureau.

V. Instead of the Bureau's proposed APR calculation, we propose an additional pricing test for short-reset ARMs.

We are concerned that the proposed treatment of ARMs for purposes of the General QM pricing standard and the definition of higher-priced covered transaction effectively prohibits from QM eligibility any ARMs that reset in 5-years or less ("short-reset ARMs"). Under the Proposal, short-reset ARMs would have the same APR-spread requirement as fixed rate loans to achieve QM status, except, rather than using the disclosed APR to determine the spread, the APR would be calculated based on the highest rate in the first 5 years. This requirement would effectively prevent many short-reset ARMs with typical adjustment caps from being QM and would introduce unnecessary complications by requiring a different APR calculation. Additionally, this new APR calculation would be used to determine whether a General QM short-reset ARM is a higher-priced covered transaction for purposes of determining whether the loan qualifies for a safe harbor.

We propose an alternative approach that would satisfy the intent of the proposed rule to establish a clear connection between the underwriting requirement for short-reset ARMs and a pricing mechanism to reinforce that requirement. In lieu of the APR calculation using the highest rate in the first five years, the Bureau should impose a constraint on the maximum interest rate in the first five years, using a published data set to ensure an objective measure

against which the rate would be compared. Generally, the highest rate in the first five years reflects a set of rate adjustments that are subject to a cap, which is historically 200 basis points for a 5-year ARM. Therefore, we believe and recommend a sensible, yet conservative, cap for short-reset ARMs to be eligible for QM status is to restrict the maximum rate in the first five years to no more than 250 basis points over the Average Initial Interest Rate ("AIIR") for a comparable ARM loan, which the Bureau publishes on the FFIEC web site.

We view the Bureau's AIIR, as opposed to APOR, as an apples-to-apples test designed to cap any unreasonable payment shocks that may result from rate adjustments that occur during the 60 month period for short-reset ARMs. Please see *Appendix A* for additional analysis performed to inform this recommendation.

This new cap would be separate from, and in addition to, the proposed General QM and safe harbor rate spread thresholds. In addition to meeting the proposed General QM pricing threshold, for a short-reset ARM to be eligible for QM, the highest rate in the first five years cannot exceed the AIIR by 2.5 or more percentage points. The HPC proposal would eliminate the need for a different APR calculation for short-reset ARMs for purposes of the General QM pricing and determining whether a loan is a higher-priced covered transaction, which is relevant for the safe harbor threshold. Instead, the loan's disclosed APR would be used to calculate those spreads.

Our proposal maintains the connection to the TILA QM underwriting requirement for short-term ARMs, which mandates that the creditor use the highest rate in the first five years to calculate the borrower's debt-to-income ratio, without adding a new APR calculation. Please see *Appendix B* for an illustration of this proposal.

We do not believe the Bureau's proposed solution to restrict short-reset ARMs from becoming QMs is the correct path forward. We note that the Bureau's own data showed that the product features and pricing feature (rate spread within 2 percentage points of APOR) substantially reduced the early delinquency rates of short-reset ARMs from 14.9 percent to 5.5 percent. In comparison to the 5.5 percent early delinquency rate for short-reset ARMs, other ARMs have an early delinquency rate of 4.3 percent and fixed-rate mortgages have a rate of 4.2 percent. While we agree that short-reset ARMs may require an additional pricing control, we do not believe this minimal differential in default rates warrants effectively preventing all short-reset ARMs from obtaining QM status.

Additionally, the Proposal would introduce an entirely new APR calculation that would add complexity and confusion. The Proposal uses neither the standard APR calculation that is used for disclosures (a composite rate that reflects the initial rate and subsequent adjustments to the fully-indexed rate) nor the HOEPA APR calculation (using the higher of the introductory rate or fully-indexed rate). Instead, for purposes of the pricing standard in General QM and the safe harbor determination, the APR for short-reset ARMs would be calculated using the

maximum interest rate that may apply in the first five years. We do not believe that the introduction of this new APR calculation is warranted or necessary. Given the substantial resources that are being dedicated to the transition away from London Interbank Offer Rate (LIBOR) ARMs to Secured Overnight Financing Rate (SOFR) ARMs (or ARMs based on other reference rates), adding a new APR calculation would require significant implementation time, likely beyond the six months envisioned by the Bureau.

To illustrate the detrimental impact of the Proposal, we applied the Proposal to the new SOFR products released by the GSEs. The new Fannie/Freddie SOFR ARM products include a 3 year/6 month and 5 year/6 month product. These products have a 2 percentage point cap on the first adjustment, a 1 percentage point cap on subsequent adjustments, and a 5 percentage point lifetime cap. These products were developed after considerable consultation with the Alternative Reference Rates Committee (ARRC) and financial regulatory agencies. Under the proposed APR calculation method, the APR on the 3 year/6 month product would be more than 5 percentage points over the initial interest rate, and the APR on the 5 year/ 6 month product would be more than 2 percentage points over the initial interest rate. It would be impossible for the 3 year/6 month product to qualify as a QM, unless its initial rate were less than zero percent. The 5 year/6 month product would need a significantly discounted initial rate to be QM. The Proposal would make these products difficult, if not impossible, to offer to qualifying borrowers.

To reiterate, HPC recommends that, instead of the proposed, operationally onerous treatment of short-reset ARMs, the Bureau should establish a simple-to-execute pricing cap – the highest rate in the first five years cannot exceed AIIR by 2.5 or more percentage points. With this approach, the Bureau could forgo the unique APR calculation and permit creditors to use the standard practice yet have a specialized pricing control that reinforces the TILA underwriting rules for short-reset ARMs.

VI. Effective Date

The transition to a new QM regime must be smooth and without disruption to the mortgage market. HPC supports the elimination of the GSE Patch and the proposed changes to the General QM, with our recommended modifications noted above, and we support the Bureau’s proposal that the effective date of a final rule on General QM would be six months after publication in the Federal Register. The new rule would apply to covered transactions for which creditors receive an application on or after this effective date. We ask that the Bureau be explicit that for applications received prior to the effective date, the old rule is applicable, and that is true for the life of the loan. In other words, the designation of QM at consummation date under the existing rule should be replaced with application date, so that all QM loans are determined at application date – either under the old rules or the new rules. Such clear guidance will help provide certainty to borrowers, creditors, insurers, servicers, and investors.

Also, as we stated in our comment letter on the extension of the GSE Patch, we ask the Bureau to coordinate with FHFA and the GSEs to achieve this goal.

Again, thank you for the opportunity to comment on this important Proposal that will help ensure that creditworthy borrowers continue to have access to affordable home financing options. Please contact Meg Burns, EVP, at 202-589-1926 with any questions.

Yours truly,

Edward J. DeMarco
President
Housing Policy Council

Appendix A: Short-reset ARM Test Proposal
Qualified Mortgage Rule

Background:

One of QM's statutory requirements for adjustable rate mortgages is that the loans must be underwritten to the maximum possible interest rate permitted under the loan in the first five years.[5] This requirement is generally intended to minimize the risk that the borrower experiences a payment shock when the rate adjusts in the first five years, which may compromise the ability to repay the loan.

Attributes of short-reset ARMs, generally defined as 5/1 or less hybrid ARMs, relevant to this QM statutory requirement include the following:

- **Type of ARM:** such as a 5/1 Hybrid ARM, which fixes the rate for the first 5 years, after which the rate will adjust annually thereafter over the remaining 25 years of the original 30-year term.

- **Initial Interest Rate:** The rate set by the lender for the initial fixed-rate period. The initial interest rate may be set by the lender according to the following approaches:

    - **Fully Indexed Rate (FIR):** Lenders may set the initial interest rate based on the loan's **Index** plus **Margin**.
        - **Index**: Benchmark rate used by lenders, which floats over time to reflect the lender's changing costs of funds. Examples include 1-Year Treasury or SOFR.
        - **Margin**: The amount the lender adds on to the index, which may vary according to the loan's credit risk factors but remains constant over the loan term.

    - **Discounted Rate:** Also known as a teaser rate, when rates are relatively stable, lenders may choose to discount the FIR for the initial fixed period in order to make the product more attractive to borrowers.

    - **Premium Rate:** When the Index is at record lows and the lender believes the loan Index to be volatile, the lender may choose to charge a premium to the FIR to manage their interest rate risk. It has not been uncommon for the initial interest rate on ARMs to be higher than the FIR over much of the last decade, though this will likely change if interest rates begin to rise in a stable fashion.

- **Periodic Adjustment Cap:** Once the initial fixed rate period has expired, the loan adjusts according to the FIR. The Periodic Adjustment Cap limits the amount that the rate can adjust up or down from one adjustment period to the next. It is common in today's market

[5] The Bureau defines a short-reset ARM to be 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.

for ARMs to have an initial periodic adjustment cap of 2 percentage points followed by subsequent periodic adjustment cap of 2 percentage points every year or 1 percentage point every 6 months.

- **Lifetime Cap:** Limits the interest rate increase over the life of the loan. It is common in today's market for ARMs to have a Lifetime Cap of 5 percentage points.

Objectives of the Short-Reset ARM Test:

Under the current QM rule, most stakeholders are comfortable with the statutory requirement to underwrite the loan to the maximum rate in the first five years, which means that the monthly payment used to calculate the DTI is based upon this maximum rate. Generally, the loan is subject to the to 43 percent DTI ratio limit under the QM General Definition, or, in the case of the GSE Patch, the DTI limits imposed by the GSEs.

However, under the CFPB's proposed General QM Definition rule, both the GSE Patch and the 43 percent DTI ratio will expire, consideration of DTI ratio policy will be left to the lender's discretion, and a price-based approach will determine QM status. This change, in spite of the underwriting requirement of ATR, has left some stakeholders concerned that payment shock risk could reemerge, similar to pre-crisis practices, for borrowers of short-reset ARMs.

To address this concern, CFPB proposed in its rule that lenders run a separate and new APR calculation on all short-reset ARMs, in addition to the normal APR calculation, that applies the maximum rate for the first five years to the full term of the loan. Stakeholders are concerned about the complexity of implementing this proposal. Further, this approach would also make it very difficult for ARMs that reset in the first five years with an initial 2 percent adjustment cap to achieve QM status. An alternative QM eligibility test that would be easier to implement and that allows for 5-year ARMs to qualify is feasible, using market pricing for average interest rates of prime rate loans to effectively cap the amount of payment shock that borrowers of short-reset ARMs can experience.

Structure of the Proposed Short-Reset ARM Test:

In addition to the QM rate spread cap proposed by the CFPB, which requires QM mortgages to have an APR that does not exceed APOR by more than 200 basis points and the QM safe harbor rate spread threshold, which allows conclusive presumption that a QM fulfills ATR for those QMs with an APR that does not exceed APOR by more than 150 basis points, short reset ARMs would be subject to a third pricing cap. This new cap would be designed to reinforce the statutory underwriting obligation described above, which is intended to ensure that a borrower has the ability to repay a short-reset ARM over the long term.

The test would compare the maximum interest rate on the ARM in the first 5 years with the average prime initial interest rate plus 250 basis points for a similar product. Specifically:

*If **Loan's Maximum Interest Rate in the First Five Years** ([the Loan's Initial Interest Rate] plus [the sum of the Initial and any subsequent Periodic Adjustment Caps that apply within the first 60 months of the loan term]) <= **Reasonable Payment Shock Cap** ([CFPB Average Initial Interest Rate] plus 250 bps], then loan that satisfies all other QM requirements = QM, else loan = Non-QM.*

As outlined in the above rule, the left hand side of the equation would calculate **the maximum possible interest rate on the loan in the first five years** by summing the initial interest rate set by the lender for the initial fixed-rate period, as well as the Initial and any subsequent Periodic Adjustment Caps that apply up to the 60 month mark in the loan term. In the case of a 5-1 ARM, there would be just one adjustment to consider, generally of 200 basis points.

The right-hand side of the equation would calculate a **reasonable payment shock cap** to apply as a basis of comparison against the maximum rate on the loan in the first five years. We propose to do this by taking the CFPB's Average Initial Interest Rate (i.e., the average initial interest rate offered by lenders for prime loans) and adding to it a 250 basis point allowable buffer reflecting the industry standard Periodic Adjustment Cap for short-reset ARMs and then adding to that an additional allowable buffer of 50 basis points in risk-based pricing that may be reflected in the Loan's Initial Interest Rate.

The following provides an illustrative example:

- Date of Loan Origination = 7/1/2010
- Loan Type = 5/1 Hybrid ARM
- Loan Initial Interest Rate = 4.5 percent
- First Periodic Adjustment Cap = 2 percentage points
- Maximum rate in first 5 years = 6.5 percent
- CFPB Average Initial Interest Rate = 4.44 percent
- Permissible increase = 2.5 percent
- Test = 6.94 percent

Because Loan's Maximum Interest Rate in First Five Years (6.5 percent) <= Reasonable Payment Shock Rate Cap (6.94 percent), the loan is a QM.

<u>Empirical Evidence:</u>

To test and evaluate the market impacts of this approach, we asked CoreLogic to use its Loan Level Market Analytics (LLMA) loan performance data to run a batch of historical loans through this test to ascertain how many loans would have retained QM status under this Short-Reset ARM Test.

Data:
CoreLogic LLMA
2010 Originated Loans

5/1 Hybrid Arms
163,558 Loan Count

Results:

2010 Vintage - 5/1 Hybrid ARMs	CFPB Average Initial Interest Rate plus [Periodic Adjustment Caps plus Risk-Based Pricing Buffers @]:				
Total Loan Count - 163,558	**250 Bps**	**300 Bps**	**350 Bps**	**400 Bps**	**450 Bps**
QM Loans	144,579	161,037	163,284	163,524	163,549
Non-QM Loans	18,979	2,521	274	34	9
Non-QM population as % of total	11.6%	1.5%	0.2%	0.0%	0.0%

<u>Why Not Use APOR in the Test?:</u>

This is also a reasonable option; use of the APOR threshold in place of the CFPB Average Initial Interest Rate remains a viable option the CFPB should consider. Our recommendation to use the CFPB Average Initial Interest Rate is based on the following considerations:

Considerations arguing in favor of using CFPB Average Initial Interest Rate:

- As a test designed to cap any unreasonable payment shocks that may result from rate adjustments that occur during the 60 month period for short-reset ARMs, we view CFPB Average Initial Interest Rate as an apples-to-apples test that uses market-pricing of average initial interest rates offered by lenders for prime rate loans combined with industry best practice buffers for periodic interest rate caps and risk-based pricing premium on loan margin.

- APOR is based on an average of APRs calculated by CFPB. The APR itself is calculated as a composite of the Average Initial Interest Rate (during the initial fixed-rate period of the loan term) and the Average Fully-Indexed Rate (during the remaining term of the loan), also factoring Average Points and Fees. Reviewing historical data, there is an observable, unpredictable, and at times significant spread between the loan's initial interest rate and the fully-indexed rate (in either direction), resulting in APRs (and by extension APORs) that can be significantly higher or lower than the CFPB Average Initial Interest Rate.

- The following tables demonstrate the observable, yet inconsistent spread between APOR and Average Initial Interest Rate, looking at weekly survey from the start of May through end of August of 2010 and 2020, respectively.

	5-Year ARM						
Date	Average Initial Interest Rate	Average Points & Fees	Average Margins	1-Year Treasury Index	Average Fully-Indexed Rate	APOR	Spread (APOR - AIIR)
5/7/2020	3.17	0.3	2.75	0.15	2.9	3.02	-0.15
5/14/2020	3.18	0.3	2.75	0.15	2.9	3.03	-0.15
5/21/2020	3.17	0.4	2.75	0.16	2.91	3.03	-0.14
5/28/2020	3.13	0.4	2.75	0.17	2.92	3.03	-0.1
6/4/2020	3.1	0.4	2.75	0.17	2.92	3.01	-0.09
6/11/2020	3.1	0.4	2.75	0.19	2.94	3.03	-0.07
6/18/2020	3.09	0.4	2.75	0.19	2.94	3.02	-0.07
6/25/2020	3.08	0.5	2.75	0.17	2.92	3.01	-0.07
7/2/2020	3	0.3	2.75	0.16	2.91	2.96	-0.04
7/9/2020	3.02	0.3	2.75	0.14	2.89	2.96	-0.06
7/16/2020	3.06	0.3	2.75	0.14	2.89	2.98	-0.08
7/23/2020	3.09	0.3	2.75	0.14	2.89	2.98	-0.11
7/30/2020	2.94	0.4	2.75	0.11	2.86	2.94	0
8/6/2020	2.9	0.4	2.75	0.14	2.89	2.92	0.02
8/13/2020	2.9	0.4	2.75	0.14	2.89	2.92	0.02
8/20/2020	2.91	0.3	2.75	0.12	2.87	2.91	0
8/27/2020	2.91	0.2	2.75	0.13	2.88	2.91	0

	5-Year ARM						
Date	Average Initial Interest Rate	Average Points & Fees	Average Margins	1-Year Treasury Index	Average Fully-Indexed Rate	APOR	Spread (APOR - AIIR)
5/6/2010	3.97	0.7	2.74	0.34	3.08	3.5	-0.47
5/13/2010	3.95	0.6	2.74	0.4	3.14	3.47	-0.48
5/20/2010	3.91	0.6	2.74	0.34	3.08	3.43	-0.48
5/27/2010	3.97	0.7	2.75	0.37	3.12	3.47	-0.50
6/3/2010	3.94	0.7	2.74	0.38	3.12	3.46	-0.48
6/10/2010	3.92	0.7	2.75	0.34	3.09	3.44	-0.48
6/17/2010	3.89	0.7	2.75	0.28	3.03	3.41	-0.48
6/24/2010	3.84	0.7	2.74	0.29	3.03	3.37	-0.47
7/1/2010	3.79	0.7	2.75	0.32	3.07	3.37	-0.42
7/8/2010	3.75	0.7	2.74	0.3	3.04	3.36	-0.39
7/15/2010	3.85	0.7	2.74	0.27	3.01	3.37	-0.48
7/22/2010	3.79	0.6	2.74	0.27	3.01	3.33	-0.46
7/29/2010	3.76	0.7	2.75	0.3	3.05	3.35	-0.41
8/5/2010	3.63	0.6	2.74	0.27	3.01	3.28	-0.35
8/12/2010	3.56	0.7	2.74	0.25	2.99	3.24	-0.32
8/19/2010	3.56	0.6	2.74	0.25	2.99	3.24	-0.32
8/26/2010	3.56	0.6	2.75	0.25	3.00	3.25	-0.31

- Notably, the Average Initial Interest Rate was higher than the APOR in every 2010 and 2020 survey month with the exception of 3 weeks in 2020. Equally notable is that the average spread between APOR and Average Initial Interest Rate was 6.4 bps for 2020 survey weeks compared to 42.9 bps for 2010. To wit, when CoreLogic uses the APOR in the same test (as opposed to the CFPB's Average Initial Interest Rate), significantly fewer loans in the 2010 test data set achieve QM status. The following table illustrates the impact on QM eligibility using APOR. We feel these results lend more evidence to the contention that comparing the loan's maximum interest rate in the first five years to the CFPB Average Initial Interest Rate index will result in a more apples-to-apples comparison.

2010 Vintage - 5/1 Hybrid ARMs	Average Prime Offer Rate (APOR) plus [Periodic Adjustment Caps plus Risk-Based Pricing Buffers @]:						
Total Loan Count - 163,558	250 Bps	275 Bps	300 Bps	325 Bps	350 Bps	375 Bps	400 Bps
QM Loans	105,186	136,334	152,576	159,612	162,149	162,994	163,361
Non-QM Loans	58,372	27,224	10,982	3,946	1,409	564	197
Non-QM population as % of total	35.7%	16.6%	6.7%	2.4%	0.9%	0.3%	0.1%

Considerations arguing in favor of using APOR nonetheless:

- While CFPB Average Initial Interest Rate may provide for a more apples-to-apples comparison, it is also fair to argue that APOR is a long-standing test used by CFPB for market pricing index purposes, including most notably as the basis for the overarching QM-

eligibility and safe harbor tests in the proposed rule. To the extent CFPB views an APOR-index based approach as less "novel," CFPB may be more inclined to include the APOR index in a Short-Reset ARM Test as part of the QM definition.

- A Short-Reset ARM Test like the one specified above can still be reasonably executed using APOR. By looking back on this history of spreads between APOR and Average Initial Interest Rate, we can compensate for variations when calibrating the allowable buffers for the Industry Standard Periodic Adjustment Cap (presently at 2 percent) and the risk-based pricing premium for loan margin (presently at 50 basis points). CoreLogic results from the APOR test (above) may form the basis of such an assessment.

- APOR may be perceived by lenders as easier to implement than the CFPB Average Initial Interest Rate, though the following section provides some insight on this complexity.

Operational Considerations:

The following operational considerations would need to be accommodated by CFPB in a final rule in order to make the implementation of the Short-Reset ARM Rule seamless:

- The Average Initial Interest Rate is the rate used by the CFPB in its calculation of APORs for ARMs with initial reset periods of 1, 2, 3, and 5 years. The source of the Average Initial Interest Rate for the 5-year ARM is Freddie Mac's PMMS survey. The source of the Average Initial Interest Rate for the 1-year ARM is a survey by the CFPB. The CFPB uses the Average Initial Interest Rate for the 5-year and 1-year ARMs to estimate the Average Initial Interest Rate for the 2-year and 3-year ARMs.

- The CFPB currently publishes the Average Initial Interest Rate for 1-year and 5-year ARMs on its website at https://ffiec.cfpb.gov/tools/rate-spread, at the "Mortgage Rate Survey Data" link. The CFPB calculates, but currently does not publish, the Average Initial Interest Rate for 2-year and 3-year ARMs, which we would ask CFPB to start publishing as part of the final Rule.

Appendix B: HPC Proposed QM Pricing Test

This diagram only addresses the pricing features of QM; all other QM requirements also must be met.