Analysis of the BCFP’s (CFPB’s) temporary Qualified Mortgage category announced in January 2013, commonly known as the “Patch”

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The views expressed in this comment are those of the authors alone and do not necessarily represent those of the American Enterprise Institute or the Heritage Foundation.
Executive Summary

Conclusion 1: The patch has led to the needless and risky proliferation of high DTI loans by the FHA, the VA, and the GSEs.

Conclusion 2: The patch enables risk layering.

Conclusion 3: The patch puts minority borrowers at greater risk.

Conclusion 4: The patch enables even greater risk layering for buyers with incomes below the median census tract family income.

Conclusion 5: the patch has helped fuel a house price boom.

Conclusion 6: The patch did not achieve what the Bureau intended.

Recommendations for Action

In 2012, the Bureau of Consumer Financial Protection (the Bureau, also known as the BCFP or CFPB) has stated it believes that loan performance by DTI, as measured by an ever-to-date delinquency rate such as 60 days or more delinquent, is an appropriate metric to evaluate whether consumers had the ability to repay those loans at the time made and that ever-to-date delinquency rates increase as DTIs increase.\(^1\)

Also as noted in 2012, the Bureau has stated that empirically derived ever-to-date delinquency rates for loans with DTIs above 43 percent have historically not resulted in comparatively low rates of delinquency and default during adverse economic conditions.\(^2\)

The final rule provided three factors (considerations) that may serve as “evidence that a creditor’s ability-to-repay determination was reasonable and in good faith.”\(^3\) Based on two of those factors, the patch violates the underlying purpose of the ability-to-repay standard:

- The creditor used underwriting standards that have historically resulted in comparatively low rates of delinquency and default during adverse economic conditions.
- The creditor used underwriting standards based on empirically derived, demonstrably and statistically sound models.

It is clear from the above evidence that the patch promoted the expansion of loans in a manner directly counter to both of the above noted factors because it encouraged loans which would result in comparatively higher rates of delinquency and default during adverse economic conditions.

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\(^1\) Supra. BCFP, 2012.
\(^2\) Supra. BCFP, 2012.
\(^3\) Bureau of Consumer Financial Protection, Pg. 6603.
Finally, the Bureau also has broad discretion to effectuate Section 129B, including the latitude to allow the patch to expire by its own terms in January 2021. With respect to its authority to revise the QM safe harbor, Section 1412 states:

The Board may prescribe regulations that revise, add to, or subtract from the criteria that define a qualified mortgage 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 this section, necessary and appropriate to effectuate the purposes of this section and section 129B, to prevent circumvention or evasion thereof, or to facilitate compliance with such sections.

Based on the empirical evidence provided and for all the above-mentioned reasons, we respectfully recommend that the Bureau should take the following actions as soon as possible.

- Announce that the GSE patch will not be renewed.
- Provide guidance to GSEs that they should immediately begin reducing industry’s reliance on patch in a measured manner, thereby reducing any market impacts between now and the 2021 expiration of the patch.
- Coordinate with HUD/FHA on reductions to its DTI policies as part of a broader effort to counter-cyclically slow down the home price boom.
- Indicate it will be looking at changes to the QM rule so that, in the future, it has a counter-cyclical component.
Summary of QM Purpose and Definition

One of the main Congressional responses to the 2008 mortgage crisis is Title XIV of the Dodd-Frank Act. Title XIV, known as the Mortgage Reform and Anti-Predatory Lending Act, is based on the idea that a primary cause of the financial crisis was creditors steering customers into the wrong mortgages. These low quality/high risk mortgages, in turn, ostensibly made it difficult for borrowers to make scheduled payments. Thus, Title XIV purports to protect the economy from another financial crisis by controlling mortgage quality.

Section 1402 of Dodd-Frank amended the Truth in Lending Act (by adding Section 129B and Section 129C) based on the finding that “economic stabilization would be enhanced by the protection, limitation, and regulation of the terms of residential mortgage credit and the practices related to such credit, while ensuring that responsible, affordable mortgage credit remains available to consumers.”

Title XIV aims to accomplish this finding through various mechanisms, including implementing a set of minimum mortgage standards known as a qualified mortgage. The core of these minimum standards is in Section 1411’s “ability to repay” requirements and Section 1412’s “safe harbor and rebuttable presumption” relating to those requirements. Section 1411 amends the Truth in Lending Act and requires federal regulators to promulgate rules so that “no creditor may make a residential mortgage loan unless the creditor makes a reasonable and good faith determination based on verified and documented information that, at the time the loan is consummated, the consumer has a reasonable ability to repay the loan.” Although section 1411 does provide some guidance on what constitutes a reasonable and good faith determination, it leaves most of the details to the regulators.

Section 1412 amends the Truth in Lending Act so that a lender may presume a mortgage meets the ability to repay requirements provided the loan is a qualified mortgage (QM). Section 1412 does require several specific loan features for the QM, but it also gives federal regulators discretion to create the final QM standard. For instance, Section 1412 stipulates that a QM cannot have “total points and fees (as defined in subparagraph (C))” that exceed 3 percent of the total loan amount. Section 1412 also generally prohibits loans with negative amortization, interest only payments, balloon payments, and terms exceeding 30 years from being qualified mortgages, but does provide limited exceptions based on regulatory discretion. Similarly, Section 1412 requires federal regulators to establish a QM rule that includes “ratios of total monthly debt to monthly income or alternative measures of ability to pay regular expenses after payment of total monthly debt,” but does not provide specific ratios.

Thus, in a supposed attempt to control mortgage quality, Congress gave federal regulators a great deal of discretion to develop the required minimum standard – the QM – for residential

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4 15 U.S. Code § 1639c(a).
5 Presumption of Ability to Repay. 15 U.S. Code § 1639c(b)
mortgages. In 2013, the Bureau issued the final QM rule, which included a maximum total or back-end debt-to-income ratio (DTI) of 43 percent of pre-tax income, subject to substantial exceptions. In addition to statutory requirements, noted above, the final QM standard also limits points and fees, explicitly restricts the underwriting standards for adjustable-rate mortgages (ARMs), narrows the statutory limitation of prepayment fees, and requires full documentation of income and financial resources.

Summary of Findings on QM and DTI as Part of Final 2013 Rule Making

The Bureau’s final rule, which became effective January 10, 2014, establishes the general underwriting criteria for the QM. The Bureau states: “Most importantly, the general rule requires that monthly payments be calculated based on the highest payment that will apply in the first five years of the loan and that the consumer have a DTI that is less than or equal to 43 percent.”

Thus, this maximum DTI of 43 percent was a key feature of the QM, designed to “protect consumers by ensuring that creditors use a set of underwriting requirements that generally safeguard affordability.” Statements by Bureau officials described the final rule in these terms:

When consumers sit down at the closing table, they shouldn’t be set up to fail with mortgages they can’t afford. Our Ability-to-Repay rule protects borrowers from the kinds of risky lending practices that resulted in so many families losing their homes. This common-sense rule ensures responsible borrowers get responsible loans.

For the largest single consumer financial market – the mortgage market, worth trillions of dollars – we have adopted sweeping new rules to ensure that the excesses and irresponsible practices that helped precipitate our nation’s financial calamity cannot be repeated.

Recently, we released the Ability-to-Repay rule designed to protect consumers from irresponsible lending and begin to lay the framework for stability in the mortgage

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9 Bureau of Consumer Financial Protection, “Ability-to-Repay and Qualified Mortgage Standards under the Truth in Lending Act (Regulation Z),” Federal Register, Vol. 78, No. 20, January 30, 2013, https://www.gpo.gov/fdsys/pkg/FR-2013-01-30/pdf/2013-00736.pdf (accessed May 25, 2018). Section 1412 requires the Federal Reserve Board of Governors to issue the QM rule because the Board, prior to Dodd-Frank, was responsible for enforcing the Truth in Lending Act. However, Title X of Dodd-Frank (Section 1100A) transferred this authority to the newly created Bureau of Consumer Financial Protection. Section 1412 also requires the Department of Housing and Urban Development, the Department of Veterans Affairs, the Department of Agriculture, and the Rural Housing Service to promulgate their own QM rules. 15 U.S. Code § 1639c(b)(3)(B)(ii).

10 Section 1412 allowed regulators to make exceptions for the 30-year term in certain high-cost areas, but the Bureau decided against making such an allowance. See Bureau of Consumer Financial Protection, Pg. 6518.

11 Bureau of Consumer Financial Protection, Pg. 6409. The Bureau based its guidelines for the DTI calculations on those of the Federal Housing Administration.

12 Ibid.


We estimate that the vast majority of loans originated today will meet the standards for a ‘Qualified Mortgage’ so long as creditors follow the required procedures.\(^{15}\)

The final rule also stated that the Bureau believes “that there are many instances in which individual consumers can afford a debt-to-income ratio above 43 percent based on their particular circumstances.”\(^{16}\) (Emphasis added.)

The Bureau argued that a blanket presumption was inappropriate for these loans, and that such mortgages would be better evaluated on an individual basis (though still within the ability to repay framework). The Bureau also expressed concerns that, due to the fragile nature of the market in the aftermath of the financial crisis, lenders may be reluctant to make non-QM loans.

The final rule states that:

The Bureau acknowledges it may take some time for the non-qualified mortgage market to establish itself in light of the market anxiety regarding litigation risk under the ability-to-repay rules, the general slow recovery of the mortgage market, and the need for creditors to adjust their operations to account for several other major regulatory and capital regimes.\(^ {17}\)

To mitigate these problems, the Bureau created a temporary QM category, now commonly known as the patch.\(^ {18}\) The patch established a second QM category for loans that meet other QM requirements (see next paragraph) but for which the borrower’s DTI exceeds 43 percent, provided that the loan is either: (1) eligible for purchase or guarantee by Fannie Mae or Freddie Mac while they are in federal conservatorship; or, (2) eligible to be insured or guaranteed by the Federal Housing Administration (FHA), the US Department of Veterans Affairs (VA), the US Department of Agriculture (USDA), or the Rural Housing Service (RHS).\(^ {19}\)

Additionally, to be a QM that falls into this temporary category, the creditor must satisfy the requirements under 12 CFR §§ 1026.43(e)(2)(i) through (iii). As a result of these requirements, to qualify for the temporary QM category, a mortgage must (1) meet the specified points and fees; (2) must not exceed a term of 30 years, and, (3) must have substantially equal periodic payments that do not: (A) result in an increase of the principal balance; (B) allow the consumer to defer repayment of principal (with limited exceptions); or, (C) result in a balloon payment (with limited exceptions). Thus, “the temporary definition does not include requirements to (1) verify and document the consumer’s income or assets relied upon in qualifying the consumer; (2) underwrite a fixed rate loan based on a payment schedule that fully


\(^{16}\) Ibid.

\(^{17}\) Bureau of Consumer Financial Protection, Pg. 6533.

\(^{18}\) The general QM is codified at 12 CFR § 1026.43(e)(2), and the temporary QM category is codified at 12 CFR § 1026.43(e)(4). The Bureau also created a separate QM category for small creditors that operate predominately in rural or underserved areas. See Bureau of Consumer Financial Protection, Pg. 6556 and 12 CFR § 1026.43(e)(5).

\(^{19}\) See 12 CFR § 1026.43(e)(4)(ii)(A) through (E).
amortizes the loan over the term and takes into account all applicable taxes, insurance, and assessments; or (3) underwrite an adjustable-rate loan using the maximum interest rate permitted in the first five years.”

The final rule states that the Bureau believes it is appropriate to presume that Fannie and Freddie (and agency) eligible loans were originated with “appropriate consideration of consumers’ ability to repay, where those loans also satisfy the requirements of § 1026.43(e)(2) concerning restrictions on product features and total points and fees limitations.” Still, the Bureau made it clear that the patch was only to provide “a reasonable transition period to the general qualified mortgage definition, including the 43 percent debt-to-income ratio requirement.” (Emphasis added.)

Similarly, the Bureau believed that the patch would “provide an adequate period for economic, market, and regulatory conditions to stabilize,” and that it would “provide an orderly transition period, while preserving access to credit and effectuating the broader purposes of the ability-to-repay statute during the interim period.” (Emphasis added.) The patch has expired for the FHA, the VA, the USDA, and the RHS because each agency has issued its own QM rules. For Fannie and Freddie, the patch will sunset in seven years from the effective date of the rule (January 10, 2014) or when their federal conservatorship ends. Given the current state of the conservatorship, the patch – which now applies only to Fannie and Freddie loans – will expire in January 2021.

The final rule also provided two upfront factors (considerations) for non-QM loans that elaborate on what would constitute “evidence that a creditor’s ability-to-repay determination was reasonable and in good faith.”

- The creditor used underwriting standards that have historically resulted in comparatively low rates of delinquency and default during adverse economic conditions.
- The creditor used underwriting standards based on empirically derived, demonstrably and statistically sound models.

**Summary of 5-year Bureau review**

Section 1022(d) of the Dodd-Frank Act requires the Bureau assess each significant rule or order that it adopts. By law, this assessment must address “among other relevant factors, the effectiveness of the rule or order in meeting the purposes and objectives of this title [Title X] and the specific goals stated by the Bureau.” Section 1021 of Dodd-Frank lists the Bureau’s “Purpose, objectives, and functions.” The stated purpose of the Bureau is to “seek to implement and, where applicable, enforce Federal consumer financial law consistently for the purpose of

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20 Bureau of Consumer Financial Protection, Pg. 6534.
21 Bureau of Consumer Financial Protection, Pg. 6534.
22 Ibid.
23 Bureau of Consumer Financial Protection, Pg. 6534.
24 Section 1412 of Dodd-Frank requires each of these agencies to issue its own QM rules. 15 U.S. Code § 1639c(b)(3)(B)(ii).
25 Bureau of Consumer Financial Protection, Pg. 6603.
ensuring that all consumers have access to markets for consumer financial products and services and that markets for consumer financial products and services are fair, transparent, and competitive.” Section 1021 also lists the following five objectives:

1. Consumers are provided with timely and understandable information to make responsible decisions about financial transactions;
2. Consumers are protected from unfair, deceptive, or abusive acts and practices and from discrimination;
3. Outdated, unnecessary, or unduly burdensome regulations are regularly identified and addressed in order to reduce unwarranted regulatory burdens;
4. Federal consumer financial law is enforced consistently, without regard to the status of a person as a depository institution, in order to promote fair competition; and
5. Markets for consumer financial products and services operate transparently and efficiently to facilitate access and innovation.

Thus, Dodd-Frank includes clear statutory requirements for the Bureau to enforce its authority in a manner that ensures fair and competitive markets as well as explicit financial consumer protections.

Dodd-Frank also requires that the assessment reflect “available evidence and any data that the Bureau reasonably may collect,” and that the Bureau publish a report of the assessment no later than 5 years after the effective date of the rule in question. Furthermore, the Bureau can only publish the report after inviting “public comment on recommendations for modifying, expanding, or eliminating the newly adopted significant rule or order.” The Bureau determined the QM rule was a significant rule and, as required by law, sought public comment on its plan to assess the ability to repay/QM rule. The comment period closed July 31, 2017, and nearly 500 comments were submitted to the Bureau, many of which called for the Bureau to extend and/or expand the patch. These comments served as prima facie evidence that the patch did not work to accomplish “a reasonable transition period to the general qualified mortgage definition, including the 43 percent debt-to-income ratio requirement.” (Emphasis added.)

26 Separately, Section 1412 of Dodd Frank gives the Bureau the authority to “prescribe regulations that revise, add to, or subtract from the criteria that define a qualified mortgage 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 this section, necessary and appropriate to effectuate the purposes of this section and section 129B, to prevent circumvention or evasion thereof, or to facilitate compliance with such sections.” 15 U.S.C. § 1639c(c)(3)(B)(i).
27 1022(d), 12 U.S.C. § 5512(d).
29 https://www.regulations.gov/docketBrowser?rpp=50&so=DESC&sbt=postedDate&po=0&dct=PS&D=CFPB-2017-0014
30 Bureau of Consumer Financial Protection, “Request for Information,” Pg. 25249.
In January 2019, the Bureau released its assessment report of the QM rule, confirming that the patch had failed to provide such a reasonable transition period. In particular, the report notes that “The continued prominence of Temporary GSE QM originations is contrary to the Bureau’s expectations at the time of the [original] rulemaking, and certain goals of the Rule have therefore not been met.” The Bureau further acknowledges that the patch has increased the proliferation of high-DTI loans in the market, thus increasing the number of loans in the market that have historically resulted in comparatively higher default and delinquency rates. Citing evidence from loan application data of nine major lenders, the report states the following:

Those data show a decline in high DTI lending in the non-GSE space relative to the GSE space and thus the continued prominence of the Temporary GSE Exemption among high DTI borrowers. Thus, although the Bureau expected that loans with DTI above the 43 percent threshold would increasingly be originated outside the Temporary QM category, i.e., as non-QM loans, the available data suggests that the opposite is happening.

One reason that the patch furthered the spread of these high DTI loans is that the GSEs changed their own underwriting guidelines (as the Bureau acknowledges). In July of 2017, Fannie announced elimination of the DTI eligibility overlay for loans between 45% and 50%, effectively eliminating the need to use compensating factors. Thus, as will be documented below, it is not surprising that the patch has served to increase, rather than reduce, market reliance on DTIs above 43 percent, thereby making it more difficult, without Bureau guidance, to broadly attain QM’s core 43 percent DTI requirement by the patch’s January 2021 expiration date.

More importantly, the fact that the patch has provided the only sure-fire means of QM compliance for most of the high DTI loan market means that the existence of the patch works against the Bureau’s main QM goals. In other words, lenders and investors have little reason to move such high DTI loans outside of the temporary QM category as long as the patch guarantees QM compliance. The Bureau’s report acknowledges this possibility with statements such as the following:

- Thus the use of the GSEs adds compliance certainty for loans that could also satisfy the General QM test, and for high DTI loans the Temporary GSE QM provides the only means of compliance certainty. These factors may have contributed to investors’ persistent preference for GSE-guaranteed loans as well as to creditors increased use of...
GSE underwriting for certain categories of loans, their reluctance to originate non-QM loans, and their shift away from high-DTI loans in the non-GSE eligible space.\textsuperscript{35}

- Overall, it is possible that the breadth of the Temporary GSE QM category in itself is inhibiting the growth of the non-QM market.\textsuperscript{36}

- The Temporary GSE QM does not require that these new methods of income verification and calculation be compliant with Appendix Q, and it would be difficult for a creditor to determine if they were, as much of the underlying requirements and technical specifications are maintained under proprietary confidentiality between the vendors and the GSEs. Similarly, while a private investor or lender could seek to originate and privately securitize mortgage loans using these same innovations, the complexity of the GSE-approved methods, at least in some cases, and the fact that these methods are private, would make it difficult for an entity to know if the loan was in fact eligible for purchase by the GSEs. These constraints may explain, at least in part, why innovation in one segment of the market does not appear to have spurred growth and innovation in others.\textsuperscript{37}

**Housing finance principles relevant to DTIs, income leverage, and capitalization into prices during seller’s markets**

In 1951, Ernest Fisher, FHA’s first chief economist during the 1930s, made the following observations, based upon empirical studies of FHA and VA lending:

- [I]n a seller's market, when choice is restricted and the seller virtually dictates sales terms, more liberal credit is likely to be [capitalized] in price with probably a reduction in housing standards.\textsuperscript{38}

- [In transitioning] from a buyer's to a seller's market, maximum terms become so commonly used they tend to be considered the minimum.\textsuperscript{39}

The operation of these principles on housing finance and the cyclical nature of real estate markets cannot be understated. Unlike traditional insurance businesses such as fire and life, for which reliable experience or mortality tables may be developed, projected losses for the mortgage guaranty business by cohort year varies by as much as an order of magnitude. Further, while “[t]he sequence of [market cycle] events is fairly predictable, though the period of the phases of the cycle and the amplitude of the variations are not subject to dependable forecasting.”\textsuperscript{40}

\begin{footnotesize}
\begin{enumerate}
\item Burea\textsuperscript{u} of Consumer Financial Protection, “Ability-to-Repay and Qualified Mortgage Rule Assessment Report,” pp. 204-205.
\item Burea\textsuperscript{u} of Consumer Financial Protection, “Ability-to-Repay and Qualified Mortgage Rule Assessment Report,” pg. 205.
\item Burea\textsuperscript{u} of Consumer Financial Protection, “Ability-to-Repay and Qualified Mortgage Rule Assessment Report,” pg. 206.
\item Fisher, *Financing Home Ownership*, NBER, 1951
\item Ibid.
\item Ratcliffe, *Urban Land Economics*, 1949
\end{enumerate}
\end{footnotesize}
This concept is demonstrated by the experience of Fannie Mae where cumulative defaults rates varied by an order of magnitude over the comparatively short period of 2002 to 2007.

**Single-Family Cumulative Default Rates**

The chart below traces the history of GSE DTIs greater than or equal to 42 percent from about 1990 through 2018.41 This percentage has ranged from less than 5 percent in 1988-1991, up to 15 percent in

**History of GSE DTIs 1990 – 2018**

In this section we leverage a number of data sets, including data collected by the Bureau when writing the QM regulation, in order to depict the history of GSE DTIs. The chart below traces the history of GSE DTIs greater than or equal to 42 percent from about 1990 through 2018.41 This percentage has ranged from less than 5 percent in 1988-1991, up to 15 percent in

41 Greater than or equal to 42 percent is a common data point available for the entire time period.

- With the exception of 1988-1991 common data point which is based on loan counts, all other calculations based on loan dollars.
- Loan type used for BCFP analysis: first-lien mortgages on first or second homes, that have fully documented income and that are fully amortizing with a maturity that does not exceed 30 years. The BCFP further noted that the tabulations do not include the following types of loans: loans for investor-owned properties, low- or no-document mortgages; interest-only (IO) mortgages; negatively-amortizing mortgages such as payment option-ARMs; or mortgages with a balloon payment feature.
1998, hitting a peak of 43 percent in 2007, back down to 17 percent in 2012, and now back up to 38 percent in 2018 (the same as the average level attained in 2005-2006). GSE DTIs are still climbing.

The inflation-adjusted house price trend looks quite similar to the DTI trend, above. The DTI trend is remarkable for two reasons: (i) the tremendous volatility in the incidence of high DTIs and (ii) the interest rate trend has been declining to flat for the 1991-2017 time period. The house price trend is also unprecedented for two reasons: (i) the amplitude of the booms and (ii) their occurring so close together.

The Bureau has stated it believes that loan performance by DTI, as measured by an ever-to-date delinquency rate such as 60 days or more delinquent, is an appropriate metric to evaluate whether consumers had the ability to repay those loans at the time made.\(^{42}\)

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- With the exception of 1988-1991, all calculations use the same defined sub-set of GSE loans.

Data sources:
- 1988-1991: Fannie Mae random sample for loan acquisitions, percent greater than or equal to 42 percent based on extrapolation of data results, document in files of Edward Pinto
- 2010-2016: Fannie Mae and Freddie Mac, loan performance files
- 2017-March 2018: Fannie Mae and Freddie Mac loan level securitization data

\(^{42}\) Ibid.
The next chart provides Bureau delinquency data using this metric covering an eleven year period encompassing the house price boom which preceded the financial crisis.\textsuperscript{43} It sets forth delinquency findings through 2011 for the 1997-2007 cohorts as reported by the Bureau, along with the 2007 cohort delinquency data extended through 2016 (estimated) using AEI data sources:\textsuperscript{44}

- While delinquency rates almost always rose in tandem with DTIs, this relationship became particularly significant for the 2004-2007 cohorts.
  - As noted earlier, mean reversion in home prices can lead to an order of magnitude increase in default rates. Therefore, it is useful to compare the 2002 cohort delinquency findings (2002 was little affected by the “home price bust” stress event of 2007-2012 to the extended 2016 delinquency estimate for the 2007 cohort (2007 was the most affected by the “home price bust” stress event of 2007-2012). The 2007 cohort had an estimated ever-to-date delinquency rate of about 39 percent, compared to a rate of about 5 percent for the 2002 cohort.
- While delinquency rates for the 1997 and 1998 cohorts declined for DTIs above about 40 percent, this is believed due to the rigorous use of compensating risk factors at origination, which usage declined in subsequent years.
- Maximum ever-to-date delinquencies in the 1997-2002 cohort years for the greater than 46 percent DTI bin never exceeded about 5-6 percent.
- Maximum ever-to-date delinquency rate in the 2007 cohort year through 2011 was at 10.6 percent for the less than 32 percent DTI bin.
  - Maximum ever-to-date delinquency rate in the 2007 cohort year extended through 2016 was estimated at 15.0 percent for the less than 32 percent DTI bin, or an ever-to-date rate that was 42 percent higher than the Bureau’s earlier figure.\textsuperscript{45}
- Maximum ever-to-date delinquencies in the 2007 cohort year through 2012 were 30.3 percent for the greater than 46 percent DTI bin.
  - Maximum ever-to-date delinquency rate in the 2007 cohort year extended through 2016 was estimated at 39.0 percent for the greater than 46 percent DTI bin, or an ever-to-date rate that was 29 percent higher than the Bureau’s earlier figure.\textsuperscript{46}
  - In the 2007 cohort year, 31 percent of loans had a DTI greater than 46 percent, compared to 6 percent and 17 percent for the 1997 and 2002.

\textsuperscript{43} Derived from BCFP, \url{http://files.consumerfinance.gov/f/201205_cfpb_Ability_to_Repay.pdf}, 2012. The percentage of loans that were ever 60 days or more delinquent, tabulated by the total DTI on the loans and year of origination. Delinquency data through 2011.
\textsuperscript{44} Ibid.
\textsuperscript{45} When the data through 2011 were published by the BCFP in 2012, the earlier cohorts of say 1997-2002 had about 9-14 years of seasoning, while the worst performing cohort (2007) had only about 4 years of seasoning, leading to a substantial truncation of actual 2007 performance. To help address this seasoning difference, the ever-to-date delinquency for the 2007 cohort was estimated through 2016 using AEI data sources on GSE loan performance, thus adding 5 more years of seasoning.
\textsuperscript{46} Ibid.
Recent trends and analysis of impact of the patch

We now look at DTIs across agency and non-agency loans, with the latter providing us an important non-patch benchmark. We do so by using a sample from the AEI Center on Housing Markets and Finance based on data from Black Knight, CoreLogic, and the Center’s National Mortgage Risk Index (NMRI).

Conclusion 1: The patch has led to the needless and risky proliferation of high DTI loans by the FHA, the VA, and the GSEs.

With the notable exceptions of private portfolio lending and the Rural Housing Service’s (RHS’s) guaranteed loan program, the FHA, the VA, and the GSEs have all taken advantage of the patch to promote the proliferation of high DTI loans. This has occurred across all their business lines—purchase, rate and term refinance, and cash out refinance loans.\(^47\)

As the chart below for purchase lending demonstrates, DTIs at the 75\(^{th}\) percentile for the period from early January 2013 to November 2018 changed as follows:\(^48\)

- RHS’s declined from 42 percent to 41 percent
- Private portfolio lending has risen slightly from 38-39 percent to 40 percent
- FHA’s rose from 47 percent to 52 percent

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\(^{47}\) Sources for next seven charts: AEI Center on Housing Markets and Finance based on data from Black Knight, CoreLogic, and the Center’s National Mortgage Risk Index.

\(^{48}\) In a market, the marginal buyer sets the price. The 75\(^{th}\) percentile represents the marginal buyer with added buying power through the granting of higher DTIs under the patch.
- GSEs’ rose from 40 percent to 44 percent
- VA’s rose from 46 percent to 50 percent

As the chart below for rate-and-term refinance lending demonstrates, DTIs at the 75th percentile for the period from early January 2013 to November 2018 changed as follows:

- RHS – not applicable as does few refinance loans
- Private portfolio lending’s rose from about 37 percent to 40 percent
- FHA’s rose from about 41 percent to 50 percent
- GSEs’ rose from 39-40 percent to 44 percent
- VA’s rose from about 37 percent to 50 percent
As the chart below for cash-out refinance lending demonstrates, DTIs at the 75th percentile for the period from early January 2013 to November 2018 changed as follows:

- RHS – not applicable as does few refinance loans
- Private portfolio lending’s rose from about 38 percent to 41 percent
- FHA’s rose from about 48 percent to 50 percent
- GSEs’ rose from 40 percent to 45 percent
- VA’s rose from about 43-44 percent to 50 percent
To summarize, on average RHS DTIs at the 75th percentile were down slightly across its purchase business lines and portfolio DTIs were up an average of 2.5 percentage across all 3 business lines, while the FHA, the GSEs, and the VA DTIs at the 75th percentile were up an average of 5.5 percentage points across all three business lines.

As a result of the broadly applicable patch, 36 percent of agency purchase guaranteed loans that were originated in March 2018 had a DTI in excess of 43 percent, double the level the month before the patch was announced. This rate continues to rise.

An examination of the trend of DTIs greater than 43 percent across purchase, rate and term refinance, cash-out refinance discloses a similar pattern by the FHA, the VA, and the GSEs to take advantage of the patch to promote the proliferation of high DTI loans, in many cases doubling or more the percentage of DTIs greater than 43 percent. Once again, private portfolio lenders and the RHS have been the exceptions, showing the same or less usage of DTIs greater than 43 percent over time. Furthermore, the results are similar for portfolio loans below the GSE national conforming loan limit.
As a final note, *purchase* loans with DTIs over 50 percent are mostly FHA or VA insured. The GSEs and RHS back only a negligible number of loans, if any, over 50 percent.

In order to relate DTIs to other borrower and loan characteristics, we also created a matched sample of HMDA Agency purchase loans and a number of other datasets including NMRI and Public Records data. After eliminating observations for which DTI is not reported, the dataset consists of 5.4 million unique one-to-one matched agency loans in the largest 73 CBSAs from...
2013-2017, which corresponds to 48 percent of all HMDA purchase loans over this period in those metros.\textsuperscript{49}

\textit{Conclusion 2: The patch enables risk layering.}

In order to assess DTIs and risk layering since the patch was put in place, we examine Agency purchase loans, and separately, the subset of purchase loans backed by the GSEs. We do this so that on one hand we can understand how credit is changing for the bulk of the market (Agency lending represents more than 80 percent of institutional mortgage lending as of 2017). On the other hand, the patch is currently mainly relevant for the GSEs because the other government agencies have issued their own QM rules. We conduct analysis on group differences and changes over time in DTIs, where groups are created based on CLTV, FICO scores, first time and minority borrower status, and income.\textsuperscript{50}

\textit{All Agency purchase market (FHA, VA, Fannie, Freddie, and RHS): CLTV}

The share of Agency purchase loans with DTIs greater than 43 percent is about twice as great for high combined loan to value ratio (CLTV) loans compared to lower CLTV loans and this in part reflects differences in CLTVs across Agency programs. Over time, the share of Agency purchase loans with DTIs over 43 percent has increased as follows:

- CLTVs at or below 95 percent: from 16 percent in 2013 to 21 percent in 2017 (left panel below).
- CLTVs over 95 percent: from 35 percent to 42 percent (right panel below).

The share of DTIs greater than 50 percent among high CLTV loans is notably greater than for those with lower CLTVs and are attributable to FHA and VA insured lending.

\textsuperscript{49} We report statistics using the unweighted matched sample. The list of largest CBSAs excludes Atlanta CBSA because of data quality issues.

\textsuperscript{50} Sources for next ten chart groups: AEI Center on Housing Markets and Finance based on a matched sample of HMDA Agency purchase loans and a number of other datasets including NMRI and Public Records data.
**Fannie and Freddie (GSE) purchase market only: CLTV**

While initially lower, the DTI over 43 share of high CLTV GSE loans “caught up” to the share among lower CLTV loans over time:

- CLTVs at or below 95 percent: 14 percent in 2013, increasing to 20 percent in 2017 (left panel below).
- CLTVs over 95 percent: 11 percent in 2013, increasing to 20 percent in 2017 (right panel below).

**All Agency purchase market (FHA, VA, Fannie, Freddie, and RHS): FICO scores**

While lending to borrowers with FICO scores below 620 is still unusual, its overall share of the Agency market is increasing, and DTIs for very low credit score borrowers have increased much more rapidly than for other groups (first panel below). In particular, the share of Agency purchase loans between 2013 and 2017 with DTIs greater than 43 percent has changed as follows:

- Very low FICO score loans (<620): increased from 17 percent to 39 percent (first panel below).
- Low FICO score loans (≥620, <660): increased from 34 percent to 42 percent (second panel below).
- Middle-high FICO score loans (≥660): increased from 22 percent to 28 percent (third panel below).
Fannie and Freddie (GSE) purchase market only: FICO scores

The vast majority of GSE loans are originated with FICO scores above 660. But for the low and middle-high FICO score groups, the share of GSE purchase loans between 2013 and 2017 with DTIs greater than 43 percent changed as follows:

- Low FICO score loans (>=620, <660): increased from 18 percent to 24 percent (left panel below).
- Middle-high FICO score loans (>=660): increased from 14 percent to 20 percent (right panel below).
**All Agency purchase market: first time buyers**

First time buyers are somewhat more likely than repeat buyers to obtain greater income leverage in the Agency mortgage market. The share of Agency purchase loans between 2013 and 2017 with DTIs greater than 43 percent has increased for first time and repeat buyers as follows:

- First time buyers: increased from 24 percent to 32 percent (left panel below).
- Repeat buyers: increased from 22 percent to 27 percent (right panel below).

**Fannie and Freddie (GSE) purchase market only: first time buyers**

For GSE first time buyer purchase loans, the pattern is somewhat different with first time buyers obtaining less income leverage than repeat buyers. The share with DTI greater than 43 percent has increased in the following way for GSE purchase loans:

- First time buyers: increased from 11 percent to 18 percent (left panel below).
- Repeat buyers: increased from 15 percent to 21 percent (right panel below).
Conclusion 3: The patch puts minority borrowers at greater risk.

All Agency purchase market: minority and non-Hispanic white buyers

Even as the share of minority borrowers is recovering in the Agency market, the share of loans with high DTIs has increased dramatically for this group. From 2013 to 2017 the share of Agency purchase loans with DTIs greater than 43 percent has increased as follows:

- Non-Hispanic white borrowers: from 22 percent to 28 percent (left panel below)
- Minority borrowers: from 28 percent to 38 percent (right panel below).

Fannie and Freddie (GSE) purchase market only: minority and non-Hispanic white buyers

For the GSE’s in particular, the increase for minority buyers are similarly dramatic:

- Non-Hispanic white borrowers: from 14 percent to 20 percent (left panel below).
- Minority borrowers: from 17 percent to 25 percent (right panel below).

Notice that the overall minority share represented by the yellow line in the following charts (which is based on data from 73 CBSAs) is higher than the national minority share based on HMDA first-lien purchase originations since the minority share is higher in more urban areas.
**Conclusion 4: The patch enables even greater risk layering for buyers with incomes below the median census tract family income.**

**All Agency purchase market: borrower income**

Borrowers with incomes below the median census tract family income (from HMDA) are substantially more likely to have high DTIs and this likelihood is increasing. From 2013 to 2017 the shares of Agency purchase loans with DTIs greater than 43 percent are as follows:

- Borrowers with incomes greater or equal the median census tract family income: from 18 percent to 26 (left panel below).
- Borrowers with incomes less than the median census tract family income: from 30 percent to 40 (right panel below).

![DTI Shares, Ag. Borrowers > Tract Med. Fam. Inc.](image1)

![DTI Shares, Ag. Borrowers ≤ Tract Med. Fam. Inc.](image2)

**Fannie and Freddie (GSE) purchase market only: borrower income**

For the GSEs, the increases are equally dramatic:

- Borrowers with more than census tract median family income: from 12 percent to 18.
- Borrowers with less than census tract median family income: from 20 percent to 28.

![DTI Shares, GSE Borrowers > Tract Med Fam Inc](image3)

![DTI Shares, GSE Borrowers ≤ Tract Med Fam Inc](image4)
In summary, for Agency loans, we find that high DTIs are related to other higher risk factors in purchase mortgage lending. For the Agency purchase mortgage market, higher DTIs are positively correlated with higher CLTVs, lower FICO scores, lower relative incomes, as well as first time buyer status. Because many of these borrowers are also minorities, the patch and associated risk layering will likely have a disparate impact resulting from higher defaults, foreclosures, propensity for wealth loss and negative credit impacts.

With respect to GSE purchase loans patterns, while the shares of loans with DTIs in excess of 43 are generally lower than for the overall agency market, we observe similar increases in high DTI shares over time indicating that credit is expanding with the cycle along this dimension, thanks to the patch. We observe slightly less risk layering compared to the overall Agency market with respect to GSE first time buyer loans and higher CLTVs loans. Because many of these borrowers are also minorities, the patch and associated risk layering will likely have a disparate impact resulting from higher defaults, foreclosures, propensity for wealth loss and negative credit impacts.

*Conclusion 5: the patch has helped fuel a house price boom.*

There is a positive correlation between DTIs and home prices and because the patch allows government agencies and the GSEs to increase DTIs, the patch is helping to fuel the current house price boom. When DTIs expand alongside of home prices, there is little “friction” in mortgage markets to slow the growth of a housing boom.

To better understand this boom and the impact of credit easing, one needs to measure home sales, price trends, mortgage risk trends, and other characteristics over time. To this end, AEI’s Housing Center has developed an 10.4 million sale transaction study covering 6-years of home price appreciation (HPA) for over 40,000 census tracts in 73 large metros areas. We found a generally strong correlation between increasing tract HPA and increasing tract mortgage risk index or MRI (a measure of equity and income leverage). This dataset was used to create a new tiered House Price Index (HPI) that allows for the most thorough analysis of home price trends ever available. In particular it allows for a detailed analysis of the role equity and income leverage, and high risk lending in particular, play on home prices.52

Price tiers at the county-level are defined as follows:

- Low: \( \leq 40\text{th}\) percentile of FHA sales price
- Low-Medium: \( > 40\text{th} \text{ & } \leq 80\text{th}\) percentile of FHA sales price
- Medium-High: \( > 80\text{th}\) percentile of FHA sales price \& \( \leq 125\%\) of GSE limit
- High: \( > 125\%\) of GSE limit

The chart below sets forth key characteristics of the four price tiers. First-time buyers (FTBs) were 66\% of buyers in low and low-med priced tiers. At 14\%, these tiers have a much higher

52 A high risk loan has a Mortgage Risk Index of greater than 12 percent.
Mortgage Risk Index (MRI) and prices have increased much faster (+43%) than for med-high and high tiers (+30%), which have much lower FTB share and an MRI of 7%.

The next chart demonstrates how constant quality home prices by tier have increased since 2012:Q4, which was just about the beginning of the current boom. The Low- and Low-Med tiers, largely consisting of first-time buyers and with about 28% of these two tier’s home sales financed with FHA-insured loans, had substantially higher price increases. In the case of the Low tier, prices went up 47%, compared to 31% and 29% for the Med-High and High tiers, respectively. If Low tier prices had increased at the same rate as the Med-High and High tiers, entry-level buyers would today be able to buy these homes at much more affordable prices and with less risk of default—an average of $20,500 per home less than today.

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<tbody>
<tr>
<td>Low</td>
<td>47%</td>
<td>24%</td>
<td>29%</td>
<td>14.6%</td>
<td>72%</td>
<td>$ 166,200</td>
</tr>
<tr>
<td>Low-Med</td>
<td>39%</td>
<td>28%</td>
<td>26%</td>
<td>13.3%</td>
<td>61%</td>
<td>$ 249,000</td>
</tr>
<tr>
<td>Med-High</td>
<td>31%</td>
<td>38%</td>
<td>9%</td>
<td>8.1%</td>
<td>38%</td>
<td>$ 393,000</td>
</tr>
<tr>
<td>High</td>
<td>29%</td>
<td>11%</td>
<td>0%</td>
<td>3.1%</td>
<td>NA</td>
<td>$ 910,000</td>
</tr>
<tr>
<td>Combined Low &amp; Low-Med</td>
<td>43%</td>
<td>52%</td>
<td>28%</td>
<td>13.9%</td>
<td>66%</td>
<td>$ 215,000</td>
</tr>
<tr>
<td>Combined Med-High &amp; High</td>
<td>30%</td>
<td>48%</td>
<td>7%</td>
<td>7.0%</td>
<td>NA</td>
<td>$ 445,000</td>
</tr>
</tbody>
</table>
The next chart shows Low tier price trends by financing source. It is noteworthy that FHA and GSE HPIs for the low priced tier went up about the same amount over 6 years (50%), with the Private HPI only slightly behind. This is because FHA and other buyers with access to high levels of equity and income leverage set the price for that market segment (the “FHA effect”). The VA and RHS had lower price gains, likely due to differing appraisal practices and DTI limitations.

53 While beyond the scope of this analysis, the “FHA effect” results from the following chain of events: homes purchased with high mortgage risk loans (FHA loans generally and certain other loans) generally also have a higher level of income leverage (up to 57% for FHA and 50% for the GSEs). In the case of FHA this higher leverage is made available at no premium increase and with no discernible additional credit requirements. When the high risk loan share exceeds 30% in a census tract, this allows the price paid by buyers with high mortgage risk loans to effectively set the price for virtually all the buyers in the tract (both those with high risk and non-high risk loans) through current appraisal practices. See http://www.aei.org/publication/the-impact-of-federal-housing-policy-on-housing-demand-and-homeownership-evidence-from-a-quasi-experiment/
Finally, our research demonstrates that high risk home purchase lending is fueling home price appreciation. Currently 42 percent of agency purchase lending is high risk. As shown in the chart below, FHA accounts for 54 percent of such high risk lending, down from 72 percent in 2012. Significantly, the GSEs account for nearly all of this high risk share shift, increasing from 11 percent in 2012 to 33 percent in 2018.

There is a strong positive correlation between higher mortgage risk (higher expected default rates under stress) and higher home price appreciation and lower home prices. The two scatter charts below show correlations at the census tract level relating to: (i) mortgage risk which measures

*Unable to identify RHS loans as HMDA data for 2018 are not yet available

54 A high risk loan has a Mortgage Risk Index of greater than 12 percent.
expected default rates under stress (x-axis) and ratio of tract home price appreciation (HPA) to county HPA, and (ii) mortgage risk (x-axis) and median home price appreciation. The scatter dots for each chart are color coded based on the percentage of high risk purchase loans as a share of all purchase loans in the tract. Those from the green color palette have a high risk share of less than 30%. Those from the blue color palette have a high risk share of greater than or equal to 30%.

Correlation 1: Census Tract Mortgage Risk and House Price Appreciation, by Tract Share of High Risk Lending

There is a strong positive correlation between higher mortgage risk ((higher expected default rates under stress) and home price appreciation.

The binned scatterplot below shows that the greater a census tract’s mortgage risk index (MRI), the faster house prices have appreciated for the period 2013 to 2017. The scatterplot has a clear upward trend: as the tract MRI increases (x-axis), the ratio of tract home price appreciation relative to county home price appreciation also increases (y-axis). For example, the dark green dots on the left, which had <15% high risk loans, had low average tract MRIs (about 3-6%) and the dark purple dots on the right, which had >=60% high risk loans, had high tract MRIs (about 17-23%). For the dark green dots, the median ratio of tract to county house price appreciation is 0.89, while for the dark purple dots, the median ratio of tract to county appreciation is 1.29—a 45% higher level of price appreciation for the dark purple over dark green tracts.

Further, the blue color palette tracts all had a high risk loan share of 30% or more. Together these tracts represent about 50% of all sale transactions and had higher price appreciation relative to the county than the green color palette tracts. In these tracts, a critical mass of buyers (at least 30%) has access to high-risk loans providing higher equity and income leverage, thereby allowing this group to essentially set the price for all buyers (and for borrowers in the tract who are refinancing). Therefore, all these borrowers (and lenders and mortgage guarantors) in a tract with a greater share of high risk lending are exposed to dangerous home price volatility that is not related to fundamentals but to increases in leverage.

The Bureau’s DTI patch bears special mention in this regard. Because the patch allows government agencies and the GSEs to increase DTIs, the patch is helping to fuel the current house price boom. When mortgage risk expands alongside of home prices, there is little “friction” in mortgage markets to slow the growth of a housing boom.
Correlation 2: Census Tract Mortgage Risk Index and Home Price by High Risk Loan Share of Tract Lending

There is a strong positive correlation between higher mortgage risk and lower home prices.

The binned scatterplot below shows that the greater a census tract’s mortgage risk index (MRI), the lower the median home price. High risk census tracts are concentrated among tracts with median home prices of $300,000 or less. High risk lending is associated with at least 30% of purchases for all these tracts (blue color palette dots).

Further, the scatterplot has a clear downward trend: as the tract MRI increases (x-axis), the median tract home prices decreases (y-axis). For example, the dark green dots on the right, which had <15% high risk loans, had low average tract MRIs (about 3-6%) and the dark purple dots on the right, which had >=60% high risk loans, had high tract MRIs (about 17-23%). For the dark green dots, the median tract home price is $540,000 while for the dark purple dots, the median tract home price is $171,000.

Eighty-five percent of the binned census tracks with median home prices below $300,000, had average tract MRIs of 9% or greater. As was demonstrated by correlation 1 above, there is a strong positive correlation between higher mortgage risk and home price appreciation. When the inevitable reversion of real house prices to their trend growth path occurs, these lower priced census tracts and their residents, who are more likely to be low-income and minority, will again be subjected to more price volatility, greater loss of equity, and higher rates of loan default.
Variation in the credit policy of two government insurance programs provides some further insight into the pro-cyclical role of the Patch. In particular, prior charts reveal that the RHS 75th percentile DTI for purchase loans fell from 42 to 41 percent between Jan. 2013 and Nov. 2018 while the same statistic for FHA rose from 47 percent to 52 percent. At the same time, the median house price for RHS borrowers rose by just 6 percent (in total) over the five years spanning February of 2013 to November of 2018 while the FHA median price increased by 29 percent. Even though many factors may cause differences in home price appreciation between the markets served by these two government agencies, because both programs already have high CLTVs for their programs, expanding income leverage (DTI) is the main channel through which credit can support higher home prices.

### Conclusion 6: The patch did not achieve what the Bureau intended.

Given this proliferation of high DTI agency loans, there are at least two provisions of the final rule that suggest the QM patch is working counter to what the Bureau intended. For instance, the final rule states that:

<table>
<thead>
<tr>
<th></th>
<th>Median downpayment</th>
<th>Median saleprice</th>
<th>Change from Nov. 2013 to Nov. 2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>RHS</td>
<td>-$2,200</td>
<td>-$800</td>
<td>6%</td>
</tr>
<tr>
<td>FHA</td>
<td>$3,700</td>
<td>$3,900</td>
<td>29%</td>
</tr>
</tbody>
</table>
The Bureau also is concerned that evaluating underwriting standards based on whether they are widely accepted could have other undesirable consequences. In a market bubble or economic crisis, many creditors may change their underwriting standards in similar ways, leading to widely accepted underwriting standards becoming unreasonably lax or unreasonably tight. A regulatory directive to use underwriting standards that are widely accepted could exacerbate those effects. Also, referring creditors to widely accepted governmental and nongovernmental underwriting standards could hinder creditors’ ability to respond to changing market and economic conditions and stifle market growth and positive innovation.

At the time of the Bureau’s announcement in January 2013, it noted “the general slow recovery of the mortgage market.” Yet, we now know that home prices hit the cyclical trough in mid-2012 and have been increasing rapidly for the subsequent 6 years and are now growing at an unsustainable rate.

As the following chart demonstrates, entry-level home prices (bottom one-third of market) are growing at an even more unsustainable pace.

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55 Bureau of Consumer Financial Protection, Pg. 6533.
56 “[t]he continuing run-up in home prices above the pace of income growth is simply not sustainable. From the cyclical low point in home prices six years ago, a typical home price has increased by 48% while the average wage rate has grown by only 14%. Rising interest rates also do not help with affordability. Therefore, more supply is needed to level out home prices. Homebuilding will be the key as to how the housing market performs in the upcoming years.” NAR Chief Economist Lawrence Yun’s reaction to May 29, 2018 S&P/Case-Shiller release on March home prices. [http://narnewsline.blogs.realtor.org/2018/05/29/instant-reaction-sp-case-shiller-march-home-prices/](http://narnewsline.blogs.realtor.org/2018/05/29/instant-reaction-sp-case-shiller-march-home-prices/)
Aside from the Bureau’s stated intent, the statutory purpose of the QM regulation was to enhance economic stabilization. In particular, Section 1402 of Dodd-Frank amended the Truth in Lending Act (by adding Section 129B and Section 129C) based on the finding that “economic stabilization would be enhanced by the protection, limitation, and regulation of the terms of residential mortgage credit and the practices related to such credit, while ensuring that responsible, affordable mortgage credit remains available to consumers.”

Yet, the QM regime and patch were implemented near the bottom of the 2012 cyclical trough and contained no counter-cyclical provisions. Instead the QM regime and patch have fueled an unsustainable home price boom since they operate exclusively in a pro-cyclical manner. Given the size of the boom and eventual mean reversion, the result will likely be to destabilize financial markets, rather than enhancing stability. This was entirely foreseeable, as was noted in January 2013: “Booms are fueled by excessive leverage. This rule does little to limit borrower leverage and lays the foundation for the next bust.”

**Recommendations for Action**

In 2012, the Bureau has stated it believes that loan performance by DTI, as measured by an ever-to-date delinquency rate such as 60 days or more delinquent, is an appropriate metric to evaluate whether consumers had the ability to repay those loans at the time made and that ever-to-date delinquency rates increase as DTIs increase.

Also as noted in 2012, the Bureau has stated that empirically derived ever-to-date delinquency rates for loans with DTIs above 43 percent have historically not resulted in comparatively low rates of delinquency and default during adverse economic conditions.

The final rule provided three factors (considerations) that may serve as “evidence that a creditor’s ability-to-repay determination was reasonable and in good faith.” Based on two of those factors, the patch violates the underlying purpose of the ability-to-repay standard:

- The creditor used underwriting standards that have historically resulted in comparatively low rates of delinquency and default during adverse economic conditions.
- The creditor used underwriting standards based on empirically derived, demonstrably and statistically sound models.

It is clear from the above evidence that the patch promoted the expansion of loans in a manner directly counter to both of the above noted factors because it encouraged loans which would result in comparatively higher rates of delinquency and default during adverse economic conditions.

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58 Supra. BCFP, 2012.
59 Supra. BCFP, 2012.
60 Bureau of Consumer Financial Protection, Pg. 6603.
Finally, the Bureau also has broad discretion to effectuate Section 129B, including the latitude to allow the patch to expire by its own terms in January 2021. With respect to its authority to revise the QM safe harbor, Section 1412 states:

The Board may prescribe regulations that revise, add to, or subtract from the criteria that define a qualified mortgage 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 this section, necessary and appropriate to effectuate the purposes of this section and section 129B, to prevent circumvention or evasion thereof, or to facilitate compliance with such sections.

Based on the empirical evidence provided and for all the above-mentioned reasons, we respectfully recommend that the Bureau should take the following actions as soon as possible.

- Announce that the GSE patch will not be renewed.
- Provide guidance to GSEs that they should immediately begin reducing industry’s reliance on patch in a measured manner, thereby reducing any market impacts between now and the 2021 expiration of the patch.
- Coordinate with HUD/FHA on reductions to its DTI policies as part of a broader effort to counter-cyclically slow down the home price boom.
- Indicate it will be looking at changes to the QM rule so that, in the future, it has a counter-cyclical component.