September 16, 2019

Qualified Mortgage Definition under the Truth in Lending Act (Regulation Z)
Consumer Financial Protection Bureau
Docket No. CFPB-2019-0039
RIN 3170-AA98

Action: Advance notice of proposed rulemaking.

Dear Sir/Madam:

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

Thank you for the opportunity to comment on the CFPB’s Qualified Mortgage Definition under the Truth in Lending Act (Regulation Z).

It would be a pleasure to discuss this recommendation further with you at your convenience, should you so desire. Thank you again for the chance to participate in this timely rulemaking.

Yours respectfully,

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In its Advance Notice of Proposed Rulemaking, the Consumer Financial Protection Bureau (the CFPB or Bureau) posed many questions, and in each case, commenters were requested to provide data and analysis to support their views. We applaud the Bureau for taking this empirical approach.

To properly evaluate current and alternative approaches, any data series used must meet two key criteria:

- It must be long enough to encompass a complete boom-bust cycle, which means it must extend back to the late 1990s.
- It must consist of a comprehensive and representative share of mortgage originations.

It is also necessary to evaluate the QM rule and the Patch in terms of their disparate or disproportionately adverse impact in promoting higher risk outcomes for minorities. These impacts and the suggested means for addressing them will be discussed throughout this comment letter.

This comment letter contains the following recommendations:

1. Allow the Patch to sunset according to its terms.
2. Expand the QM status and alternative to Appendix Q for seasoned portfolio lending.
3. The Bureau should eliminate the 43% DTI limit applicable to QM loans and substitute a stressed Mortgage Default Rate (MDR) limit.
4. The CFPB should test the effectiveness of the residual income method in reducing default rates under stress conditions.
5. The Bureau should test the effectiveness of varying levels of months of Principal/Interest/Taxes/Insurance (PITI) reserves at origination in reducing default rates under stress conditions.
6. The Bureau should not establish the current APOR margin or an alternative APOR margin as a substitute for the current 43% DTI limitation.
7. Replace Appendix Q with a general requirement to use a “reasonable method” with the option to use, as a safe harbor, a specified compendium of widely used methods for calculating and verifying amounts of income or assets.
8. Long term, the Bureau should replace ATR utilizing DTI as an input with an ATR utilizing a more broadly defined DTI and, perhaps, an experience-validated residual income method.
9. Key industry participants should work with the CFPB, HUD, and the FCC to greatly expand the voluntary reporting of utility and rental payment information to credit repositories.
ATR/QM Framework – with Added Seasoned Loan and Stressed Mortgage Default Rate QM Provisions. 43% DTI Provision Replaced, GSE Patch Sunset, and Appendix Q Replaced

1) Does the borrower have an Ability to Repay (ATR)?
   - Lender Must Consider:
     - Credit history
     - Current income
     - Expected income
     - Current obligations
     - DTI or residual income
     - Employment status and
     - Other financial resources.
   - Verify income & assets relied upon.
   - Based on fully amortizing payment schedule.
   - Recommendation 7: Replace Appendix Q.
   - Recommendation 8: Long term, replace DTI with a broader measure of borrower fixed expenses.

2) Is the loan a Qualified Mortgage?
   - No negative am
   - No interest only
   - No balloon payments
   - Income and financial resources relied upon are verified and documented.
   - UW based on fully amortizing loan
   - Total P&F do not exceed 3%
   - Loan term does not exceed 30 years.
   - Recommendation 1: Allow the Patch to sunset according to its terms
   - In place of the current 43% DTI, either:
     - Recommendation 2: Seasoned portfolio loans or
     - Recommendation 3: Non-portfolio loan: Stressed Mortgage Default Rate (MDR) limits. MDR is a summary measure of risk layering associated with determining ATR.
     - Recommendations 4 and 5: Evaluate residual income and monetary reserves as alternative approaches.

3) Is the APR margin to APOR <= 150 basis points and, if a portfolio loan, no Ever-60-day+ late payments within first 36 months of origination (Recommendation 2)?
   - Recommendation 6: make no changes to the APOR margin rule.

   Yes
   - Loan can be made under QM Safe Harbor.
   - Loan can be made under QM Rebuttable Presumption.

   No
   - The loan cannot be made.

   Yes
   - Loan can be made under ATR standard as a non-QM loan.
1. Qualified Mortgage definition

**Recommendation #1: Allow the Patch to sunset according to its terms.**

**Proposal and supporting data:**

The Patch, which was announced in January 2013, has pro-cyclically supported the current home price boom.\(^1\) This impact has been the most pronounced for entry-level homes. The Patch has had a disparate or disproportionately adverse impact in promoting higher home prices and higher risk outcomes for minorities, who tend to purchase lower priced homes with risk layered mortgages.

It is well documented that rising DTIs are correlated with rising home price appreciation and default risk under stress. Chart 1 below traces the history of GSE DTIs greater than or equal to 42 percent from about 1990 through 2018.\(^2\) As the chart shows, the inflation-adjusted house price trend looks quite similar to the DTI trend. 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) the booms’ close proximity to one another.

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\(^2\) Greater than or equal to 42 percent is a common data point available for the entire time period.

- With the exception of the 1988-1991 common data point which is based on loan counts, all other calculations are based on loan dollars.
- Loan type used for CFPB 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 CFPB 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.
- 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.
Chart 1:

GSE Loan Share with DTI ≥ 42% and Real House Prices

Sources: AEI Housing Center, Fannie Mae, CFPB, BEA and FHFA

Chart 2 provides delinquency data using this metric covering an eleven-year period encompassing the house price boom which preceded the financial crisis. 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. The main take-away is that while delinquency rates almost always rose in tandem with DTIs, this relationship became particularly significant for the 2004-2007 cohorts. This fact demonstrates that rising DTIs are correlated with greater default risk.

Chart 2:

GSE Ever 60-day Delinquency Rate by DTI at 12.31.11 & 2007 (est.) @ 12.31.16

Derived from CFPB, http://files.consumerfinance.gov/f/201205_cfpb_Ability_to_Repay.pdf, 2012. When the data through 2011 were published by the CFPB in 2012, the earlier cohorts of 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 the GSEs’ publicly available sources on loan performance, thus adding 5 more years of seasoning.
A recent working paper published by FHFA and AEI confirmed this key relationship and found that across 320 risk buckets created utilizing credit score, CLTV, and DTI, default rates increased virtually monotonically with increasing DTI (increasing 96 percent of the time) for fixed rate, fully documented GSE loans originated in 2006 and 2007.\(^3\)

AEI research has also demonstrated that high risk lending in a seller’s market helps drive up home prices faster than market fundamentals, such as wage growth and construction cost increases, would otherwise justify.\(^4\) As Chart 3 demonstrates, affordability has worsened as gains in house prices have far outpaced gains in wages. This wedge between prices and wages is extremely wide for the low price tier. With house price appreciation again picking up steam due to the recent drop in mortgage rates, this wedge will only increase further. This trend has been worsened through the availability of leverage, which has enabled less credit-worthy buyers to stay in the market and drive up prices.

**Chart 3:**

![Cumulative Growth in Home Price Appreciation (HPA) and Wages](chart_image)

Note: Production Wage Index refers to BLS' average hourly earnings of production and nonsupervisory employees: total private. Source: AEI Housing Center and BLS

Charts 4 and 5 below show how home price appreciation (HPA) increases with a census tract’s mortgage risk index and the tract’s share of high risk lending. HPA increases faster than the county average when the risk index exceeds 12% or the share of high risk loans rises above 40%.

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\(^4\) The national existing home market has had continuous seller’s market conditions since 2012.
Charts 4 & 5:

Note: Instead of a standard scatterplot, which plots all the data points, the binned scatterplot only plots the binned data points. It first groups the x-axis variable into equal-sized bins and then computes the mean of the x and y-axis variables within each bin thereby simplifying the plot while keeping the relationship between x and y variable intact. The binned scatterplot has 100 equally sized bins, with the bins weighted by the number of loans in each tract. Data cover nearly 40,000 census tracts. High risk loans are loans with a Mortgage Risk Index ≥12%.

Source: AEI Housing Center

Government policies that encourage excessive borrowing and constrain supply fuel unsustainable home price appreciation (HPA) which in turn has a disparate impact on minorities. This trend is more pronounced for the entry-level, where supply is most restricted and mortgage credit risk is greatest. Minority homebuyers are disproportionately represented in the entry-level price tier. The result is that home prices have risen far faster than incomes, which has led to entry-level borrowers spending an increasing proportion of their incomes on housing.

Specifically, the QM Patch fueled excessive borrowing. Rather than free market price discovery, the QM Patch’s allowance for ever-expanding DTIs served to substantially remove income as an underwriting constraint. As a result, housing markets, particularly entry-level segments, experienced unsustainable house price appreciation (HPA) and higher risk of default.

Charts 6 and 7 demonstrate the disparate impact that current housing policies, and the QM Patch in particular, have on minorities. Minority census tracts experienced disproportionately unsustainably high HPA (Chart 6) and are at higher risk of default as measured by the AEI National Mortgage Risk Index (Chart 7).\(^5\) As a result, the outcomes for minorities are undue risk and price volatility.

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\(^5\) The AEI National Mortgage Risk Index (NMRI) measures how the loans originated in a given month would perform if subjected to the same stress as in the financial crisis that began in 2007. This is similar to stress tests routinely performed to ascertain an automobile’s crashworthiness or a building’s ability to withstand severe hurricane force winds. For more on the methodology, please see:
Chart 6:

Note: Tracts with fewer than 10 loans in a given year are excluded. Minorities are defined as the primary applicant having a race variable as Black or African American or ethnicity variable as Hispanic or Latino.

Source: AEI Housing Center, www.AEI.org/housing.

Chart 7 is for Los Angeles and is representative of the disparate outcome in metros throughout the United States.\(^6\)

Chart 7:

Source: AEI Housing Center, www.AEI.org/housing.

\(^6\) To see more charts on other metros, please see the Outcome tab in *The State of the Housing Market: An In-depth Look at County and State Housing Market Indicators*, http://www.aei.org/housing/the-state-of-the-housing-market-an-in-depth-look-at-county-and-state-housing-market-indicators/
As Chart 8 indicates, historic house price trends inform us that the housing market, if unconstrained by underwriting limitations, will rise to unsustainable levels of HPA. Sustainable levels are those that track wage gains, construction costs, rents, or other fundamental factors. Over longer periods unsustainable levels of HPA tend to self-correct.

Chart 8:

Still, some have argued that the GSE Patch “disproportionately benefits younger millennials and retirees, Non-W-2 borrowers, low-income borrowers, and borrowers purchasing low-to-mid priced homes” (emphasis added). Thus, these groups are disproportionately represented within the GSE Patch and will switch to Non-QM, absent additional policymaking by the CFPB.”7 In a related blog post, it is noted that minority borrowers and those purchasing homes in underserved neighborhoods similarly depend on the GSE Patch.8 Observing this dependence, the implicit conclusion is that the GSE Patch helps low-income groups achieve homeownership, and thus these groups would be harmed should the GSE Patch expire in accordance with the CFPB’s plan.

These types of analyses focus on the seen—borrowers who took advantage of the Patch. Yet there were two other effects: the foreseeable result of higher home prices resulting from the Patch and the likely large number of borrowers who would not have needed the Patch, but for the Patch-induced home price inflation.9

The analysis of these two effects starts with the impact that the GSE Patch has had on home price appreciation (HPA), especially for the entry-level price segment (low and low-medium price tiers).

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Chart 9 shows the cumulative home price appreciation by price tier. HPA for the entry-level segment has been much faster than for the move-up segment (medium-high and high price tiers).

Chart 9:

Note: Data for July 2019 are preliminary. Price tiers are set at the metro level and are defined as follows: Low: all sales at or below the 40th percentile of FHA sales prices; Low-Medium: all sales at or below the 80th percentile of FHA sales prices; Medium-High: all sales at or below the 125% of the GSE loan limit; and High: Rest. HPAs are smoothed around the times of FHFA loan limit changes. For more on the HPA methodology, see http://www.aei.org/home-price-appreciation-index-and-months-remaining-inventory/. Source: AEI Housing Center, www.AEI.org/housing.

The GSE Patch enabled borrowers to take on additional debt (leverage), and a similar effect occurred for FHA borrowers under FHA’s own exemption from the QM 43% rule. The GSEs and FHA were in a favored position to acquire/insure loans that exceeded the DTI limit of 43% imposed on private lenders. This “seen” effect of additional leverage helped fuel price appreciation for lower-priced homes at a much higher pace than higher-priced homes, a trend that was both foreseeable and may now be estimated.

There has also been a robust correlation between faster home price appreciation and the prevalence of loans with high DTIs. As one can see in Chart 10, from 2012-2018, census tracts that had above-average DTIs (those above 37%) experienced HPA that is faster, and in many cases much faster, than the county average. The same relationship can be seen in the Chart 11, which classifies census tracts by the share of loans with a DTI > 43% rather than by the tract-level average DTI. Thus, a policy that

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10 This analysis has been replicated when controlling for CLTV buckets. For loans in the CLTV >= 90% bucket, the same trend holds: Higher average DTIs in census tracts (and higher shares of loans with DTI > 43%) are correlated with higher ratios of tract to county house price appreciation. For loans in the CLTV < 90% bucket, the trend also holds, except for census tracts with the lowest average DTIs and the lowest share of loans with DTI > 43%.
assists buyers in taking on high DTI levels undermines home affordability, driving up home prices faster than they would have, absent the Patch-provided stimulus.\textsuperscript{11}

Charts 10 & 11:

Note: Instead of a standard scatterplot, which plots all the data points, a binned scatterplot only plots the binned data points. It first groups the x-axis variable into equal-sized bins and then computes the mean of the x and y-axis variables within each bin thereby simplifying the plot while keeping the relationship between x and y variable intact. The binned scatterplot has 100 equally sized bins consisting of census tracts. The bins are weighted by the number of loans in each tract. Data are for purchase loans, including portfolio, GSEs, FHA, VA, and Rural Housing Services. Data are for more than 46,000 census tracts. Source: AEI Housing Center, www.AEI.org/housing.

Given that the market has experienced this unintended, but foreseeable outcome, it is worth considering a counter-factual of what home prices might have been like had the Patch not been enacted.

As a counter-factual, we will assume that in the absence of government provided leverage to help fuel the home price boom, census tracts with more rapid HPA would only have appreciated at the same rate as the county average. In effect, this leaves the rate of HPA for census tracts with below-county-level HPA unchanged, but it reduces the rate of HPA for tracts with above-county level-HPA. Tracts with the greatest appreciation, therefore, experience the greatest slowdown in HPA in the counter-factual analysis.\textsuperscript{12} This slower HPA would have resulted in lower home prices over time. These lower home prices, of course, would have resulted in a corresponding reduction in DTIs for borrowers over time.\textsuperscript{13}

Chart 12 shows the share of borrowers with a DTI > 43% by income bin. The red line represents the actual results by income for GSE purchase loans with DTIs greater than 43% in 2017, and the yellow

\textsuperscript{11} The data used for the counter-factual analysis combine public records data from First American via Data Tree, HMDA, CoreLogic LLMA, Black Knight McDash, Fannie Mae and Freddie Mac Loan Performance data, and FHA Snapshot data. The data are weighted quarterly by loan type at the county level to make them representative. The final dataset consists of 11.5m loans.

\textsuperscript{12} Note that by using the county average, this approach likely still overstates the HPA for tracts with higher DTIs because the county average itself has been elevated by tracts with access to higher leverage.

\textsuperscript{13} There is a linear relationship between home prices growth and DTI growth. A 10% increase in a home’s price will result in a 10% increase in borrower DTI holding all else equal.
line represents the same in 2012 before the Patch and before the ensuing boom in home prices began. Two things stand out: 1) In 2012, about 17% of borrowers with incomes below $80,000 had DTIs above 43%. By 2017, this figure had risen to about 26% 2) For higher income borrowers (those with annual incomes of at least $80,000), the reliance on the Patch had risen less, from about 11% in 2012 to 17% in 2017. The sharper increase in reliance on DTIs above 43% for lower-income borrowers is due to the more rapid home price appreciation for entry-level homes.

The dark blue line in the chart represents the counter-factual, assuming that census tracts with more rapid HPA had only appreciated at the county average. The DTIs for these counter-factual borrowers have been reduced by the same percentage as the reduction in home price growth. The 2017 counter-factual line is marginally above the 2012 actual line, which implies that across all income levels, buyers would have had little additional need for DTIs above 43% in 2017. The reliance on DTIs greater than 43% would have been, on average, unchanged from 2012, especially for lower-income with income below $80,000.

Chart 12:

While the counter-factual illustrates a hypothetical world without the Patch, the reality is that the Patch was enacted, and, since its inception, the number of GSE borrowers reliant on the Patch has increased (Chart 13). Furthermore, due to the Patch, there has been an explosion in the number of loans with DTIs greater than 45% since mid-2017, which the GSEs have seemingly started to rectify.
As Chart 13 above shows, the share of GSE loans with a DTI of 46-50% increased from on average around 6% before July 2017 to 20% in December 2018, but has since then fallen back to 16% in May 2019, whereas the trend of loans with a 44% or 45% DTI is largely unchanged at about 7-8%. Based on this trend, the Patch’s planned sunset in 2021 will provide the GSEs plenty of time to shrink that share further. Once that reduction has been achieved, borrowers with DTIs of 44% and 45% can more easily adjust their DTIs downward to 43%, which will allow them to stay within the QM domain. As this adjustment occurs, the rate of home price appreciation will slow to more sustainable levels.

While it is true that today lower income and minority borrowers have had an increased reliance on DTIs greater than 43% (facilitated by the Patch), this increased dependence has been the result of government provided leverage that has helped fuel rapid HPA. Without this HPA-inducing leverage, the need for DTIs in excess of 43% would have been considerably lower. Pro-cyclical policies such as the Patch guarantee their own necessity.

Contrary to the assertions of many, the sunset of the GSE conventional loan patch, along with the FHA limiting its borrowers to a maximum 50% DTI limit (down from the current maximum of 57%), will not result in fewer homes being sold. Due to the strong seller’s market inadequate supply, home purchase volume will be largely unchanged.

Chart 14 below lays out the specifics. With respect to the conventional market, about 30% of those affected would most likely adjust their consumption of housing and debt so as to be within a 43% DTI limit. With lower DTIs (and some borrowers also reducing loan-to-values), this would reduce risk layering. This adjustment is what normally happens in markets when prices are going up more rapidly than incomes—a household substitutes chicken for steak. Another 30% would likely be served by private conventional lenders at DTIs greater than 43%, but likely with less risk layering. Those unwilling or unable to adjust consumption (about 18%) would continue renting. However,
given the dearth of entry-level supply, other first-time buyers would likely take their place, albeit at somewhat lower prices due to reduced upward price pressure. These replacement first time buyers will be less leveraged, with less risk layering than the ones they replace. About 18 percent of conventional buyers affected will most likely choose FHA loans (but will have lower risk profiles than most current FHA buyers). The remaining 4 percent are already homeowners and would simply choose to stay put.

Chart 14:

**What would happen to loans after the Patch expires and FHA limits its DTIs to 50**

Note: Data are for primary owner-occupied loans. Portfolio loans are calculated by taking the difference in loan totals from HMDA 2018 for conventional loans and AFI's National Mortgage Risk Index for GSE loans. Conventional loans with missing DTIs are assumed to have the same distribution of DTI > 43% as the rest of the population. Source: AFI Housing Center, [www.AFI.org/housing](http://www.AFI.org/housing).
Recommendation #2: Expansion of QM status and alternative to Appendix Q for seasoned portfolio lending by an insured depository institution (with more than $10 billion in assets), an insured credit union (with more than $10 billion in assets), a Real Estate Investment Trust (REIT), or other portfolio lender.

Background:

The Economic Growth, Regulatory Relief, and Consumer Protection Act of 2018 (EGRRCPA) provided for expanded QM status for portfolio loans made by small (<=$10 billion in assets) banks and credit unions (covered institutions).\textsuperscript{14} Technically, this change built upon a provision contained in amendments to the original QM regulation.\textsuperscript{15}

It provided a Qualified Mortgage safe harbor for eligible loans and covered institutions as follows:

1. The term “qualified mortgage” includes any residential mortgage loan:
   a. That is originated and retained in portfolio by a covered institution;
   b. That is in compliance with the limitations with respect to prepayment penalties otherwise applicable to QM loans;
   c. For which total points and fees do not exceed 3 percent of the total loan amount;
   d. That does not have negative amortization or interest-only features;
   e. For which the covered institution considers and documents the debt, income, and financial resources of the consumer.

2. Exception: such a loan shall not qualify for the safe harbor above if the legal title to the residential mortgage loan is sold, assigned, or otherwise transferred to another person unless the residential mortgage loan is sold, assigned, or otherwise transferred:
   a. To another person by reason of the bankruptcy or failure of a covered institution;
   b. To a covered institution so long as the loan is retained in portfolio by the covered institution to which the loan is sold, assigned, or otherwise transferred;
   c. Pursuant to a merger of a covered institution by another person or the acquisition of a covered institution by another person or of another person by a covered institution, so long as the loan is retained in portfolio by the person to whom the loan is sold, assigned, or otherwise transferred;
   d. To a wholly owned subsidiary of a covered institution, provided that, after the sale, assignment, or transfer, the residential mortgage loan is considered to be an asset of the covered institution for regulatory accounting purposes

Proposal and supporting data:

Provide a QM safe harbor to seasoned QM loans held in portfolio with APOR margin of <=150 basis points and an E60+ rate of zero during the first 36 months from origination (i.e. loans that that have never been delinquent 60 days or more during their first three years). Providing this safe harbor would help to further the goal of the QM safe harbor approach.

Provide a QM rebuttable presumption to seasoned QM loans held in portfolio with one or more E60+ during the first 36 months from origination regardless of the APOR margin and to seasoned QM loans

\textsuperscript{14} Bill text at \url{https://www.congress.gov/115/bills/s2155/BILLS-115s2155enr.pdf}

held in portfolio with an E60+ rate of zero during the first 36 months from origination and an APOR margin of greater than 150 basis points.\textsuperscript{16}

The fact that a covered institution is willing to hold a loan on portfolio for 36 months demonstrates an acceptance of the default risk associated with that loan. Demonstrating a 36-month record without an E60+ delinquency occurrence confirms that the covered institution met its ability to repay obligations. Thus, to further the goal of the QM safe harbor approach, these loans should be given the QM safe harbor, but only for loans that meet the never E-60+ test for the 36-month period since origination.

The Treasury Department noted as an alternative approach for a QM safe harbor: “…provid[ing] that a mortgage loan conclusively becomes a qualified mortgage after a specified seasoning period under the rationale that most defaults after that period would be a result of a change in the borrower’s circumstances and not due to the lender’s initial assessment of the borrower’s ability to repay.”\textsuperscript{17}

In making this recommendation, we rely on historical Fannie Mae loan data.\textsuperscript{18} In Chart 1 below, all reported Fannie Mae loans are bucketed by cohort year of origination, and the level of ever-60-day plus (E60+) delinquency occurrence over the 36 months since origination of each cohort. In Chart 1, for each cohort year (shown on the horizontal axis) the blue line shows the value of the E60+ delinquency for the first 36 months of the loans in that cohort (vertical axis) while the orange line shows the same default rate after holding the expected stress default rate from the NMRI constant over the years.

So, for example, the 2007 cohort is the worst performing, with approximately 8 percent of the loans after 36 months having ever been delinquent for 60 days or more. This is about three times the E60+ rate for the non-stress 2000-2003 cohorts. Thus for 2007, approximately 92 percent of the loans were still performing in that they had never been delinquent for 60 days or more. Though some loans that fall into this new safe harbor category may still default at some point in the future, it is unreasonable to argue that the ability-to-repay determination made at origination contributed to that default.

\textsuperscript{16} U.S. Department of the Treasury Housing Reform Plan, September 2019, p.40
\textsuperscript{17} Id.
\textsuperscript{18} The data consist of 9.2 million loans, the universe of Fannie Mae primary owner occupied (POO) purchase loans, excluding manufactured home loans.
Data are for fully documented, fully amortizing, POO, fixed rate, of all loan terms, all property types excluding Leaseholds and Manufactured Housing, Fannie Mae purchase loans. These data, especially those with a CLTV > 95 and those with credit scores < 580, have been heavily censored by the GSEs, especially around the crisis years. For fully documented, fully amortizing, POO, fixed rate, 30-year term 2006-2007 GSE purchase loans, the censoring is over 50%. The censored loans generally experienced higher default rates than the uncensored ones, which implies that this analysis understates overall risk. Censoring analysis is based on supplemental data published in ”Mortgage Risk Since 1990” (FHFA Working Paper 10-02) accessible at https://www.fhfa.gov/PolicyProgramsResearch/Research/Pages/wp1902.aspx. Source: AEI Housing Center, www.AEI.org/housing.

In Chart 16 below, historical Fannie Mae loan data is again relied upon. This time only reported Fannie Mae loans with a mortgage risk index rating greater than 12 percent are included. These are bucketed by cohort year of origination and the level of ever-60-day plus (E60+) delinquency occurrence over the 36 months since origination of each cohort. For each cohort year (shown on the horizontal axis) the vertical axis gives the value of the E60+ delinquency for the first 36 months of the loans in that cohort.

So, for example, the 2007-2008 cohorts are the worst performing, with approximately 20 percent of the loans after 36 months having ever been E60+. Again, this is about three times the E60+ rate for the non-stress 2000-2003 cohorts. Thus, about 80 percent of the loans were still performing in that they had never been delinquent for 60 days or more. Though some loans that fall into this new safe harbor category may still default at some point in the future, it is unreasonable to argue that the ability-to-repay determination made at origination contributed to that default. The similar non-stress and stress E60+ ratios for both the all and high risk loan groups supports this conclusion.

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19 The data consist of 1.6 million loans, the high risk universe of Fannie Mae POO purchase loans, excluding manufactured home loans.
Chart 1:

Data are for fully documented, fully amortizing, POO, fixed rate, of all loan terms, all property types excluding Leaseholds and Manufactured Housing, Fannie Mae purchase loans.
These data, especially those with a CLTV > 95 and those with credit scores < 580, have been heavily censored by the GSEs, especially around the crisis years.
For fully documented, fully amortizing, POO, fixed rate, 30-year term 2006-2007 GSE purchase loans, the censoring is over 50%. The censored loans generally experienced higher default rates than the uncensored ones, which implies that this analysis understates overall risk.
Source: AEI Housing Center, www.AEI.org/housing.
Recommendation #3: The Bureau should eliminate the 43% DTI limit applicable to QM loans and substitute a stressed Mortgage Default Rate (MDR) limit. MDR is a summary measure of risk layering associated with determining ATR. MDR would operate counter-cyclically during both the boom and the recovery cycles. It would be applicable to all non-portfolio loans. A non-portfolio loan is a loan sold, assigned, or otherwise transferred to another entity within 36 months of origination. This would encompass all secondary market transactions occurring within the 36-month time frame.

Background:

Even though DTI is a key risk metric for gauging ability to repay, relying on it to the exclusion of other key metrics such as combined loan-to-value (CLTV), credit score, loan term, loan type, and tenure (primary or secondary owner occupied) was a mistake that should not be continued. By ignoring these other key factors, the DTI bright line of 43% and the Patch operate to promote risk layering and pro-cyclically provide credit easing during boom periods when the supply of homes is tight.

Chart 17 shows market supply conditions by price bin since January 2013, the month QM and the Patch were announced. Overall supply has been well-below 6 months for the entire period and has been generally declining throughout the period. Six months is the dividing point between seller’s and buyer’s market. In a seller’s market (<6 months) prices tend to rise faster than market fundamentals such as wages or the overall rate of inflation in the economy.

Chart 17:

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20 The QM rule eliminates the need to factor in certain risk metrics, such as negative amortization, loan documentation, interest only, and investor loans.
Substituting stressed Mortgage Default Rate (MDR) limits that take into account key metrics at origination that impact ability to repay is both desirable and administratively feasible. MDR limits, by definition, take into account risk layering. Second, since the MDR is empirically based on the long term performance of 3 million loans subjected to severe stress, it is superior to many compensating factors. Some compensating factors are opinion based, lack rigorous empirical support, or not only fail to take into account risk layering, but promote it. Finally, credit standards have historically tended to ease during boom periods, resulting in an increase in risk layering. MDR limits would operate to become more binding as a boom progresses, thereby operating counter-cyclically by constraining risk layering. This would help keep home prices from increasing much faster than wages, particularly for entry-level borrowers. During bust periods, the MDR limits would be unchanged, thereby allowing more normal credit terms to available as the recovery progresses.

Table 1 (the Periodic Table) below shows cumulative default rates through 2017 for 30-year fixed-rate, fully documented, fully amortizing, primary owner-occupied GSE purchase loans acquired in 2006-07. This Periodic Table is based on a comprehensive database of GSE loans meeting these criteria as maintained by FHFA.

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21 William Larson (FHFA), Morris Davis (Rutgers), Stephen Oliner (American Enterprise Institute), Benjamin R. Smith (American Enterprise Institute), Working Paper 19-02: Mortgage Risk Since 1990, 2.1.19, https://www.fhfa.gov/PolicyProgramsResearch/Research/Pages/wp1902.aspx This working paper sets forth the research and data used to develop the stressed Mortgage Default Rate (MDR).

22 Id. A parallel table will also be made available for home purchase ARMs, and adjustment factors for other risk characteristics (ie. 20-year and 15-year loans and second homes) will also be made available. Work is under way to produce a parallel set of tables for various types of refinance loans.
In terms of the color coding, red signifies loans with high risk of default under stress. There is sea of red representing high risk lending, (156 of 320 bins) that is largely the result of risk layering.

Focusing on the 128 bins where the DTI is above QM’s current 43% DTI limit, 24 are green (low risk), 31 are orange (medium risk), and 73 are red (high risk).
Proposal and supporting data:

The stressed Mortgage Default Rates (MDR) solution is both straightforward and easy to implement and calculate. CFPB would take notice of the work by FHFA, a sister regulatory agency. It would publish the Periodic Table and a table of additional risk factors to use as multipliers where applicable.

The Periodic Table represents historical stressed MDRs for the cohort years 2006-2007 calculated through 2017, which represents the worst case scenario similar to a car crash test or a hurricane safety rating. Therefore, there is no need to publish updates. All data elements used to select the applicable stressed MDR are known at origination and commonly available on all loans. Thus, an originator may easily assign the appropriate MDR and determine whether the loan is a QM. For example, today, 100% of GSEs’ primary owner occupied fixed rate purchase acquisitions are covered by the 320 bins in the Periodic Table. However, none have a DTI in excess of 50% and 0.02% have a credit score below 620.

Implementing the MDR approach should be done with three changes to the QM definition:

- Cap the maximum CLTV at 95 percent
  - Affects 15% of GSE loans in June 2019
- Cap the maximum DTI at 50 percent
  - Affects 0% of GSE loans today
- Set maximum loan term based on a loan’s MDR
  - A maximum of 16% stress default rate if the term is >20 years or <=30 years
    - Of GSE loans not included in the above two provisions,
  - A maximum of <30% stress default rate if the term is >15 years or <=20 years,
  - A maximum of <40% stress default rate if the term is <=15 years,

The first two provisions would contribute significantly towards ending the dangerous and inappropriate competition between FHA and the GSEs.

The Treasury noted: “FHFA and HUD should develop and implement a specific understanding as to the appropriate roles and overlap between the GSEs and FHA, for example, with respect to the GSEs’ acquisitions of high LTV and high DTI loans and FHA’s underwriting of cash-out, conventional-to-FHA, and other refinancing loans and loans to repeat FHA borrowers.”

The third provision would contribute significantly towards ending dangerous risk layering prevalent under the 43% DTI rule, particularly at CLTVs above 80%.

The impact of the third provision was analyzed using June 2019 GSE acquisitions of 30-year, fixed rate, fully amortizing, fully documented, primary owner occupied loans. The impact would be as follows:

- 91.5% of the loans had an MDR of <16%,
- 8.2% of the loans had an MDR of >=16% and <30% and would have necessitated a maximum term of <=20 years, and

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23 HUD Recommendation: “FHA should examine incentives to make shorter-term mortgages that accelerate equity accumulation more attractive to FHA’s mission borrowers.” U.S. Department of Housing and Urban Development Housing Reform Plan, September 2019, p. 34
24 Supra. U.S. Department of the Treasury, p.50
- 0.3% of the loans had an MDR of >=30% and <40% and would have necessitated a maximum term of <=15 years

The three QM changes noted in this recommendation would:
- Eliminate risk layering,
- Eliminate dangerous competition between the GSEs and FHA,
- Provide FHA a more balanced book of risk,
- Moderate unsustainable home price appreciation,
- Reduce the disparate impact in terms of outcomes for minorities,
- Replace risky 30-year term loans with 20- and 15-year term loans,\(^{25}\) and
- Operate in a counter-cyclical fashion.

\(^{25}\) Oliner, Peter, and Pinto, *The wealth building home loan*, American Enterprise Institute, 2018
Recommendation #4: The CFPB should test the effectiveness of the residual income method in reducing default rates under stress conditions. If residual income is empirically demonstrated to be of utility in determining ability to repay, the Bureau should consider utilizing it as a factor in conjunction with the recommended stressed Mortgage Default Rate (MDR) limit.

Background:

In the CFPB’s recent Advance Notice of Proposed Rulemaking, the Bureau posed many questions, including:

- Should the Bureau grant QM status to loans with DTI ratios above a prescribed limit if certain compensating factors are present?
- Should the Bureau replace or supplement the DTI limit with another method (e.g., residual income or another method)?

In these and all other cases the Bureau requested that commenters provide data and analysis to support their views about alternative approaches.

Any data series used to evaluate the residual income method must meet two keys criteria:

- It must be long enough to encompass a complete boom-bust cycle, which means it must extend back to the late 1990s.
- It must contain a comprehensive and representative share of mortgage originations.

With respect to evaluating the utility of residual income as an alternative approach, there appears to be only one source for data that meets the two-part test noted above—the Veterans Administration. The CFPB should immediately approach the VA to request access to these data, so that an evaluation may be done.

As noted earlier in Chart 2, in 2011 the Bureau presented such a comprehensive dataset for debt-to-income ratios (2007 date were updated to include loan default experience after 2011). This dataset was obtained from FHFA and provides a useful precedent.
Recommendation #5: The Bureau should test the effectiveness of varying levels of months of Principal/Interest/Taxes/Insurance (PITI) reserves at origination in reducing default rates under stress conditions. If months of PITI reserves is empirically demonstrated to be of utility in determining ability to repay, the Bureau should consider utilizing it as a factor in conjunction with an economic stress-cycle based mortgage risk index.

With respect to the utility of PITI reserves as an alternative approach, there appears to be at most two sources for data that meets the two-part test noted earlier—Fannie Mae and Freddie Mac. The CFPB should immediately approach the Federal Housing Finance Agency to request access to these data, so that an evaluation may be done. This is the same process the Bureau used in 2011 to obtain DTI data from FHFA.
Recommendation 6: The Bureau should not establish the current APOR margin or an alternative APOR margin as a substitute for the current 43% DTI limitation.

It has already been documented that the Patch, which was announced in January 2013, has pro-cyclically supported the current home price boom and that this effect has been the most pronounced for entry-level homes. Further, it has also been shown that rising DTIs are correlated with rising home price appreciation and that rising DTIs are correlated with increased default risk under stress.

Substituting (or expanding) the APOR rule for the Patch would merely replace one pro-cyclical policy with another. The APOR rule is not an appropriate substitute for the Patch or QM’s 43% DTI limit.

Some members of the Housing Lobby propose substituting QM’s existing “Average Prime Offer Rate” (APOR) structure for the current QM “Patch”, which sunsets in January 2021. This approach, like the Patch itself, is fatally flawed.

Supporters of the APOR approach claim that:

- “…replacing the current DTI-heavy framework with one that captures risk more holistically [the APOR rate spread option] would strike better balance between expanding access while mitigating credit risk. [This] option would also create a more level playing field between the agency-backed and purely private capital-backed channels, potentially providing incentives for more private lending.”

- “The APR/APOR cap serves as the proxy measure of credit risk inherent in the loan.”

- “[T]he APOR threshold without a DTI, empirically balances responsible credit risk taking based on market pricing signals. Hard DTI ratios could merely encourage high DTIs. While counterintuitive, it may be better for consumers for there to be no stand-alone DTI as the sole measure for QM.”

Given the GSEs’ and FHA’s combined market dominance, one must analyze their market impact and APOR rules holistically as it relates to any constraint provided by the operation of the conventional loan APOR rule.

Using this approach, the claims made by the supporters of the APOR approach are unfounded for two simple reasons. First, almost all home purchase loans are either generally not priced for risk (FHA) or are subject to substantial cross-subsidies, which result in low-risk loans being overpriced and high-risk loans being underpriced (the GSEs). These policies are undertaken by the federal government, which operates or controls five separate mortgage guarantee agencies, which guaranteed about 85 percent of all primary owner occupied home loans and about 90 percent of all first time buyer home loans, by count. Further, a combination of regulations currently exempts all five agencies from QM’s 43% DTI limitation.

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26 [https://www.urban.org/sites/default/files/publication/99268/2018_10_30_qualified_mortgage_rule_update_finalized_4.pdf]. Presumably what is meant is that the current 43% DTI conventional QM rule, which would be applicable once the Patch sunsets, would be removed by regulatory action of the CFPB, leaving the existing conventional APOR rule as the primary risk limiting factor.

27 ATR / QM Proposal, May 8, 2019, Housing Policy Council

28 Ibid.

29 Fannie Mae, Freddie Mac, the FHA, the VA, and Rural Housing Services (Department of Agriculture)
Second, HUD, in its QM rule, redefined the rebuttable presumption rule applicable to loans with an APR to APOR margin in excess of 115 bps plus the applicable annual mortgage insurance premium. As a result, with regard to compliance with ability to repay, it is extremely difficult for a consumer to overcome the presumption of compliance granted a lender, in effect providing virtually as much legal protection as the safe harbor rule provides for loans meeting the APR/APOR margin limit. Since exceeding HUD’s APR limitation effectively results in no additional liability, it does little to constrain credit risk, which is guaranteed by the taxpayer.

When the QM rule was announced in January 2013 by the Bureau, it established a definition of a conventional prime loan based on the interest rate paid by the consumer. In short, a prime conventional loan (whether privately funded or guaranteed by the GSEs) was one where the rate was no more than 150 bps above the APOR. In general, these loans qualify for safe harbor treatment.

The Bureau observed at the time:

In many cases, the pricing of a subprime loan is the result of loan level price adjustments established by the secondary market and calibrated to default risk.... The fact that a consumer receives a prime rate is itself indicative of the absence of any indicia that would warrant a loan level price adjustment, and thus is suggestive of the consumer’s ability to repay.

Thus the Bureau was of the view that, with risk-based pricing, the rate charged on a prime loan would reflect low default risk.

AEI’s Edward Pinto noted in 2013: “[the QM rule] is being touted as making sure ‘prime’ loans will be made responsibly. Yet true to the government’s long history of promoting excessive leverage, it sets no minimum down payment, no minimum standard for credit worthiness, and no maximum debt-to-income ratio. Under its tortured definition of “prime”, a borrower can have no down payment, a credit score of 580, and a debt ratio over 50% as long as approved by a government-sanctioned underwriting system. This opens the door to politicized lending at its worst.”

In the 6+ years since the rule was announced, the Bureau’s rate-based definition of a prime loan clearly demonstrates that the APOR rule is not, in fact, “calibrated to default risk.”

From Chart 18, one can see that in 2018 for GSE purchase loans:
- The median APR to APOR spread was 0.42%
- 3.8% of the 2018 GSE purchase loans had a spread greater than the limit of 1.5%.

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31 The weakening by HUD of FHA’s rebuttable presumption rule was proposed by Todd Hill representing the Housing Policy Council in an October 2013 comment letter. This is the same group that is now proposing replacing the 43 percent DTI limit for conventional loans with the APOR structure. See Todd Hill's comment letter at [https://www.regulations.gov/document?D=HUD-2013-0093-0057](https://www.regulations.gov/document?D=HUD-2013-0093-0057). Mr. Hill is now a Policy Program Manager at the Urban Institute.


33 Pinto, [CFPB’s new ‘qualified mortgage’ rule: The devil is in the details - AEI](https://www.aei.org/2013/01/03/cfpb-s-new-qualified-mortgage-rule-the-devil-is-in-the-details/) January, 2013

34 Based on anecdotal reports, loans in excess of 1.5% largely appear to be QM rebuttable presumption loans.
From Chart 19 below, one can see that in 2018 for FHA purchase loans:

- The median APR to APOR spread was 1.37%
- 12.4% of the loans had a spread greater than the limit of 2.0% (this is the predominant spread limitation). Notice there is not a particularly noticeable cliff above and below the 2.0% limit.

Source: AEI Housing Center and HMDA (as of July 2019)
Given the compelling evidence of the APOR rule’s failure to constrain default risk with respect to GSE and FHA guaranteed loans, the Housing Lobby’s suggestion to replace the sun-setting GSE Patch with the APOR prime loan rule is a veiled attempt to substitute a different means of providing pro-cyclical leverage support during the ongoing house price boom. It is even more dangerous than the patch it would replace, since the patch provided some friction.

Back in 2013, when writing about the just promulgated QM rule, Pinto noted: “Booms are fueled by excessive leverage. This [QM] rule not only does little to limit borrower leverage, it greases the slope for the next bust.” It is clear that the suggested APOR rule suffers from the same pro-cyclical infirmities.

It has been suggested that the APOR margin should be increased to say 200 basis points from 150 basis points to account for the higher rate of interest generally charged on smaller loan balances. There is no justification for such an increase. First, as noted earlier, the median APR to APOR spread was 42 basis points, well below the 150 basis safe harbor limit. Second, as Chart 20 below demonstrates, the average small loan rate premium is quite modest—an average premium of 12.5 basis points on loans of $75,000 or less, as compared to loans of more than $75,000 up to $200,000.

The APOR rule is ineffective in credibly constraining leverage growth during a home price boom. Further, given the clear lack of empirical support for the rule, it is prone to lobbying and definitional changes.

Chart 20:

![Chart 20: Median Interest Rate by Loan Amount for June 2019 Fannie Mae Purchase Loans](attachment:image)

Note that low balance Fannie Mae loans (those at or below $75,000) tend to have interest rates only slightly higher than those for higher balance loans.

Note: Data are for Fannie Mae primary-owner occupied purchase loans with a loan term of 360 months.
Source: AEI Housing Center

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35 Id.
Recommendation #7: Replace Appendix Q with a general requirement to use a “reasonable method” with the option to use, as a safe harbor, a specified compendium of widely used methods for calculating and verifying amounts of (i) income or assets, including expected income or assets, by reviewing the consumer’s Internal Revenue Service Form W–2, tax returns, payroll receipts, financial institution records, or other third-party documents that provide reasonably reliable evidence of the consumer’s income or assets and (ii) debts and payments thereon.

Background

With the upcoming sun set of the Patch in January 2021, lenders will need to determine a borrower’s Ability to Repay (ATR) for virtually all single family loans based on the provisions of Appendix Q. The shortcomings of Appendix Q are well known. What is less well known is the fundamental difference in approaches between Appendix Q and, say, the Fannie Mae Seller Guide. Appendix Q may be best likened to a menu and the Fannie Seller’s Guides to a cookbook. This may be conclusively demonstrated by one example of vastly contrasting treatment relating to an applicant’s likelihood of continued employment:

- Appendix Q: Analyzing a Consumer’s Employment Record.
  - When analyzing the probability of continued employment, creditors must examine:
    - The consumer’s past employment record;
    - Qualifications for the position;
    - Previous training and education; and
    - The employer’s confirmation of continued employment (emphasis added).

- Fannie Mae Selling Guide: Standards for Employment Documentation -- General Documentation Requirements36
  - Selling Guide makes no mention of confirmation of continued employment when using pay stubs, W-2s, or federal tax return (emphasis added).
  - The Selling Guide also allows for the use of Request for Verification of Employment (Form 1005 or Form 1005(S)) to document income for a salaried or commissioned borrower. Item 11 of Form 1005 is an employer fill-in box entitled: “Probability of Continued Employment”. However, the Selling Guide explicitly provides that Item 11 is optional (emphasis added).

So there is an inherent conflict. Appendix Q explicitly requires the employer’s confirmation of continued employment (but provides no details on how this should be done), yet the Fannie Selling Guide does not require any such confirmation.

This example (and there are others) disqualifies reliance on Appendix Q once the Patch expires.

The Treasury Department reached a similar conclusion: “In particular, Appendix Q, which was adopted from the outdated manual underwriting guidelines once used by FHA, lacks the clarity and detail necessary to provide a bright line safe harbor and should be either revised or removed.”37

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36 https://www.fanniemae.com/content/guide/selling/b3/3.1/02.html
37 U.S. Department of the Treasury Housing Reform Plan, September 2019, p. 39
At the same time, as pointed out by the US Treasury: “[t]he QM patch also gives the GSEs a quasi-regulatory role in defining ATR requirements that, while arguably appropriate on a temporary basis while the GSEs were in conservatorship, would be inappropriate if continued on a permanent basis or after the end of the GSEs’ conservatorships.”

Finally, the Treasury noted: “Amending Appendix Q to reference the relevant sections of the GSEs’ selling guides could perhaps avoid this need for frequent amendments, but with the downside of continuing the competitive advantage conferred on the GSEs by incorporating by reference their underwriting guidelines into the ATR rule.”

Proposal:

The solution is for an industry group or groups to develop a compendium of widely used methods for calculating and verifying amounts of income or assets and submit such compendium to the Bureau for its consideration. After the Bureau review, it would publish, as a safe harbor, a compendium of widely used methods for calculating and verifying amounts of income or assets.

The Bureau would concurrently implement a process for issuing no action letters related to ATR. This approach is consistent with the Bureau’s new No-Action Letter (NAL) policy, both in principle and in the sense that the NALs could reduce regulatory uncertainty. This would help the Bureau stay abreast of new and evolving methods. While keeping abreast of innovation is important, care must be taken to distinguish between improvements in access to and verification of needed information as opposed to entirely new sources or methods. The latter need to be tested through a credit cycle. Experience with low- and no-doc lending in the 1980s (and again in the late-1990s and 2000s) provides a cautionary tale. Citi Mortgage developed a new method of income verification in the early-1980s for self-employed borrowers called Mortgage Power. When Citi Mortgage approached Fannie Mae in 1985, the response was—this may be promising, however, until we have substantial experience, Citibank will need to be responsible for any losses on these loans. By the late-1980s low- and no-doc lending had greatly expanded and was being used by many originators (Fannie still required each to cover any losses). The July 1991 Wall Street Journal headline says it all: “Haste Makes...Quick Home Loans Have Quickly Become Another Banking Mess. Lenders that Didn’t Require Usual Data on Borrowers Find Delinquencies Rising.”

38 Id. p. 39
39 Id. p. 39
40 This compendium would also provide guidance in support of the stressed Mortgage Default Rates (MDR) recommendation. This would include definitions for credit score and CLTV.
41 On September 10, 2019 the Bureau issued a No-Action Letter (NAL) Policy to promote innovation and facilitate compliance, “The primary purposes of the Policy are to provide a mechanism through which the Bureau may more effectively carry out its statutory purpose and objectives and to facilitate compliance with applicable Federal consumer financial laws. The Bureau believes that the NoAction Letters issued pursuant to the Policy will benefit consumers, entities that offer or provide consumer financial products and services, and the public interest more generally. The Bureau expects that implementation of the Policy will also inform the exercise of its other authorities, including rulemaking.”
Recommendation 8: Long term, the Bureau should replace ATR utilizing DTI as an input with an ATR utilizing a more broadly defined DTI and, perhaps, an experience-validated residual income method. A more broadly defined DTI should take into account additional fixed expenses, including income and payroll taxes, utilities, cell, cable, satellite, broadband, home repairs, home maintenance, commuting expense, and residual income.

Recommendation 9: Key industry participants should work with the CFPB, HUD, and the FCC to greatly expand the voluntary reporting of utility and rental payment information to credit repositories.

Background:

The Bureau has published three studies about consumers with limited credit histories. The first, *Credit Invisibles*, estimated the number and demographic characteristics of consumers who were credit invisible or had an unscorable credit record.\(^{42}\) The second, *Becoming Credit Visible*, explored the ways in which consumers establish credit records.\(^{43}\) The third, *New research report on the geography of credit invisibility*, explored the relationship between geography and credit invisibility.\(^{44}\)

It appears that little progress has been made in the more than 4-years since the Bureau first published *Credit Invisibles*. An analogous situation existed in the 1980s. Notwithstanding a Fannie Mae Servicing Guide requirement that mortgage delinquencies be reported to the three credit repositories, the reality was that these delinquencies were practically invisible or non-existent in credit reports. When Fannie staff asked servicers how this could happen, the uniform answer was that mortgage delinquencies were reported to the credit repositories. When the credit repositories were asked the same question, they responded:

> See that large pile of paper reports in the corner? Those are the reports from mortgage servicers. At the end of each month, we throw those out and start over. All other credit grantors provide electronic reports, which promptly get machine processed.

The solution was both simple and inexpensive. Fannie amended its Servicing Guide to provide a second option: electronically submit a full file report on all loans whether current or delinquent. We were assured the repositories would prompt process these submissions. Within 2-3 years, complete mortgage histories (not just a smattering of delinquencies) were being reported each and every month for the vast majority of mortgage loans whether or not acquired by Fannie Mae. Servicers found it easier to electronically report on all their loans each and every month at no real cost. This approach may provide a low cost and quick way to make progress with both credit unscorables and invisibles.

\(^{42}\) CFPB, Data Point: Credit Invisibles, 2015, https://www.consumerfinance.gov/data-research/research-reports/data-point-credit-invisibles/


**Proposal:**

Focus on the “low hanging fruit” in terms of credit file expansion for both credit unscorables and invisibles:

- Today, credit repositories have the capability of receiving utility and rental credit histories,
- Today, credit scoring company models have the capability of scoring utility and rental histories contained in repository files,
- Large utilities and public housing agencies presumably have the ability to provide credit histories to credit repositories.

Key industry participants should work with the CFPB, HUD, and the FCC to greatly expand the voluntary reporting of utility and Public Housing Agency rental payment information to credit repositories. This would decrease the number of both credit unscorables and invisibles by including these forms of credit history in an individual’s credit file.

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*Utilities in this context include: cable, satellite, cell, gas, water, electric, wired phone, broadband, and similar companies.*