

QM Roundtable Executive Summary

*August 19th, 2020
AHC: Affordable
Homeownership Coalition*

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AHC held a QM Roundtable on August 19, 2020. This is an Executive Summary of the roundtable.

A more detailed summary of the QM Roundtable is available on the AHC website.

Similarly, for background on the QM rule, please visit the AHC website.

Affordable Homeownership Coalition members convened to hear some of the emerging perspectives on the newly proposed QM Rule.

No consensus was sought or reached on the elements of the QM Rule that were discussed. Instead, the discussion relayed information and created an opportunity for further elaboration and questions.



EXECUTIVE SUMMARY

AHC gathered a group of industry experts ranging from the private sector to non-profit organizations to discuss the CFPB’s proposal for the QM rule and how it differs from current regulations. Below is a summary of the main points covered by our speakers.

Executive Summary

Consideration of the Rate Spread Thresholds: Is 150 bps enough “headroom”?

- **Lindsey Johnson**, Executive Director of USMI, presented the information put together by the trade group that argued in favor of raising the proposed threshold for “safe harbor” loans from 150 bps to 200bps. USMI’s main arguments included:
 - If APOR + 150 bps were the standard in place today, more borrowers of color and borrowers of modest means would be excluded from the pricing advantages of a “safe harbor” loan.
 - APOR + 150bps is an antiquated threshold from the pre-Dodd Frank era that is not anchored to today’s market realities.
 - Consumers are not harmed by the loss of the rebuttable presumption protections because lenders simply do not take the legal risk and do not underwrite those loans.
- **Highlights of the discussion following the presentation:**
 - Delegated underwriting by the FHA, combined with the assumability of FHA loans and now this QM policy may result in “steering” to FHA and away from the GSE market.
 - Generally, industry participants have supported the move to 200 bps.
 - Data reflected in the presentation highlights the borrowers who would be “boxed out” in the 150bps-200 bps difference are primarily people of color.
 - While the FHA may still be available, on paper, for borrowers who are between 150 bps to 200 bps, it more likely they would be subject to manual underwriting. Manual underwriting is less available.
 - Money and liquidity are likely to follow the safe harbor.

“Consider” and “Verify”: What are the embedded lending and consumer implications of moving away from defined underwriting requirements?

- **Kara Ward**, Moderator, Partner at Holland and Knight, summarized the current CFPB proposal to eliminate DTI as the threshold for the QM analysis, turning the current industry reliance on underwriting criteria around defining “debt” and “income” prescriptively, to a more principles-based test according to the 8 Ability to Repay (ATR) criteria.
- **Suzanne Garwood**, Executive Director and Assistant General Counsel, JP Morgan Chase, walked the group through questions and implications of moving to a “reasonable man” standard for documentation requirements under the proposed QM rule. Through this, the group also received valuable insight into the meaning of the new “verify” prong and other significant aspects of the proposal.
 - As defined in the current regulation:

- “Verification” means that lenders are verifying current or reasonably expected income or assets, other than the value of the dwelling that is going to secure the loan, using third-party records that provide reasonably reliable evidence of the consumer's income or assets.
 - “Reasonably reliable third-party records”, which is the most important concept in verification, means that you can no longer rely on borrower representations, alone. This requirement persists in the new proposal.
 - This proposal will allow lenders to rely on their own records about the consumer. This in turn will enable lenders to be more efficient and innovative.
 - The ATR provisions were updated in the proposal’s commentary to talk about income verification. Creditors must consider “unidentified funds” as income.
 - Under the proposal, lenders will not be required to affirmatively verify employment (in contrast to the current regulation).
 - The proposal has a “cure” for the 3% cap on points and fees. This cure will sunset at the same time as the GSE patch.
- **Chrissi Johnson**, Quicken, provided an overview of the “consider” prong under the proposal:
 - In APOR + 200bps, we arrive at a place where we are:
 - Maintaining all product requirements.
 - Eliminating the DTI threshold.
 - Removing Appendix Q and using existing statutory language in asset and income verification. It is paper-centric.
 - Creditors must consider 8 areas of a borrower’s financial capacity.
 - We will not be ignoring underwriting requirements or completely disregard DTI according to empirically derived standards. It is retained in the 8 points of ATR.
- **Ted Tozer**, Milken Institute, provided additional analysis on the “consider” prong:
 - This change is going to force more loans to go to the GSEs, because most investors are going to view the GSEs as a firewall. This will mean fewer loans go to PLS or non-QM lending.
 - PLS investors today say that lenders are on the “hook” for violating investor guidelines.
 - The 150 bps is based on 1994 technology. Why not take machine learning to weigh factors to understand the likelihood of default? Fannie and Freddie are already using AI, it is not DTI based underwriting. We should push CFPB for a process to replace manual underwriting for machine learning.
 - APOR measures expected loss, not expectation of default. This is where LTV plays a more heavily weighted factor in the analysis. LTV is not a borrower-specific measure of their financial capacity.
- **Gerron Levy**, NCRC, then concluded the discussion on the “consider prong”:
 - The advocate community does not have a singular view on the QM approach, except to say that a 43% DTI does not work.
 - Some advocates support raising the DTI and permitting more residual underwriting, others are broadly supportive of the rate spread approach, with some adjustments.

- NCRC has supported the rate spread approach because it seemingly increases access to credit to modest means individuals.
- It is important to emphasize that all other fair lending laws have status and enforcement in addition to ATR.

- **Highlights of the discussion following the presentation:**

- Will there be an opportunity for the kind of residual underwriting that allows a lender to underwrite based on the fact that a borrower's rent currently exceeds the monthly loan amount for which they would qualify?
 - The respondents generally agreed that there is hypothetically room for that consumer to gain access to credit. It allowed Ms. Garwood of JPM to reiterate that there is still a significant effort for lenders to carefully manage their risk- such as not agreeing to buy loans that are based on one month of bank statements.
- Will the prices continue to go up and up and exclude the working poor?
 - Ted Tozer pointed out that the FHA channel will grow under this proposal. They have no cost of capital, but also investors that want some degree of certainty in the underwriting and no credit risk.
- Is PLS doomed? Will there be QM loans in the private loan space? Will there be too many underwriting standards that eliminate the fungibility of the security?
 - Ted Tozer shared that investors will just rep and warrant to lenders, which likely increases costs so much that they cannot compete with the GSEs. If anything comes through, it will be extremely low risk loans.
- Should the CFPB be in the business of approving underwriting standards?
 - Ted Tozer suggested that it is impractical based on too many permutations on compensating factors. What makes more sense? Measuring outcomes and the likelihood of default.

