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The CFPB's Proposed QM Rule Will Responsibly Ease Credit Availability
Data Show That It Can Go Further

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On June 22, 2020, the Consumer Financial Protection Bureau (CFPB) issued a proposed rule to amend the qualified mortgage (QM) rule by eliminating the 43 percent debt-to-income (DTI) cap so that pricing will determine which loans fall within its legal protections (Galban 2020). This would be a fundamental change—one that will determine not only who gets a qualified mortgage in the future but who will have the opportunity to build long-term wealth via homeownership. The Urban Institute strongly supports the move, as the DTI ratio is a weaker predictor of default than pricing, as we have shown in previous briefs (Kaul and Goodman 2018; Kaul, Goodman, and Zhu 2019). This change also paves the way for the elimination of both the "GSE (government-sponsored enterprise) patch" and the CFPB's appendix Q. The latter is widely believed to have made it very difficult for non-W-2 workers (e.g., self-employed and gig economy workers) to obtain mortgage credit (Kaul, Goodman, and Zhu 2018).

The proposed QM rule would make a second major change to the QM rule. Today, first-lien mortgages with rate spreads no higher than 150 basis points above the average prime offer rate (APOR) receive a conclusive, or nonrebuttable, presumption of compliance with the statutory ability-to-repay standards, a so-called safe harbor. This offers lenders the highest level of legal protection against claims that the lender failed to comply with the ability-to-repay standards. All other QM loans, regardless of rate spread, receive a presumption of compliance that can be rebutted in litigation by showing that the lender failed to verify borrower ability to repay. The proposed rule would change this last part. It would institute a new rate spread cap of 200 basis points as the outer QM boundary. Any loans over this threshold would be considered nonqualified mortgages, even if they complied with product feature and other QM requirements.

By eliminating the DTI cap, the proposed rule would treat non-GSE conventional loans with DTI ratios above 43 percent as qualified mortgages, thus expanding the QM eligibility box[1] along the DTI

dimension. At the same time, it would treat loans with a rate spread of 200 basis points or more above the APOR as nonqualified mortgages, thus shrinking the QM box along the rate spread dimension.

In this brief, we discuss the net impact of the proposed changes on lending volumes and demonstrate that even though it would responsibly expand safe harbor lending, it would still leave a meaningful share of lending to first-time homebuyers, purchase borrowers, and minorities outside the safe harbor. We then show that raising the safe harbor line from 150 basis points to 200 basis points and the QM cap from 200 basis points to 250 basis points would increase overall defaults very marginally. Finally, we discuss the impact of the almost certain widening of rate spreads in the coming years and conclude, on balance, that the gain in lending by raising the two thresholds is highly justified.

How Much Positive Impact Would the Proposed Rule Have on Lending Volumes?

To estimate the overall impact of these proposed changes on QM lending volumes, we applied the CFPB's proposed changes to 2019 Home Mortgage Disclosure Act (HMDA) data.[2] The elimination of the DTI cap would treat non-GSE conventional loans with DTI ratios above 43 percent and a rate spread under 200 basis points as qualified mortgages. There were 346,376 such loans made in 2019. These were nonqualified mortgages in 2019 but would be qualified mortgages under the proposal (figure 1; green cells). But this number would be offset by the proposed 200 basis-point QM rate-spread hard cap. In 2019, about 10,900 GSE loans and 38,300 non-GSE conventional QM loans, or 49,200 loans in total, had rate spreads above 200 basis points. These were qualified mortgages in 2019 but would be rendered nonqualified mortgages under the proposal (figure 1; red cells). Thus, on a net basis, if the two proposed changes were in place in 2019, about 297,000 nonqualified loans would have been classified as qualified mortgages. Note that all of this gain in QM lending would come from the non-GSE conventional channel, partially offset by a relatively small number of GSE loans losing QM designation.

TABLE 1

The Impact of Proposed Changes on Lending Volumes

Rate spread	GSE loans		Non-GSE conventional loans	
	DTI ≤ 43 percent	DTI > 43 percent	DTI ≤ 43 percent	DTI >43 percent
≤ 150 bps	1,492,161	403,353	1,696,725	333,951
151–200 bps	19,798	6,696	36,346	12,425
201–250 bps	6,644	1,965	17,722	5,713
> 250 bps	1,871	498	20,559	7,864

Source: Urban Institute analysis of 2019 Home Mortgage Disclosure Act data.
Notes: bps = basis points; DTI = debt-to-income ratio; GSE = government-sponsored enterprise. Numbers in red would be newly nonqualified mortgages under the proposed rule, and numbers in green would be newly qualified mortgages. Others would remain unchanged.

The vast majority (i.e., 333,951 of the 346,376 non-GSE conventional nonqualified mortgages in 2019 that would become qualified mortgages) were priced under 150 basis points. The proposed rule

would designate these loans as safe harbor, a huge improvement from their nonqualified mortgage designation today. This would give lenders the greatest possible legal protection from litigation. We suspect this reduction in litigation risk will also translate into better pricing—that is, lower annual percentage rates (APR) for these loans. Most importantly, it would place these loans, and the non-GSE conventional channel, on equal footing with the GSE channel.

What Would Be the Incremental Benefit of Raising Pricing Thresholds above 150 Basis Points for Safe Harbor and 200 Basis Points for Qualified Mortgages?

A related question is whether the credit box could be further expanded without significantly increasing defaults, by increasing the safe harbor threshold above 150 basis points, increasing the proposed QM threshold above 200 basis points, or both. There are three considerations here:

- How much would the QM or the safe harbor box expand if the thresholds were raised?
- How does this compare with the safe harbor for Federal Housing Administration (FHA) mortgages?
- What would be the incremental rise in expected defaults?

If the safe harbor threshold were raised from 150 basis points to 200 basis points, an additional 75,265 loans (26,494 GSE loans and 48,771 non-GSE conventional loans) with rate spreads from 151 to 200 basis points would receive safe harbor designation (table 1). Legally, this would fold the rebuttable presumption category into the safe harbor, eliminating rebuttable presumption. Also, raising the QM threshold from 200 basis points to 250 basis points would cause an additional 32,044 nonqualified mortgages (8,609 GSE loans and 23,435 non-GSE conventional loans) being redesignated as rebuttable presumption, which would be an improvement. Taken together, these two changes would treat more than 105,000 additional loans a year more favorably for the purposes of the QM rule. These results are summarized in table 2.

TABLE 2

Conventional Lending under Various Rate-Spread Thresholds

	Current QM rule	Proposed rule (SH = 150 bps; QM hard cap = 200 bps)	Proposed rule with SH = 200 bps; QM hard cap = 200 bps	Proposed rule with SH = 200 bps; QM hard cap = 250
Safe harbor	3,592,239	3,926,190	4,001,455	4,001,455
Rebuttable presumption	112,099	75,265	None	32,044
Non-QM	359,953	62,836	62,836	30,792

Source: Urban Institute analysis of 2019 Home Mortgage Disclosure Act data.

Note: bps = basis points; QM = qualified mortgage; SH = safe harbor.

These numbers make clear that increasing the safe harbor threshold is more important than raising the QM cap. But increasing the QM cap to 250 basis points also has merit. Loans insured by the FHA, the US Department of Veterans Affairs, or the US Department of Agriculture are governed by separate QM rules developed and implemented by each of these agencies. Currently, to meet the FHA safe harbor, the APR on the mortgage can be no more than the APOR plus the FHA annual mortgage insurance premium plus 115 basis points. If the APR is over that level, the loan is considered QM rebuttable presumption. With the current FHA annual mortgage insurance premium at 85 basis points, to qualify for the safe harbor, the APR on an FHA mortgage can be no more than 200 basis points over the APOR. Thus, raising the proposed safe harbor cap from 150 to 200 basis points, and the proposed QM hard cap from 200 to 250 basis points would create a more level playing field between conventional and FHA lending. Doing so would also allow some FHA rebuttable presumption loans (i.e., with rate spreads between 200 and 250 basis points) to also qualify for a conventional rebuttable presumption loan, increasing consumer choice.

## Which Borrower Segments Are Served More by Lending with Higher Rate Spreads?

Figure 1 shows the distribution of 2019 conventional lending by loan purpose and race or ethnicity for non-safe-harbor loans with rate spreads of 151 to 200 basis points, 201 to 250 basis points, and above 250 basis points.

FIGURE 1

Composition of Lending above 150 Basis Points, by Race or Ethnicity and Loan Purpose

GSE channel   *Non-GSE conventional channel*
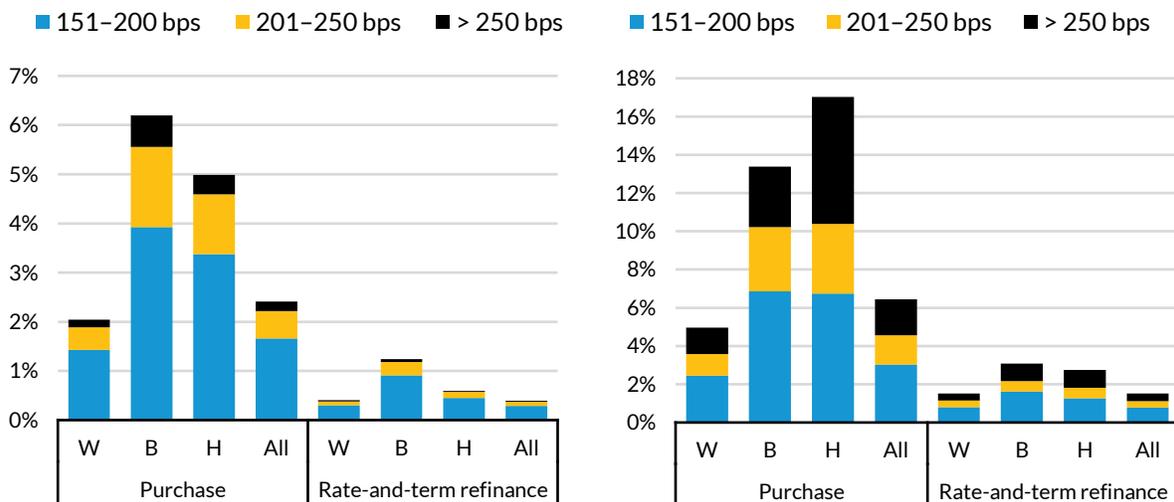
Source: Urban Institute analysis of 2019 Home Mortgage Disclosure Act data.
Note: B = Black; bps = basis points; GSE = government-sponsored enterprise; H = Hispanic; W = white.

Two points are worth emphasizing.

First, purchase loans are much more likely than rate-and-term refinance loans to have rate spreads above 150 basis points. In the GSE channel, 2.4 percent of all purchase lending was above the 150 basis-point safe harbor threshold, compared with only 0.4 percent of refinances. The difference was even wider in the non-GSE conventional channel: 6.4 percent of all purchase loans versus 1.5 percent of rate-and-term refinances had rate spreads above 150 basis points. Refinance borrowers have lower rate spreads because they have higher credit scores and higher incomes than purchase borrowers, most of whom are first-time homebuyers. Purchase lending is what makes homeownership accessible for first-time homebuyers and puts them on the path to long-term wealth creation. Raising the safe harbor threshold from 150 basis points to 200 basis points would have a disproportionately more positive impact on purchase lending volumes than on refinances.

Second, minority households are much more likely to have mortgages with higher rate spreads than white households. In the GSE channel, 6.2 percent and 5.0 percent of all purchase lending to Black and Hispanic households had rate spreads above 150 basis points, compared with only 2 percent for white households. The racial disparity was even wider in the non-GSE conventional channel: 13.4 percent and 17.0 percent for Black and Hispanic households versus 5 percent for white households. Note that the blue bars (representing rate spreads from 150 to 200 basis points) constitute most lending above 150 basis points for both loan purposes and all three racial and ethnic groups in the GSE channel[3] and a sizable share in the non-GSE conventional channel. Thus, increasing the safe harbor threshold from 150 basis points to 200 basis points would not only reduce the racial and ethnic disparity but help increase lending volumes for every racial and ethnic group.

Another way to visualize who would benefit more from expanded rate-spread thresholds is to look at the lending distribution by loan-to-value (LTV) ratios. Figure 2 covers Fannie Mae's historical originations back to 1999. It shows the share of Fannie Mae lending above 150 basis points for various year groups and confirms that loans with LTV ratios above 80 percent—which typically are loans to first-time homebuyers and households with limited wealth and with private mortgage insurance—are significantly more likely to be priced outside the current safe harbor. Equally important, most of these loans (above 150 basis points) are priced between 151 and 200 basis points. This provides further evidence in support of raising the safe harbor cap to 200 basis points. The next key question is whether this expanded access to credit produces significantly higher default rates.

FIGURE 2

Composition of Fannie Mae Lending above 150 Basis Points, by LTV Ratio
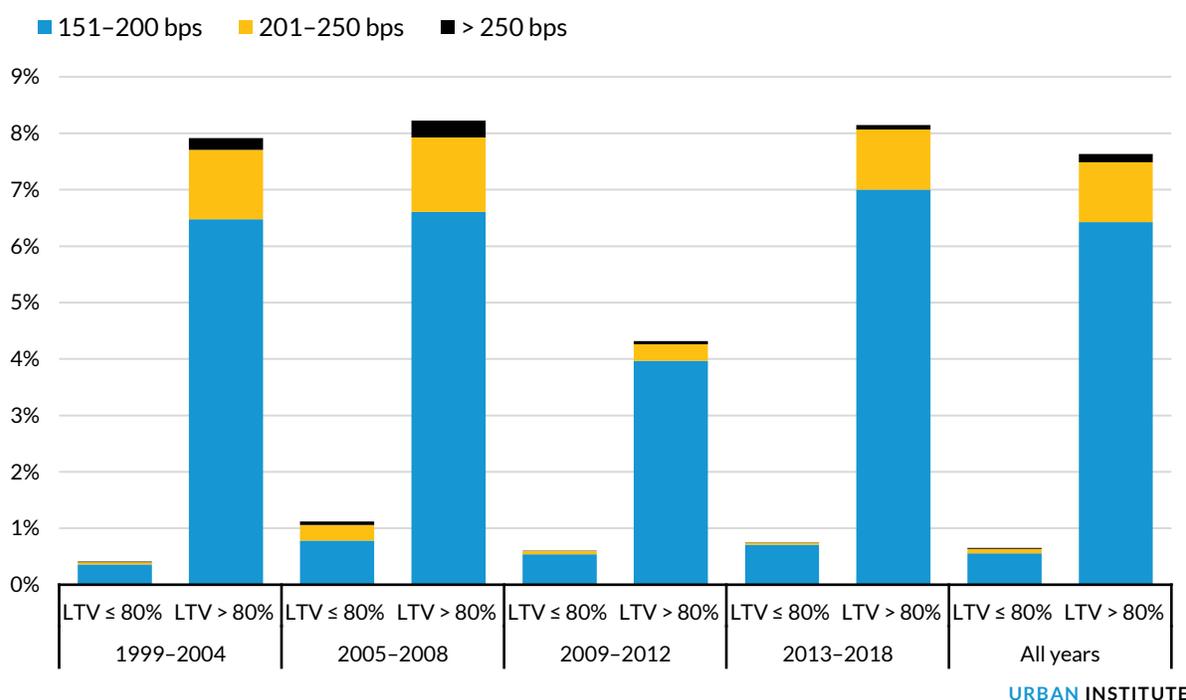
Source: Urban Institute analysis of Fannie Mae loan-level performance dataset.
Note: bps = basis points; LTV = loan-to-value.

How Much Would Defaults Increase If the Thresholds Were Raised?

We rely on two datasets to answer this question. We study GSE default rates using Fannie Mae's single-family historical loan performance data released in support of its credit risk transfer program. For the portfolio and private-label securities (PLS) channels, we rely on the Black Knight McDash database.[4] Our definition of default is loans that were ever 60 or more days delinquent. We studied several measures of default and selected loans that have ever been 60 or more days delinquent because it is more conservative (i.e., it produces higher default rates) than the two-year 60-day delinquency measure used in the CFPB's analysis or the 90-day or 180-day delinquency measures. Our analysis found all measures of default to be highly correlated with rate spreads.

Figure 3 shows loans that were ever 60 or more days delinquent by rate spread,[5] channel, and origination year. Figure 3A covers all loans, figure 3B covers purchase loans, and figure 3C covers rate-and-term refinances. We focus on the yellow lines, which represent loans that were ever 60 or more days delinquent for 2013–18 originations (i.e., postcrisis originations). These loans are most indicative of the types of loans we are likely to see in the foreseeable future. Starting with figure 3A, it is clear that defaults on postcrisis originations are lower than for any other period in recent history. This reflects

drastic improvements in mortgage underwriting. These defaults also do not exhibit a "hockey stick" effect" at higher rate spreads. In the GSE space, defaults rise gradually up until the 200 basis-point mark and then flatline. In the portfolio and PLS spaces, defaults rise even less gradually until 200 basis points and eventually flatten out after 250 basis points. That defaults generally flatten out as opposed to escalating at higher rate spreads is noteworthy. It reflects the impact of additional underwriting requirements these borrowers are subject to.
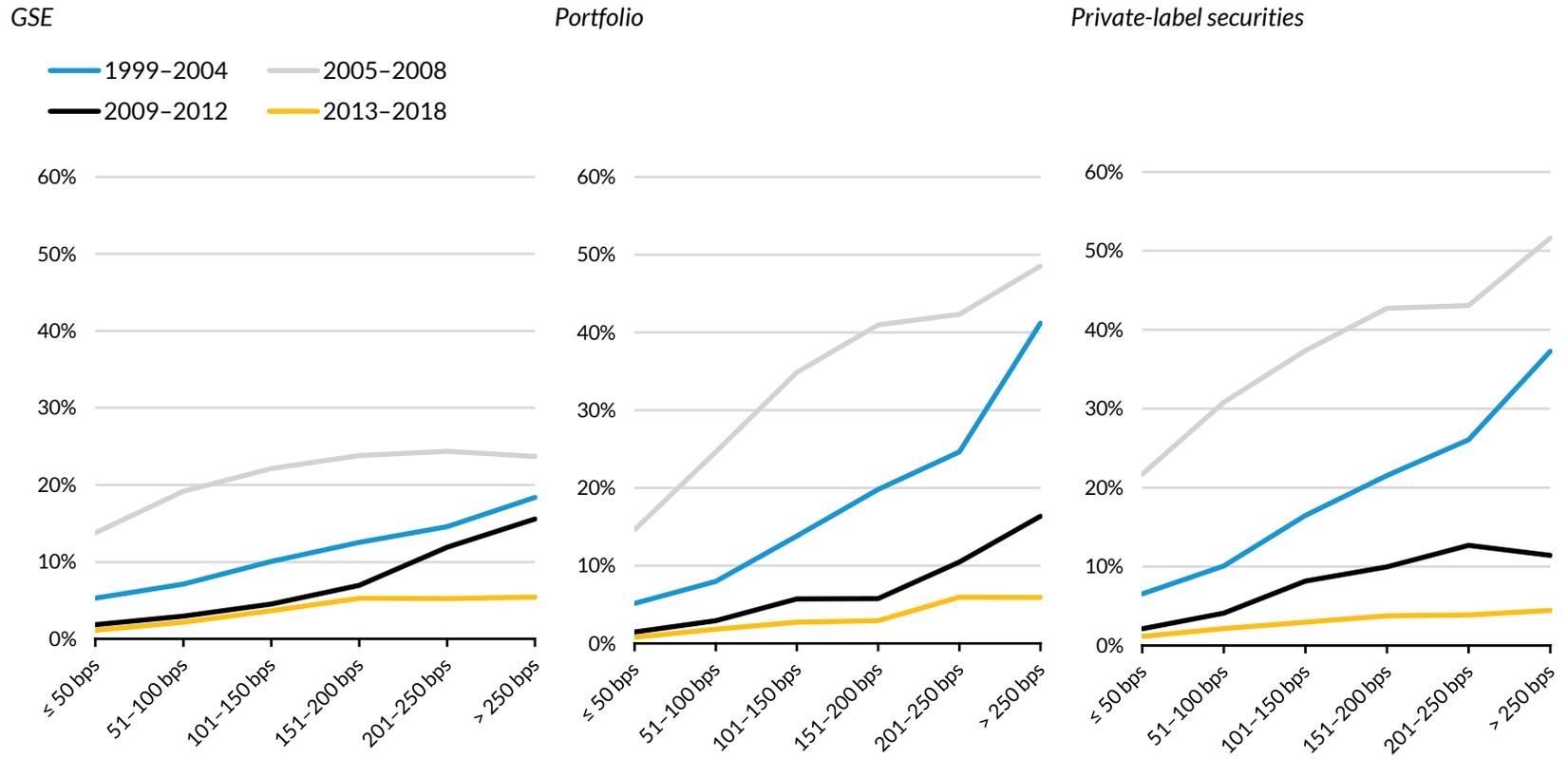
In figure 3A, the share of loans that were ever 60 or more days delinquent for GSE originations from 2013 to 2018 in the 200-to-250-basis-point bucket is 5.2 percent, compared with 5.3 percent in the 150-to-200-basis-point bucket and 3.7 percent in the 100-to-150-basis-point bucket. The maximum variation in the share of loans that were ever 60 or more days delinquent across these three buckets is 1.6 percentage points. In the portfolio space, the share of loans that were ever 60 or more days delinquent increases only from 2.7 percent in the 100-to-150-basis-point bucket to 2.9 percent in the 150-to-200-basis-point bucket. It jumps to 5.9 percent in the 200-to-250-basis-point bucket and then flatlines. For PLS loans, the rate rises from 2.9 to 3.7 to 3.9 percent between the three rate-spread buckets and then flatlines. When evaluating whether to raise the safe harbor line from 150 to 200 basis points, it is important to account for not just the small increase but the low baseline at which we are operating today relative to any time in the past 20 years.

To fully appreciate how low default rates are today, observe that the default rate for 2013–2018 originations (yellow line) in the 150-to-200-basis-point bucket is the *same or less than* the default rate for 1999–2004 originations (blue line) in the up-to-50-basis-point rate-spread bucket for all three channels, across the three panels. Although robust house price appreciation is keeping defaults low, permanent improvements in underwriting; automated verification of income, employment, and assets; more accurate appraisals; and better data also play a large role. In this context, we think it is reasonable to tolerate the small increase in default rates that would result from increasing the safe harbor threshold to 200 basis points or the QM hard cap to 250 basis points. The fact that doing so would cause an additional 75,000 to 105,000 mortgages a year to receive a more favorable designation under the QM rule only strengthens the argument.

The figures showing delinquency rates for purchase loans (figure 3B) and for rate-and-term refinance loans (figure 3C) tell a similar story. The share of loans that were ever 60 or more days delinquent on postcrisis loans rises gradually and stays low at higher rate spreads for all three channels. There is some evidence of rising defaults for refinances over 250 basis points, but even this level is an order of magnitude lower than the 1999–2004 pre-bubble loans.

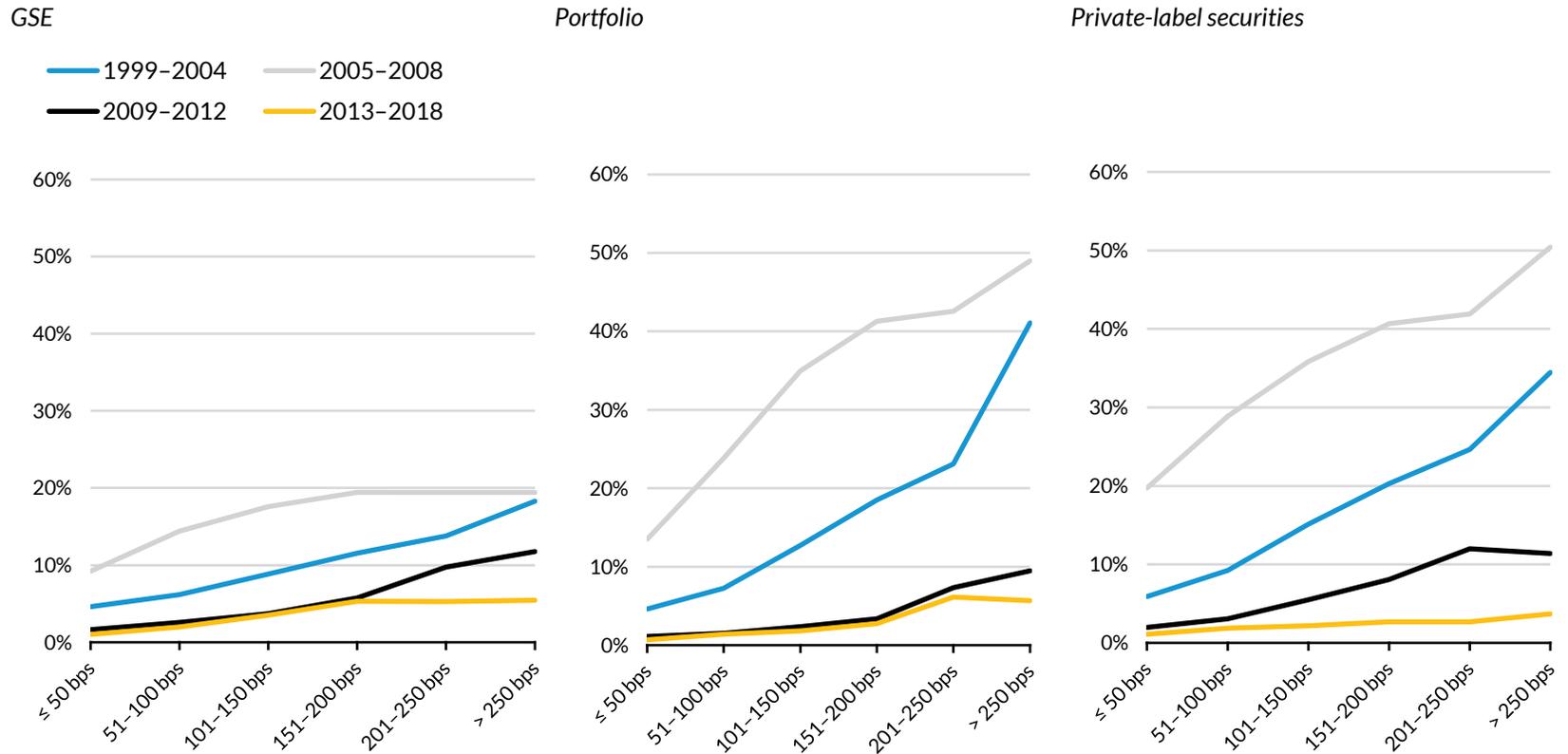**Share of Loans That Were Ever 60 or More Days Delinquent, by Channel and Rate Spread, All Loans**

GSE   Portfolio   Private-label securities

1999–2004   2005–2008
2009–2012   2013–2018

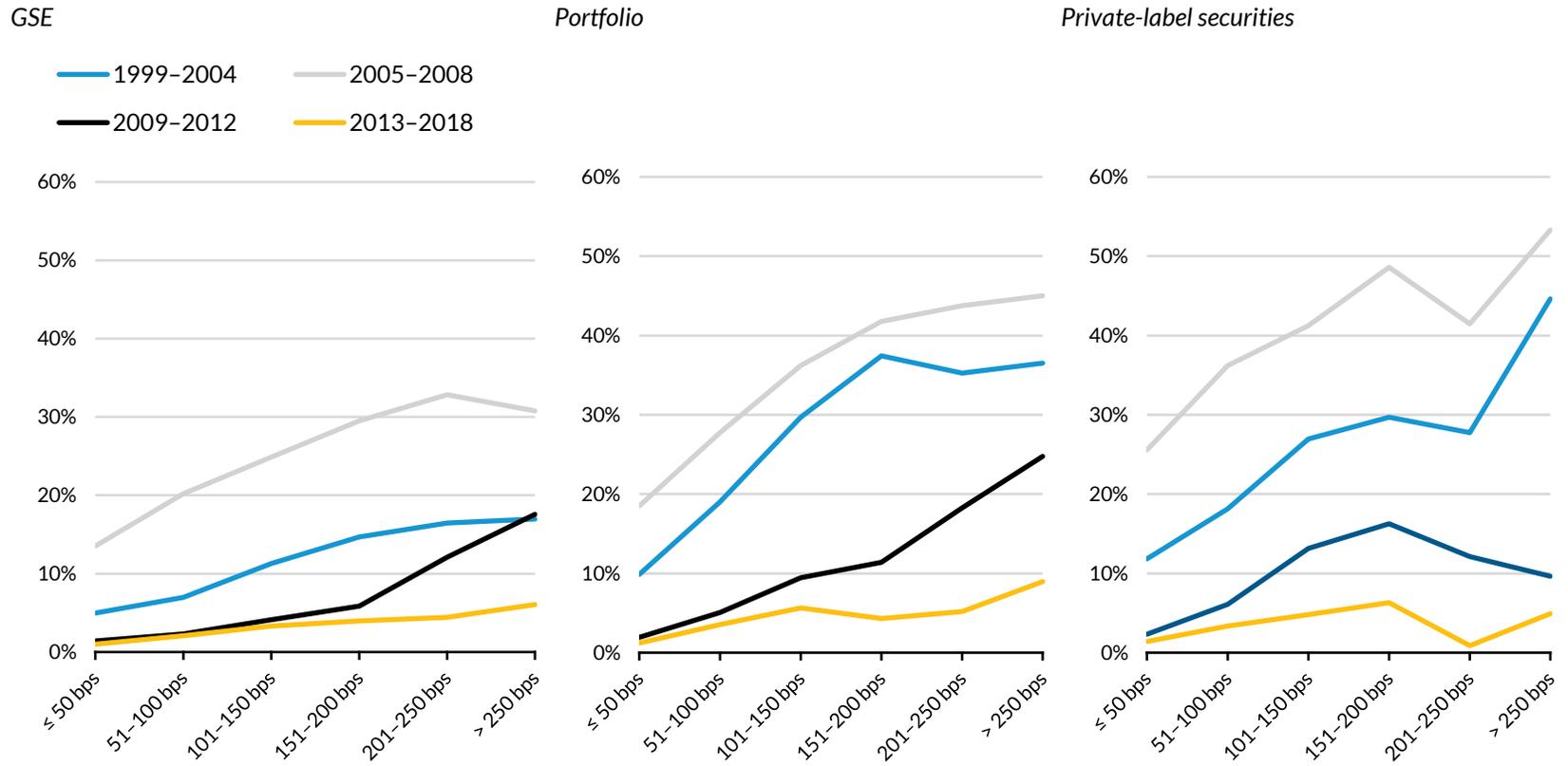**Source:** Urban Institute analysis of Fannie Mae loan-level credit data and Black-Knight McDash data.
Note: bps = basis points; GSE = government-sponsored enterprise.

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FIGURE 3B

Share of Loans That Were Ever 60 or More Days Delinquent, by Channel and Rate Spread, Purchase Loans

GSE

Portfolio

Private-label securities

— 1999–2004   — 2005–2008
— 2009–2012   — 2013–2018

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Source: Urban Institute analysis of Fannie Mae loan-level credit data and Black-Knight McDash data.
Note: bps = basis points; GSE = government-sponsored enterprise.

Share of Loans That Were Ever 60 or More Days Delinquent, by Channel and Rate Spread, Rate-and-Term Refinance Loans

GSE   *Portfolio*   *Private-label securities*

Legend: 1999–2004 · 2005–2008 · 2009–2012 · 2013–2018

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Source: Urban Institute analysis of Fannie Mae loan-level credit data and Black-Knight McDash data.
Note: bps = basis points; GSE = government-sponsored enterprise.

We can further quantify the small increase in defaults by using a simple ordinary least squares regression equation using the same Fannie Mae loan-level performance data from 1999 to 2018 (table 3). Our regression includes the rate spread and other control variables that should matter in predicting default, such as FICO scores, DTI ratios, and LTV ratios. We also control for origination year, original unpaid principal balance, loan purpose, property type, occupancy type, and first-time homebuyer status. All the variables have the expected sign, and the rate spread is highly predictive of default.

TABLE 3
Incremental Default Rate, by Rate Spread

Rate spread	Estimate	*t*-value	Increase in the share of loans ever 60 or more days delinquent over lower bucket
51–100 bps	2.0%	195.82	2.0%
101–150 bps	4.2%	269.23	2.2%
151–200 bps	6.4%	199.67	2.2%
201–250 bps	7.9%	103.07	1.5%
> 250 bps	10.5%	53.42	2.6%

Source: Urban Institute analysis of Fannie Mae loan-level performance data.
Note: bps = basis points.

Mortgages with rate spreads from 51 to 100 basis points have a probability of ever becoming 60 or more days delinquent (on average and controlling for other factors) that is 2.0 percentage points higher than our assumed baseline default rate of 0 percent for loans with rate spreads up to 50 basis points. Loans with rate spreads from 101 to 150 basis points have a probability of ever being 60 or more days delinquent that is 2.2 percentage points higher than the previous category. Loans with rate spreads from 151 to 200 basis points add another 2.2 percentage points to the default probability of the previous bucket, while loans with rate spreads from 201 to 250 basis points add another 1.5 percentage points.

This regression is based on the entire Fannie Mae dataset covering loans originated from 1999 to 2018, including bubble-era loans. The coefficients would be much smaller if the sample were restricted to postcrisis loans. The fact that the 1.5 percentage-point increase in default rate for loans with rate spreads of 201 to 250 basis points is less than the 2.2 percentage points for loans with rate spreads from 151 to 200 basis points—which in turn is the same as the 2.2 percent probability of ever going 60 or more days delinquent for loans with rate spreads from 101 to 150 basis points—strongly validates the key outcome from figure 2—that is, no rapid deterioration in loan performance.

The Interplay between the QM Rule and Future Price Increases

So far, we have demonstrated that increasing the safe harbor and QM thresholds to 200 and 250 basis points would cause an additional 105,000 mortgages a year to be designated more favorably while keeping defaults very low. There is, however, another important reason to increase this threshold: rate

spreads are a moving target. Spreads typically narrow during economic expansions and widen during recessions. Spreads are also constantly influenced by industry, regulatory, and market changes. In the past 10 years, we have witnessed a substantial increase in the base guarantee fees and the loan-level price adjustments charged by the GSEs. The premiums charged by private mortgage insurers have also increased significantly. Other less apparent items that add to the rate spread include market dynamics such as high costs of originating and servicing loans, all of which are either rolled into the note rate or paid up front by borrowers at closing.

Spreads are likely to widen over the next few years if the Federal Housing Finance Agency's (FHFA's) proposed capital rule[6] is finalized, which would increase the price of GSE mortgages in ways that are likely to increase the number of borrowers who would pay more than 150 basis points above the APOR. The FHFA's proposal contains capital requirements that are much higher than what is implicit in current pricing, making it all but certain that GSE pricing will go up. Moreover, the way the rule is structured, the GSEs will lose a significant share of their low-risk borrowers to banks, leading to a loss of the cross-subsidy that these loans generate today. Less cross-subsidy will mean a steepening of the price curve, pushing more borrowers above the 150 basis-point threshold. The disproportionate share of the price increase will be borne by high-risk borrowers who remain at the GSEs. In the more immediate term, the FHFA's decision[7] to charge an additional loan-level price adjustment of 50 basis points on most Fannie Mae and Freddie Mac refinances, effective December 1, can cause refinance spreads to widen relative to the APOR.

Consequently, the rate-spread thresholds embedded in the QM rule must include adequate buffers that account for future price increases. While the GSEs, private mortgage insurers, and the FHFA can change pricing with short notice, the QM rule cannot be quickly changed. If the CFPB were to leave the caps unchanged at 150 basis points for safe harbor and 200 basis points for QM, and the FHFA finalized its rule as proposed, it would have the same effect as lowering the two caps. The impact would be felt more by purchase borrowers than by refinance borrowers and by minority borrowers more than by white borrowers.

The FHFA's proposed capital rule is estimated to raise mortgage rates by 15 to 20 basis points while the GSEs remain in conservatorship and by 30 to 35 basis points upon exit from conservatorship (Parrott, Ryan, and Zandi 2020). Higher charges for the latter reflect the fact that the GSEs would hold slightly more capital as private entities, incur higher borrowing costs, and pay for any backstop fees charged by the US Treasury. Using the midpoint of these two ranges yields rate increases of 18 and 32 basis points, respectively. In addition, the 50 basis-point loan-level price adjustment charge on refinances could increase spreads on refinance mortgages by up to 12 basis points, assuming an average four-year life of loan. Combining these two charges would cause purchase mortgage rate spreads to widen by 18 basis points while the GSEs stay in conservatorship and by 32 basis points upon exit. Refinance rate spreads would widen by an additional 12 basis points to 30 and 44 basis points, respectively.

To determine the impact that these changes would have on who falls within the safe harbor, we applied these charges to Fannie Mae's historical loan-level dataset to calculate the share of lending that

would have exceeded the 150 basis-point threshold. Figure 4 shows the results for various year groups and all years combined. Panel A shows the actual share of Fannie Mae lending that was above the 150 basis-point safe harbor threshold. Panel B shows the share of lending above safe harbor caused by the FHFA's new capital rule during conservatorship and by the refinance fee. Panel C shows the same after exit from conservatorship.
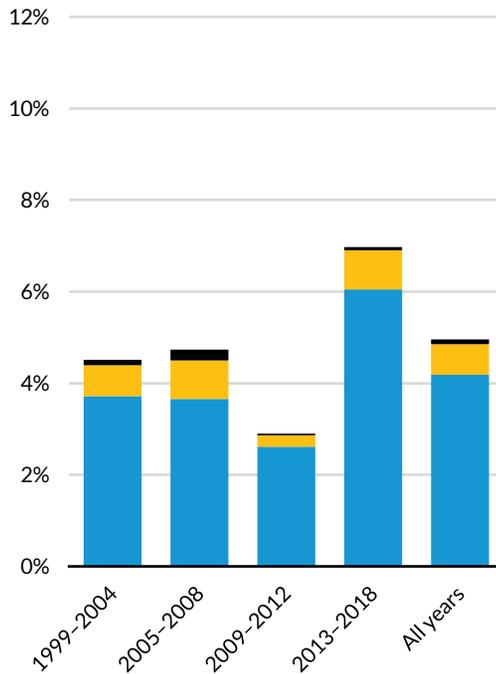
FIGURE 4

Distribution of Fannie Mae Lending with and without Proposed Pricing Charges

A. Actual lending distribution by rate spread
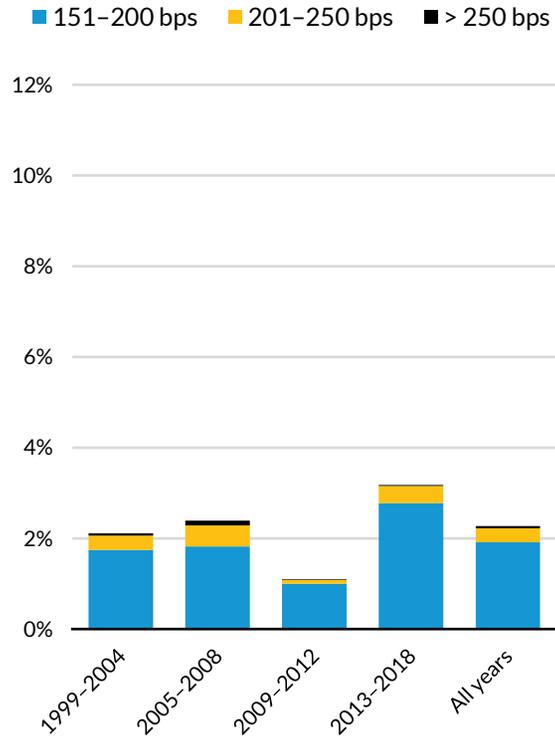
B. Impact of capital rule during conservatorship and refinance fee

C. Impact of capital rule after conservatorship and refinance fee
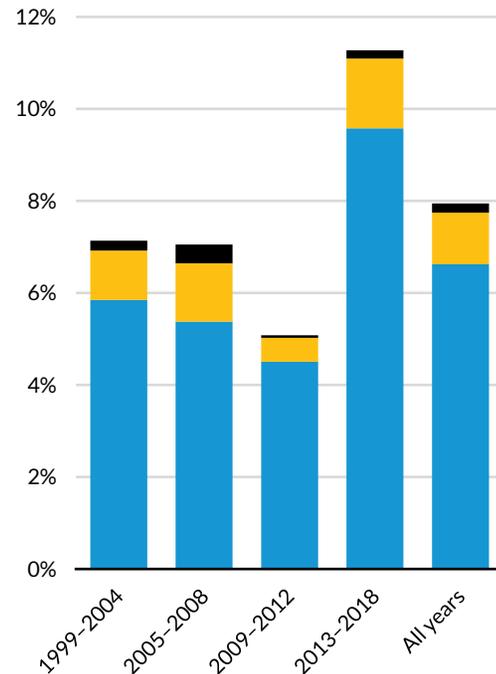
■ 151–200 bps   ■ 201–250 bps   ■ > 250 bps

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Source: Urban Institute analysis of Fannie Mae loan-level performance dataset.
Note: bps = basis points.

If we compare "all years" across the three panels, the share of Fannie Mae lending above 150 basis points would rise from an actual of 2.3 percent in panel A, to 5 percent in panel B, to 7.9 percent in panel C. The corresponding loan counts are 0.65 million, 1.4 million, and 2.3 million. Put differently, applying the FHFA's capital rule and the new refinance charge to Fannie Mae's entire book of business from 1999 to 2018 would have cut safe harbor lending by 750,000 loans (i.e., 1.4 million minus 0.65 million) assuming conservatorship pricing and by more than 1.7 million loans assuming postconservatorship pricing. If we look at lending from 2013 to 2018, the share of lending outside the safe harbor would increase from an actual of 3.2 percent in panel A (0.3 million loans), to 7.0 percent in panel B (0.6 million loans), to 11.3 percent (1 million loans) in panel C. That is, the proposed pricing changes would have cut safe harbor lending by 300,000 loans from 2013 to 2018 assuming conservatorship pricing and by more than 700,000 loans assuming postconservatorship pricing. And these loan counts are for Fannie Mae only. The actual reduction in safe harbor lending would be much greater, as Freddie Mac would be roughly equally affected by the FHFA's proposed changes. And to the extent the GSEs' price increases encouraged portfolio and PLS lenders to raise prices, the curtailment in safe harbor lending would be larger.

In light of this, we strongly favor increasing the safe harbor cap to 200 basis points and the QM cap to 250 basis points. Doing so would preserve current safe harbor and rebuttable presumption designations for most loans (even if the proposed GSE capital changes were finalized) without causing a meaningful increase in defaults. Raising both caps would preserve the rebuttable presumption category, leaving a buffer for high-quality loans made during periods of wider spreads without rendering them outright nonqualified mortgages.

On the other hand, leaving the proposed caps at 150 and 200 basis points would cause unnecessary disruption in the mortgage market by tightening access to credit once the FHFA's capital rule is finalized, especially for minority homebuyers and purchase and high-LTV-lending-dependent first-time homebuyers. This detrimental impact will only be amplified if the coronavirus pandemic is ongoing and the economy is still struggling when the revised QM rule and GSE capital requirements go into effect.

If the CFPB does not increase the thresholds, it should at least conduct an automatic reevaluation every year to ensure that price increases are not cutting lending to responsible borrowers. The bureau may want to conduct this evaluation even if it raises the thresholds because market conditions can change rapidly, as they did at the start of the pandemic. But this exercise is backward looking, which is why we favor higher thresholds. In particular, leaving the safe harbor threshold at 150 basis points is unrealistic, given the magnitude of upcoming changes to GSE capital requirements.

Lastly, the CFPB may want to consider whether to evaluate the proposed changes to the general definition of the QM rule in conjunction with its more recent proposal[8] to create a new QM category for loans that have seasoned for 36 months. Additional analysis might be required to study the interplay between default rates, rate spread caps, loan products, and seasoning periods. To the extent the seasoning proposal has any implications for the general definition of the QM rule or vice versa, a combined evaluation of both would be more accurate than considering the rules serially.

Conclusion

The CFPB is on the verge of the first fundamental revision of the general definition of the QM rule since it went into effect in January 2014. Moving from a DTI-centric rule to one that is based on rate spread will expand access to responsible credit for borrowers with high DTI ratios. Because rate spread is a much better predictor of default than DTI ratios, this change will allow the legal protections afforded by the QM rule to be targeted more accurately. At the same time, the proposed price caps for safe harbor and qualified mortgages will prove inadequate after future pricing increases. Given this, we urge the CFPB to increase the safe harbor cap to 200 basis points and the QM cap to 250 basis points. In particular, raising the safe harbor cap to 200 basis points would improve access to credit substantially more than leaving it at 150 basis points while increasing overall defaults—which are at a very low baseline—only marginally. And it would align the conventional safe harbor cap with the FHA's. Higher thresholds would also leave the QM rule with a rate spread "buffer" to absorb the impact of future price increases that are almost certain. At a minimum, the CFPB should pave the way for an annual reevaluation of rate spreads and adjust the caps to keep the market functioning smoothly at all times.

Notes

1   High-DTI GSE mortgages are qualified mortgages even today because of the GSE patch; purely private loans (i.e., whole loans held in bank portfolios or pooled in private-label securities) with DTI ratios above 43 percent are nonqualified mortgages and substantial in number.

2   We restricted 2019 HMDA data to owner-occupied and second homes. We excluded small loans, investor loans, subordinated liens, and loans with negative amortization, interest-only, and balloon payment features. The "non-GSE conventional loans" category might include a small portion of GSE loans, as those GSE loans might still be on banks' balance sheets at the time of HMDA reporting.

3   A significant share of non-GSE conventional purchase loans, especially those made to Hispanic borrowers, have rate spreads above 250 basis points.

4   Fannie Mae's single-family loan performance dataset includes fixed-rate, full-documentation, amortizing loans that were not purchased under an affordable housing program. These data include loans originated from the first quarter of 1999 through the fourth quarter of 2018. Loan performance is through the fourth quarter of 2019. We narrowed these data to 30-year loans. Adjustable-rate mortgages, high-risk fixed-rate loans, and mortgages with risky features (e.g., interest-only loans, 40-year loans, and loans purchased under special affordability programs) are excluded from this dataset. For the full market, we relied on the Black Knight McDash database. We restricted the sample to fixed-rate, 30-year products only. Loans with risky features (e.g., negative amortization loans and interest-only loans) are excluded, as they are banned under the QM rule.

5   Methodology for calculating the rate spread: Unlike HMDA, neither Fannie Mae loan-level data nor Black-Knight McDash data provides rate spread or APR. We estimate rate spread as follows. We (1) begin with the note rate, (2) add the origination cost, (3) add private mortgage insurance for high-LTV GSE loans, and (4) subtract the Primary Mortgage Market Survey (PMMS) rate. Inputs 1 and 4 are readily observable. For input 2, Mortgage Bankers Association application data and Freddie Mac PMMS data show up-front costs of about 50 basis points, or 10 basis points annually. For input 3 (private mortgage insurance cost), we use the same premiums as the CFPB's analysis but apply a 25 percent haircut because private mortgage insurance is not paid after the LTV ratio reaches 78 percent. We lag the PMMS rate eight weeks, as the rate on the underlying mortgage is usually set at the time of application. We do not add loan-level price adjustments, as these are typically rolled into the note rate.

[6] [Enterprise Regulatory Capital Framework](#), 85 Fed. Reg. 39274 (June 30, 2020).

[7] Federal Housing Finance Agency, "Adverse Market Refinance Fee Implementation Now December 1," news release, August 25, 2020, [https://www.fhfa.gov/Media/PublicAffairs/Pages/Adverse-Market-Refinance-Fee-Implementation-Now-December-1.aspx.](https://www.fhfa.gov/Media/PublicAffairs/Pages/Adverse-Market-Refinance-Fee-Implementation-Now-December-1.aspx)

[8] Consumer Financial Protection Bureau, "Consumer Financial Protection Bureau Proposes New Category of Qualified Mortgages to Encourage Innovation and Access to Affordable Mortgage Credit," news release, August 18, 2020, [https://www.consumerfinance.gov/about-us/newsroom/cfpb-proposes-new-category-qualified-mortgages-encourage-access-affordable-mortgage-credit/.](https://www.consumerfinance.gov/about-us/newsroom/cfpb-proposes-new-category-qualified-mortgages-encourage-access-affordable-mortgage-credit/)

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