The Evidence Supports the CFPB's New Seasoning Pathway to Safe Harbor

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On December 10, 2020, the Consumer Financial Protection Bureau (CFPB) issued a final rule that provides a pathway for conventional first-lien mortgages that are rebuttable presumption or nonqualified mortgages at origination to be deemed safe harbor 36 months after origination, subject to certain criteria. Specifically, the loan must be held on the originator's balance sheet or sold once and then held as a whole loan on the buyer's balance sheet during the entire three-year period. In addition, the loan cannot have been 30 days delinquent more than twice or 60 days delinquent ever during the three-year seasoning period.

On the same day, the CFPB also finalized a major overhaul of its 2014 qualified mortgage (QM) rule. It removed the 43 percent maximum debt-to-income ratio limit from the QM definition, thus making the GSE (government-sponsored enterprise) patch redundant. The CFPB also instituted a new rate spread cap of 225 basis points over the average prime offer rate (APOR) as the outer boundary for the QM box. Under the new regime, effective no later than July 1, 2021, loans that meet mandatory QM requirements (i.e., product restrictions, limits on points and fees, and maximum 30-year terms) and have annual percentage rates less than 150 basis points above the APOR will be deemed safe harbor, regardless of debt-to-income ratio. Loans with rate spreads of at least 150 basis points but less than 225 basis points over the APOR will be rebuttable presumption, and those with rate spreads of at least 225 basis points will be nonqualified mortgages, regardless of debt-to-income ratio.

The seasoning rule provides a conditional pathway for rebuttable presumption and nonqualified mortgages—that is, those with rate spreads of at least 150 basis points at origination—to become safe harbor, subject to meeting the seasoning requirements. The seasoned QM rule applies only to first-lien fixed-rate mortgages that satisfy the product feature requirements and limits on points and fees under the general QM loan definition. In addition, loans defined as high-cost mortgages, or HOEPA (Home

Ownership and Equity Protection Act) mortgages, are never eligible.[1] In this brief, we analyze historical loan performance to study the reasonableness of the seasoning rule.

We seek to answer two questions:

1. Is loan performance during the first three years generally predictive of long-term performance?

2. How do default probabilities for loans that are safe harbor at origination compare with default rates for loans that are not safe harbor at origination but would pass the new seasoning test to become safe harbor after three years?

Historical Loan Performance and Seasoning

Table 1 shows the historical loan performance for GSE, portfolio, and private-label security (PLS) loans originated from 1999 to 2016, after three years of seasoning. These results are based on 30-year fixed-rate mortgages. We exclude loans with nontraditional features (i.e., interest only, prepayment penalty, negative amortization, and balloon payment), terms less than 30 years, and adjustable-rate mortgages. Our methodology is as follows: We first divide these loans into buckets, based on their rate spread at origination (i.e., less than 150 basis points, at least 150 but less than 225 basis points, and at least 225 basis points) and loan performance during the first three years (i.e., has a clean payment history, went 30 days delinquent once, went 30 days delinquent twice, or went 60 days delinquent once). Thus, the initial rate spread and performance over the first three years determines the bucket the loan is placed in.

For each bucket, we then measure loan performance as the likelihood of going 90 or more days delinquent in *years four, five, and six*. This allows us to study performance during years four, five, and six for loans that pass the CFPB's seasoning criteria. The red cells show rates of going 90 or more days delinquent in years four, five, and six for loans that were rebuttable presumption or nonqualified mortgages at origination but would have passed the seasoning test to become safe harbor after three years. Cells with "N/A" indicate buckets with fewer than 500 loans. For each channel and rate-spread bucket, we also show the number of loans that were originated.

Let us focus on 2013–16 portfolio originations that were not safe harbor at origination; 3.6 percent of loans with a clean three-year pay history (i.e., no delinquencies) and rate spreads from at least 150 to less than 225 basis points went 90 or more days delinquent in years four, five, or six, and 5.0 percent of clean loans with rate spreads of at least 225 basis points did the same. The seasoning rule would deem these two loan buckets as safe harbor after three years, as they have no more than two 30-day delinquencies. Note that these percentages are less than the corresponding 90-day delinquency rates for safe-harbor portfolio loans—5.3 percent for loans that went 30 days delinquent twice and 12.2 percent for loans that went 60 days delinquent once in the first three years. The comparison with safe-harbor loans that went 60 or more days delinquent once in the first three years is especially stark. That is, rebuttable presumption and nonqualified mortgages with a clean pay history in the first three years

performed *much better* in years four, five, and six than loans that were safe harbor at origination but went 60 days delinquent once in the first three years.

Historical Loan Performance Based on the Consumer Financial Protection Bureau's 36-Month Seasoning Criteria

	Rate spread over PMMS	Share of Loans That Went 90 or More Days Delinquent in Years 4–6 That, Over the First 3 Years,				Loans originated (count)
		Had a clean pay history	Went 30 days delinquent once	Went 30 days delinquent twice	Went 60 days delinquent once	
Portfolio loans						
1999–2004	<150 bps	3.9%	6.3%	11.0%	20.7%	4,102,441
	150–225 bps	12.8%	11.0%	15.0%	23.9%	94,032
	≥225 bps	30.9%	21.3%	35.4%	41.7%	54,905
2005–2008	<150 bps	7.4%	16.9%	24.7%	45.7%	5,162,147
	150–225 bps	13.9%	20.7%	27.6%	42.3%	183,222
	≥225 bps	21.8%	25.3%	34.0%	47.0%	154,505
2009–2012	<150 bps	0.9%	3.4%	7.0%	21.9%	3,038,166
	150–225 bps	2.4%	5.5%	N/A	N/A	33,384
	≥225 bps	8.1%	N/A	N/A	N/A	4,861
2013–2016	<150 bps	1.1%	2.6%	5.3%	12.2%	2,155,781
	150–225 bps	3.6%	N/A	N/A	N/A	13,986
	≥225 bps	5.0%	N/A	N/A	N/A	5,848
PLS loans						
1999–2004	<150 bps	5.2%	7.7%	12.2%	22.6%	4,039,508
	150–225 bps	12.9%	10.7%	15.8%	24.8%	162,305
	≥225 bps	23.1%	8.5%	15.6%	23.5%	185,257
2005–2008	<150 bps	13.6%	22.5%	30.9%	50.8%	4,801,597
	150–225 bps	20.0%	18.5%	26.8%	38.7%	317,717
	≥225 bps	25.3%	18.3%	25.6%	37.7%	476,309
2009–2012	<150 bps	1.5%	3.0%	6.7%	21.9%	836,882
	150–225 bps	4.2%	N/A	N/A	N/A	6,734
	≥225 bps	3.9%	N/A	N/A	N/A	1,453
2013–2016	<150 bps	1.3%	1.9%	3.8%	12.7%	756,361
	150–225 bps	2.5%	N/A	N/A	N/A	2,764
	≥225 bps	2.5%	N/A	N/A	N/A	2,027
GSE loans						
1999–2004	<150 bps	5.5%	12.0%	18.7%	37.6%	3,684,708
	150–225 bps	14.9%	21.4%	27.0%	43.9%	44,032
	≥225 bps	15.6%	N/A	N/A	N/A	1,755
2005–2008	<150 bps	9.7%	22.6%	31.6%	62.3%	1,978,568
	150–225 bps	12.4%	24.5%	31.9%	N/A	37,785
	≥225 bps	10.4%	N/A	N/A	N/A	3,816
2009–2012	<150 bps	1.1%	5.1%	11.6%	42.9%	2,894,209
	150–225 bps	3.1%	9.2%	N/A	N/A	31,964
	≥225 bps	6.0%	N/A	N/A	N/A	850
2013–2016	<150 bps	0.4%	2.0%	4.8%	28.4%	2,930,829
	150–225 bps	0.8%	3.6%	7.2%	N/A	66,916
	≥225 bps	0.7%	N/A	N/A	N/A	700

Sources: Black Knight, Urban Institute, and GSE loan-level credit data.

Notes: GSE = government-sponsored enterprise; PLS = private-label securities; PMMS = Primary Mortgage Market Survey. Cells with "N/A" represent buckets with insufficient observations; we require 500 observations to include the data. We use Black Knight data for PLS and portfolio channels and Fannie Mae loan-level credit data for the GSE channel. We construct the rate spreads as follows: For PLS and portfolio loans, we take the difference between the note rate and the PMMS rate (lagged eight weeks) and add 10 basis points and fees. We do the same for GSE loans but add private mortgage insurance premiums as follows: We use private mortgage insurance premiums of 24 basis points for loans with loan-to-value (LTV) ratios from 80 to 85 percent, 39 basis points for loans with LTV ratios from 85 to 90 percent, and 59 basis points for loans with LTV ratios above 90 percent.

We see the same pattern for 2013–16 PLS originations. Rebuttable presumption and nonqualified mortgages with clean three-year pay histories went 90 or more days delinquent in years four, five, or six at a rate of 2.5 percent, compared with 3.8 percent of safe-harbor loans that went 30 days delinquent twice or compared with 12.7 percent of safe-harbor loans that went 60 days delinquent once in the first three years. The same pattern holds for the 2013–16 GSE originations and more broadly for historical production across the three channels. This evidence indicates that three years of loan performance is a better predictor of subsequent performance than is origination spread (which is determined by origination characteristics).

Also, safe-harbor loans constituted about 99 percent of all lending from 2013 to 2016 across all three channels, with rebuttable presumption composing most of the rest. In other words, if the CFPB's seasoning rule were in effect from 2013 to 2016, it would have applied to only about 1 percent of originations. We view this as a modest but positive step toward improving access to credit.

Allowing for a three-year seasoning pathway to safe harbor could increase lending in this segment. As we have shown in earlier work on the QM rule, higher-rate-spread conventional lending, especially in the non-GSE space, is a crucial source of credit for racial and ethnic minorities, first-time homebuyers, households with limited means, or others who do not qualify for government-backed lending, including self-employed and gig-economy workers with nontraditional sources of income (Kaul, Goodman, and Zhu 2020). The seasoning pathway to safe harbor is not a panacea, as banks and other portfolio investors tend to hold relatively few of these loans, but at the margin, the pathway will expand the credit box.

We acknowledge that this consumer segment is more susceptible to getting overcharged, as they likely shop around less and have fewer lending options to choose from. But we also cannot ignore the fact that sustainable homeownership is the *only* viable path to wealth creation for these households, and the availability of a seasoning pathway to safe harbor will likely increase lending options available to them.

Mortgage market experts agree that credit availability for people of color and those with limited incomes continues to remain tight relative to historical standards. We also know that increasing access to credit, by definition, means accepting a higher probability of default. The question is whether the increase in homeownership is worth the incremental default risk. Although there is no way to predict how much lending volumes will respond to the seasoning rule, evidence shows that long-term default probability for rebuttable presumption and nonqualified mortgages that perform well in the first three

years is much lower than safe-harbor loans with a poorer three-year performance. The seasoning rule will help address this inconsistency.

Note

[1] To be a HOEPA mortgage, a first-lien mortgage over $50,000 must have a rate more than 6.5 percent above the APOR.

Reference

Kaul, Karan, Laurie Goodman, and Jun Zhu. 2020. "The CFPB's Proposed QM Rule Will Responsibly Ease Credit Availability: Data Show That It Can Go Further." Washington, DC: Urban Institute.

About the Authors

Karan Kaul is a senior research associate in the Housing Finance Policy Center at the Urban Institute. He publishes innovative, data-driven research on complex, high-impact policy issues to improve the US mortgage finance system. A strategic thinker and thought leader with nearly 10 years of experience in mortgage capital markets, Kaul has published nearly 100 research articles on such topics as mortgage servicing reforms, efficient access to credit, benefits of alternative credit data and scoring models, and single-family rentals. He has advocated for efficient industry practices, regulation, and legislation to make the mortgage market work better for all Americans. Kaul is the lead researcher on the Mortgage Servicing Collaborative and regularly speaks at housing conferences. Before joining Urban, he spent five years at Freddie Mac as a senior strategist analyzing the business impact of postcrisis regulatory reforms. He holds a bachelor's degree in electrical engineering and a master's degree in business administration from the University of Maryland, College Park.

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