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via electronic submission

October 1, 2020

Comment Intake – Seasoned QM
Bureau of Consumer Financial Protection
1700 G Street NW
Washington, DC 20552.

Re: Qualified Mortgage Definition under the Truth in Lending Act (Regulation Z): Seasoned QM Loan Definition [RIN 3170-AA98]

Dear Sir or Madam,

The Independent Community Bankers of America (“ICBA”)¹ appreciates this opportunity to provide feedback on the Consumer Financial Protection Bureau’s (“CFPB”) Notice of Proposed Rulemaking regarding the Qualified Mortgage Definition under the Truth in Lending Act (Regulation Z): Seasoned QM Loan Definition. Community Banks are committed to responsible mortgage lending, leveraging their specialized knowledge of local markets and their customer relationships to expand access to home ownership.

ICBA recognizes and appreciates the Bureau’s efforts to examine and develop rules that satisfy the requirements established by the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd Frank Act”) and the Truth in Lending Act (“TILA” or “Regulation Z”) while also improving access to credit for consumers.

The CFPB’s proposed rule would create a new category of QM, the “Seasoned QM.” According to the Bureau, “[t]o be considered a Seasoned QM under the proposal, loans would have to be first-lien, fixed-rate covered transactions that have met certain performance requirements over a 36-month seasoning period.”² Additionally, for a loan to become a Seasoned QM, creditors would be required to “consider and verify the consumer’s debt-to-income ratio (DTI) or residual

¹ The Independent Community Bankers of America® creates and promotes an environment where community banks flourish. With more than 52,000 locations nationwide, community banks constitute 99 percent of all banks, employ more than 760,000 Americans and are the only physical banking presence in one in five U.S. counties. Holding more than \$4.9 trillion in assets, \$3.9 trillion in deposits, and \$3.4 trillion in loans to consumers, small businesses and the agricultural community, community banks channel local deposits into the Main Streets and neighborhoods they serve, spurring job creation, fostering innovation and fueling their customers’ dreams in communities throughout America. For more information, visit ICBA’s website at www.icba.org.

² Consumer Financial Protection Bureau, “Consumer Financial Protection Bureau Proposes New Category of Qualified Mortgages to Encourage Innovation and Access to Affordable Mortgage Credit” (Aug 18, 2020), available at: <https://www.consumerfinance.gov/about-us/newsroom/cfpb-proposes-new-category-qualified-mortgages-encourage-access-affordable-mortgage-credit/>.

income at origination.”³ In order to qualify as a Season QM, loans are required to have “no more than two 30-day delinquencies and no delinquencies of 60 or more days at the end of the seasoning period.”⁴

In short, as the Bureau outlines in its NPR, the idea of a Seasoned QM is that it allows a mortgage “that was not a QM at consummation to season into a QM on the grounds that a loan’s performance over an extended period should be considered sufficient or conclusive evidence that the creditor adequately assessed a consumer’s ability to repay at consummation.

Background

To originate a qualified mortgage (“QM”), a lender must (with certain exceptions) make a reasonable, good-faith determination before they consummate the loan that the consumer has a reasonable ability to repay (“ATR”) it. In general, QMs cannot contain certain features – such as allowing interest-only payments or negative amortization – because these features are considered higher risk. Lenders are also limited in the fees that they can charge on a QM. In exchange for adhering to these underwriting standards and limiting their fees, lenders are afforded the protection of a safe harbor in future litigation about the mortgage in the form of either a conclusive or a rebuttable presumption that they complied with the ATR requirements.

Under the Bureau’s 2013 amendments to the ATM/QM Rule, a new QM category was created—the Small Creditor QM.⁵ Small Creditor QMs, which are available to lenders with assets of less than \$2 billion at the end of the last calendar year (a category that includes many community banks), are not subject to the General QM definition’s 43 percent DTI limit, and the creditor is not required to use Appendix Q to calculate debt and income. However, to qualify as QMs, Small Creditor QM loans must be held in portfolio for three years.

The Seasoned QM is, in many ways, a mirror image of the Small Creditor QM, with the important distinction that it is available to financial institutions of all sizes, including those institutions with assets in excess of \$10 billion. As with Small Creditor QMs, the lender of a Seasoned QM is not subject to the rigid underwriting requirements of the General QM. However, because the lender holds a Seasoned QM loan on its own books for a period of time (thus bearing the risk of default), it is “appropriate to presume compliance with the ability-to-repay (ATR) requirements”⁶ because the borrower has actually demonstrated their ability to repay. In light of this evidence of ability to repay, the Bureau concludes that it is appropriate to extend QM protection to a “seasoned” mortgage.

ICBA Position

³ *Id.*

⁴ *Id.*

⁵ 78 Fed. Reg. 35430 (June 12, 2013).

⁶ 85 Fed. Reg. 53568.

ICBA generally supports the creation of seasoned qualified mortgages. The requirement that seasoned loans be held in portfolio for three years would ensure that lenders engage in responsible underwriting because they have a meaningful amount of “skin in the game.” Granting QM status to seasoned loans would encourage lenders to make common sense decisions and then later benefit from taking the right risks. For community banks, the proposal makes sense because community banking is based on deep local knowledge and customer relationships, so they are uniquely skilled at looking beyond rigid criteria and identifying borrowers who are a good credit risk.

No prescriptive underwriting criteria will completely eliminate the risk of default. Mortgage loans will always be subject to the macroeconomic risks of the economic cycle and the risks presented by unforeseen changes in a borrower’s individual circumstances. However, in our view, if a loan goes into default after a meaningful period of demonstrated performance, it is appropriate to conclude that default was not the result of irresponsible underwriting but rather was the result of changed circumstances for the borrower which could not have been anticipated at consummation. For this reason, it is our opinion that a seasoned loan that did not qualify for QM status when originated, but has a demonstrated record of performance, would generally meet requirements of ATR.

Granting QM status to certain seasoned loans will benefit borrowers. As with General QMs, the proposal places limits on the terms and fees of Seasoned QMs.⁷ The proposal also requires lenders to verify and consider the customer’s DTI ratio, which protects consumers from being given loans that they cannot afford.

If the proposal is finalized, lenders will be more likely to extend credit to borrowers in low- or moderate-income areas who do not qualify for General QM loans. Because seasoned loans may eventually qualify for QM status, the risks associated with subsequent litigation are decreased and the marketability of seasoned loans is improved. This will encourage lenders to seek out creditworthy borrowers who are currently not being reached.

Because attaining QM status will increase the marketability of seasoned loans, the proposal will increase lender liquidity and promote access to credit. Currently, seasoned loans that do not meet the QM criteria when underwritten are difficult to sell on the secondary market because potential purchasers must invest considerable resources in due diligence – in some cases, essentially re-underwriting the loans. If subsequent purchasers are extended the liability protections QM status provides, it will reduce the transaction costs of buying and selling

⁷ According to the existing regulations, whether a lender is protected by a conclusive (safe harbor) or rebuttable presumption that it complied with the ATR requirements depends on whether or not the loan is “higher priced.” A higher priced loan is a first-lien mortgage with an APR that exceeded APOR for a comparable transaction as of the date the interest rate was set by 1.5 or more percentage points; or a subordinate-lien mortgage with an APR that exceeded APOR for a comparable transaction as of the date the interest rate was set by 3.5 or more percentage points. These same fee limitations will apply to seasoned QMs. 12 C.F.R. 1026.43(b)(4).

seasoned loans. This ultimately provides significant benefits to consumers because it means the originating community bank can access liquidity that can be used to originate new loans in the community.

Some community banks do not currently buy or sell seasoned loans or do so only in low volumes. Granting QM status to seasoned loans makes the market for seasoned loans more attractive and may increase the number of market participants. This increased competition will further increase liquidity and may benefit borrowers by reducing interest rates.

Finally, granting QM status to certain seasoned loans may increase access to credit by allowing lenders to use alternative data in the underwriting process. Currently, the use of alternative data is limited because loans underwritten with non-traditional underwriting techniques are never able to attain QM status. This not only exposes lenders to litigation risk, but seriously limits their marketability. By allowing lenders to make underwriting decisions driven by alternative data, then bearing the risk of default through the seasoning period, lenders will be incentivized to look for new borrowers, who may not currently have access to credit, and underwrite loans to them in a responsible, quantitative way.

Recommendations

Apply the rule retroactively

Currently, the proposed rule only applies to covered transactions where the lender received a loan application after the rule's effective date.⁸ We believe that any loan that meets the criteria in proposed 12 C.F.R. 1026.43(e)(7) (i.e. the proposed seasoned qualified mortgage definition) should be granted QM status, regardless of whether it was originated or applied for before or after the effective date of the rule. The justification to grant QM status to seasoned loans is that their demonstrated record of performance provides a strong indication that they were not irresponsibly underwritten and that the borrower actually possesses the ability to repay. That justification for extending QM status applies equally to loans underwritten before the proposed rule and held for at least 36 months by the originating lender.

Modify the Small Creditor QM definition

ICBA is somewhat concerned that the proposed definition of "seasoned qualified mortgage" reduces the relative advantage provided to community banks by the small creditor qualified mortgage. As the Bureau says in the NPR, "[t]he Bureau created the Small Creditor QM category based on its determination that the characteristics of a small creditor—its small size, community-based focus, and commitment to relationship lending—and the inherent incentives associated with portfolio lending together justify extending QM status to loans that do not meet all of the ordinary QM criteria."⁹ A large bank or online lender does not have these characteristics and does not engage in relationship lending, therefore the justifications for creating the Small Creditor QM do not extend to loans made by larger institutions.

⁸ 85 Fed. Reg. 53569.

⁹ 85 Fed. Reg. 53571.

Specifically, we recommend shortening the seasoning period for Small Creditor QMs from 36 to 24 months. We believe that two years of consistent performance *plus* the community and relationship focus of small lenders justifies extending QM status more quickly than for loans made by larger lenders. Furthermore, we recommend raising the threshold to be considered a small creditor from \$2 billion in assets to \$10 billion in assets.¹⁰ This corresponds with the Federal Reserve Board’s definition of “community bank”, which we believe is appropriate due to the Bureau’s status as an independent agency within the Federal Reserve System and is also the level that the CFPB becomes a depository institution’s primary consumer protection regulator.¹¹

Conclusion

ICBA commends the CFPB for considering granting QM status to seasoned loans with a demonstrated record of performance. Not every creditworthy borrower will fall into the prescriptive underwriting criteria of Regulation Z at consummation. It is appropriate to allow community banks and other lenders to engage in responsible underwriting and take intelligent risks. We believe this proposal is a win-win for consumers and for lenders. Under this proposal, lenders will benefit from the liability protections afforded by QM status and the increased marketability of QM loans. Consumers will benefit from the QM protections from high fees and confusing loan terms, as well see increased access to credit due to the increased competition and liquidity in the market to buy seasoned loans.

ICBA once again thanks the CFPB for this opportunity to provide feedback to the Bureau on behalf of community banks. Please contact the undersigned if you have any questions regarding this letter. We encourage the Bureau to consider our recommendations and to finalize the proposed rule.

Sincerely,

/s/

Ron Haynie
Senior Vice President Housing Finance Policy
Independent Community Bankers of America

¹⁰ 12 CFR 1026.35(b)(2)(iii)(C).

¹¹ See The Board of Governors of the Federal Reserve System, Supervisory Policy and Guidance Topics, “Community Banking,” available at https://www.federalreserve.gov/supervisionreg/topics/community_banking.htm; 12 U.S.C. 5515(a)(1).