*SFIG RFC on ATR/QM*

Office of the Executive Secretary
Consumer Financial Protection Bureau
1700 G Street NW.
Washington, DC 20552

Dear Sir or Madam:

The Structured Finance Industry Group ("SFIG")[1] appreciates the opportunity to provide comments on the Ability to Repay/Qualified Mortgage Rule ("ATR/QM") from the Consumer Financial Protection Bureau ("CFPB") that was published in the Federal Register on June 1, 2017.

It is important to note that SFIG is a proponent of the ATR/QM Rule and appreciates its intention to prevent another deterioration of the lending standards that contributed to the financial crisis that both harmed consumers and severely limited their access to credit. SFIG understands that although the Bureau may not have anticipated that the assessment report will include any specific proposals to modify ATR/QM, we feel compelled to identify some specific scenarios that continue to present themselves within the current Rule that must be addressed not only to unify disparate interpretations by market participants, but to ensure ongoing significant consumer access to credit and a normalized secondary market that benefits creditors, investors, and consumers.

The members of SFIG wish to take this opportunity to stress to the CFPB that the Bureau's revisions to the Rule should be broad, strategic and seek to remove all unintended consequences due to inconsistencies in the text and a lack of guidance around specific language within the Rule, which will benefit consumers, lenders, and the capital markets alike.

In addition to the specific areas of focus reflected within this letter, SFIG asks the CFPB to reconsider the existing DTI limits imposed on Qualified Mortgages, as well as introducing optionality into the rigidity of Appendix Q. There is significant concern in the secondary market about the impact on access to credit of the GSE's exiting conservatorship or the January 10, 2021 expiration date of the temporary category of QM loans, commonly referred to as the GSE temporary patch, under §1026.43(e)(4)(ii)(A). With the recent expansion of the DTI limits by the GSE's well above the 43% threshold under Appendix Q, coupled with the GSE's approach to credit document requirements, the Bureau should model out the

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[1] SFIG is a member-based, trade industry advocacy group focused on improving and strengthening the broader structured finance and securitization market. SFIG provides an inclusive network for securitization professionals to collaborate and, as industry leaders, to drive necessary changes, be advocates for the securitization community, share best practices and innovative ideas, and educate industry members through conferences and other programs. Members of SFIG represent all sectors of the securitization market, including issuers, investors, financial intermediaries, law firms, accounting firms, technology firms, rating agencies, servicers, and trustees. Further information can be found at www.sfindustry.org.

projected impact of the temporary patch expiration, not only on consumers obtaining loans earmarked or eligible for delivery to the GSEs, but also on "non-traditional borrowers" and credit-worthy prospective homebuyers in underserved populations. Lastly, it is important to emphasize that the assessment must be an open, iterative process, allowing for comment and active involvement by all stakeholders and interested parties in the primary and secondary credit markets.

One of the unintended consequences of the 2013 Rule, currently mitigated for some consumers through the temporary patch, is the significantly constrained access to credit for consumers who lack traditional employment and/or income. And while some creditors are increasing their footprint in these areas, it is only to a very limited extent. Investors and most other market participants continue to find ambiguity in many parts of §1026.43 and Appendix Q, and the resultant uncertainty carries with it an increased perception of risk and, in turn, further credit constraint due to higher costs and greater unwillingness to lend or invest arising from this perception.

We set forth below the specific areas that concern market participants:

## Ability to Repay (ATR) and Qualified Mortgage (QM)

These areas of compliance with the ATR/QM rules have proven to be challenging to creditors.

### I. Self-Employed Consumers and Sufficiency of Documentation (Appendix Q)

#### a. The Definition of Self-Employed and Requisite Documentation

Many times, consumers have a Schedule C to the tax return for which all the income is derived from 1099's. An example of this would be a contract employee who performs works for various firms, but does not have a self-employed entity/have an ownership interest of 25 percent or more in a business.

Appendix Q states "*A consumer with a 25 percent or greater ownership interest in a business is considered self-employed and will be evaluated as a self-employed consumer*." However, the title of the Schedule C is sole proprietor.

***Q1: If a consumer has less than 25 percent ownership interest in a business, but derives all of their Schedule C/1099 income from that business, would the consumer be considered self-employed? Would this consumer be subject to the self-employed consumer documentation, such as the balance sheet and P&L statement?***

The presumption is that the filing of the 1099 income under Schedule C as a sole proprietor trumps the ownership interest concern of the entity that is paying the 1099 income to the consumer. The filing of the income on schedule C makes the signed/dated tax returns, balance sheet, and P&L statement required. The recommended solution to this scenario is to clarify the filing of a Schedule C to report 1099 income as not being determinate of the consumer being self-employed.

***Q2: If a creditor were to review a consumer who owns less than 25 percent (a situation not addressed in Appendix Q), what documentation is required to verify such a consumer's income and/or loss?***

The presumption is that because the consumer does not have an ownership interest, or an ownership interest of at least 25 percent, the balance sheet and P&L statement are not required. Industry standard would suggest K-1 and individual signed and dated tax returns or transcripts for the most recent two years. Due to this being a presumption, creditors may be apprehensive to offer credit to consumers that have all of their income from Schedule C/1099 employment that do not own 25 percent or more of the businesses from which they derive income.

**b. Self-Employment Income: Negative Income or Minimal Income and Evidencing with Documentation**

A consumer is self-employed (has ≥ 25 percent ownership interest) and the business is generating a loss.

***Q3: For self-employed borrowers, is income documentation (i.e.,. balance sheet, P&L statement) required? Or is a K-1 sufficient to document liability?***

Some industry participants take the presumption that because this is a liability, and no income is being relied upon with this business, a K-1 is sufficient to support this liability. But not everyone has taken this presumption; others take a more conservative approach to this issue, and require a balance sheet and P&L as well as a K-1; however, the consumer may not have access to the balance sheet and P&L, thereby disqualifying the individual from access to credit due to insufficient documentation.

***Q4: For W-2 wage earners who receive minimal additional income, or whose spouse has minimal additional income, reflected on Schedule C or Schedule F, should the consumers still be considered self-employed borrowers, with the additional income documentation (i.e. signed/dated tax returns, balance sheet, and P&L statement) required?***

Some industry participants take the presumption that although this income is still used to qualify the consumer, since it is less than 5% of their total income, the additional income being relied upon would not require the additional self-employed consumer documentation. But not everyone has taken this presumption; others take a more conservative approach to this issue and require the signed/dated tax returns, balance sheet and P&L; however, the consumers may not consider themselves to be self-employed or have access to a balance sheet and P&L, thereby disqualifying them from access to credit due to insufficient documentation.

**c. In Establishing Self-Employed Consumers Earnings Trend: Defining a Significant Decline in Income for Self-Employed Consumer**

Industry participants understand that the creditor must consider the self-employed consumer's business' financial strength by examining annual earnings. It is clear that annual earnings that are stable or increasing are acceptable, but businesses that show a **<u>significant decline</u>** in income over the analysis period are not acceptable.

***Q5: Is there an objective standard for determining a "significant decline" in income?***

Self-employed consumers, whether a sole proprietorship or an owner of 25 percent or more of a partnership, corporation, or S corporation, will frequently experience income fluctuations. Looking at a decline in income generated from a business over a two-year period could be indicative of an actual decline in income year over year or it could be indicative of a significant boost in income during the prior year (with no credit-based cause for concern as opposed to the first scenario). Without any specific guidance within Appendix Q for evaluating the income decline, self-employed consumers that would otherwise qualify for credit based on the declined income may still be denied access.

### d. Establishing a Declining Earning Trend

To determine if there is a declining earnings trend for a self-employed consumer under Appendix Q, certain creditors are using any two years of tax returns obtained. For example, in the scenario where 2014, 2015 and 2016 tax returns and a YTD P&L for 2017 are obtained, a creditor may state that because 2015 is greater than 2014 earnings, even though 2016 is less than 2015, there is not a declining earnings trend over two full years.

The rule is that if the consumer's earnings trend for the previous two years is downward and the most recent tax return or P&L is less than the prior year's tax return, the consumer's most recent year's tax return or P&L must be used to calculate his/her income.

***Q6: Does the declining earnings trend requirement relate to the most recent two full years – i.e., 2016 earnings are less than 2015 for determination of the declining earnings trend as of the date of consummation? Or if the current YTD P&L demonstrates that the consumer is tracking to a second consecutive year of declining earnings, must the creditor have to take that into consideration?***

The presumption is that the preceding two full years must show a decline for it to be a declining earnings trend.

***Q7: Within Appendix Q to Part 1026 under (I)(D)(6), Analyzing the Business's Financial Strength it states that, "…businesses with a significant decline in income over the analysis period are not acceptable." Could the Bureau add commentary to Appendix Q to clarify the treatment of income declines as it pertains to consideration of the income for qualifying a borrower within the context of Appendix Q?***

The presumption is that the significant decline would need to raise questions about the viability of the business. Some industry participants view a business with a decline of income that exceeds 20 percent to be significant, but the decline may be indicative of extraneous events and the consumer may still qualify based on the current income, therefore forcing the consumer to obtain financing via a Non-QM loan program that will typically include a higher note rate and corresponding APR. For example, if the business income went from $10 million to $3 million, that is a significant decline, but the business may still be viable and the consumer should not be denied access to a QM loan based on that decline.

***Q8: With respect to self-employed consumer documentation under Appendix Q, questions exist regarding the appropriate aging of YTD P&L statements permitted to be considered. Appendix Q***

***references the need for a YTD P&L/Balance Sheet, but there is no reference to whether YTD is based on the application date, underwriter approval date or consummation date. In addition, some loans will face delays. At what point must a creditor obtain an updated YTD P&L / Balance Sheet?***

The presumption is that the YTD consideration will require the profit and loss statement and balance sheet through the end of the most recent quarter that is one month prior to the application date. There is concern in the marketplace as to whether the consideration should be based on the application date. There is also concern regarding loans with an extended origination lifecycle that may stretch several months, and under what circumstances would a lender be obligated to obtain updated documents through a more recent quarter?

## II. <u>General Consumer Income Assessment</u>

### a. Assessing Consumer Income: Individual Tax Returns

Obtaining signed and dated tax returns, in an age of electronic submissions, raises questions as to the requirement that signed and dated tax returns are exclusively non-electronically submitted tax returns.

Participants understand that the Appendix Q requirements specifically state that a creditor must obtain signed and dated tax returns (except for the two circumstances where Appendix Q Notes state that the tax transcripts are permissible in lieu of signed tax returns).

***Q9: Can lenders rely on copies of electronically submitted tax returns obtained from the consumer as being reasonably reliable without additional supporting documentation, such as a tax transcript?***

The presumption here is that Appendix Q has no requirements for tax transcripts to validate the tax returns provided to the lender by the consumer. (The only reference to the tax transcripts within Appendix Q was in place of tax returns, not in addition to tax returns.)

***Q10: Must these electronically submitted tax returns, without tax transcripts, be hand signed and/or dated?***

The presumption here is that Appendix Q has specific requirements for certain income types to include signed/dated tax returns, therefore electronically submitted tax returns would still require a consumer signature and date when provided to the lender. SFIG is seeking clarification that transcripts can be used to evidence implicit adherence to the requirement for signed dated returns as the IRS will not accept tax returns without either an electronic or physical signature.

***Q11: Are tax transcripts permitted to be used in other places under Appendix Q where there is not such express permission in lieu of electronically submitted tax returns?***

The presumption here is that signed and dated means any hand signed and hand dated tax returns submitted by the consumer electronically or actual physically submitted hand signed tax returns. There are only two occasions in which the transcripts are specifically identified as permissible in place of the actual tax returns. Additional permissible uses for business and personal transcripts would be beneficial to consumers.

### b. Stability of Rental Income: Lease Agreements and Schedule E Income

This pertains to the analysis of the stability of rental income using expired term leases, automatically renewable on a month-to-month basis, as a current lease.

In analyzing the stability of rental income, it is understood that rent received for properties owned by the consumer is acceptable as long as the creditor can document the stability of the rental income through three factors. One of these factors is the requirement that there is a current lease. There are often circumstances under which a year term lease has expired and the consumer tenant is occupying the property on a month-to-month basis legally, in accordance with state law.

***Q12: May a creditor accept the expired one year initial term lease and post initial term month-to-month concurrent cashed rent checks, consistent with the amounts detailed within the expired lease, as sufficient documentation to meet the current lease/agreement to lease under Appendix Q?***

The concern here is that there are conflicting perspectives regarding the appropriate validation of the expired lease terms as still effective – e.g., location, consistent payment amounts that match or exceed expired lease, and concurrent rent checks for period after expiry of initial lease term – that may or may not establish stability of rental income for properties owned by the consumer.

### c. Imputed Income from Asset Depletion or Dissipation

When the income of each consumer who will be obligated for the mortgage debt and whose income is being relied upon in determining ability to repay is analyzed to determine whether his/her income level can be reasonably expected to continue, or whether the investment income will be available as needed at a future time, there are questions around how the imputed income must be determined. Participants understand that assets should not be "double-counted" to be considered for both reserves for the consumer and funds that can be depleted.

***Q13: Does Appendix Q permit asset depletion methodology for calculating income and the DTI ratio or can a lender look to HUD's Imputed Income from Asset Dissipation model?***

Generally, competing perspectives exist in the industry about if and how a creditor may reconcile the preamble to Appendix Q that permits reliance on agency guidance, where Appendix Q does not resolve how a specific type of income should be treated with the Commentary to Paragraph 43(e)(2)(v)(2). "*... the creditor must consider and verify, at a minimum, any income specified in appendix Q. A creditor may also consider and verify any other income in accordance with § 1026.43(c)(2)(i) and (c)(4); however, such income would not be included in the total monthly debt-to-income ratio determination required by § 1026.43(e)(2)(vi).*" It would be very helpful for the Bureau to add commentary to Appendix Q that specifically affords lenders the opportunity to consider the consumer's assets, other than the subject dwelling securing repayment of the loan, in determining the consumer's ability to meet the 43% DTI requirements through asset depletion as the primary source of income or to augment the consumer's income. Participants understand that any such commentary should be tailored to ensure a responsible approach to asset depletion in the calculation of current or future income.

**d. Assessing Consumer Rental Income**

VRBO/short term vacation rentals. Questions exist if consumer income from short-term rentals be reasonably relied upon as income.

***Q14: If there is a rental history that is consistent, can amounts be relied upon as reasonably consistent with appropriate documentation that there existed an agreement to rent the property (since there are usually no current lease agreements)?***

The presumption here is that the VRBO rental income may not meet the explicit requirements within Appendix Q for the current lease agreement, but the consideration of this type of consistent rental income as either an income source or an offset to the housing expense is beneficial to the consumer to be considered in their qualification on the subject loan. In the event the VRBO rental was owned by an LLC that is 100% owned by the consumer, the business revenue could be considered without a current lease, if accompanied by the business returns and the YTD P&L and Balance Sheet.

***Q15: Is there a difference between residential and commercial rental income as treatment of income from multifamily properties with more than 4 units?***

The presumption here is that rental income, whether originating from residential or commercial rental properties, have the same requirements when owned by the consumer. In the event the property is owned by an LLC or S-Corp, then the business returns requirements with YTD P&L and Balance Sheet would negate the requirements for a lease(s).

**e. TILA Points and Fees**

**Qualified Mortgage 3% Points and Fees: Bona Fide Discount Points**

***Q16: With respect to the exclusion of bona fide discount points from the calculation of "points and fees," what documentation should by maintained within a closed loan file to appropriately reflect that the reduction in interest rate is equal to the BFDP as excluded?***

Creditors are apprehensive to include pricing sheets into the loan file for archival. But subsequent purchasers in conducting due diligence need evidence to substantiate the bona fide aspect of the discount points. What documentation can the lender include within the loan file to evidence the interest rate reduction is consistent with established industry practices?

### f. Employment Verification

**Verification of Employment Issues**

***Q17: With respect to the lender's verification of the consumer's employment, for consumers that have had more than one job in the prior two years, there are circumstances in which the prior employer is not responding to the lender's request for the VOE. Can the consideration of other third-party records including but not limited to W-2s, paystubs, tax returns, etc., be considered sufficient evidence of the employment history reflected by the consumer on the loan application?***

The presumption here is the VOE is preferred, as it is can evidence the actual dates of employment, while some of the other documentation will corroborate the employment and income, but will not yield specific employment date adherence or further validate the dates of employment reflected on the 1003 loan application.

***Q18: With respect to obtaining post-closing VOEs to backstop the documentation that was considered and verified prior to consummation, can a post-close VOE be considered in the determination of Appendix Q documentation adherence?***

The presumption here is that Appendix Q requires the lender to consider and verify the consumer's income and employment at or before consummation. For loans delivered to the GSEs, a post-close VOE that is retrieved by the lender can be used to meet the verification requirements of the GSEs. A loan's GSE eligibility should not be a factor with respect to this practice; therefore, can a non-GSE eligible loan consider post-close VOEs when the file contains, prior to consummation, documentation of employment or income, where such documentation is deemed "stale" at the time of closing?

### g. Foreign Nationals

**Foreign National Consumers in relation to Qualified Mortgage or ATR considerations**

***Q19: Foreign Nationals are not specifically excluded from QM considerations. Some of the requirements within Appendix Q, specifically for self-employed consumers, do not correspond to a foreign national's income documentation. In such cases, can a lender use alternate documentation to meet the spirit of Appendix Q?***

The presumption here is that Appendix Q addresses specific IRS form types required for the various self-employed business entity types, but a foreign national that does not file US tax returns would only be able to provide the equivalent tax forms from the country in which they file their income taxes. There are conflicting interpretations in the industry on whether a loan to at foreign national can adhere to certain aspects of Appendix Q. Note that there are also conflicting interpretations about whether certain types of foreign nationals are covered under the ATR/QM rule, as well (separate and apart from income questions), leading to true discrepancies among lenders nationwide with respect to this type of lending.

***Q20: Foreign Nationals have additional concerns pertaining to the work visa that the consumer is using to continue their residence and employment within the United States. In the event the employer provides feedback on the VOE that the consumer's visa has a specific renewal date, should that impact QM or Ability to Repay considerations?***

The presumption here is that Appendix Q does not require the forecasting of continued employment for at least three additional years, and it affords lenders the ability to assume that employment is ongoing in the event the employer verifies current employment and does not indicate the employment is set to be terminated, but there are concerns in the industry whether the renewal status for employment visas need to be considered by the lender in determining the consumers ability to repay the subject loan.

### h. Qualified Mortgage Exceptions

Loans intended to be originated as a Qualified Mortgage in adherence with Appendix Q may have issues that would cause the loan to not be considered as a Qualified Mortgage.

***Q21: Although there is a specific cure provision available to a lender for a loan that exceeds the 3% points and fees threshold, are there any other exceptions or variants that can be addressed post-close?***

The presumption here is that Appendix Q requires the consideration and verification of the requisite documentation at or before consummation to be considered as a Qualified Mortgage. In the event there was a deficiency in a document (e.g., the 2015 Tax Return was not signed by the consumer), the recommendation would be to enable the lender to remediate the deficiency post-close, as long as the correction would not cause the loan to have failed to qualify as a Qualified Mortgage in the first place. In addition, an issue with the calculations that result in an incorrect DTI when the initial credit decision is made on the loan should still result in a loan's status as a Qualified Mortgage if the actual recalculated DTI is still less than 43%.

### i. Temporary QM

There is concern in the industry that the expiration of the Temporary QM "patch" for loans eligible for sale to the GSEs will disrupt the market and restrict consumer access to credit.

***Q22: Are there any plans to revisit the temporary qualified mortgage expiration to phase out the expiration or to align certain aspects of Appendix Q and/or the DTI limits?***

Loans that are eligible for sale to either of the two GSEs receive the Temporary QM status and do not require adherence to Appendix Q. In addition, the GSEs have recently expanded their permissible DTI to 50%. Loans that are not eligible for sale to one of the GSEs are limited to a 43% DTI. Industry participants request the re-evaluation of the DTI threshold under Appendix Q yielding QM status in order to expand the availability of credit for Qualified Mortgages. Non-agency loans are often underwritten just as if not more stringently than GSE loans, and include automated underwriting (i.e., DU/LP) approval certification apart from loan limits. The greater the chasm between the GSE Temporary QM permissible documentation requirements and DTI limits for Qualified Mortgages under Appendix Q, the more significant the impact will be on available credit when the Temporary QM patch expires.

***Q23: If a loan receives an Approve Eligible finding from the GSE Automated Underwriting System, (AUS), but certain requirements of the AUS report are not adhered to (such as specified income documentation or bank statements to evidence reserves), would the loan still be considered as eligible for sale to the GSEs and therefore meet the Temporary QM designation?***

What are the standards for materiality when, for example, an agency Automated Underwriting System (AUS) requires underwriting documentation which is not present in the loan file, but the loan receives an Approve/Eligible recommendation from the AUS? Is such a loan definitively not GSE-eligible and therefore not a QM based on the Temporary QM patch?

### j. Ability to Repay - Alternative Income Documentation

There are loan programs that utilize bank statements as third-party documentation to confirm the employment and income of the consumer when the respective lenders make their credit decision on a Non-QM loan.

***Q24: There are loan programs in the marketplace that rely on bank statements to document the income and assets of the consumer in accordance with 1026.43(c)(4)((iv). These programs range from 1 month to 24 months of bank statements. Industry participants understand the Bureau's intent to provide flexibility to the marketplace while minimizing the risk of deterioration of lending standards, which contributed to the financial crisis. Will the Bureau address the gray area surrounding bank statement programs?***

The presumption here is that 1026.43 allows lenders the flexibility to use financial institution records to meet the requirement to verify income or assets. The concern in the marketplace is how many months must a lender require to validate this information and confirm its accuracy. Should the lender require both the business bank statements and the personal statements to determine the net income received by the consumer from the business where applicable?

## III. Conclusion

In sum, SFIG has a vested interest in restoring a thriving capital market that provides consumers with access to mortgages that they have the capacity and willingness to repay while providing lenders and the secondary market with the certainty of execution based on updated guidance within §1026.43 and Appendix Q.

The members of SFIG want to thank the CFPB for affording us with this opportunity to provide feedback on the ATR/QM rule to focus on the gaps in the rule as implemented that can be addressed through subsequent rule making. The members of SFIG encourage the Bureau to take this opportunity to revisit ATR/QM for modifications and to deliver clarity to the documentation requirements, which will benefit consumers, lenders, and the capital markets.

Sincerely,

Richard Johns
Executive Director
Structured Finance Industry Group