CFPB Ability to Repay/Qualified Mortgage Rule

February 19, 2014

What is the ATR/QM Rule?

- Requires creditor to make a reasonable, good-faith determination before or at loan origination that the consumer has a reasonable ability to repay (ATR) the loan
- Applies to closed-end residential mortgage loan originators, loans secured by a dwelling
  - Excludes open-end credit plans, timeshare plans, reverse mortgages, construction-to-permanent loans (with construction phase of 12 months or less), credit transactions secured by vacant land and temporary loans
- Full responsibility lies on creditor to ensure repayment ability
- The rule establishes “safe zones” for lending which afford the creditor legal presumptions of compliance if they adhere to specific product and underwriting guidelines
  - For example, a QM loan that is not considered “higher-priced” and whose ATR determination is fully documented will receive the highest protection under the regulation.

What is the ATR/QM Rule? (cont.)

- ATR determination must be supported by reasonably reliable third-party documentation.
  - For example a creditor may verify employment status by requesting recent payroll statements and a letter from the employer on company letterhead, stating position, salary, etc.
  - See further slides for additional examples
- Records evidencing compliance with ATR must be retained for a period of three years after consummation.
  - Electronic records must be accurately retrievable
    - Ensure electronic records have been downloaded and saved if transmitted through a temporary FTP link
- Failure to comply with ATR standards exposes institutions to significant liabilities and litigation risk

8 ATR Underwriting Factors

- At a minimum, the organization must consider these factors:
  1. Current or reasonably expected income or assets, other than that securing this loan
  2. Current employment status
  3. Monthly mortgage payment for this loan
  4. Monthly payment on any simultaneous loans secured by the same property, (e.g. a HELOC)
  5. Monthly payments for property taxes and insurance that the consumer is required to buy and other related property costs (e.g. HOA fees)
  6. Debts, alimony, and child support obligations
  7. Monthly DTI ratio or residual income
  8. Credit history
- Additional factors that are deemed reasonable good-faith efforts:
  - Underwriting standards that have historically proven to yield low rates of delinquency/default during adverse economic conditions
  - Empirically derived, demonstrably and statistically sound models.
- Generally, no specific DTI or residual income thresholds
- Not required to validate underwriting criteria using mathematical models

Third Party Records

- Verification of the 8 ATR Underwriting Factors must be supported by reasonably reliable third-party records. Below are a few examples:

Underwriting Factor	Third-Party Record
Current income/assets	Payroll statements, financial institution records, military leave and earnings statement, government agency letters detailing consumer's benefits or entitlements
Current employment status	Records from consumer's employer; if self-employed, independently reviewed financial statements and tax returns
Monthly payment on simultaneous loan	Statements for existing mortgage
Monthly payment for other related property costs	Records from tax authorities or local governments, ground rent or lease agreement, statements provided by HOA or condominium association
Debts, alimony, child-support obligations	Court orders for support obligations
Monthly DTI ratio	Statements for student loans, auto loans, credit cards or existing mortgage
Credit history	Credit reports, judgments, rental payment history, utility payments

Qualified Mortgage

- The rule provides a presumption that creditors that originated QMs have complied with the ATR requirements

- There are four types of QMs under the rule
  - Two types can be originated by all creditors
    - General QM
    - Temporary QM
  - Two other types can only be originated by small creditors (not covered in this presentation)
    - Balloon-Payment QM
    - Small Creditor QM

Features of Qualified Mortgages (QM)

- Prohibition of certain risky features like negative amortization
- Points and fees may not exceed 3% of total loan amount
  - Higher thresholds are provided for loans below $100,000
- Higher-priced QM: Loan having APR that exceeds the APOR by 1.5 percentage points for first-lien loans; 3.5 percentage points or more for subordinate-lien loans
- Lower-priced QM: Not higher-priced and receive highest legal protections
- Prepayment fees are only allowed for fixed or step-rate QMs that are not higher-priced and only when applicable law permits prepayment penalty

Type 1: General QM

- Prohibition of risky features:
  - No negative amortization
  - No interest-only payments
  - No longer than a 30-year term
  - Points and fees may not exceed 3% of loan balance (generally, although larger amounts are allowed for loans under $100,000)
  - No balloon-payments (applicable to General and Temporary QMs)
- Underwritten based on fully-amortizing schedule using the maximum rate permitted during the first five years after date of the first periodic payment
  - Although consideration and verification of a consumer's credit history is not specifically incorporated into the General QM definition, creditors must verify a consumer's debt obligations using reasonably reliable 3rd-party records, which may include the use of a credit report or records that evidence nontraditional credit references

Type 1: General QM (con't)

- Consider and verify the consumer's income or assets, current debt obligations, alimony and child-support obligations
- Total monthly DTI of consumer cannot exceed 43%
  - Definitions and other requirements are provided in Appendix Q of Regulation Z
    - When Appendix Q does not resolve how a specific type of debit or income should be treated, creditors may rely on the guidelines of the GSEs or certain federal agencies to resolve the issue
    - However, a creditor may not rely on GSE or agency guidelines where they are in conflict with Appendix Q standards

Type 2: Temporary QM

- Mortgages originated during regulatory transitional period and eligible for purchase or guarantee by government-sponsored enterprises (GSEs) or for insurance or guarantee by certain federal agencies

Eligible For:	Entity
Purchase by	Fannie Mae, Freddie Mac
Guarantee by	Fannie Mae, Freddie Mac, VA, USDA
Insurance by	FHA, Rural Housing Service

- These loans receive QM status until expiration of GSE federal conservatorship or federal agency’s own QM rules take effect, or January 10, 2021, whichever occurs first
- Must meet same requirements of General QM’s regarding prohibitions on risky features

Type 2: Temporary QM (con't)

- They must also meet at least **one** of the following additional requirements:
  - Eligible for purchase or guarantee by FannieMae or Freddie Mac while operating under federal conservatorship or receivership
  - Eligible for FHA insurance
  - Eligible to be guaranteed or insured (as applicable) by one of the following:
    - U.S. Dept. of Veterans Affairs (VA)
    - U.S. Dept. of Agriculture (USDA)
    - Rural Housing Service
  - Eligibility for purchase, guarantee or insurance by an agency can be established by:
    - Valid recommendation from a GSE automated underwriting system (AUS) or an AUS that relies on an agency underwriting tool
    - GSE of agency guidelines contained in official records
    - Written agreements between a GSE or agency and the creditor (or direct sponsor)
    - Individual loan waivers from a GSE or agency
- Underwritten according to standards set by entities above
- Do **not** have to meet the 43% DTI threshold that applies to General QMs

Special Requirements for Calculating DTI on QM Loans

- As noted, the General QM definition requires that a consumer's total DTI ratio not exceed 43%
- Regulation Z and Appendix Q of the ATR/QM rule contain the definitions of debt and income for purposes of the General QM definition
- Different DTI rules apply to loans complying under the ATR standard and to the other QM definitions:
  - To satisfy the general ATR standard, creditors must consider DTI or residual income
  - To originate QM under the temporary definition (eligible for sale to or guarantee by a GSE or insured or guaranteed by a specified agency), the loan must meet the relevant entity's applicable DTI and other requirements
  - To originate a Balloon-Payment QM, creditors must consider DTI or residual income, but do not have to meet a specific threshold requirement

QM Points and Fees Caps

- For a loan to be a QM, points and fees may not exceed the points-and-fees caps
- The points-and-fees caps are higher for smaller loans
  - 3% of the total loan amount for a loan >= to $100,000
  - $3,000 for a loan >= to $60,000 but < $100,000
  - 5% of the total loan amount for a loan >= to $20,000 but < $60,000
  - $1,000 for a loan >= to $12,500 but < $20,000
  - 8% of the total loan amount for a loan < $12,500
- The dollar amounts above will be adjusted annually for inflation and published yearly in the Commentary to Regulation Z
- The October 17, 2013 CFPB compliance guide details the instructions for determining whether a loan is within the QM points-and-caps and contains additional information on points-and-fees calculations, including the effect of loan originator compensation, real-estate related fees, premiums for insurance, prepayment penalty amounts, charges by third-parties, and creditor-paid charges

Prepayment Penalties on a Covered Transaction

- As previously covered, prepayment penalties may only be applied to fixed-rate or step-rate QMs that are **not** higher-priced and only when applicable law otherwise permits
- Creditors must include the maximum prepayment penalty amount when calculating the loan’s fees and points to determine whether the points and fees exceed the specified limits
- Other Restrictions (such as cannot be imposed after first three years, percentage limits, alternative transactions)

Refinancing from Non-Standard Loans: ATR Special Circumstances

- Many consumers have adjustable rate, interest only, or negative amortization loans that they may not be able to afford when the loans adjust or reset
- To provide creditors with more flexibility to help these homeowners refinance, the ATR/QM rule gives creditors the option to refinance current mortgage customers from a **non-standard mortgage** into a standard mortgage **without having to meet** the rule's ATR requirements including considering the 8 underwriting factors required for ATR
- Creditors can use this option when:
  - The creditor holds or services the mortgage (not available to subservicers and third parties)
  - The payments under the refinance will not cause the consumer's principal balance to increase
  - The proceeds are used to pay off the original loan and for closing or settlement charges appearing on the HUD settlement statement
  - No cash out is taken from the transaction
  - The monthly payment will materially decrease

Refinancing from Non-Standard Loans: ATR Special Circumstances (con't)

  - Consumer has only one 30-day late payment within the last 12 months and no late payments within the last six months
  - The written application for the standard mortgage is received no later than two months after the non-standard mortgage has recast
  - The creditor has considered whether the standard mortgage likely will prevent the consumer from defaulting on the non-standard mortgage one the loan is recast
  - If the non-standard mortgage originated on or before 1/10/14, the non-standard mortgage was made in accordance with the rule's ATR requirements or QM provisions, as applicable

- The new loan must meet the following guidelines:
  - Cannot have deferred principal, negative amortization, or a balloon
  - Points and fees must be within the thresholds for QMs
  - Loan term cannot exceed 40 years
  - Interest rate must be fixed for at least the first 5 years

Refinancing from Non-Standard Loans: ATR Special Circumstances (con't)

- The ATR/QC rule does not apply when creditors alter an existing loan without refinancing it
- A loan can be modified to a defaulted or non-defaulted consumer without complying with the ATR
- Regulation Z at 12 CFR 10265.20(a) details what changes to a loan will be treated as a modification rather than a refinancing

Comparison of Ability-to-Repay Requirements with Qualified Mortgages

	ATR Standard	General QM Definition	Temporary Agency/ GSE QM	Balloon-Payment QM
Loan feature limitations	No limitations	No negative amortization, interest-only, or balloon payments	No negative amortization, interest-only, or balloon payments	No negative amortization or interest-only payments
Loan term limit	No limitations	30 years	30 years	30 years
Points & fees limit	No limitations	3%	3%	3%
Payment Underwriting	Greater of fully indexed or introductory rate	Max rate in first 5 years	As applicable, per GSE or agency requirements	Amortization schedule no more than 30 years; loan term no less than 5 years
Mortgage-related obligations	Consider and verify	Included in underwriting monthly payment[2] and DTI[3]	As applicable, per GSE or agency requirements	Consider and verify
Income or assets	Consider and verify	Consider and verify	As applicable, per GSE or agency requirements	Consider and verify
Employment status	Consider and verify	Included in underwriting DTI	As applicable, per GSE or agency requirements	No specific requirement
Simultaneous loans	Consider and verify	Included in underwriting DTI	As applicable, per GSE or agency requirements	No specific requirement
Debt, alimony, child support	Consider and verify	Consider and verify	As applicable, per GSE or agency requirements	Consider and verify
DTI or Residual Income	Consider and verify	DTI ≤ 43 percent	As applicable, per GSE or agency requirements	Consider and verify
Credit History	Consider and verify	Included in underwriting DTI	As applicable, per GSE or agency requirements	No specific requirement

Legal Protections

- QM receives two different levels of legal protection depending on whether it is higher-priced or not
  - Non higher-priced QM receives safe harbor protection, meaning they are conclusively presumed to comply with ATR requirements
    - Consumer can challenge the ATR determination and claim that a reasonable, good-faith determination of repayment ability was not made or that the loan does not satisfy QM requirements (miscalculation of factors)
    - If court determines that originator met QM requirement and the mortgage is not higher-priced, the consumer loses the claim.
  - Higher-priced QM receives rebuttable presumption that it complies with ATR requirements
    - Consumer can rebut the presumption
    - To prevail on the argument, consumer must show that they did not have enough residual income left to meet living expenses after paying their mortgage and other debts based on the information that was available to the originator at the time of origination.

Legal Risks

- 3 year statute of limitations from the date of loan origination on ATR claims brought as affirmative cases
- After 3 years, consumers can bring ATR claims only as setoff/recoupment claims in defense to foreclosure
- If consumer can prove that organization failed to make a reasonable, good-faith determination before consummation of the loan, court will find originator liable
- Penalty of three years of finance charges and fees plus consumer’s legal fees

Important Considerations

- General
  - Smooth processing of loan apps and readily accessible documentary support for organization's loan decisions
  - Consider if vendors are providing an adequate environment for bank to demonstrate compliance with ATR
  - Bank must consider the potential fair lending implications of potential responses to ATR or making only certain non-QM loans
- Non-QM loans
  - Proving compliance with ATR requires an evaluation of general underwriting standards the bank plans to use and how the bank plans to implement those standards
  - Bank must consider its borrowing ability when using non-QM loans as collateral
  - May be excluded from exceptions to risk retention requirements thereby making securitization more challenging
- QM loans
  - Demonstrate that QM safe harbor and rebuttable presumption requirements are met

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