# Ability to Repay and Qualified Mortgages

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## CFPB issued Final QM Rule January 2013

- First revision to the final rule: May 29, 2013
  - Clarifications:
    - Compensation paid to loan originator employees of a lender or a broker does not count into the points and fees analysis;
    - Housing Fin. Auth. & non-profit lenders are exempted from ATR;
    - Small creditor rules expanded
- Second revision: July 10, 2013
  - Clarifications:
    - Loan is a QM if it is eligible for purchase by Fannie or Freddie or for insurance/guarantee of FHA/VA/RHS, regardless of whether it is actually purchased or insured/guaranteed by such entity;
    - Calculation of debt and income (Appendix Q - rental, SS, self-employment, OT, etc)
- April 30, 2014
  - CFPB issued a proposed rule change that would permit Lenders to refund any monies that exceed the points & fees test for QM loans and therefore stay eligible for QM status with some restrictions.



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CFPB adopted regulations implementing the Ability to Repay (ATR) and the Qualified Mortgage rules.

- **Effective Date**: applications 1/10/2014 or later
- **Why?:** CFPB constructed these regulations to help protect consumers from taking out a loan that they cannot afford. If a Lender doesn't follow the rules, a consumer can later sue the original Lender and/or stop a foreclosure.
- **Key Concept:** Lender has protections from challenge that the loan was made without regard to the borrower's ability to pay if at time of loan closing:
  - Lender has determined the borrower is able to repay the loan using the criteria in the regulation
  - All Qualified Mortgage requirements regarding loan terms and characteristics have been satisfied



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It all starts with the Ability to Repay Rule aka “ATR”

- The ATR requirements is simple enough--that the lender must make a reasoned determination that the borrower has the ability to repay the loan; basically a sound underwriting decision.
- The ATR requirement is presumed to be satisfied if the loan meets the “Qualified Mortgage” (QM) requirements.
- Violations of the ATR requirement can lead to claims for significant monetary damages; $4,000 in statutory damages, refund of finance charges paid at close, 3 yrs. of interest actually paid plus attorneys fees.
- Fannie and Freddie have announced that they will only purchase QM loans

- Rule includes consumer credit transactions secured by a dwelling, including:
  - First and subordinate lien loans secured by 1-4 family residential property:
    - Owner-occupied homes
    - Vacation homes
    - Non-owner occupied homes  or investment properties

- Rule excludes the following:
  - HELOCs
  - Time share plans
  - Reverse mortgages
  - Bridge loans
  - Business purpose loans
  - Construction loans

## What are the QM Requirements?

1. Lender must establish the borrowers’ ability to repay the loan on the terms offered;
2. The loan product must not contain any prohibited features;
3. Points and fees cannot exceed 3% (except loans < $100k)
4. Underwriting factors: DTI ≤ 43% (must utilize Appendix Q for specific standards for defining debt and income) & max rate in 1st 5 years, unless loan is eligible for purchase by Fannie and Freddie or insurance/guarantee by FHA, VA, or RHS, then must use their guidelines

## What features are prohibited for a QM?

1. Negative amortization
2. Interest-only payments
3. Loan terms > 30 years
4. Balloon payments







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In underwriting a loan, lender must consider the following to determine borrower's ability to repay:

1. Current or reasonably expected income and assets excluding the value of the home securing the loan;
2. Current employment status;
3. Monthly payment consideration for the new loan;
4. Monthly payments of any simultaneous seconds;
5. Monthly payments for mortgage related obligations;
6. Current debt obligations, alimony, and child support;
7. Monthly DTI ratio as well as residual income; and
8. Credit history







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Points and fees must be within the defined limits based on loan amount as follows:

- 3% of the total loan amount for loan amounts greater than or equal to $100,000;
- $3,000 for loan amounts from $60,000 to $99,999.99;
- 5% for loan amounts from $20,000 to $59,999.99;
- $1,000 for loans equal to or greater than $12,500 but less than $20,000; and
- 8% for loans less than $12,500

Points and fees include:

- Compensation paid to a mortgage broker by a borrower;
- Compensation paid to a mortgage broker by a lender;
- Any origination charges paid by a borrower to the lender;
- Fees paid to a lender affiliate;
- Non-refundable PMI;
- All prepayment penalties paid to the lender (impact to the refinancing of portfolio loans that have a prepayment penalty);
- LLPA's that are not "baked in" to the interest rate of the loan;
- Discount points that do not lower the interest rate
- Credit life or similar insurance payable at closing if the lender is the beneficiary;

Note: This determination is the same under QM, QRM and HOEPA

# Points and fees excluded:

- Interest;
- Government program mortgage guarantee insurance or VA Funding Fee;
- Up-front PMI as long as certain criteria are met such as not exceeding FHA premium amount **and including a pro-rated refund upon early payoff**;
- Bona fide 3rd party charges that are not retained by the lender or an affiliate; and
- Fees for extensions, renegotiations, and float downs; or any fee that protects the rate and is reflected in Block 2 of the GFE
- Bona fide Discount Points
  - Up to 2 discount points if interest rate without the discount does not exceed the APOR by more than 1%
  - 1 discount point if interest rate exceeds APOR by more than 1% but less than 2%
  - if the interest rate without any discount does not exceed: APOR by more than two percentage points.

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- **Private Mortgage Insurance Premiums:**
- 1.Included amounts: Non-refundable up-front premiums
- 2.Excluded amounts:
  a. Monthly mortgage insurance
  b. Lender Paid Mortgage Insurance
  c. Up-front premium is refundable on a pro rata basis and that the amount does not exceed 1.75%
- 3.Partially excluded: If the PMI is refundable but it exceeds the 1.75% amount, then only the amount by which it exceeds 1.75% counts into the points and fees.

# Bona Fide Discount Points:

1. A discount point is *bona fide* if it reduces the consumer's interest rate by an amount that reflects industry practices, such as secondary market norms.

2. Up to 2 *bona fide* discount points can be excluded ***if the interest rate before the discount does not exceed the average prime offer rate ("APOR") by more than 1% or 1 point may be excluded if the interest rate before the discount does not exceed the APOR by more than 2%. -(key test)***

3. "Industry practices" as defined in the CFPB commentary states that a creditor may show that the calculation complies with requirements prescribed by Fannie Mae and Freddie Mac.

    a. The CFPB referenced the Fannie and Freddie definition of a bona fide discount point definition requiring a reduction in the rate of at least 25 basis points for 1% point.

    b. Fannie and Freddie as of August 20, 2013 removed their definitions of bona fide discount points from the selling guides.

    c. Lenders must now define the industry standard ourselves and risk that the definition might not work.

## APOR

- Definition - "Average prime offer rate" means an annual percentage rate that is derived from average interest rates, points, and other loan pricing terms currently offered to consumers by a representative sample of creditors for mortgage transactions that have low-risk pricing characteristics. The Bureau (Per 1026.35) publishes average prime offer rates for a broad range of types of transactions in a table updated at least weekly as well as the methodology the Bureau uses to derive these rates.
- Links to Published APOR for fixed and Adjustable Loans
  - http://www.ffiec.gov/ratespread/YieldTableFixed.CSV
  - http://www.ffiec.gov/ratespread/YieldTableAdjustable.CSV
- 

| | 3 year | 5 year | 7 year | 10 year | 15 year | 20 year | 25 year | 30 year |
|---|---|---|---|---|---|---|---|---|
| Fixed | N/A | N/A | N/A | 4.38 | 3.53 | 3.53 | 4.48 | 4.48 |
| ARM | N/A | 2.93 | 3.26 | 3.78 | N/A | N/A | N/A | N/A |

- Example: 30 Year Fixed with APOR of 4.48%
  - 2 bona fide discount points can be excluded if the interest rate before the discount does not exceed 5.48%.
  - 1 bona fide discount points can be excluded if the interest rate before the discount does not exceed 6.48%.

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# Affiliate:

- TILA defines “affiliate” as “any company that controls, is controlled by, or is under common control with another company, as [control is defined] in the Bank Holding Company Act.
- The Bank Holding Company Act defines “control” as:
- A [person] has control over a . . . company if—

  **(A)**the [person] directly or indirectly . . . owns, controls, or has power to vote 25 per cent or more of [the shares] of the company;

  **(B)**the [person can] control . . . the election of a majority of the directors. . . of the company; or

  **(C)**the [person] directly or indirectly exercises a controlling influence over the management or policies of the company.

State law and regulatory and court interpretations of affiliation and control vary. Generally, if entities have25% or more common ownership or subsidiary relationship **or if one entity or person otherwise exercises a controlling influence of the management or policies of the other entity**, the entities will be deemed to be affiliates.

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# QM Points and Fees treatment of affiliates

1. All lender affiliate fees are included in the points and fee test
2. Not all Broker affiliates are included in the points and fees test, examples:
    a. Included:
        i. Title
        ii. Escrow
        iii. Closing
        iv. Processing
    b. Excluded:
        i. Appraisal companies or AMCs
        ii. Credit report fees
        iii. Inspection companies
        iv. Flood insurance
        v. Hazard insurance

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# QM – Impact to Production

- Agency & Government loan product offerings are in alignment with QM requirements;
- HPML loans require the same ability to repay analysis as for other QM loans,  but the safe harbor is only a rebuttable presumption—meaning that a borrower can challenge whether ability to pay was properly determined, but the borrower has the burdening of proving that allegation;
- Lender Paid and Borrower Paid Broker compensation count into the 3% fee limitation
  - Example:  With a Lender Paid compensation plan at 2.5%, only .5% in fees may be charged without exceeding the cap.

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- Debt to Income Ratio
  - The loan's DTI must be ≤ 43% or
  - The loan must be eligible for GSE purchase or government insurance/guarantee (regardless of whether the loan is actually purchased, guaranteed, or insured)
    - Must have an "approve/eligible" recommendation from DU or an "Accept and Eligible to Purchase" from LP
    - Must comply with all Verification Messages/Approval Conditions listed in the Underwriting Findings report
    - Must document the file accordingly
    - Repurchase demand is not dispositive of QM status

# Key Points:

- Document calculation methodology and verifications to tell the ATR/QM story
- Must verify relied upon calculation information using reasonably reliable 3rd party records (e.g. IRS tax transcripts or W-2's)
- Ensure that all data entered into the system is accurate and correct
- Use income and credit analysis worksheets
- Retain documentation

- Future of FNMA /FHLMC & Private Market
  --Loan Limits
- Future of FHA
- QM/Non QM
- Sub Prime?
- Banks/Credit Unions vs. Mortgage Bankers
- Correspondent Lenders vs. Brokers (TPO)
  -Risk vs. Reward and added responsibilities

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- "Non QM loans" should not be considered sub-prime loans.
- For "Non QM loans" to be widely available they have to be eligible for inclusion in residential mortgage backed securities pools (RMBS).
  - Even if a bank or credit union wants to hold the loans as assets initially, they will want an ultimate "take-out" and thus the importance of an active securitization market for Non QM Loans.
- Fitch has recently come out with criteria that should start to open the door for Non QM loans inclusion in RMBS.
  - Fitch believes the risk of massive losses on these loans is relatively slight, but even with a limited amount of loans to challenge the ATR status, significant legal costs will be incurred.
  - Originators will have to designate loans as QM vs. Non QM loans and this will be verified by third party due diligence of the pool.
  - Ironically, the primary resolution to these matters will likely be modifications.

## So What if My Member's Loan Doesn't Meet QM

- The Lender may pass on the loan, adjust their fees, or they could choose to take the risk. Risk can range from less salability (No GSE) and difficulty in foreclosing on a delinquent loan (Borrower challenges ATR) to increased costs and additional restrictions to sell Non QM loan in the marketplace.
- Just because the loan doesn't meet the QM rules doesn't necessarily make it a bad loan/borrower. Many of these loans are still "good quality" loans as has been borne out from historical data and low delinquency rates on Portfolios. They just now carry a higher risk associated with the new QM rules.

# How Might The Industry Work Through This?

1. The QM points and fees limitation likely is not an issue for most Lenders on most loans
   - Lenders may include their fees in the interest rate
   - Lenders may restructure service provider relationships to minimize impact of use of affiliated service providers
2. Some Brokers may convert to a correspondent lending arrangement that qualifies as a secondary marketing relationship, with purchase price premium paid to the originator not subject to QM points and fees test. This though will involve becoming licensed as a Lender & supplying all appropriate Lender disclosures and subject to greater compliance and regulatory oversight.
3. We may begin seeing private securitization options that help Lenders manage the risk of closing non-QM loans – and help more people buy homes.

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# New Disclosures Your Clients May See After 1/10/2014

1. Homeownership Counseling Notice and Disclosure: Within 3 business days of application receipt - Lenders must provide the applicants with a notice concerning the value of engaging housing counselors and disclosure of a list of approved housing counselors within the loan applicant's vicinity.
2. Loan Originator NMLS Number Disclosure: loan originator's name and NMLS number must be disclosed on certain loan documents: the loan application form, the promissory note, and the security instrument.

# New Disclosures Your Clients May See after 1/18/2014

1. Valuations: Lender must provide to loan applicants: A notice and copies of all appraisal reports or other "valuations" developed in connection with the transaction on all first lien loans.
   - **Notify Right to Receive Appraisal.** Within 3 business days of receipt of the loan application/initial disclosure packet, the lender must notify the applicant of their right to receive a copy of any appraisal or other valuations.
   - **Prompt Delivery.** Valuation(s) must be delivered to applicant at a) valuation completion or b) 3 business days before funding, whichever is earlier. The consumer may waive the right to receive valuation copies early. Should the loan be cancelled or declined, the lender is still required within 30 days of lender's determination of cancellation to provide copies to the consumer.
   - **HPML's Notice** In connection with higher-priced mortgage loans ("HPML"), lenders must provide to applicants a notice and copies of all the loan transaction's appraisal reports.
   - **Own Appraiser.** At their own expense, the applicant may hire an appraiser to prepare an appraisal for their own use (not to be considered in loan evaluation).
   - **Interior Report.** The lender must obtain the appraisal report from a licensed or certified appraiser. The appraisal must include an interior report.

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