AFFORDABLE HOMEOWNERSHIP COALITION

To: Meeting Participants

From: Kara M. Ward

Re: Primer on the Qualified Mortgage Rule

The Qualified Mortgage Rule Background: A Primer

In 2010, the *Dodd-Frank Wall Street Reform Act* made substantial changes to the existing law known as the *Truth In Lending Act* (TILA). No change was more important to homeowners and aspiring homeowners than the new rules that ensured predatory mortgage lending would be outlawed. These rules became known as the "Ability to Repay" (ATR) rules and they now apply to every mortgage originated in the United States.

When mortgage lenders make a loan, they must adhere to the eight fundamental principles of the ATR rules which require them to consider eight underwriting factors:

(1) current or reasonably expected income or assets;
(2) current employment status;
(3) the monthly payment on the covered transaction;
(4) the monthly payment on any simultaneous loan;
(5) the monthly payment for mortgage-related obligations;
(6) current debt obligations, alimony, and child support;
(7) the monthly "debt-to-income" (DTI) ratio or residual income; and
(8) credit history.

Under the ATR, the CFPB is given authority to offer guidance on what loans meet the eight factor criteria above and to elaborate on how to meet them. The resulting set of rules are known as the "qualified mortgage" (QM) rules.

Loans that meet the criteria for a QM loan are entitled to a presumption that the lender making the loan satisfied the ATR requirements. This presumption is incredibly important to lenders in today's market. Without it, lenders have said they would increase the cost of the loan to accommodate for the potential legal liability by anywhere from 50 to 500 basis points for otherwise creditworthy borrowers in affordable loan products.

From 2013 to today, the general underwriting criteria for QM loans has required that monthly payments be calculated based on the highest payment that will apply in the first five years of the loan and that the consumer have a total DTI ratio that is less than or equal to 43 percent. The appendices to the rule go on to define "debt" and "income." The CFPB also created a temporary provision that would allow the loans GSEs would be willing to purchase the ability to be called a QM loan. Shorthand for this criteria is known as the "GSE Patch."

When lenders are found to violate ATR and not to have originated a QM loan (without regard to being a safe harbor or rebuttable presumption loan) the consumer is eligible for damages equal to all financing charges and fees, and such failure by the lender can be used as a defense in foreclosure proceedings.

Today, the CFPB is proposing to eliminate the 43 percent DTI threshold in favor of relying on a rate spread approach that determines the relative legal protections afforded to consumers. Loans that are 150 bps above the average rate offered on a typical loan will be granted "safe harbor" status so long as they meet the eight ATR principles of good underwriting and the lender obeys their own underwriting and documentation standards.

The "GSE Patch" is allowed to sunset and "Adjustable Rate Mortgages" (ARMs) will be treated separately. The proposal is available here.

What Changes and What Stays the Same?

CHANGE	STAYS THE SAME	NOTES
43% DTI is eliminated, with its attendant Appendix Q		Definitions of "income" and "assets" no longer exists
GSE Patch is eliminated		Only as of the date of the implementation of the new QM rule.
	All 8 underwriting factors of the ATR test	
	3% cap on points and fees	Industry is requesting an extension of cure periods due to sunset
	Product features of a QM: fully amortizing (no negative amortization, IO, Balloons), maximum 30–year term,	
	FHA, VA, USDA and GNMA rules	These underwriting rules may become "specific verification" standards by the CFPB
	Balloon–payment portfolio loans under QM for small rural lenders	
	No minimum downpayment	Investor guidelines and the GSEs still generally require 3% down and anything less than 20% will require credit enhancement (PMI)
	The QRM rule	
APOR + 150 bps*		Continues to be the safe harbor- proposed as the sole QM test
APOR + 200 bps		Continues to be the "rebuttable presumption" threshold

	APOR calculation	Continues to be set by the FFIEC guidance, generally the prevailing rate for a 30-year fixed rate loan with at least a 20% downpayment.
	APR and “basis points” definitions	The components of the APR as inclusive of all costs, including GSE guarantee fees, are unchanged.
“Consider”		These are the new, flexible underwriting criteria lenders use. They rely on the 8 factors above.
“Verify”		These are the new, flexible documentation standards. The CFPB is considering specifying compliant standards to aid lenders with compliance.

*APOR is “Average Prime Offer Rate”.