ICBA Summary of the Ability-to-Repay/Qualified Mortgage Rule

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I. BACKGROUND

The Consumer Financial Protection Bureau (CFPB) issued final rules implementing the Ability-to-Repay and Qualified Mortgage Rule under Regulation Z (Truth in Lending Act) on January 10, 2013 with subsequent amendments to the rule issued May 29, 2015, July 10, 2013, September 13, 2013, September 21, 2015, and March 22, 2016. Under the provisions, mortgage lenders must consider a consumer's ability to repay a mortgage loan before extending credit. The qualified mortgage (QM) provisions provide certain legal protections for mortgage lenders. The original ATR/QM rule went into effect on January 10, 2014.

Overall, the rules create three categories of loans with different protections: (1) loans not deemed "qualified mortgages" that must therefore satisfy the "ability-to-repay" requirements; (2) loans deemed "qualified mortgages" that receive safe harbor legal protection because they are not higher interest mortgage loans; and (3) loans deemed "qualified mortgages" that receive a rebuttable presumption of legal compliance (a lesser legal protection) because they are higher interest loans.

Small Creditor Exemptions

"Small creditors" under the rules receive safe harbor legal protection for QM loans that have higher interest rates, as long as the rates are less than 3.5 percentage points above the average prime offer rate (APOR). Under amendments issued in September 2015 and effective January 1, 2016, a "small creditor" is defined as a creditor with under $2 billion in assets (adjusted annually) that originates fewer than 2000 first-lien mortgage loans in a year. Furthermore, loans held in portfolio by small creditors will not count toward the 2,000 loan limit. It is important to note that while the new rule does not change the current asset limit for small-creditor status, under the new rule the assets of the creditor's mortgage-originating affiliates are included in calculating whether a creditor is under the threshold.

Under the March 2016 amendments to Regulation Z, small creditors that make at least one covered mortgage loan in a rural or underserved area in the previous calendar year can take advantage of QM safe harbor treatment of balloon payment loans retained in portfolio. The September 2015 amendments also expanded the definition of rural area to include not only certain rural counties, but any census blocks that are not in an urban area as defined by the U.S. Census Bureau. Note: Counties that are already considered "rural" will retain their "rural" designation.

Link to the CFPB's ATR/QM Resource Page - *http://www.consumerfinance.gov/regulations/ability-to-repay-and-qualified-mortgage-standards-under-the-truth-in-lending-act-regulation-z/*

II. SCOPE

- The rule applies to all consumer closed-end mortgage loans including home-purchase loans, refinances, and home equity loans. This includes first or subordinate liens.

- The rule DOES NOT cover:

    - Home equity lines of credit (HELOCs) or other open-end loans;
    - Mortgages secured by an interest in a timeshare plan;
    - Reverse mortgage loans;
    - Temporary or "bridge" loans with a term of 12 months or less, such as a loan to finance the purchase of a new dwelling where the consumer plans to sell a current dwelling within 12 months or a loan to finance the construction of a dwelling;
    - A construction phase of 12 months or less of a construction-to-permanent loan;
    - Business-purposes loans even if they are secured by a dwelling;
    - Loan modifications, except if the modification is a "refinancing" under Regulation Z; or
    - Extensions of credit made by a Community Development Financial Institution.

    Note: The rule's provisions on prepayment penalties also apply to reverse mortgages, temporary loans, and construction loans, whereas the rest of the rule does not.

- For loans within the rule's scope, a creditor must make a reasonable and good faith determination at or before consummation that the consumer will have a reasonable ability to repay the loan according to its terms. This requirement can be satisfied by *any* of the following:

    - Following the "ability-to-repay" requirements;
    - Making a "qualified mortgage" (QM);
    - Refinancing a non-standard mortgage into a standard mortgage pursuant to the rule; or
    - For small creditors that provide mortgage loans primarily in areas deemed to be "rural" or "underserved" pursuant to the rule, making a balloon payment mortgage loan that otherwise satisfies the QM requirements.
        - Small creditors that do not operate predominantly in rural or underserved areas can provide balloon mortgage loans and satisfy these requirements until April 1, 2016.

III. ABILITY TO REPAY

- The rule requires that lenders consider a borrower's ability to repay a consumer mortgage loan before providing the loan. The rule describes certain minimum requirements for creditors making ability-to-repay determinations but does not dictate following particular underwriting models. At a minimum, creditors generally must consider eight underwriting factors:

    - Current or reasonably expected income or assets (other than the value of the collateral). The creditor may consider assets alone.
    - Consumer's current employment status if the creditor relies on income from their employment.

- The monthly payment on the covered transaction. Payments on adjustable rate mortgages (ARM) must reflect use of the "fully indexed rate" or any introductory rate, whichever is greater.
- The monthly payment on any simultaneous loan that the creditor knows or has reason to know will be made. This includes any loan covered by this rule, or any HELOC that will be secured by the same property as the loan at issue and that is made at, before, or after consummation of the loan.
- The monthly payment for mortgage-related obligations such as property taxes, insurance, condominium assessments, etc.
- Current debt obligations, alimony, and child support.
- The monthly debt-to-income (DTI) ratio or residual income. Creditors must make a reasonable and good faith determination of consumer's ability to repay.
- Credit history. Creditors are not required to obtain or consider a consolidated credit score. Creditors may look to nontraditional credit references, such as rental payment history or utility payments.

- Creditors must generally use reasonably reliable third-party records to verify the information they use to evaluate the factors. Also, monthly payments must generally be calculated by assuming that the loan is repaid in substantially equal monthly payments during its term. For ARM loans, the monthly payment must be calculated using the fully indexed rate or an introductory rate, whichever is higher.

IV. QUALIFIED MORTGAGES

A. Safe Harbor vs. Presumption of Compliance

- For loans that meet the QM definition, creditors may receive either a "safe harbor" or "presumption of compliance" from the ability-to-repay requirements. Mortgage loans that are considered qualified mortgages (QM) do not have to satisfy all of the ability-to-repay requirements.

  - Certain qualified mortgages receive a safe harbor from compliance. A QM loan receives a safe harbor if it has an annual percentage rate (APR) less than 1.5 percentage points above the average prime offer rate (APOR). The safe harbor creates a legal defense for the creditor. For example, the creditor may defend an ability to repay claim under the rule by showing it made a safe harbor QM loan.

  - Other QM loans will only receive a "presumption of compliance," which provides less legal protection for the creditor. A QM loan receives a presumption of compliance with the rule if has an APR that is less than 3.5 percentage points above the APOR. With this standard, a consumer could "rebut the presumption of compliance" for a QM loan if they showed that despite having made a QM, the creditor did not make a reasonable and good faith determination of their ability to repay the loan.

  - ***NOTE:* For community banks that satisfy the "small creditor" exception, QM first lien mortgages receive safe harbor protection if they are less than 3.5 percentage points above the APOR.**

B. Product Features

- QM loans must meet certain product-specific criteria. Loans that have the following characteristics are not considered QM loans:

    - Negative amortization;
    - Interest-only payments;
    - Balloon payments (with some exceptions for small rural lenders)
    - Terms exceeding 30 years; or
    - No-doc loans.

C. Underwriting Tests

- In addition, QM loan monthly payments must be calculated based on the highest payment including any amounts escrowed for taxes, and insurance that will apply in the first five years of the loan. The consumer must also have either a total (or back-end) debt-to-income ratio of less than or equal to 43 percent **OR** satisfy a GSE/Federal Agency test, in which the loan passes as a QM if it is eligible for:

    - Purchase or guarantee by Fannie Mae or Freddie Mac;
    - Insurance by the Department of Housing and Urban Development (HUD);
    - Guarantee by the Department of Veterans Affairs (VA);
    - Guarantee by the Department of Agriculture pursuant to its Single Family Housing Guaranteed Loan Program; or
    - Insurance by the Rural Housing Service.

    Note: The Fannie Mae/Freddie Mac provision will terminate once their conservatorship ends or after January 2021, whichever occurs first.

D. Points and Fees Limitations

- Points and fees payable in connection with the loan also cannot exceed specified amounts or percentages of the total loan amount. These amounts are adjusted annually.

    2016 Points and Fee Limits

    For 2016, loans greater than or equal to $101,749 have a cap on points and fees is 3% of the total loan amount. For loan amounts less than $101,749, the caps are:

    - $3,052 for loans in an amount greater than or equal to $61,050 but less than $101,749;
    - Five percent of the total loan amount for loans greater than or equal to $20,350 but less than $61,050;
    - $1,017 for loans in an amount greater than or equal to $12,719 but less than $20,350;
    - Eight percent of the total loan amount for loans less than $12,719;

2017 Points and Fee Limits

Effective January 1, 2017, loans greater than or equal to $102,894 have a cap on points and fees is 3% of the total loan amount. For loan amounts less than $102,894, the caps are:

- $3,087 for loans in an amount greater than or equal to $61,737 but less than $102,894;
- Five percent of the total loan amount for loans greater than or equal to $20,579 but less than $61,737;
- $1,029 for loans in an amount greater than or equal to $12,862 but less than $20,579;
- Eight percent of the total loan amount for loans less than $12,862;

- Points and fees include all non-interest components of the finance charge except:
  - Government mortgage insurance or guarantee fees;
  - Private mortgage insurance (PMI) premiums payable after consummation;
  - Certain up-front PMI fees where the premium is refundable on a pro rata basis; or
  - Any bona fide third-party charge not retained by the creditor, loan originator, or an affiliate of either.
- Points and fees also include any loan level price adjustments charged by Fannie Mae or Freddie Mac.
- In addition, certain charges, even if they are retained by the creditor, loan originator, or affiliate of either, are also considered “points and fees”:
  - Real estate charges that are not reasonable;
  - Premiums for credit insurance and debt cancellation or suspension coverage that are payable at or before consummation; and
  - PMI premiums payable at or before consummation that either exceed the FHA premium or are not required to be refunded when the loan is paid in full.
- All compensation paid directly or indirectly by a consumer or creditor to a loan originator that can be attributed to the transaction at the time the interest rate is set is included in the calculation of “points and fees.”
  - “Compensation” is the dollar value of monetary and non-monetary rewards such as a bonus, commission, or award of merchandise, service trips, or similar prizes.
  - “Loan originator” is a person who for, or in expectation of, compensation arranges, negotiates, or otherwise obtains a loan for another person.
- “Points and fees” also include the following where they are payable at or before consummation:
  - Credit life, credit disability, credit unemployment, or credit property insurance;
  - Any other life, accident, health, or loss-of-income insurance for which the creditor is a beneficiary; and
  - Any payments for any debt cancellation or suspension agreement or contract.

- Certain prepayment penalties are also counted toward the 3% cap.

- The rule EXCLUDES from points and fees:

  - Loan originator compensation paid by a consumer to a mortgage broker when that payment has already been counted toward the points and fees thresholds as part of the finance charge;
  - Compensation paid by a mortgage broker to an employee of the mortgage broker because that compensation is already included in points and fees as loan originator compensation paid by the consumer or the creditor to the mortgage broker; and
  - Compensation paid by a creditor to its loan officers.

V. SPECIAL EXCEPTIONS FOR SMALL CREDITOR PORTFOLIO LOANS

- A loan is automatically a QM loan[1] if:

  - It is originated and held in portfolio for at least 3 years;
  - It is originated by a *"small creditor,"* which defined as a creditor with under $2.060 billion in assets (inclusive of any mortgage originating affiliates) that originates fewer than 2000 first-lien mortgage loans in a year (loans held in portfolio by small creditors do not count toward the 2,000 loan limit);
  - It meets the general restrictions on qualified mortgages with regard to loan features and points and fees; **AND**
  - Creditors evaluate consumers' debt-to-income ratio or residual income.

- For creditors that satisfy this exception:

  - QM first-lien loans receive safe harbor protection if they are less than 3.5 percentage points above APOR.
  - The loans **ARE NOT** subject to the 43% debt-to-income ratio as they would be under the general qualified mortgage definition.

VI. SPECIAL EXCEPTION FOR COMMUNITY BANK BALLOON MORTGAGE LOANS

- Certain mortgage loans with balloon payments will be considered QM loans if all of the following criteria is satisfied:

  - The lender meets the small creditor definition;
  - The loan is originated and held in portfolio for at least 3 years;

[1] The revised small creditor definition is effective January 1, 2016.

The lender providing the loan provided at least one covered mortgage loan[2] in areas that are considered rural or underserved in the previous calendar year or for applications received before April 1 of a calendar year, in either of the two prior calendar years.

- Rural is defined as any census block that is not in an urban area as defined by the U.S. Census Bureau.
- Underserved is defined as a county with no more than two creditors that extend covered mortgage transactions secured by a first lien five or more times in that county during a calendar year.

Note: the CFPB will designate a list of "rural" and "underserved" areas each year.

- Balloon loans are only eligible for the exception if they have a term of at least 5 years, a fixed interest rate, and meet certain basic underwriting standards. Debt-to-income ratios must be considered but are not subject to the 43 percent requirement.

VII. REFINANCE OF A NON-STANDARD INTO A STANDARD MORTGAGE

- Creditors may also refinance a "non-standard mortgage" into a "standard mortgage" and not have to satisfy the ability to repay requirements. A non-standard mortgage is:
  - An ARM with an introductory fixed rate for a period of 1 year or longer; A
  - An interest-only loan; or
  - A negative amortization loan.
- Non-standard mortgages do not include balloon payment loans.
- A standard mortgage must have:
  - A fixed interest rate for at least the first 5 years;
  - Total points and fees in compliance with QM requirements;
  - A loan term that does not exceed 40 years; and
  - The loan proceeds must only be used to pay the outstanding balance of the non-standard mortgage and closing and settlement fees for the standard mortgage.
- The creditor must also consider whether the consumer is likely to default on the non-standard mortgage and whether the standard mortgage would prevent the consumer's default. Considerations include:
  - Whether the creditor for the standard mortgage is the current holder of the non-standard mortgage;
  - Whether the monthly payment for the standard mortgage is lower than for the non-standard mortgage; and

[2] A "covered mortgage loan" is generally a consumer credit transaction that is secured by a first-lien on a dwelling, other than a transaction exempt from the Ability to Repay Rule under 12 CFR 1026.43(a).

- Whether the creditor receives the consumer application for the standard mortgage no later than 2 months after the standard mortgage has recast; and the consumer has made no more than 1 payment 30 days late on the non-standard mortgage in the 12 months preceding the application and no late payments in the preceding 6 months.

VIII. EXEMPTIONS FOR CERTAIN CREDITORS AND LENDING PROGRAMS

- There is an exemption from the ability-to-repay requirements for extensions of credit made pursuant to programs administered by a housing finance agency and for an extension of credit made pursuant to an Emergency Economic Stabilization Act program, such as extensions of credit made pursuant to a State Hardest Hit Fund program.