New Lending Opportunities in the Changed Mortgage Market: Dodd-Frank Act Mortgage Regulations

Kenneth Benton
Senior Consumer Regulations Specialist
May 14, 2014

Disclaimer: the views expressed are the presenter’s and do not necessarily reflect the views of the Federal Reserve Bank of Philadelphia or the Federal Reserve System
Qualified Mortgages (QMs) under the Dodd-Frank Act (DFA)

Proliferation of residential mortgage loans made with little or no underwriting played a significant role in the financial crisis and prompted Congress to impose ability-to-repay (ATR) requirements on residential mortgage lenders.
Lenders must verify repayment ability and have two compliance options: the QM standard and the general ATR standard.

General ATR standard. Consider and verify 8 underwriting factors:
- Current or reasonably expected income or assets
- Employment status
- Monthly payment on this loan
- Monthly payment on “simultaneous loans”
- Monthly payment for “mortgage-related obligations”
- Current debt obligations
- Monthly DTI ratio, or residual income
- Credit history
Qualified Mortgages (QMs) under the Dodd-Frank Act (DFA)

- QM standard, 4 different types of QMs:
  - General QM
  - Temporary GSE/federal agency QM
  - Small creditor balloon QM
  - Small creditor QM

- QMs provide legal presumption of compliance with ATR requirement, while general ATR standard does not provide legal protection

- Lenders can offer QMs, non-QMs or both
<table>
<thead>
<tr>
<th></th>
<th>ATR Standard</th>
<th>General QM Definition</th>
<th>Agency/GSE QM (Temporary)</th>
<th>Balloon-Payment QM</th>
<th>Small Creditor QM</th>
<th>Small Creditor Balloon-Payment QM (Temporary)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loan feature limitations</td>
<td>No limitations</td>
<td>No negative amortization, interest-only, or balloon payments</td>
<td>No negative amortization, interest-only, or balloon payments</td>
<td>No negative amortization or interest-only payments</td>
<td>No negative amortization, interest-only, or balloon payments</td>
<td>No negative amortization or interest-only payments</td>
</tr>
<tr>
<td>Loan term limit</td>
<td>No limitations</td>
<td>30 years</td>
<td>30 years</td>
<td>No more than 30 years, no less than 5 years</td>
<td>30 years</td>
<td>No more than 30 years, no less than 5 years</td>
</tr>
<tr>
<td>Points &amp; fees limit</td>
<td>No limitations</td>
<td>3%</td>
<td>3%</td>
<td>3%</td>
<td>3%</td>
<td>3%</td>
</tr>
<tr>
<td>Payment Underwriting</td>
<td>Greater of fully indexed or introductory rate</td>
<td>Max rate in first 5 years</td>
<td>As applicable, per GSE or agency requirements</td>
<td>Amortization schedule no more than 30 years</td>
<td>Max rate in first 5 years</td>
<td>Amortization schedule no more than 30 years</td>
</tr>
<tr>
<td>Mortgage-related obligations</td>
<td>Consider and verify</td>
<td>Included in underwriting monthly payment and DTI</td>
<td>As applicable, per GSE or agency requirements</td>
<td>Included in underwriting monthly payment and DTI</td>
<td>Included in underwriting monthly payment and DTI</td>
<td>Included in underwriting monthly payment and DTI</td>
</tr>
<tr>
<td>Income or assets</td>
<td>Consider and verify</td>
<td>Consider and verify</td>
<td>As applicable, per GSE or agency requirements</td>
<td>Consider and verify</td>
<td>Consider and verify</td>
<td>Consider and verify</td>
</tr>
<tr>
<td>Employment status</td>
<td>Consider and verify</td>
<td>Included in underwriting DTI</td>
<td>As applicable, per GSE or agency requirements</td>
<td>No specific requirement</td>
<td>No specific requirement</td>
<td>No specific requirement</td>
</tr>
<tr>
<td>Simultaneous loans</td>
<td>Consider and verify</td>
<td>Included in underwriting DTI</td>
<td>As applicable, per GSE or agency requirements</td>
<td>Included in underwriting DTI</td>
<td>Included in underwriting DTI</td>
<td>Included in underwriting DTI</td>
</tr>
<tr>
<td>Debt, alimony, child support</td>
<td>Consider and verify</td>
<td>Consider and verify</td>
<td>As applicable, per GSE or agency requirements</td>
<td>Consider and verify</td>
<td>Consider and verify</td>
<td>Consider and verify</td>
</tr>
<tr>
<td>DTI or Residual income</td>
<td>Consider and verify</td>
<td>DTI ≤ 43 percent</td>
<td>As applicable, per GSE or agency requirements</td>
<td>Consider and verify</td>
<td>Consider and verify</td>
<td>Consider and verify</td>
</tr>
<tr>
<td>Credit History</td>
<td>Consider and verify</td>
<td>Included in underwriting DTI</td>
<td>As applicable, per GSE or agency requirements</td>
<td>No specific requirement</td>
<td>No specific requirement</td>
<td>No specific requirement</td>
</tr>
</tbody>
</table>

2 “Included in underwriting monthly payment” means that the rule does not require the creditor to separately consider and verify this factor. However, a creditor must consider this factor when underwriting the consumer’s monthly payment under the rule.

3 “Included in underwriting DTI” means that the rule does not require the creditor to separately consider and verify these factors. However, a creditor considers and verifies these factors when calculating the consumer’s debt-to-income ratio.
General QM

- Substantially equal, amortizing regular payments
- No negative amortization, interest-only payment, or balloon payment
- Loan term cannot exceed 30 years
- Points and fees cannot exceed 3% of the loan amount (except different standards for loans under $100,000)
- Underwriting must consider mortgage-related obligations, be based on maximum rate in first five years, and consider and verify income or assets used in making ATR determination
- Back-end DTI cannot exceed 43%
Small Creditor QM

- Only applies to “small creditors”
  - $2 billion or less in assets in preceding calendar year
  - Made 500 or fewer 1st-lien mortgages in previous calendar year, including affiliates
  - Holds them in portfolio for at least 3 years (with exceptions) and not be subject to forward commitments

- Has same requirements as general QM, except:
  - DTI **can** exceed 43%
  - Small creditor can charge higher rate for 1st-lien mortgage loan and still receive safe harbor for compliance with ATR requirement
  - Does not have to follow Appendix Q for calculating DTI
Small Creditor Balloon QM

- Only applies to “small creditors”

- Same requirements as general QM, except:
  - DTI can exceed 43%
  - Small creditor can charge higher rate for 1st-lien mortgage loan
  - Balloon payment is permitted
  - Loan term must be between 5 and 30 years
  - Must have fixed-rate and monthly amortizing payments (except for final balloon payment)
  - Does not have to follow Appendix Q for calculating DTI

- CFPB originally required creditor to make at least 50% of its mortgages in “rural & underserved areas” but is temporarily waiving requirement until January 10, 2016 while researching the issue because industry said definition was too narrow
Temporary GSE and Agency QM

- Applies to loans *eligible* to be purchased, insured, or guaranteed by GSEs (while in receivership), FHA, VA, U.S. Dept. of Agriculture, or Rural Housing Service

- Lender must follow GSE/government agency underwriting requirements instead of general QM underwriting requirements

- 43% DTI requirement does *not* apply

- This temporary QM expires for GSEs when Fannie/Freddie receivership ends, or for agencies when they adopt their own QM rule, or January 10, 2021, whichever comes first

- HUD has created a QM for FHA loans

- Congress is currently considering GSE legislation to end receivership
Points and fees cannot exceed 3% of the total loan amount (amount financed minus certain financed costs included in points/fees) for a loan greater than or equal to $100,000.

For loans under $100,000, different limits apply:
- $3,000 for loan ≥ $60,000 but < $100,000
- 5% of total loan amount for loan ≥ $20,000 but < $60,000
- $1,000 for a loan ≥ $12,500 but < $20,000
- 8% of total loan amount for loan < $12,500

These amounts will be adjusted for inflation.
Points and Fees Test (cont.)

• Creditors must be diligent in calculating points and fees because if the 3% limit is exceeded, mortgage will not receive QM status

• CFPB recently proposed a cure procedure: if points and fees limit exceeded, but creditor refunds excess fees to borrower within 3 months after loan closing, loan retains QM status
Prepayment Penalties

- Prepayment penalties are prohibited for non-QMs, for adjustable rate loans, and for higher-priced loans.

- For loans on which prepayment penalties are permitted, limits apply:
  - 2% during 1st two years
  - 1% during 3rd year after consummation
  - No penalties allowed after 3rd year

- If loans containing prepayment penalties are offered, creditor must also show borrower a loan without the penalty.
Legal Protections for Creditors offering QMs

- Lender offering QMs receive legal protection in the event of a lawsuit alleging repayment ability was not verified.

- Strength of legal protection depends on whether QM is prime or higher-priced.

- If APR exceeds FreddieMac average prime mortgage loan rate by 150 basis points for 1st lien loans or 350 basis points for subordinate lien loans, the loan is higher-priced.

- If the rate is below this threshold, it is a non-higher priced QM.
Legal Protections for Creditors offering QMs

• Non-higher priced QM receives true **safe harbor**: it is “conclusively presumed that the creditor made a good faith and reasonable determination of the consumer’s ability-to-repay”

• Higher-priced QM receives **rebuttable presumption of compliance**. A consumer can rebut the presumption by showing that the loan payment did not leave sufficient income or assets to meet required living expenses
Changes to TILA Civil Liability

• Higher damages for violating ability-to-repay (ATR) or loan originator compensation (LOC) requirements: actual damages, twice the amount of the finance charge paid (capped at $4,000), the sum of all finance charges and fees consumer paid, court costs, and attorney’s fees — unless the creditor demonstrates that the failure to comply is not material.

• Statute of limitations extended from one year to three for ATR and LOC violations

• Setoff claims allowed for ATR or LOC violations in foreclosure without regard to statute of limitations
Qualified Residential Mortgages (QRM) under the Dodd-Frank Act

• Original proposal issued in 2011

• New proposal issued August 2013. Final rule pending

• Proposing QRM = QM for purposes of statutory exception from risk retention requirement

• Seeking comment on alternative “QRM Plus” approach
  • QMs + 1-4 Family Principal Dwelling + First Lien + Credit History Restrictions + LTV not exceeding 70%
  • Excludes GSE/federally guaranteed, small creditor and small creditor balloon loans
  • Fewer loans would be exempt from risk retention requirements under this approach
2014 ABA Lender Survey

- 2% of respondents will stop offering mortgage loans while 33% will restrict lending to QM loans
- 29% of respondents will restrict lending to primarily QM loans but will offer non-QM loans in some targeted markets
- 36% of respondents will make no changes to their current underwriting practices and will originate non-QM loans
- 95% of respondents originating non-QM loans expect to hold them in portfolio
2014 ABA Lender Survey (cont.)

- 80% of respondents expect that QM rules will limit credit availability in some markets.

- 40% of respondents expect the rules will reduce credit availability in all mortgage lending segments, while 20% expect no reduction in credit availability.

- 10% of respondents expect QM rules to have a severe impact on credit availability, 66% expect a moderate impact, and 24% expect a negligible impact.
Lending Opportunities

• Certain creditors are **exempt** from the ATR/QM rule:
  
  • Housing finance agencies (as defined by HUD)
  • Community Development Financial Institutions
  • Creditors designated as Downpayment Assistance through Secondary Financing Provider by HUD
  • Creditors designated as Community Housing Development Organizations
  • Non-profit lenders, provided lender in prior calendar year did no more than 200 mortgage loans and loans were to LMI borrowers

• Borrowers impacted by ATR/QM rule could possibly obtain credit from these lenders

• Low- and moderate-income borrowers impacted by 43% DTI ratio for standard QM can also look to small creditors, the FHA, and creditors offering GSE-conforming loans, which are not subject to 43% DTI

• Non-QM market could expand to serve borrowers adversely impacted by QM rule
Resources

• CFPB Mortgage Rule Page: http://tinyurl.com/cfpb-MR

• CFPB Mortgage Implementation Page: http://tinyurl.com/reg-imp

• CFPB ATR/QM Compliance Guide: http://tinyurl.com/CFPB-ATRQM


Questions?