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Qualified v. Non-Qualified Mortgages

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Qualified Mortgages v. Non-Qualified Mortgages

I. Background. The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act")[1] became law on July 21, 2010. Section 1411 of the Dodd-Frank Act amends the Truth in Lending Act ("TILA")[2] to include new ability-to-repay ("ATR") requirements for residential mortgage loans.[3] The requirements are designed to address the belief by Congress that a contributing factor to the recent mortgage crisis was lenders making mortgage loans to consumers who had no reasonable ability to repay. Under these provisions, a lender must make a "reasonable and good faith determination based on verified and documented information" that the consumer "has a reasonable ability to repay" the residential mortgage loan.[4]

Section 1412 of the Dodd-Frank Act provides a "safe harbor" for lenders by establishing a presumption of compliance with the ATR requirements by originating a certain category of mortgages called "qualified mortgages" ("QMs").[5] Section 1412 also authorizes the Bureau of Consumer Financial Protection ("CFPB") to prescribe regulations for a QM and directs four federal agencies -- the Department of Housing and Urban Development ("HUD"), the Department of Veterans Affairs ("VA"), the Department of Agriculture ("USDA") and the Rural Housing Service ("RHS") -- to prescribe rules to define a QM with regard to mortgages eligible for purchase, guaranty, or insurance by the applicable agency.

On January 10, 2013, the CFPB issued its Ability-to-Repay and Qualified Mortgage Rule (the "ATR/QM Rule") as a part of Regulation Z, the implementing regulation for TILA. The rule became effective on January 10, 2014 (i.e., loans for which the creditor receives an application on or after January 10, 2014).[6] To aid implementation, the CFPB has issued other guidance including a Small Entity Compliance Guide (the "Guide").[7]

To comply with the ATR requirements, a lender can originate a residential mortgage loan by following the general ATR requirements, or by originating a QM. There are four different QMs (each of which has its own requirements): (i) the General QM; (2) the Agency/GSE QM (Temporary); (3) the Small Creditor Portfolio QM; and (4) the Small Creditor Balloon-Payment QM. For refinance transactions that meet certain conditions, a lender can alternatively satisfy specific ATR requirements when refinancing a non-standard mortgage into a standard mortgage.[8]

This paper is intended to provide an overview regarding the ATR/QM Rule and certain developments regarding it. **THIS PAPER IS NOT A DEFINITIVE EXPLANATION OF**

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1 Pub. L. No. 111-203, 124 Stat. 1376 (2010).

2 15 U.S.C. § 1601 *et seq.*

3 Pub. L. No. 111-203, § 1411(a)(2), 124 Stat. 1376, 2142-45 (2010) (codified at 15 U.S.C. § 1639c(a)(1)).

4 15 U.S.C. § 1639c(a).

5 15 U.S.C. § 1639c(b)(1)-(3).

6 78 Fed. Reg. 6408 (Jan. 30, 2013) (codified at 12 C.F.R. pt. 1026). The ATR/QM rule is composed of ATR provisions and QM provisions. Further information is available on the Consumer Financial Protection Bureau's website at http://www.consumerfinance.gov/regulations/ability-to-repay-and-qualified-mortgage-standards-under-the-truth-in-lending-act-regulation-z/ and http://www.consumerfinance.gov/regulatory-implementation/title-xiv/.

7 CFPB Ability-to-Repay and Qualified Mortgage Rules – Small Entity Compliance Guide (January 8, 2014), *available at* http://files.consumerfinance.gov/f/201401_cfpb_atr-qm_small-entity-compliance-guide.pdf.

8 *See* 12 C.F.R. § 1026.43(d).

THE ATR/QM RULE AND SHOULD NOT BE RELIED UPON AS LEGAL ADVICE REGARDING THE MEANING OF ANY PROVISION OF THE LAW.

II. Ability-to-Repay Requirements. For any covered transaction (discussed below), a lender is required to 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."[9] In making this repayment ability determination, a lender is required to consider and verify at a minimum the following eight underwriting factors.[10]

- Current or reasonably expected income or assets (other than the value of the property that secures the loan) that the borrower will rely on to repay the loan.[11]

- Current employment status (if the lender relies on employment income to determine repayment ability).[12]

- Monthly mortgage payments on the loan.[13]

- Monthly payment on any simultaneous loans secured by the same property.[14]

- Monthly payments for mortgage-related obligations (e.g., property taxes and insurance, homeowners' association fees or ground rent).[15]

- Current debt obligations, alimony and child support.[16]

- Monthly debt-to-income ("DTI") ratio or residual income.[17]

- Credit history.[18]

A lender is not precluded from considering additional factors, but must consider at least these eight factors. In addition, the lender must verify the information the lender relies on in determining a borrower's repayment ability under these factors using reasonably reliable third-party records.[19]

The ATR provisions setting forth these underwriting and verification requirements do not contain much detail, unlike the QM provisions. For example, the general ATR standard does not

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[9] 12 C.F.R. § 1026.43(c)(1).
[10] 12 C.F.R. § 1026.43(c)(2).
[11] 12 C.F.R. § 1026.43(c)(2)(i).
[12] 12 C.F.R. § 1026.43(c)(2)(ii).
[13] 12 C.F.R. § 1026.43(c)(2)(iii). This is calculated using the introductory or fully-indexed rate, whichever is higher, and monthly, fully-amortizing payments that are substantially equal.
[14] 12 C.F.R. § 1026.43(c)(2)(iv).
[15] 12 C.F.R. § 1026.43(c)(2)(v).
[16] 12 C.F.R. § 1026.43(c)(2)(vi).
[17] 12 C.F.R. § 1026.43(c)(2)(vii).
[18] 12 C.F.R. § 1026.43(c)(2)(viii).
[19] 12 C.F.R. §§ 1026.43(c)(3) and (4).

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