December 17, 2020

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Coming in 2021: CFPB Finalizes Changes to "Qualified Mortgage" Definition and Creates a New "Seasoned QM" Loan Category

Changes are coming in 2021 to the eligibility requirements for "Qualified Mortgage" or "QM" loans. The Ability-to-Repay/Qualified Mortgage Rule administered by CFPB ("ATR/QM Rule") requires a creditor to make a reasonable, good faith determination of a consumer's ability to repay a residential mortgage loan according to its terms. Residential mortgage loans that meet the criteria for QM status obtain certain protections from liability under Truth in Lending Act/Regulation Z labelled as "safe harbor" and "rebuttable presumption."

The CFPB issued final rules amending the General Qualified Mortgage loan definition in Regulation Z and, by separate rule, creating a new "Seasoned QM" loan category in Regulation Z. Both rules take effect sixty days from the date they are published in the Federal Register and have a mandatory compliance date of July 1, 2021. The CFPB is applying the mandatory compliance date to the date on which a creditor receives a consumer's QM loan application. Starting on the effective date and until July 1, 2021, compliance with the General QM Final Rule is optional.

New Eligibility Requirements for General QM Loan Category

The General QM Final Rule redefines what a covered Qualified Mortgage transaction is. It replaces the 43 percent Debt-To-Income (DTI) ratio limit with a price-based limit, and removes the Appendix Q national underwriting standards as well as any requirement to use Appendix Q for General QM loans. Under the new definition, a General QM Loan meets all of the following criteria.

(1) The loan must be fixed rate, fully amortizing and provides for regular periodic and substantially equal monthly payments or, in the case of adjustable-rate or step-rate mortgages:
   - (i) the loan is **fully amortized**,
   - (ii) the loan does not allow for **deferment** of principal loan amount repayment (with limited exception for temporary payment accommodation in connection with a disaster or pandemic-related national emergency), and
   - (iii) the loan does not have a **balloon payment** unless it meets the balloon payment QM requirements of 12 CFR 1026.43(f).

(2) The **maximum loan term** is 30 years.

(3) "Total Points and Fees" do not exceed the QM limits set forth in 12 CFR 1026.43(3)(i) (for loans over $100,000 adjusted for inflation, the limit is 3 percent of total loan amount).

(4) Replacing the former 43% DTI cap, the eligible loan must now adhere to a new ***Price-Based Limit*** whereby the Annual Percentage Rate (APR) does not exceed the Average Prime Offer Rate (APOR) for a comparable transaction by a certain percentage points threshold. That threshold is 2.25 percentage points for loan amounts equal to or greater than $110,260 (adjusted annually for inflation). For lower loan amounts, the threshold percentage increases incrementally up to 6.5 percentage points.

The threshold for *subordinate-lien covered loans* is 3.5 percentage points if the loan amount is at or above $66,156, and increases to 6.5 percentage points if the loan amount falls below $66,156.

If the loan is secured by *manufactured housing that meets HUD code standards* and the loan amount is at or above $110,260, the threshold is 2.25 percentage points. That threshold increases to 6.5 percentage points if the loan amount falls below $110,260. If the manufactured housing does not meet HUD code standards, the loan is not eligible for QM treatment.

If the loan's interest rate may or will change in the first 5 years, creditors are instructed to calculate APR for purposes of measuring this threshold by applying the highest potential or scheduled interest rate during the initial 5 years and assume that rate will apply for the full loan term.

(5) Replacing the former Appendix Q underwriting standards, the creditor must instead meet Regulation Z **"consider and verify"** loan underwriting requirements. This means the creditor must <u>consider</u> the consumer's current or reasonably expected income or assets other than the value of the subject dwelling, debt obligations, alimony, child support, and monthly debt-to-income ratio or residual income in order to assess the consumer's ability to repay the mortgage loan, and <u>verify</u> this information using <u>third-party records</u> that provide <u>reasonably reliable evidence</u> to support accuracy.

(6) The underwriting takes into account the monthly payment for mortgage-related obligations, using <u>both</u> the maximum interest rate that may apply during the first five years, and the periodic loan payments of principal and interest that will repay the loan amount over the scheduled loan term or, for adjustable rate loans, the outstanding principal balance over the remaining term of the loan as of the date the interest rate adjusts to the maximum interest rate, assuming the consumer will have made all required payments as due prior to that date.

Agency Loans Remain As Covered Transactions

Loans that qualify for federally insured or guaranteed FHA, VA and USDA/RHS mortgage loan programs will remain as covered transactions under the General QM Final Rule.

Sunsetting of the Temporary QM Patch (GSE Loans)

In 2013, the CFPB created a temporary Qualified Mortgage category for residential mortgage loans eligible for purchase by Fannie Mae or Freddie Mac while they operate under conservatorship or receivership of the Federal Housing Finance Agency (FHFA). This temporary QM category was scheduled to expire no later than January 10, 2021 under the ATR/QM Rule. On October 20, 2020, the CFPB extended this expiration date to align with whatever mandatory compliance date would be established in the impending Final General QM Rule. The December 2020 Final General QM Rule gets more specific on the new expiration date. The Temporary QM Patch category will be available only for covered transactions for which the creditor <u>receives</u> the consumer's application for a Fannie Mae or Freddie Mac eligible mortgage loan <u>prior to July 1, 2021, or sooner if the GSEs exit conservatorship of FHFA at an earlier date</u>.

QM Safe Harbor and Rebuttable Presumption Thresholds Remain

The Final General QM Rule does not change the percentage thresholds for "Safe Harbor" vs "Rebuttable Presumption" treatment. To be eligible for "Safe Harbor" liability protection (a conclusive presumption of meeting Regulation Z's Ability To Repay loan underwriting standard), the APR on a first lien QM loan cannot exceed the APOR for a comparable transaction by more than 1.5 percentage points. For subordinate lien QM loans, the APR cannot exceed the APOR by more than 3.5 percentage points.

The New "Seasoned QM" Loan Category Requirements

To qualify as a Seasoned QM, a mortgage loan must meet loan eligibility requirements that are similar to General QM with slight variation <u>plus</u> the loan must be held in the lender's portfolio for three years (a 36-month seasoning period), and meet certain performance requirements and portfolio requirements.

<u>"Seasoned QM" Produce Features and Underwriting Requirements</u>

The loan must be in compliance with certain restrictions on product features and points and fees and meet certain underwriting requirements, including that:

- It is a first lien fixed rate loan with substantially equal periodic payments (with certain limited allowance for temporary payment accommodation in connection with a disaster or pandemic-related national emergency).
- It is fully amortizing.
- It does not have a balloon payment unless it meets the balloon payment QM requirements of 12 CFR 1026.43(f).
- The loan term does not exceed 30 years.
- Points and fees do not exceed the QM points and limits set forth in 12 CFR 1026.43(3)(i) (for loans over $100,000 adjusted for inflation, the limit is 3 percent of total loan amount).
- It is not a high-cost loan as defined in 12 CFR 1026.32(a).
- The underwriting takes into account the monthly payment for mortgage-related obligations, using:
    - The maximum interest rate that may apply during the first five years;

- Periodic payments of principal and interest that will repay either:
  - The outstanding principal balance over the remaining term of the loan as of the date the interest rate adjusts to the maximum interest rate, assuming the consumer will have made all required payments as due prior to that date; or
  - The loan amount over the loan term;

- At or before consummation, the creditor:
  - Considers the consumer's current or reasonably expected income or assets other than the value of the dwelling that secures the loan, debt obligations, alimony, child support, and monthly debt-to-income ratio or residual income.
  - Uses reasonably reliable third party records to verify the consumer's:
    - Current or reasonably expected income or assets other than the value of the dwelling that secures the loan using reasonably reliable evidence from third-party records; and
    - Current debt obligations, alimony, and child support using reasonably reliable third-party records.

<u>"Seasoned QM" Performance Requirements</u>

The loan must have no more than two 30-day delinquencies and no delinquencies of 60 or more days during the three-year seasoning period. However, there are exceptions. If a loan is 30 days or more delinquent at the end of the seasoning period, the seasoning period is not considered ended until the delinquency is cured. In addition, if a loan is delinquent at the end of the seasoning period due to a disaster or pandemic-related national emergency, the loan may still be a Seasoned QM if certain conditions are met, the consumer receives a temporary payment accommodation, the payment accommodation requirements are fulfilled and the accommodation period has ended. The time of the accommodation period will not be counted toward the three year seasoning period.

A creditor can generally accept deficient payments within a payment tolerance of $50 on up to three occasions during the seasoning period.

<u>"Seasoned QM" Portfolio Requirements</u>

To be a Seasoned QM, the covered transaction must not be subject, at consummation, to a commitment to be acquired by another person. In addition, legal title to the loan cannot be transferred to another person before the end of the 3-year seasoning period. There are exceptions to both rules that will allow limited opportunity for loan sale, assignment or transfer prior to the end of the seasoning period, as follows.

The transaction may be transferred pursuant to a capital restoration plan or other prompt corrective action under 12 U.S.C. 1831o, actions or instructions of any person acting as conservator, receiver, or bankruptcy trustee, an order of a State or Federal government agency with jurisdiction to examine the creditor pursuant to State or Federal law, or an agreement between the creditor and such an agency.

The transaction may also be transferred pursuant to a merger of the creditor with another person or acquisition of the creditor by another person or of another person by the creditor.

Finally, the transaction may be transferred once before the end of the seasoning period, provided that the covered transaction is not securitized as part of the transfer or at any other time before the end of the seasoning period.

Buchalter's Mortgage Banking Practice Group is available to help lenders understand and address the full range of mortgage banking related issues. Feel free to contact any of the Buchalter Mortgage Banking Industry Group.

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