Section 1026.43

Ability-to-Repay (ATR) §1026.43(c)(1) and Qualified Mortgage (QM) §1026.43(e), (f)

This section applies to any consumer credit transaction that is secured by a dwelling, as defined in § 1026.2(a)(19), including any real property attached to a dwelling.

Therefore, any loan that is not primarily for a consumer purpose (such as primarily for a business, commercial, or agricultural purpose) is not covered by this requirement, even if secured by a dwelling. A loan for investment property must be analyzed to determine if it is primarily for consumer or commercial purpose, in accordance with 1026.3 and associated commentary.

Similarly, this section does not apply to any modification / change to an existing loan that is not treated as a refinancing under 1026.20(a).

Lastly, any loan not secured by a dwelling (such as vacant land) is also not subject to this requirement.

Per 1026.2(a)(19) "***Dwelling***" means a residential structure that contains one to four units, whether or not that structure is attached to real property. The term includes an individual condominium unit, cooperative unit, mobile home, and trailer, if it is used as a residence. Therefore, Section 43 covers:

Purchase and Refinance transactions on first and second liens for:

- Principal residence;
- Secondary residence; **or**
- Vacation residence

Exemption Types for all of Section 43:

- Mortgage transactions secured by a Timeshare; or
- Home Equity Line of Credit subject to §1026.40 (open-end). Important note:
    - Only HELOCs secured by the *consumer's (borrower's)* dwelling (as defined above) are exempt. If the HELOC is secured by a dwelling pledged by a non-borrowing grantor, then it is a covered transaction subject to Section 43 requirements.
    - 1026.43 warns creditors not to structure a consumer's dwelling loan as a HELOC to evade Ability To Repay underwriting requirements. If a creditor documents a loan as open-end credit but the features and terms, or other circumstances, demonstrate that the loan does not meet the definition of open-end credit, the loan is subject to all rules for closed-end credit, including Section 43.

Exemption Types for ATR and QM classifications *:

- Reverse mortgages subject to § 1026.33
- Temporary or "bridge" loans with a term of 12 months or less;
- A construction phase of 12 months or less on a construction-to-permanent loan (longer than 12 months <u>is not</u> exempt);or
- Loans made in connection with a program by HFA, DFIs, DA, or other specific Non-profits.

* Note: This exemption does NOT include prepayment penalty provisions. These loans are strictly limited in their ability to charge a prepayment penalty per 1026.43(g)

<u>The Qualified Mortgage (QM)</u>

Qualified Mortgages are broken down into four main classifications:

1. **QM General (available to creditors of all sizes)**: §1026.43(e)(2)

- Meets all QM requirements and Underwritten as per specific guidelines in Appendix Q, with use of 8 ATR determining factors.
    - Must qualify based on a fully amortizing schedule using the max rate permitted during the first 5 years after the 1st regular payment due date (this is more stringent than plain ATR requirements which do not require the payment be computed at the max rate in 5 years, unless it is a balloon).
- Contains no "toxic" loan features such as balloon payments, terms in

excess of 30 years, interest only payments, or negative amortization;

- Must pass Points and Fees test (as set forth in §1026.32(b)(1)); and
- Maximum debt-to-income ratio of ≤43%.

2. **QM Agency/GSE Eligible**: §1026.43(e)(4) **(Sunsets for transactions consummated on or before January 10, 2021)**
   - Meets government-sponsored enterprise (GSE), government guaranteed or insured underwriting and salability requirements. Examples: Fannie Mae (FNMA), Freddie Mac (FHLMC), FHA, VA and USDA;
   - The loan must receive the approval from the GSE automated underwriting service (Ex: DU or LP), and meet conditions provided therein, but <u>is not required to be sold</u> to the GSE in order to receive this classification;
   - Contains no "toxic" loan features such as balloon payments, terms in excess of 30 years, interest only payments, or negative amortization;
   - Must pass Points and Fees test (as set forth in §1026.32(b)(1));
   - Not limited to Appendix Q underwriting guidelines; and
   - These classifications will sunset on the earlier event of either January 10, 2021 or the GSE's creation of their own QM guidelines.

3. **QM Balloon:** §1026.43(f)
   - Classification provided for creditors who pass the "Rural and Underserved" test set forth by the CFPB.
     - ➢ Creditor has extended a single covered transaction in a "Rural or Underserved" area during the previous calendar year; or, during either of the two preceding calendar years, if the application is received prior to April 1st;
     - ➢ Creditor and affiliates have fewer than 2000 first lien covered transactions during the previous calendar year, not including those held in portfolio by creditor or affiliate; and
     - ➢ Together with its affiliates, has less than $2.06 billion (2017) in assets during the previous calendar year (adjusted annually per CPI).
     - ➢ Grace period through April 1st of following year to comply.
   - Meets certain QM requirements including:
     - ➢ Payments do not result in an increase of the principal balance;
     - ➢ Term does not exceed 30 years;
     - ➢ Points and Fees limitation

- No toxic features, except balloon
    - ATR 8 determining factors
- Exempt from Appendix Q underwriting, 43% DTI cap, and Balloon exclusion.
- HPCT threshold increased to 3.5% to allow these loans to maintain safe harbor status.
- Required to be held in portfolio for at least 3 years, and cannot be subject to a forward commitment or loses QM status; with exception of transfer to qualified "Small Creditor"
- Permanent exception to Section 32 balloon restriction (1026.32(d)(ii)(c)
- Balloon loans under this classification are restricted by;
    - Calculating payments based on a maximum 30 year amortization
    - Interest rate cannot increase over the term (fixed rate); and
    - Minimum loan term of 5 or more years.

4. **QM Small Creditor:** §1026.43(e)(5)

- Classification to allow small creditors to continue to operate with specific beneficial exemptions.
    - Creditor and affiliates have fewer than 2000 first lien covered transactions during the previous calendar year, not including those held in portfolio by creditor or affiliate; and
    - Together with its affiliates, has less than $2.06 billion (2017) in assets during the previous calendar year (adjusted annually per CPI).
    - Grace period through April 1st of following year to comply.
- HPCT threshold increased to 3.5%, allowing them to maintain safe harbor
- Exempt from Appendix Q underwriting and 43% DTI cap.
- No restriction on geographic location
- Must pass Points and Fees test (as set forth in §1026.32(b)(1))
- No negative amortization, interest only, or balloon features.
- Required to be held in portfolio for at least 3 years, and cannot be subject to a forward commitment or loses QM status; with exception of transfer to another designated "Small Creditor".
- Must establish reasonable ability-to-repay.
    - Must qualify based on a fully amortizing schedule using the max rate permitted during the first 5 years after the 1st regular payment due date (this is more stringent than plain ATR requirements which do not require the payment be computed at the max rate in 5 years).

Yet To Come: S. 2155 Exemption

- The Economic Growth, Regulatory Relief, and Consumer Protection Act, signed into law May 24, 2018 creates additional QM relief for creditors with assets under $10billion.
- Loans originated and held in portfolio will be deemed to be QMs:
  - Without following Appendix Q
  - Balloon notes will qualify
  - Creditor will still need to consider and verify debt, income, and financial resources
  - Documentation requirements and product limitations will apply
    - Prepayment restrictions
    - Points & Fees rules apply
    - No negative amortization or interest-only
  - QM status lost if loan is transferred, assigned, or sold, except in limited circumstances (such as creditor bankruptcy, merger, or sale to a similar institution or wholly owned subsidiary)
  - Requires regulatory action from the CFPB to fully implement, despite self-executing wording in statute.

Overall QM requirements:

No Toxic Features:

- Balloon (except as indicated above in QM #3); or
- Interest-only; or
- Negative Amortization; or
- Term exceeding 30 years

Prepayment Penalties:

- Permitted only on *Non-HPCT QM;
- Fixed or Step Rate only;
- Cannot exceed 3 years following consummation; and
- Must not exceed 2% if incurred during the first 2 years; and 1% if incurred during the third year.

Points and Fees

A covered transaction is not a Qualified Mortgage unless the transaction's total points and fees, as defined in § 1026.32(b)(1), do not exceed: (all amounts to be indexed annually for inflation) (2018)

A. For a loan amount greater than or equal to $105,158: 3% of the total loan amount;

B. For a loan amount greater than or equal to $63,095 but less than $105,158: $3,155;

C. For a loan amount greater than or equal to $21,032 but less than $63,095: 5% of the total loan amount;

D. For a loan amount greater than or equal to $13,145 but less than $21,032: $1,052;

E. For a loan amount less than $13,145: 8% of the total loan amount.

Points and Fees include(§ 1026.32(b)(1)):

- All items required to be disclosed in "finance charges" §1026.4(a-b):
  - Except for interest or time-price differential; and
  - Any amount in excess of FHA UFMIP, for Federal or State agency guaranty or mortgage insurance; Non-Agency MI payable after consummation; or for Non-Agency MI payable at or prior to closing, unless refundable on a pro- rata basis;
- Less excludable discount points; **(See Bona Fide Discount section)
- All compensation or fees paid directly or indirectly to creditor, loan originator or its affiliates known at consummation;
- All items listed as real-estate related fees, unless reasonable, and creditor or affiliate receives no direct or indirect compensation for charge;
- Premiums for any credit insurance payable at or before consummation;
- Maximum Prepayment Penalty that may be collected if allowable;
- Total Prepayment penalty incurred if the borrower refinances with creditor or its affiliate; and
- Any compensation paid by creditor to a mortgage broker.

****Bona Fide Discount Points:** An amount equal to each 1 point charged that reduces the interest rate over the term of the loan, by an industry standard amount (generally
$1/8^{th}$ % (.25)).

- Up to 2 bona fide discount points can be excluded if pre-discounted rate does not exceed APOR by more than 1%.
- Up to 1 bona fide discount points can be excluded if pre-discounted rate does not exceed APOR by more than 2%.

***ATR Presumptions of Compliance for QMs**

- **QM- Non-HPCT** (Prime Loans) = **Safe Harbor** and presumption of compliance with ATR requirements. Lower risk for delay or issue upon occurrence of default.
- **QM-HPCT** (Sub Prime Loans) = **Rebuttable Presumption** of compliance with all ATR requirements. Borrower has ability to rebut the creditor's compliance with requirements for a minimum of 3 years. Creditor must prove its compliance
  with ATR by valid documentation; which, can lead to delays, fines and additional liabilities upon occurrence of default.
- **Non-QM** = No presumption of compliance with ATR requirements.

Ability-to-Repay(ATR) Underwriting Factors

General Requirements: "A creditor shall not make a loan that is a covered transaction unless the creditor makes 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." Creditors must take into account the following eight factors when determining the borrower's ATR;

1. The consumer's current or reasonably expected income or assets;
2. The consumer's current employment status;
3. The consumer's monthly payment on the covered transaction;
4. The consumer's monthly payment on any simultaneous loan that the creditor knows or has reason to know will be made;
5. The consumer's monthly payment for mortgage-related obligations;
6. The consumer's current debt obligations, alimony, and child support;
7. The consumer's monthly debt-to-income ratio or residual income; and
8. The consumer's credit history.

What is the benefit of doing an QM? While the ATR standard is required by regulation, achieving QM status is optional. A creditor gains the following benefits by going the extra mile to obtain a QM:

- Presumption of Compliance
- If the loan is a Higher Priced Mortgage Loan, relief from the more stringent appraisal requirements of 1026.35(c)