Section 1026.43

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

Effective January 10, 2014

As of 10/15/2013- By Venessa Snell

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.

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, includes:

Purchase and Refinance transactions on first and second liens for;

- Principle residence;
- Secondary residence; **or**
- Vacation residence

Exemption Types for 43:

- Home Equity Line of Credit subject to §1026.40 (open-end);
- Mortgage transactions secured by a Timeshare
- Reverse mortgages subject to § 1026.33;
- Investment properties; or
- Vacant Land;

Exemption Types for ATR:

- Temporary or "bridge" loans with a term of less than 12 months;
- A construction phase of 12 months or less on a construction-to-permanent loan (longer than 12 months is not exempt) ;
- Refinance of "Non-Standard Mortgage" to a "Standard Mortgage"; or
- HFA, DFIs, DA, and other specific Non-profits.

The Qualified Mortgage (QM)

Qualified Mortgages are broken down into five main classifications:

1. **QM General**:
   - Meets all QM requirements and Underwritten as per specific guidelines in Appendix Q, with use of 8 ATR determining factors.
   - 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 (fees identical to §1026.32); and
   - Maximum debt-to-income ratio of ≤43%.

2. **QM Agency/GSE Eligible**: **(Sunsets 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 is not required to be sold to the GSE in order to receive this classification.
   - Not limited to Appendix Q underwriting guidelines.
   - These classifications will sunset on the earlier event of either January 10, 2021 or the GSE's creation of their own QM guidelines.
     - On May 2, 2013 Fannie Mae and Freddie Mac released announcements citing that once § 43 is in effect January 10, 2014, they will require all loans to meet ATR 8 determining factors, and will not purchase loans with toxic features, or those exceeding the Points and Fees limitations. They will be updating automated underwriting programs (DU and LP) to this affect.
     - Further releases have indicated FNMA and FHLMC both will be holding to the 43% DTI requirement and will not purchase loans with a prepayment penalty.
     - Additionally, FHA has indicated that they are already in the process of creating their own QM guidelines.

3. **QM Balloon: (Rural Balloon)**
   - Classification provided for creditors who pass the "Rural and Underserved" test; which meet both county designations and criteria set forth by the CFPB.
     - Creditor must extend over 50% of its loans in predominantly "rural or underserved" areas during the previous 3 calendar years, along with affiliates have fewer than 500 first lien covered transactions, and less than $2 billion in assets during the previous calendar year.
   - Meets all QM requirements including;
     - Points and Fees,
     - No toxic features, except balloon
     - 43% DTI cap
     - ATR 8 determining factors
   - Exempt from Appendix Q underwriting, and Balloon exclusion.
   - HPML threshold to be increased to 3.5% to allow these loans to maintain safe harbor.
   - Required to be held in portfolio for at least 3 years; and cannot be subject to a forward commitment or loses QM status.
   - 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:**
   - Classification to allow smaller credit unions and community banks to continue to operate with specific beneficial exemptions.
     - Creditor and affiliates have fewer than 500 first lien covered transactions and less than $2 billion in assets during the previous calendar year and will maintain loan in portfolio for no less than 3 years.
     - HPML/HPCT threshold to be temporarily increased to 3.5% to allow these loans to maintain safe harbor.
     - Exempt from Appendix Q underwriting and 43% DTI cap.
     - Must establish reasonable ability-to-repay.

5. **QM Small Creditor Balloon:**
    - Temporary Classification to allow smaller credit unions and community banks a 2 year transition period for Balloon loans held in portfolio.
        - Creditor and affiliates have fewer than 500 first lien covered transactions and less than $2 billion in assets during the previous calendar year and will maintain loan in portfolio.
    - HPML/HPCT threshold to be temporarily increased to 3.5% to allow these loans to maintain safe harbor.
    - Exempt from Appendix Q underwriting and 43% DTI cap.
    - No negative amortization or interest only features.
    - Required to be held in portfolio for at least 3 years; and cannot be subject to a forward commitment or loses QM status.
    - 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.
- Sunsets January 10, 2016

No Toxic Features:

- Balloon (except as indicated above in QM 3 and QM 5); or
- Interest-only; or
- Negative Amortization; or
- Term exceeding 30 years

Prepayment Penalties:

- Permitted only on *Non-HPML QM;
- Fixed or Step Rate only;
- Cannot exceed 3 years following consummation;
- 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)

(A) For a loan amount greater than or equal to $100,000: 3 % of the total loan amount;

(B) For a loan amount greater than or equal to $60,000 but less than $100,000: $3,000;

(C) For a loan amount greater than or equal to $20,000 but less than $60,000:\ 5% of the total loan amount;

(D) For a loan amount greater than or equal to $12,500 but less than $20,000: $1,000;

(E) For a loan amount less than $12,500: 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;
- 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; and
- Total Prepayment penalty incurred if the borrower refinances with creditor or its affiliate.
- Any compensation paid by creditor to a mortgage broker.

****Bona Fide Discount Points:** An amount equal to each 1 point charged that reduces the rate by no less than a ¼ percentage point (.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-HPML** (Prime Loans) = **Safe Harbor** and presumption of compliance with ATR requirements. Lower risk for delay or issue upon occurrence of default.
- **QM-HPML/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.