Understanding the Qualified Mortgage (QM) Final Rule from CFPB under Dodd–Frank

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The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) created a new requirement that all residential mortgages meet an "Ability to Repay" (ATR) standard, prohibiting creditors from making a mortgage loan without determining the consumer's ability to repay, and establishing minimum requirements to make this determination. Key components include:

1. Lenders must obtain and verify information supporting the borrower's ability to make payments;
   - based on income, assets, employment status, mortgage PITI and other debt obligations, alimony, child support, debt-to-income ratio and credit history.
2. Borrowers proving a failure to meet ATR standards can win damages equal to all financing charges and fees, and such failure can be used as a defense in foreclosure proceedings. Loans that do not satisfy the standards should not be originated.
3. Dodd-Frank grants a presumption of ATR compliance for loans meeting a Qualified Mortgage (QM) standard. General characteristics:
   - Product Features: fully amortizing (no negative amortization, IO, Balloons), maximum 30-year term, points and fees capped at 3 percent for loans of $100,000 or more. *Note: Borrower Paid Single Premium MIP is included within the 3 percent limit, limiting this product.*[1]
   - Underwriting Requirements: full documentation of income, assets, debt and other obligations; underwritten on fully amortizing payment schedule at maximum note rate in first five years; DTI capped at 43 percent including PITI, debt and other obligations. *Note: the 43 percent DTI cap is waived for up to seven years for loans satisfying underwriting requirements of Fannie, Freddie, FHA, VA or Rural Housing.*
   - Limited exemptions allow balloon-payment portfolio loans under QM for small rural lenders and a waiver of the 43% DTI cap for small portfolio lenders.
4. There are two levels of legal protection for QM, based on the APR:
   - QMs with an APR within 1.5 percent of average rates ("APOR")[2] have a "safe harbor," which is a shield against ability-to-pay litigation. Note that borrowers in foreclosure proceedings can still assert that they did not have the ability to pay the mortgage by contesting that the loan was not originated to QM standards. Refer to Exhibit A.
   - QMs with APR greater than 1.5 percent above APOR have "rebuttable presumption"[3] of compliance with the ATR requirement.
   - The APR safe harbor allowance is raised to 3.5 percent above APOR for small portfolio lenders.
5. Consistent with the legislative language for ability to pay in Dodd-Frank, there is no down payment requirement (or MI requirement) in connection with QM.
6. The Qualified Residential Mortgage (QRM) rule is still pending; QRM can be no broader than QM.
7. The ATR rule has an effective date of January 10, 2014, and applies to all consumer-purpose mortgages except HELOCs, timeshares and reverse mortgages.

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[1] Upfront private MI premiums not in excess of FHA upfront premiums are excluded from points and fees, provided that the premium is automatically refundable on a pro-rata basis. Entire amount of private MI lender-paid single may be eligible for exclusion. Consult with your legal advisor.

[2] Average Prime Offer Rate (APOR) is an index published by the Federal Reserve Board.

[3] Rebuttable presumption of compliance is a weaker shield from borrower litigation. To rebut the presumption, the borrower must prove that the lender failed to make a reasonable and good faith determination of the consumer's repayment ability at the time of consummation of the mortgage.

Exhibit A – Ability to Pay – Qualified Mortgage Rule Summary

	Qualified Mortgage Rule
LTV Requirement	None
Maximum Term	30 Years
Ability To Repay Factors	Creditors must consider current or reasonably expected income, the monthly payment on the covered transaction, monthly payment on simultaneous loan, current debt obligations, alimony, child support, employment status. ARMs: monthly payment amount must use the fully indexed rate or an introductory rate, whichever is higher. Exception: If consumer is refinancing from a non-standard mortgage held by creditor to a standard mortgage, and monthly payment will be materially lower. Other conditions apply.
Loan Types Allowed	Excludes: negative amortization, interest only, pay-options, balloons.
Debt-To-Income	43% Total DTI Based on max interest rate in first five years, fully amortizing payment schedule. *(temporary exceptions for GSE, FHA, VA and Rural Housing loans)*
Points and Fees	Points and fees capped at 3% for loans of $100,000 or more, although certain bona fide discount points and third party fees are excluded (such as appraisal and inspection fees). ***Private MI borrower-paid single premium is included when calculating points and fees.*** *(Some exceptions, see footnote* 1.*)*
Safe Harbor/ Rebuttable Presumption[3]	Prime loan meeting QM definition; Rebuttable presumption for QM loans with APR more than 1.5% above APOR.[2]
Prepayment Penalties	Maximum penalty chargeable must be included in Points and Fees.

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