CFPB's Qualified Mortgage Rules

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Earlier this year, the Consumer Financial Protection Bureau (CFPB) issued a number of mortgage-related rules, including its long-awaited qualified mortgage (QM) rules in an 804-page set of complex guidelines for residential real estate lending mandated by the Dodd-Frank Act. The rules take effect in January 2014.

The QM rules are intended by the CFPB to address many of the mortgage lending practices that played a part in the housing "bubble" issues leading to the "mortgage crisis," and to create a bright-line limited "safe harbor" standard for certain residential mortgage lending activities. They will require extensive lender documentation relating to a borrower's ability to repay, which is intended to address some of the low-and-no-doc loans that abounded in the heyday of the "bubble." QM standards will bar such practices as interest-only and negative-amortization mortgage loans, as well as loans with a maturity in excess of 30 years. Bank and thrift institutions have routinely incorporated many of these and other types of credit and "ability to pay" safeguards in their processes and procedures, including analyzing for the prospective impact of increased rates on adjustable rate mortgages, so some of the QM rules may seem old hat to bank and thrift lenders.

Loans meeting the criteria set forth in the QM rules will be categorized as "qualified mortgages." The result will be that borrowers whose loans meet the QM standards will not be able to bring lawsuits against lenders or holders of RMB securities with regard to issues involving "ability to repay" claims. Community banks may in some instances be able to secure certain protections even if they fail to comply with the QM standards but instead utilize their own strict standards for residential mortgage lending activities. Applicability of this exception is somewhat unclear.

A variety of standards will apply to the mortgages in addition to the credit analysis standards, including limits on associated charges, loan terms and a maximum debt-to-income ratio of 43%.

Loans that do not meet the technical QM standards may nonetheless be subject to the QM "safe harbor" lender protections if FMNA, FHLMC, FHA or other government agencies are willing to purchase the loans.

Failure to comply with the "safe harbor" QM standards or to meet criteria established for sales to government agencies creates a "rebuttable presumption" that borrowers can use to contest a foreclosure and/or to assert that the loan was in fact, in some fashion, a "subprime" credit or involve violation of "ability to repay" standards.

The new rules also provide new restrictions on "high-cost" mortgage loans that, among other things, reduce the points and fees lenders can charge on so-called "high-cost" mortgages, bar modification fees, require mandatory borrower housing counseling, require mandatory escrow accounts, limit late fees and eliminate the practice of including closing costs in the amount loaned. Balloon payments are also barred in most instances as are pre-payment penalties, and loans may become subject to HOEPA protections if they do not meet the new standards. These restrictions on high-cost loans, coupled with the potential penalties for the complex disclosure regime that accompanies such loans and HOEPA coverage, may serve to discourage lending in this area. Like the QM rules, certain limited exemptions from the new high-cost mortgage rules may be available to lenders in rural and underserved markets.

Following on the initial rulemaking, on February 15 the CFPB released an explanation of the QM "Ability-to-Repay" rule and implementation plan which endeavors to provide further guidance regarding the impact of the QM rule, and on April 19 the agency issued a related proposed rule that amends some of the final mortgage rules issued in January. Specifically, the proposed rule amends the "Ability-to-Repay" and QM standards under the TILA (Reg Z) and the mortgage servicing rule.

As a result of the new rules, mortgage lenders will hopefully have the ability to operate with greater certainty through a better-defined set of guidelines if they desire to work within the "safe harbor" protections of the QM rules going forward. Compliance with the rules will, however, add significantly to the overall compliance burden for affected institutions.

The QM rules get mixed reviews, however. Time will tell. Some are concerned that the "safe harbor" provision rule will result in lenders being unwilling to venture outside of its provisions and do anything that does not fall directly within the QM parameters for fear of exposure. Others are concerned that the result will be counter-competitive, tighten credit, and result in increased overall costs. Still others believe that it will provide a needed boost to bank mortgage lending activities. The QM rules may also have an impact on RMBS "put-back" issues.
It remains to be seen how these standards will ultimately be applied, the impact on other pending CFPB mortgage-related initiatives, the risk/reward of compliance, the impact on mortgage lending and access to credit, and what other approaches may be taken as a result by plaintiff's lawyers and bankruptcy trustees in addressing residential mortgage lending issues and claims.

Additional CFPB mortgage-related regulations under Dodd-Frank are anticipated.