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The Ability-to-Repay Rule: Possible Effects of the Qualified Mortgage Definition on Credit Availability and Other Selected Issues

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Summary

On January 10, 2013, the Consumer Financial Protection Bureau (CFPB) released a final rule implementing the Ability-to-Repay (ATR) requirement of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). The rule is effective January 10, 2014. The ATR rule will require a lender to determine based on documented and verified information that at the time a mortgage loan is made, the borrower has the ability to repay the loan. Failure to make such a determination could result in a lender having to pay damages to a borrower who brings a lawsuit claiming that the lender did not follow the ATR rule.

The final rule provides multiple ways for a lender to comply, one of which is by originating a Qualified Mortgage (QM). To receive QM status, a loan must meet certain underwriting and product-feature requirements. For example, in most cases a QM cannot have a balloon payment (a large payment that is typically due at the end of the loan). If a loan is a QM, then the lender receives a presumption of compliance for legal purposes.

The type of presumption of compliance that a QM receives depends on the rate of the loan. If the loan is a *higher-priced* mortgage (the mortgage's rate exceeds the average rate for a prime mortgage by more than 1.5 percentage points for a purchase), then the lender receives a *rebuttable presumption* of compliance. It is presumed that the lender complied, but the borrower could win his case if, for example, the court finds that the lender should have known that the borrower did not have sufficient *residual income* after paying his mortgage and other obligations to afford his living expenses. If the QM is *not a higher-priced* mortgage, then the lender receives a *safe harbor*. So long as the mortgage meets the QM standards, the lender is considered to have complied with the ATR rule.

Some are concerned that, at least in the short term, only mortgages meeting the QM standards will be originated because of the legal protections they afford, even though there are other means of complying with the ATR rule. The definition of QM, therefore, could determine who would receive a mortgage in the future. To increase access to credit, the CFPB also included a temporary QM option for loans eligible to be purchased by Fannie Mae and Freddie Mac or to be insured by the government through the Federal Housing Administration (FHA), the Department of Veterans Affairs (VA), the U.S. Department of Agriculture (USDA), or the Rural Housing Service (RHS). According to the final rule, the temporary option would last for, at most, seven years from when the rule goes into effect in January 2014.

The CFPB's analysis of the mortgage market as of the end of 2011 concluded that, excluding the temporary option, approximately 76% of mortgages would have received safe harbor QM status. An additional 2% would have been qualified mortgages with a rebuttable presumption, and 22% would have satisfied the ATR rule through other compliance options. Including the temporary option, the CFPB estimates that more than 95% of the mortgage market as of the end of 2011 would have received QM status. Underwriting standards and access to credit are considered to have been tighter in 2011 than before the housing crisis, however.

In addition to concerns about credit availability, experts have raised other potential issues with the final rule. Some ask how the temporary QM option might affect the government's role in the housing market, while others raise concerns about the final rule's impact on rural and community banks. The ATR rule is one of several mortgage market rules released by regulators; some worry about how the rules, in aggregate, will affect the mortgage market.

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Introduction

On January 10, 2013, the Consumer Financial Protection Bureau (CFPB) released a final rule implementing the Ability-to-Repay (ATR) requirement of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act; P.L. 111-203).[1] The final rule is effective January 10, 2014, one year after it was issued.

Section 1411 of the Dodd-Frank Act states that,

> no creditor may make a residential mortgage loan unless the creditor makes a reasonable and good faith determination based on verified and documented information that, at the time the loan is consummated, the consumer has a reasonable ability to repay the loan, according to its terms, and all applicable taxes, insurance (including mortgage guarantee insurance), and assessments.

As discussed later in this report, lenders can comply with the statute in different ways, one of which is by originating "qualified mortgages," certain mortgages that meet criteria laid out in the ATR rule. A qualified mortgage (QM) provides additional legal protections for a lender that the other options do not afford. Some observers and mortgage market participants have expressed concerns that, because of the additional legal protection, some lenders will only originate mortgages that receive QM status.[2] The scope of the QM definition, therefore, could affect who can qualify for a mortgage.

This report summarizes the ATR rule and analyzes the potential effects it may have on the mortgage market. The next section provides background information on the perceived problems in the mortgage market that motivated the ATR requirement.

Background on the ATR Rule

When a potential borrower applies for a mortgage, a lender underwrites or evaluates the borrower to determine whether a loan should be extended and on what terms. The underwriting process typically involves the lender examining a borrower's income, assets, credit history, and other factors that may affect a lender's ability to recover the amount loaned.

Some studies found that underwriting criteria loosened in the mid-2000s while house prices were rising.[3] In particular, some lenders accepted loan applications with little or no documentation to support what was in the applications. Rather than relying on a borrower's verified income or assets to decide whether to extend a loan, some lenders relied on the underlying value of the house to justify offering a mortgage, a process known as collateral-dependent lending.[4] In a mortgage, the borrower pledges the house as collateral; if the borrower is unable to repay the mortgage, the lender can sell the house to recover some or all of the amount of the mortgage debt

[1] Consumer Financial Protection Bureau, 78 *Federal Register* 6407, January 30, 2013.

[2] CFPB, *Prepared remarks of Richard Cordray at a meeting of the Credit Union National Association*, February 27, 2013, at http://www.consumerfinance.gov/speeches/prepared-remarks-of-richard-cordray-at-a-meeting-of-the-credit-union-national-association/.

[3] For example, see Yuliya Demyanyk and Otto Van Hemert, *Understanding the Subprime Mortgage Crisis*, at http://www.fdic.gov/bank/analytical/cfr/2008/mar/CFR_SS_2008_DemyanykHemert.pdf.

[4] McKinley L. Blackburn and Todd Vermilyea, "The Prevalence and Impact of Misstated Incomes on Mortgage Loan Applications," July 2010, at http://www.frbsf.org/economics/conferences/1007/blackburn_vermilyea.pdf. Collateral-dependent lending was more prevalent with subprime and Alt-A loans than with prime mortgages.

outstanding. When house prices started to fall and the economy weakened in 2007, foreclosure rates increased significantly, especially for loans with little or no documentation of borrower income or assets.[5]

In response to increasing foreclosure rates, the Federal Reserve Board issued a rule in 2008 that prohibited lenders from originating a "higher-priced mortgage" without assessing the borrower's ability to repay the loan and verifying the borrower's income and assets.[6] A first-lien mortgage was deemed to be higher-priced if the annual percentage rate exceeded 1.5 percentage points above the average prime offer rate, which is an estimate of the market mortgage rate based on a survey of rates.[7] When issuing the rule, the Federal Reserve noted that the "rule's definition of 'higher-priced mortgage loans' will capture virtually all loans in the subprime market, but generally exclude loans in the prime market."[8] The Federal Reserve's 2008 ability-to-repay rule enhanced the prior approaches to consumer protection that generally emphasized disclosure to borrowers.

The ATR requirements in the Dodd-Frank Act are similar to the Federal Reserve's 2008 rule but expand the ATR requirements to a broader portion of the mortgage market, not just higher-priced mortgages. The Federal Reserve issued the proposed rule implementing the Dodd-Frank Act's ATR requirements in 2011 before the authority to issue the final rule was transferred to the CFPB. In issuing the final rule, the CFPB stated, "a primary goal of the statute was to prevent a repeat of the deterioration of lending standards that contributed to the financial crisis."[9]

The next section will explain the CFPB's January 2013 final rule.

Description of Final Rule[10]

Prior to offering a borrower a mortgage that is subject to the rule, the ATR rule will require a lender to determine, based on documented and verified information, that the borrower has the ability to repay the loan.[11] Failure to comply could result in a lender having to pay damages to a borrower who brings a lawsuit and claims that the lender did not follow the ATR rule. The final rule provides six methods for lenders to comply: (1) the General ATR Option, (2) the Standard Qualified Mortgage, (3) the Temporary Agency/GSE QM Option, (4) Balloon Mortgages in Rural or Underserved Areas, (5) the Temporary Small Creditor Balloon-Payment QM, and (6) the Small Creditor QM. The different compliance options afford lenders different levels of protection in the

[5] Michael LaCour-Little and Jing Yang, "Taking the Lie Out of Liar Loans," August 30, 2009, at http://www.fhfa.gov/webfiles/15048/website_lacour.pdf.

[6] Board of Governors of the Federal Reserve System, press release, July 14, 2008, at http://www.federalreserve.gov/newsevents/press/bcreg/20080714a.htm.

[7] The 1.5 percentage point threshold applies to first mortgages. For subordinate mortgages, the threshold is 3.5 percentage points. Board of Governors of the Federal Reserve System, press release, July 14, 2008, at http://www.federalreserve.gov/newsevents/press/bcreg/20080714a.htm.

[8] Board of Governors of the Federal Reserve System, press release, July 14, 2008, at http://www.federalreserve.gov/newsevents/press/bcreg/20080714a.htm.

[9] CFPB, "Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act," 78 *Federal Register* 6570, January 30, 2013.

[10] The CFPB issued several final rules amending certain provisions of the ATR rule. This section describes the ATR rule as of the date of this report's publication.

[11] The final rule does not apply to, among other things, "an open-end credit plan, credit secured by an interest in a timeshare plan, reverse mortgage, or temporary loan." CFPB, "Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act," 78 *Federal Register* 6415, January 30, 2013.

event that a borrower brings a lawsuit against a lender. In addition, lenders may be exempt from the ATR rule in certain instances. The compliance options and exemptions are described below.

Compliance Options

General ATR Option

Lenders can satisfy the ATR rule through the General ATR Option. The General ATR Option requires lenders to consider at least eight criteria:[12]

1. current or reasonably expected income or assets;
2. current employment status;
3. the monthly payment on the covered transaction;
4. the monthly payment on any simultaneous loan;
5. the monthly payment for mortgage-related obligations (e.g., taxes and insurance);
6. current debt obligations, alimony, and child support;
7. the monthly debt-to-income ratio or residual income; and
8. credit history.

Unlike the qualified mortgage compliance options described in the next sections, the General ATR Option does not have restrictions on mortgage product features.

Lenders, in most cases, must verify the eight criteria using reasonably reliable third-party records, such as a borrower's tax return, to verify income.[13] The requirement that lenders verify the criteria using third-party records "effectively prohibit(s) no documentation and limited documentation loans that were common in the later years of the housing bubble."[14]

If a borrower sues a lender claiming the lender did not verify the borrower's ability to repay, the "borrower will bear the burden of proof for establishing a violation."[15] Unlike the qualified mortgage option described below, mortgages that comply with the rule through the General ATR Option will not provide the lender with a "presumption of compliance" in the event an action is brought against it. Consequently, lenders could be exposed to additional legal risk if they originate non-qualified mortgages.

Standard Qualified Mortgage

Rather than complying through the General ATR Option described above, a lender could also comply by originating a "qualified mortgage." A qualified mortgage must satisfy certain *underwriting* and *product-feature* requirements. For underwriting requirements, the borrower's total debt-to-income (DTI) ratio cannot be greater than 43%.[16] In addition, the borrower's

[12] CFPB, "Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act," 78 *Federal Register* 6408, January 30, 2013.

[13] Exceptions to third-party records at CFPB, "Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act," 78 *Federal Register* 6585, January 30, 2013.

[14] CFPB, "Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act," 78 *Federal Register* 6555, January 30, 2013.

[15] Ibid., p. 6564.

[16] Ibid., p. 6409. For how the DTI ratio is calculated, see Appendix Q of the final rule. The General ATR Option also includes a monthly DTI component but does not prescribe a specific cut-off.

monthly payment must "be calculated based on the highest payment that will apply in the first five years of the loan."[17]

With regard to product-feature restrictions, a QM cannot have[18]

- negative amortization—a borrower's monthly payment does not cover the amount of accrued interest so that the amount owed increases;
- interest-only payments—the borrower's monthly payment is only sufficient to cover the interest that accrued and does not pay down any principal;
- balloon payments—payments that are "more than two times a regular periodic payment," often due at the end of the mortgage;[19]
- terms exceeding 30 years; or
- points and fees exceeding 3% of the total loan amount, though there are exceptions for smaller loan amounts.[20] The points and fees calculation includes, among other things, the compensation paid to the loan originator, some real estate-related fees paid to affiliates of the lender (for example, for property appraisals), premiums for some types of insurance (such as credit property insurance), and prepayment penalties.[21]

QM and QRM

A *Qualified Mortgage (QM)* is one way to comply with the ability-to-repay requirement. QM is sometimes confused with QRM, another component of the Dodd-Frank Act. A *Qualified Residential Mortgage (QRM)* is an exemption to Dodd-Frank's Section 941 risk retention requirements.

Dodd-Frank required certain entities to retain part of the underlying credit risk of asset-backed securities, including mortgage-backed securities (MBS). If the mortgages that compose an MBS satisfy the QRM definition, then entities are exempt from retaining the risk.

The standards for a QRM can be no broader than the standards for a QM (if a loan would meet the QRM standards then it would meet the QM standard, but the reverse would not necessarily be true). The six agencies writing the QRM rule released a proposed rule on April 29, 2011 and issued a notice revising the proposed rule on August 28, 2013. Under the new proposal, the definition for QRM would be aligned with the QM definition.

A lender that originates a QM is entitled to a "presumption of compliance" with the ATR requirement, but the type of presumption of compliance and the amount of legal protection the lender receives depends on the mortgage interest rate.

The CFPB will publish the average prime offer rate (APOR), an estimate of the market mortgage rate based on a survey of rates. A QM with an annual percentage rate (APR)[22] less than 1.5 percentage points above the APOR for a first lien or less than 3.5 percentage points above the APOR for a subordinate lien[23] qualifies for a *safe harbor*, a conclusive presumption of compliance with the ATR requirement. Mortgages that qualify for a safe harbor are referred to by

[17] CFPB, "Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act," 78 *Federal Register* 6409, January 30, 2013.

[18] Ibid.

[19] Ibid., p. 6517.

[20] Ibid., p. 6529.

[21] CFPB, "Ability-to-Repay and Qualified Mortgage Rule Small Entity Compliance Guide," pp. 32-35, at http://files.consumerfinance.gov/f/201304_cfpb_compliance-guide_atr-qm-rule.pdf.

[22] The APR is the annual cost of a loan, which includes the interest cost of the principal loan amount, insurance, and other fees expressed as a percentage.

[23] A first lien is said to be first because, in the event of foreclosure, the first lien is entitled to be repaid first and the subordinate lien is paid second from the remaining amount of the foreclosure sale.

the CFPB as *prime* mortgages.[24] Mortgages above the thresholds that otherwise meet the QM requirements are deemed to be "higher-priced covered transactions" and qualify for a *rebuttable presumption* of compliance. The CFPB refers to QMs receiving a rebuttable presumption as *subprime* loans.

Safe Harbor

A safe harbor QM has a conclusive presumption of compliance. If a borrower with a prime mortgage sues a lender, the court would need to find that the mortgage is not actually a QM because it fails to meet the necessary underwriting or product feature requirements for the borrower to win his case. "If a court finds that the loan met the QM requirements and was not higher-priced, the consumer would lose this claim."[25] Some lenders may choose to have a larger percentage of their mortgages be prime mortgages to take advantage of the safe harbor.

Rebuttable Presumption

If a borrower has a mortgage that is higher-priced, the borrower could rebut the presumption that the lender complied with the ATR rule. Similar to the safe harbor QM, a borrower could win his case if the court finds that the mortgage was not actually a QM. In addition, if the mortgage is otherwise a QM (meets the other underwriting and product feature requirements), the subprime borrower could win his case if the court finds that "the creditor did not make a reasonable and good faith determination of the consumer's repayment ability at the time of consummation."[26] The borrower could win if, for example, the mortgage payment and other recurring payments that the borrower must make and that the creditor was aware of (such as alimony or child support payments) did not leave the borrower with sufficient *residual income or assets* to meet living expenses.

The CFPB "determined that the bifurcated approach in which only higher-priced covered transactions provide the consumer with the opportunity to rebut the presumption of compliance best balances the concerns of costs, certainty, and consumer protection."[27]

Temporary Agency/GSE QM Option

The CFPB is concerned that lenders may initially only originate mortgages that meet the QM standards because "of the fragile state of the mortgage market as a result of the recent mortgage crisis."[28] The CFPB final rule, therefore, establishes a Temporary Agency/GSE QM Option for loans eligible to be purchased by Fannie Mae and Freddie Mac or to be insured by the government through the Federal Housing Administration (FHA), the Department of Veterans Affairs (VA), the U.S. Department of Agriculture (USDA), or the Rural Housing Service (RHS). In addition to being eligible to be purchased or insured by those entities, a mortgage must also satisfy product-feature requirements, such as the limitation on points and fees, to receive the temporary QM status. The Temporary Agency/GSE QM option provides lenders with the same

[24] CFPB, "Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act," 78 *Federal Register* 6408, January 30, 2013.

[25] CFPB, "Ability-to-Repay and Qualified Mortgage Rule Small Entity Compliance Guide," p. 26, at http://files.consumerfinance.gov/f/201304_cfpb_compliance-guide_atr-qm-rule.pdf.

[26] CFPB, "Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act," 78 *Federal Register* 6587, January 30, 2013.

[27] Ibid., p. 6575.

[28] Ibid., p. 6409.

bifurcated compliance protection as the Standard QM option: a prime borrower affords a lender a safe harbor and a subprime borrower affords a lender a rebuttable presumption of compliance.

The different treatment of the DTI ratio between the Standard QM Option and the Temporary Agency/GSE QM Option, some argue, could have a significant effect on credit availability. The GSEs and agencies purchase mortgages that have DTI ratios above the standard option's 43% cut-off. Mortgages ineligible for the standard option, therefore, could still receive QM status through the temporary option because of the less restrictive underwriting criteria used by the GSEs and agencies.

The Temporary Agency/GSE QM option is not permanent. The temporary option for loans eligible to be purchased by Fannie Mae and Freddie Mac will expire when Fannie Mae and Freddie Mac are removed from conservatorship (or receivership, should the entities be placed into receivership). The temporary QM option for loans insured by the government will expire on the date that each agency's own QM rule for mortgages that it insures becomes effective (if each agency decides to issue its own QM rule).[29] The temporary QM option would also expire if none of those events occurs within seven years after the CFPB's rule becomes effective (January 2021).[30]

Balloon Mortgages in Rural or Underserved Areas

The QM product-feature requirements described in the "Standard Qualified Mortgage" section state that a QM cannot have a balloon payment. The CFPB final rule, however, establishes an additional category of qualified mortgages for mortgages with balloon payments that are originated by small creditors in rural or underserved areas. The CFPB estimates that "approximately 10 percent of the U.S. population lives in areas that" the CFPB defines as rural or underserved and that 2,707 lenders "will be able to originate balloon qualified mortgages as a result of the provision."[31]

To qualify for the balloon mortgage QM, the mortgage must meet certain lender-specific and loan-specific requirements. The lender-specific criteria require a lender to[32]

- have less than or equal to $2 billion in assets;
- originate 500 or fewer mortgages in the previous year;
- make more than half of their covered transactions in counties that are rural[33] or underserved;[34] and

[29] HUD issued a final rule to define QM for FHA on December 11, 2013. For additional information, see 24 C.F.R. §§ 201, 203, 1005, and 1007.

[30] Ibid.

[31] Ibid., p. 6572.

[32] CFPB, "Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act," 78 *Federal Register* 6556, January 30, 2013.

[33] A "county is considered to be rural if it is neither in a metropolitan statistical area, nor a micropolitan statistical area adjacent to a metropolitan statistical area, as those terms are defined by the U.S. Office of Management and Budget." CFPB, "Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act," 78 *Federal Register* 6618, January 30, 2013.The CFPB's definition also relies on the USDA's Urban Influence Codes (UICs).

[34] "A county is considered to be underserved if no more than two creditors extend covered transactions secured by a first lien five or more times in that county during a calendar year." CFPB, "Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act," 78 *Federal Register* 6618, January 30, 2013. The CFPB's definition also relies on the USDA's Urban Influence Codes (UICs).

- hold the mortgage for at least three years before selling it in order for the mortgage to retain its QM status.[35]

In addition, the loan must[36]

- meet the QM requirement that a lender verify a borrower's income, assets, and debt obligations;
- have a term of between 5 years and 30 years;
- have a fixed interest rate;
- satisfy the QM requirement that the lender determine that the borrower can afford all scheduled payments besides the balloon payment given the borrower's income and assets;
- not be subject to a forward commitment (an agreement to sell the loan) at the time the loan is consummated; and
- not have negative amortization.

A balloon QM provides the lender the same protection as the general QM depending on whether the mortgage is a higher-priced loan. Higher-priced mortgages afford a rebuttable presumption and non-higher-priced mortgages provide the lender with a safe harbor. For small lenders, however, the threshold for safe harbor QM is increased to 3.5 percentage points above APOR rather than 1.5 percentage points.[37]

Balloon mortgages are used by some lenders as a means of reducing the risk to which they are exposed. In the 2011 ATR proposed rule, the Federal Reserve Board (the Board) stated,[38]

> Based on outreach, it appears that some community banks make short-term balloon loans as a means of hedging against interest rate risk, and that the community banks typically hold these loans in portfolio. The Board believes Congress enacted this [category of QM] to ensure access to credit in rural and underserved areas where consumers may be able to obtain credit only from such community banks offering these balloon-payment loans.

Balloon mortgages help lenders hedge interest rate risk by passing some of the risk on to the borrower. Interest rate risk for a lender is the risk that short-term interest rates could rise, narrowing or eliminating the spread between the short-term rate at which a lender funds the mortgage and the long-term rate that the lender earns on the mortgage. The wider the spread between the short-term and long-term rates, the more the lenders can profit. When the balloon payment on a balloon mortgage is due, the mortgage typically *resets*, adjusting to the market rate at a certain point (often five or seven years after origination), or the borrower *refinances* the mortgage at the current market rate. In both a rate reset and a refinance, some risk associated with an increase in mortgage rates is assumed by the borrower.

[35] For exceptions, see CFPB, "Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act," 78 *Federal Register* 6618, January 30, 2013.

[36] CFPB, "Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act," 78 *Federal Register* 6556, January 30, 2013.

[37] CFPB, "Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act," p. 5, at http://files.consumerfinance.gov/f/201305_cfpb_final-rule_atr-concurrent-final-rule.pdf.

[38] Board of Governors of the Federal Reserve System, at http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20110419a1.pdf.

Although balloon mortgages may help lenders hedge their risks, some view the large balloon payment as potentially harmful or abusive to borrowers because borrowers may be unable to refinance when the balloon payment is due or may face much higher payments after refinancing. For example, the CFPB notes that "unscrupulous lenders may seek to take advantage of consumers faced with the necessity of making a balloon payment by offering loans on predatory terms."[39] To address these concerns, the final rule requires lenders to keep the balloon mortgage on their books for three years (or sell it before then under limited circumstances). This requirement could help better align the incentives of borrowers and lenders—lenders would not want to originate mortgages that borrowers would be unable to repay if the lenders were holding the mortgages and would bear some of the loss if the borrower defaults.

The Temporary Small Creditor Balloon-Payment QM

The CFPB established a two-year transition period for small lenders that do not operate predominantly in rural or underserved areas. During the transition period, small lenders may offer balloon mortgages that would receive qualified mortgage status so long as the mortgages are retained in the lender's portfolio and satisfy the requirements listed in the previous section. In the transition period, the CFPB "intends to study whether the definitions of 'rural' or 'underserved' should be adjusted and to work with small creditors to transition to other types of products, such as adjustable-rate mortgages, that satisfy other qualified mortgage definitions."[40]

The Small Creditor QM

The QM underwriting requirements described in the "Standard Qualified Mortgage" section state that the borrower's DTI cannot exceed 43% in order to receive QM status. The CFPB established an additional category of QM for some mortgages in which the borrower's DTI is greater than 43% and the loans are "originated and held in portfolio for at least three years (subject to certain limited exceptions) by small creditors, even if they do not operate predominantly in rural or underserved areas."[41] As is the case with small lenders making balloon mortgages, the threshold for safe harbor QM is increased to 3.5 percentage points above APOR rather than 1.5 percentage points.[42]

Summary of Compliance Options

Table 1 summarizes the compliance options described above.

[39] CFPB, "Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act," 78 *Federal Register* 6537, January 30, 2013.

[40] CFPB, "Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act," p. 6, at http://files.consumerfinance.gov/f/201305_cfpb_final-rule_atr-concurrent-final-rule.pdf.

[41] Ibid., p. 5.

[42] Ibid.

Table 1. The Ability-to-Repay Compliance Options

	General ATR Option	Standard Qualified Mortgage	Temporary Agency/GSE QM Option	Balloon Mortgage QM in Rural and Underserved Areas	Temporary Small Creditor Balloon-Payment QM	Small Creditor QM
Loan Feature Limitations	No limitations	No negative amortization, interest-only, or balloon payments	No negative amortization, interest-only, or balloon payments	No negative amortization or interest-only payments	No negative amortization or interest-only payments	No negative amortization, interest-only, or balloon payments
Loan Term Limit	No limitations	30 years	30 years	No more than 30 years, no less than 5 years	No more than 30 years, no less than 5 years	30 years
Points & Fees Limit	No limitations	3%	3%	3%	3%	3%
Payment Underwriting	Greater of fully indexed or introductory rate	Maximum interest rate in the first 5 years	As applicable, per GSE or agency requirements	Amortization schedule no more than 30 years	Amortization schedule no more than 30 years	Max rate in first 5 years
Mortgage-Related Obligations	Consider and verify	Included in underwriting monthly payment[a] and DTI[b]	As applicable, per GSE or agency requirements	Included in underwriting monthly payment[a] and DTI[b]	Included in underwriting monthly payment[a] and DTI[b]	Included in underwriting monthly payment[a] and DTI[b]
Income or Assets	Consider and verify	Consider and verify	As applicable, per GSE or agency requirements	Consider and verify	Consider and verify	Consider and verify
Employment Status	Consider and verify	Included in underwriting DTI	As applicable, per GSE or agency requirements	No specific requirement	No specific requirement	No specific requirement
Simultaneous Loans	Consider and verify	Included in underwriting DTI	As applicable, per GSE or agency requirements	Included in underwriting DTI	Included in underwriting DTI	Included in underwriting DTI
Debt, Alimony, Child Support	Consider and verify	Consider and verify	As applicable, per GSE or agency requirements	Consider and verify	Consider and verify	Consider and verify
DTI or Residual Income	Consider and verify	DTI ≤ 43%	As applicable, per GSE or agency requirements	Consider and verify	Consider and verify	Consider and verify
Credit History	Consider and verify	Included in underwriting DTI	As applicable, per GSE or agency requirements	No specific requirement	No specific requirement	No specific requirement

Source: *CFPB, at* http://files.consumerfinance.gov/f/201308_cfpb_atr-and-qm-comparison-chart_V2_final.pdf.

a. "Included in underwriting monthly payment" means that the rule does not require the creditor to separately consider and verify this factor. However, a creditor must consider and verify this factor when underwriting the consumer's monthly payment under the rule.

b. "Included in underwriting monthly payment" means that the rule does not require the creditor to separately consider and verify these factors. However, a creditor considers and verifies these factors when determining whether the consumer's debt-to-income ratio meets the 43% debt-to-income threshold.

Exemptions

Streamlined Refinance of a Non-Standard Mortgage

A lender is exempt from the requirement to verify the borrower's repayment ability if the lender is refinancing the borrower out of a *non-standard mortgage* and into a *standard mortgage*.[43] A non-standard mortgage is a mortgage that (1) has an adjustable interest rate "with an introductory fixed interest rate for a period of one year or longer" (often referred to as a teaser rate); (2) is an interest-only mortgage; or (3) is a negative amortization mortgage.[44] A standard mortgage is defined as a mortgage that, among other things, does not include a balloon payment, has limited points and fees, does not exceed 40 years, and has a fixed rate for at least the first 5 years.

To be eligible for the exemption, the originator of the standard mortgage must be the "holder of the existing nonstandard mortgage or the servicer acting on behalf of the current holder."[45] In addition, the standard mortgage's monthly payments must be less than the payments for the non-standard mortgage. The final rule lists additional criteria that must be met.[46]

The exemption would allow for borrowers to receive a streamlined refinance from the holder of their mortgage without requiring full documentation. Although "low or no doc" loans have proven to be more risky, in this case the holder of the mortgage already bears the credit risk—the risk of the borrower defaulting. Refinancing into a new mortgage with a lower monthly payment could potentially reduce the borrower's likelihood of default and therefore lower the risk faced by the mortgage holder.

Certain Creditors and Lending Programs

The CFPB exempted certain creditors and lending programs from having to comply with the ATR rule. Generally, the exempted creditors have received certifications or designations to be a part of government programs that assist low-income and underserved communities, while the exempted programs have a similar mission. Among the exempted lenders and programs are:

- Community Development Financial Institutions (CDFIs), which are lenders approved by the Department of the Treasury that "provide financial products and services, such as mortgage financing for homebuyers and not-for-profit developers, underwriting and risk capital for community facilities; technical assistance; and commercial loans and investments to small, start-up, or expanding businesses";[47]

[43] CFPB, "Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act," 78 *Federal Register* 6487, January 30, 2013.

[44] Ibid., p. 6537.

[45] Ibid., p. 6586.

[46] For additional parts of the definition, see CFPB, "Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act," 78 *Federal Register* 6586, January 30, 2013.

[47] For additional information on CDFIs, see CRS Report R42770, *Community Development Financial Institutions (CDFI) Fund: Programs and Policy Issues*, by Sean Lowry.

- Community Housing Development Organizations (CDHOs), which are private, non-profit organizations certified by the Department of Housing and Urban Development (HUD) through its HOME Program to assist with the provision of affordable housing for low and moderate income consumers;[48]
- Downpayment Assistance through Secondary Financing Providers (DAPs), which are non-profit organizations approved by HUD to help borrowers finance their downpayments;
- Certain nonprofits "that extend credit no more than 200 times annually, provide credit only to low-to-moderate income consumers, and follow their own written procedures to determine that consumers have a reasonable ability to repay their loan";[49]
- Housing Finance Agencies (HFAs), which are "state-chartered authorities established to help meet the affordable housing needs of the residents of their states";[50]
- and certain programs authorized by the Emergency Economic Stabilization Act (EESA) to assist homeowners, such as the Hardest Hit Fund program.[51]

The exemptions attempt to increase the credit available for low- and moderate-income borrowers, though some argued that all creditors should be required to follow the ATR rule.[52]

Possible Cost to Lenders

The final rule states that "a consumer who brings a timely action against a creditor for a violation of TILA section 129C(a) (the ability-to-repay requirements) may be able to recover special statutory damages" if the violation is material.[53] The statute of limitations generally is three years from when the ATR rule was violated. However, if a lender attempts to foreclose on the borrower, the borrower may assert a violation of the ATR rule "as a matter of defense by recoupment or setoff" and there "is no time limit on the use of this defense."[54]

As part of its analysis, the CFPB estimated the potential magnitude of damages that a borrower could be awarded if the borrower has a non-qualified mortgage. For a borrower that wins its case during the first three years after the loan is made outside the foreclosure context, the CFPB estimates that the average borrower would be awarded approximately $29,200 while the average estimated award for a borrower suing after three years in the foreclosure context would be roughly $51,250.[55] In addition, the CFPB estimates the lenders' legal expenses to be

[48] CRS Report R40118, *An Overview of the HOME Investment Partnerships Program*, by Katie Jones.

[49] CFPB, "Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act," p. 4, at http://files.consumerfinance.gov/f/201305_cfpb_final-rule_atr-concurrent-final-rule.pdf.

[50] National Council of State Housing Agencies, at http://www.ncsha.org/about-hfas.

[51] For more on the Hardest Hit Fund, see CRS Report R40210, *Preserving Homeownership: Foreclosure Prevention Initiatives*, by Katie Jones.

[52] CFPB, "Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act," p. 110, at http://files.consumerfinance.gov/f/201305_cfpb_final-rule_atr-concurrent-final-rule.pdf.

[53] CFPB, "Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act," 78 *Federal Register* 6416, January 30, 2013.

[54] Ibid., p. 6504.

[55] Ibid., p. 6567.

approximately $25,500, excluding the borrower's award in a successful case.[56] The CFPB believes that the costs for non-qualified mortgages serve as a reasonable "upper bound for the costs of" QMs.[57] Economic theory predicts that lenders could pass some of the expected costs on to borrowers in the form of higher borrowing costs.

Prepayment Penalties

The final rule also implements the Dodd-Frank Act's prohibition on certain prepayment penalties. A prepayment penalty is assessed against a borrower for paying all or part of a mortgage's principal before it is due. The final rule only permits a prepayment penalty on "a fixed-rate mortgage that is a qualified mortgage and not a higher-priced mortgage" and only for the first three years of the loan.[58] The final rule also limits the size of the prepayment penalty that can be imposed on eligible mortgages.

Effect on Credit Availability

Some observers and mortgage market participants have expressed concerns that lenders will only originate mortgages that satisfy the safe harbor QM requirements even though there are alternative methods of complying with the ATR rule.[59] The scope of the QM definition, therefore, could restrict who can qualify for a mortgage. This is an example of the general tradeoff between consumer protection and credit availability. Attempts to ensure that the only borrowers who receive mortgages are those who can repay the mortgage may result in some borrowers being excluded who could actually have repaid their loan.

As part of its analysis of the final rule, the CFPB estimated the fraction of the mortgage market at various points in time that would satisfy the ATR rule and receive the different types of QM status. This section reviews the CFPB's results and compares them to estimates by other researchers.

CFPB Estimates

The CFPB estimated the fraction of the 1997-2003 mortgage market that would have been in compliance with the ATR rule. The CFPB looked at the 1997-2003 period because, though it "may not be perfectly representative of an 'average' market," those "years span almost a full business cycle."[60] The CFPB also analyzed the mortgage market as of 2011. Underwriting conditions change over time so analyzing different time periods may yield different results.

The CFPB analysis concluded that approximately 70% of mortgages originated between 1997 and 2003 would have received QM status even without including the temporary QM alternative for GSE and government-insured loans. Of the 70%, the CFPB determined that most would have been safe harbor QM and "perhaps one to four percent[age] points of these loans would have

[56] Ibid., p. 6568.

[57] Ibid., p. 6567.

[58] Ibid., p. 6571.

[59] CFPB, *Prepared remarks of Richard Cordray at a meeting of the Credit Union National Association*, February 27, 2013, at http://www.consumerfinance.gov/speeches/prepared-remarks-of-richard-cordray-at-a-meeting-of-the-credit-union-national-association/.

[60] CFPB, "Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act," 78 *Federal Register* 6558, January 30, 2013.

been qualified mortgages subject to the rebuttable presumption."[61] An additional 22% would have satisfied the ATR rule through the general ATR option (though not receive QM status) and the final 8% would not have complied with the final rule.

The CFPB notes that, because of data limitations, it may have overestimated the percentage of mortgages that would have received QM status because it did not have data on the mortgages' points and fees. Some of the 70%, therefore, may not have qualified because of the 3% cap on points and fees. The CFPB may also have underestimated the number receiving QM status because it did not include those mortgages that would have qualified for rural balloon qualified mortgages.

Using data from 2011, the CFPB estimated that "76 percent of mortgages would have been qualified mortgages inside the safe harbor, 2 percent of mortgages would have been qualified mortgages with a rebuttable presumption, and 22 percent of mortgages would have been subject to the ability-to-repay requirements."[62] This implies that close to 100% of the 2011 mortgage market would have been in compliance with the rule. As with the 1997-2003 period, the CFPB's estimate excludes the temporary QM option for GSE and government-insured loans. Also as before, the CFPB's estimates may be an overestimate due to the lack of data on points and fees and an underestimate due to the exclusion of the rural QM option.

The CFPB analysis found that an additional 18% of mortgages as of the end of 2011 would qualify for the temporary QM option.[63] These mortgages may not qualify for the standard QM option because their debt-to-income ratio exceeds 43% but they are still eligible to be purchased by the GSEs or insured by a government agency. Including the temporary extensions, "over 95 percent of the market [would have been] granted qualified mortgage status."[64]

According to analysis by the Congressional Budget Office (CBO), most of the newly originated mortgages in each fiscal year since 2008 would have been eligible for the Temporary Agency/GSE QM option (the sum of FHA, VA, RHS, Fannie Mae, and Freddie Mac).[65] CBO estimates that at least half of all newly originated mortgages would be eligible for the temporary option until approximately FY2019.

The CFPB expects its final rule to both reduce future foreclosure rates and have a minimal effect on access to credit. "Based on the experience of loans originated during the 1997-2003 period, the Bureau estimates that roughly four percent of qualified mortgages loans will ever be 60 days delinquent and less than one percent are expected to result in foreclosure."[66] The CFPB also concludes that "the final rule will not lead to a significant reduction in consumers' access to consumer financial products and services, namely mortgage credit."[67] If credit is restricted for some borrowers, the CFPB expects borrowers who would not have the ability to repay the loan to be those primarily affected. The CFPB also notes that the requirement that creditors use verified and documented information to assess a borrower's ability to repay "may have a disproportionate

[61] Ibid., p. 6565.

[62] Ibid.

[63] Ibid., p. 6569.

[64] Ibid.

[65] Congressional Budget Office, "Snapshot of Guarantees of New Residential Mortgages," at http://www.cbo.gov/publication/43986?utm_source=feedblitz&utm_medium=FeedBlitzEmail&utm_content=812526&utm_campaign=0.

[66] CFPB, "Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act," 78 *Federal Register* 6566, January 30, 2013.

[67] Ibid., p. 6570.

impact on access to credit for consumers with atypical financial characteristics, such as income streams that are inconsistent over time or particularly difficult to document."[68] The CFPB's analysis, however, presumes that lenders will continue to offer loans to borrowers that would not receive safe harbor QM status and that the mortgage market in the future will continue to be similar to the 2011 and 1997-2003 mortgage markets that they studied.

Alternative Estimates

CoreLogic

CoreLogic, a provider of data and analysis on the mortgage market, analyzed 2.2 million mortgages originated in 2010 to determine how many would have received QM status.[69] CoreLogic expects the final rule to have a minor short-term impact on credit availability because most new mortgages are guaranteed by the GSEs or a government agency and are eligible for the Temporary Agency/GSE QM option. However, when "the exclusion expires ... it is estimated that only 52 percent of originations will meet the eligibility requirements of the QM rule."[70]

Jumbo loans may be most affected in the short term by the QM rule. Jumbo loans, loans that are above the GSEs' conforming loan limits,[71] are ineligible to be purchased by the GSEs and, therefore, cannot qualify for the temporary QM option. CoreLogic estimates that "more than 62 percent of total jumbo originations would meet the eligibility requirements of the QM rule."[72] Jumbo loans, according to CoreLogic's estimates, make up 10% of the mortgage market.

CoreLogic's analysis faces some of the same potential limitations as the CFPB's estimates. CoreLogic also did not include the points and fees cap in its analysis and did not discuss the rural QM option.

CoreLogic may also misestimate the number of loans that may receive QM status in the future because it uses the 2010 mortgage market as the basis of its forecast. CoreLogic estimates that, of the 48% of mortgages that do not qualify for a safe harbor, 16 percentage points are due to insufficient documentation. However, CoreLogic notes that the "reason [the] low- or no-documentation share is so high is due to the high number of refinances in the current environment."[73] CoreLogic's analysis does not attempt to account for potential changes in stakeholders' behavior as borrowers and lenders attempt to ensure that they comply with the ATR rule. Some of the households that refinanced in 2010 with low or no documentation may have been able to provide full documentation but chose not to because this was not required by their lender or may have fallen under the refinancing exemption.

Amherst Securities

Amherst Securities, a broker-dealer specializing in mortgage-related investments, studied the effect that the QM definition would have on jumbo loans if the rule had been in effect in 2012.[74]

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[68] Ibid., p. 6570.

[69] Sam Khater, "The Mortgage Market Impact of Qualified Mortgage Regulation," CoreLogic, February 12, 2013.

[70] Ibid., p. 4.

[71] CRS Report RS22172, *The Conforming Loan Limit*, by N. Eric Weiss and Sean M. Hoskins.

[72] Sam Khater, "The Mortgage Market Impact of Qualified Mortgage Regulation," CoreLogic, p. 5, February 12, 2013.

[73] Ibid., p. 4.

[74] Laurie Goodman, Roger Ashworth, and Brian Landy, et al., *QM: Mortgage Market Implications*, Amherst Securities

Because jumbo loans are ineligible for the Temporary Agency/GSE QM option, they are among the types of loans that may be most affected by the final rule. Amherst used data from jumbo loan securitizations that were completed in 2012. The study found that 24% of the 4,020 loans in the dataset would not receive QM status. Approximately 10 percentage points in the sample would not have received QM status because they are above the 43% debt-to-income ratio. The remaining 14 percentage points had other characteristics that did not comply with the QM requirements, such as interest-only payments or certain prepayment penalties. Amherst argues that the 14 percentage points of loans with interest-only or prepayment penalties "could have been QM with minor adjustments."[75]

Additional Selected Issues

In addition to affecting who may receive a mortgage, the ATR rule may have other effects on the mortgage market. Some potential issues are described below.

GSEs

The ATR rule may also affect the GSEs. In its report, CoreLogic argues that the "irony of the [Temporary Agency/GSE QM option] is that it reinforces the role that the GSE's play in the market, making it harder to enact GSE reform."[76] Offering QM status to loans that meet the GSEs' underwriting standards, some argue, reinforces the dominant role that the GSEs play in the market. Others argue that the final rule may reduce some of the uncertainty that has prevented private capital from entering the mortgage market and partially displacing the GSEs. Prior to the release of the final rule, some argued that the regulatory uncertainty about what would be included in the final rule may have been one of the factors that discouraged private capital from entering the housing finance system.[77] An analysis of the final rule by Deloitte argues that the "rule may remove many of the uncertainties to the private-label securitization market and mortgage-backed securities."[78] While other factors may prevent private capital from returning, finalizing the ATR rule may reduce one potential barrier.

In response to the final rule and as part of its effort to reduce the GSEs' role in the housing finance system, the regulator and conservator of the GSEs, the Federal Housing Finance Agency (FHFA), announced that "it is directing Fannie Mae and Freddie Mac to limit their future mortgage acquisitions to loans that meet the requirements for a qualified mortgage, including those that meet the special or temporary qualified mortgage definition, and loans that are exempt from the 'ability to repay' requirements."[79] To receive Temporary Agency/GSE QM status, a mortgage must be eligible to be purchased by the GSEs or insured by the federal government and the mortgage must also satisfy certain product-feature requirements. FHFA's announcement, essentially, aligns the GSEs' standards with the standards for the Temporary Agency/GSE QM

Group LP, January 16, 2013.

[75] Ibid., p. 5.

[76] Sam Khater, "The Mortgage Market Impact of Qualified Mortgage Regulation," CoreLogic, p. 3, February 12, 2013.

[77] For example, see American Securitization Forum, "ASF Policy Proposals to Increase Private Capital in the U.S. Housing Finance System," April, 23, 2013.

[78] Deloitte, "First Look: Implications of the ability-to-repay rule and the qualified mortgage definition," p. 9, at http://www.deloitte.com/assets/Dcom-UnitedStates/Local%20Assets/Documents/FSI/US_FSI_FirstLook_012413.pdf.

[79] FHFA, "FHFA Limiting Fannie Mae and Freddie Mac Loan Purchases to "Qualified Mortgages"," press release, May 6, 2013, http://www.fhfa.gov/webfiles/25163/QMFINALrelease050613.pdf.

Option listed in **Table 1**, especially for the first three rows. The GSEs, therefore, will not purchase loans subject to the ATR rule if the mortgage is an interest-only loan, is negative amortizing, has points and fees above the caps, or has a term longer than 30 years. The GSEs will continue to purchase some mortgages that have DTI ratios above 43%.

Rural Areas

Similar to the Federal Reserve's 2011 proposed rule, the CFPB based its definition of "rural" for "Balloon Mortgages in Rural or Underserved Areas" off of the USDA's Urban Influence Codes (UICs). UICs are a way of classifying counties into 1 of 12 categories "depending on the size of the largest city and town in the county."[80] The Federal Reserve proposed a relatively restrictive definition of rural that would have included 4 of the 12 UICs and resulted in 2.3% of the U.S. population (based on the 2000 census) deemed to be in a rural area.[81] The CFPB's final rule uses a broader definition of rural that includes additional UIC categories and results in 9.7% of the population included in rural areas.[82] It is unclear for what fraction of the 9.7% of the population in rural areas a rural lender is the only source for an affordable mortgage option.

Since the release of the final rule, some have called for the CFPB to use a more expansive definition of rural. The Conference of State Bank Supervisors (CSBS), for example, suggests that the CFPB not use a "nationwide rural classification system" but a "petition process whereby interested parties can petition the CFPB to make a determination that a specified and bounded area be considered rural."[83] H.R. 2672, the CFPB Rural Designation Petition and Correction Act, would establish a process by which individuals could petition the CFPB for counties that were not designated as rural by the CFPB to receive the designation. H.R. 2672 would also establish evaluation criteria and an evaluation process for the CFPB to follow in assessing the petitions. Others would prefer the CFPB use the USDA's Rural Housing Loan program's definition of rural which does not make classification decisions at the county level but subdivides counties into rural and non-rural areas.[84] The Rural Housing Loan definition would result in 37% of the population classified as in a rural area with an average of 10 lenders per area.[85] The CFPB, however, believes "that a wholesale adoption of the Rural Housing Loan definitions would therefore expand the definition of rural beyond the intent of the ... balloon-payment qualified mortgage exemptions ... by incorporating areas in which there is robust access to credit."[86] As mentioned previously, the CFPB has stated that it intends to study the definition of rural that it has chosen and has established a two year transition period for small lenders who do not operate in rural or underserved areas.

[80] CFPB, "Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act," 78 *Federal Register* 6536, January 30, 2013.

[81] Ibid.

[82] Ibid., p. 6543.

[83] Recommendation from John Ryan, president and CEO of Conference of State Bank Supervisors, to Richard Cordray, CFPB director, March 26, 2013, at http://www.csbs.org/regulatory/policy/Documents/2013/CSBSRuralPetitionRecommendation.pdf.

[84] For example, see Robert T. Taylor, "How the Qualified Mortgage Rule Harms Rural Borrowers," *American Banker*, January 23, 2013.

[85] CFPB, "Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act," 78 *Federal Register* 6543, January 30, 2013.

[86] Ibid.

Relationship to Other Rules

The Ability-to-Repay rule is one of several mortgage market rules required by the Dodd-Frank Act that were released by the CFPB in January 2013. Other rules, such as the Risk Retention and Qualified Residential Mortgage rule[87] and the rules related to the capital treatment of mortgage-related assets held by banks under Basel III,[88] are expected to be finalized by other agencies in the near future. While some stakeholders may take issue with a particular rule, others raise concerns about the potential aggregate effect (in terms of the effect on credit availability and in the compliance burden) that the new rules will have on the mortgage market and whether regulators are factoring these costs in to their rulemakings.[89] For its part, the CFPB notes that it "is coordinating carefully the Title XIV Rulemakings" (Title XIV refers to Title XIV of the Dodd-Frank Act which required the rules).[90] It is unclear, however, to what extend other regulators will take the CFPB's rulemakings into account when issuing their rules.

Cap on Points and Fees

To receive QM status, a loan must not have points and fees above the points-and-fees caps. For loans above $100,000, the cap is 3% of the total loan amount. For loans less than $100,000, there are different caps with each cap becoming higher as the loan total decreases so that loans less than $12,500 can have points and fees up to 8%. The points and fees calculation includes, among other things, the compensation paid to the loan originator, some real estate-related fees paid to affiliates of the lender (e.g., for property appraisals), premiums for some types of insurance (such as credit property insurance), and prepayment penalties.[91]

Points and fees are one way that lenders can earn a return on their loan, with the other being through the interest rate. Capping the points and fees may incentivize lenders to earn more through the interest rate rather than through upfront payments. The CFPB states that the cap on points and fees may make lenders "take more care in originating a loan when more of the return derives from performance over time (interest payments) rather [than] from upfront payments (points and fees). As such, this provision [the cap on points and fees] may offer lenders more incentive to underwrite these loans carefully."[92] Lenders hoping to receive safe harbor status for a mortgage, however, may be limited in their ability to adjust the interest rate to account for the cap on points and fees due to the 1.5 percentage point rate threshold between safe harbor and rebuttable presumption.

[87] CRS Report R42056, *Ability to Repay, Risk-Retention Standards, and Mortgage Credit Access*, by Darryl E. Getter.

[88] CRS Report R42744, *U.S. Implementation of the Basel Capital Regulatory Framework*, by Darryl E. Getter.

[89] Elizabeth Duke, *Community Banks and Mortgage Lending*, Board of Governors of the Federal Reserve System, November 9, 2012, http://www.federalreserve.gov/newsevents/speech/duke20121109a.htm.

[90] CFPB, "Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act," 78 *Federal Register* 6419, January 30, 2013.

[91] CFPB, "Ability-to-Repay and Qualified Mortgage Rule Small Entity Compliance Guide," pp. 32-35, at http://files.consumerfinance.gov/f/201304_cfpb_compliance-guide_atr-qm-rule.pdf.

[92] CFPB, "Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act," 78 *Federal Register* 6562, January 30, 2013.

Some argue that the caps are either too low or include too many types of fees, causing some loans to not qualify for QM status that otherwise would.[93] H.R. 1077, the Consumer Mortgage Choice Act, removes some items from the calculation of points and fees. In so doing, the bill would make it easier for mortgages to satisfy the cap on points and fees and, therefore, potentially receive QM status. For example, the bill would exclude insurance paid in escrow from the definition of points and fees (escrow for future payment of taxes is already excluded). The bill would also exclude fees paid to affiliates of the lender, such as for title insurance (the fees to third parties unaffiliated with the lender are already excluded), and exclude compensation paid by a lender to its employee from the definition of points and fees.

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[93] For example, see Mortgage Bankers Association, "Congress Should Exercise Diligent Oversight on the Ability to Repay/ Qualified Mortgage Rule," at http://www.mortgagebankers.org/files/AbilitytoRepayandQMLoans.pdf.