CFPB video guidance to the 2013 Mortgage Servicing Rules

Transcript

Kelly Cochran:
Hello. My name is Kelly Cochran and I'm the Assistant Director for Regulations at the CFPB. I am going to be giving an overview of the ability to repay and Qualified Mortgage Final Rule. The Bureau issued this rule in January of 2013 to implement provisions under the Dodd-Frank Act. The rule will take effect on January 10th of 2014. This is staff guidance and not any official interpretation of the Bureau or any legal advice. Please refer to our website for copies of the rule and other summary materials.

When the rule takes effect it will replace existing regulations that already require creditors to consider a consumer's ability to repay a mortgage loan where those loans are higher-priced mortgage loans. Under the new Dodd-Frank Act rules, the coverage of the ability to repay requirement will be much broader. It applies broadly to closed end transactions secured by a dwelling. There are certain exclusions from the rules for home equity lines of credit, timeshares, reverse mortgages, temporary or bridge loans and construction phases of a construction to permanent loan. But the rule is not limited to loans that are secured by a principal dwelling or to first lien loans so the coverage is much broader than the existing regulations, which only cover higher-priced mortgage loans. The core of the ability to repay requirement is that creditors make a reasonable good faith determination at or before consummation that the consumer will be able to repay the loan. We will talk more about the specific provisions in the rule to implement this requirement.

The second major element of the regulation concerns what are called qualified mortgages. The Dodd-Frank Act provides that qualified mortgages will receive a presumption of compliance with the ability to repay requirements, basically, where a creditor is willing to meet certain restrictions in order to have the loan become a qualified mortgage. In return, their risk of liability for failing to satisfy the ability to repay requirements is reduced. Under the regulations, there is a safe harbor for loans below the higher-priced mortgage loan threshold. For loans above that threshold, there is a rebuttable presumption in which consumers can challenge compliance, but only on certain grounds. We will discuss this in more depth later in the presentation.

The regulation also establishes the requirements for certain qualified mortgages. Under the Dodd-Frank Act, qualified mortgages receive a presumption of compliance with the ability to repay requirements. Basically, where creditors are willing to meet the requirements for a qualified mortgage, their risk of challenge for failing to satisfy the ability to repay rules is reduced. Specifically, qualified mortgages must meet certain restrictions on loan features, a cap on points and fees, and certain underwriting requirements. In return, loans that are below the threshold for higher-priced mortgage loans will be subject to a safe harbor under the ability to repay rules. Loans above the threshold for higher-priced mortgage loans are subject to a rebuttable presumption. That means that the consumer can challenge whether the creditor did in fact satisfy the ability to repay requirement, but only on certain specified grounds under the rules. We will talk further about all of these requirements later in the presentation.

As I mentioned, the creditor must make a reasonable and good faith determination that the consumer will have a reasonable ability to repay the loan according to its terms. The rule sets out specific procedures that creditors must follow in verifying information, certain elements that must be considered and rules for calculating the mortgage payment from the loan for the purpose of determining a consumer's ability to repay. At the same time, the rule is intended to permit flexibility in underwriting for creditors. It does not intend to replace reasonable underwriting with specific universal underwriting policies and procedures. So the reasonable and good faith determination is the overall requirement.

Let's start with the first element, to consider and verify certain consumer specific information. The rule sets forth eight categories of consumer information that must be considered. These are things like income or assets, the mortgage payment on the loan that is being originated, current debt obligations, alimony, child support, and other factors. The rule requires that these factors be considered as part of the underwriting process and also that the information that the consumer provides about the factors be verified using reasonably reliable third-party records. The rule set forth a number of different examples of the kinds of reasonably reliable third-party records that can be used to verify different types of information such as income.

The second major requirement in the rule is rules regarding the calculation of the monthly mortgage payment for the purposes of assessing the consumer's ability to repay. Generally, creditors must use the greater or the fully indexed or introductory rate. And must assume monthly substantially equal payments that amortize the loan amount over the loan term. There are special rules for loans with negative amortization, interest only, or balloon payments. It is worth noting that under the ability to repay requirements, there are no specific limitations on loan features or points and fees. So as long as the loan is originated using the procedures specified in the rule and the creditor makes a determination that the consumer has the ability to repay the loan, it is permissible for an ability to repay a loan to have features such as interest only or negative amortization periods and there is no specific limit on the points and fees so long as the creditor makes the overall determination that the consumer can pay the loan. When we turn to the qualified mortgage side, you will see that there are specific requirements with regard to features and points and fees for those mortgages.

Turning to the qualified mortgage part of the rule, the regulation sets out three different types of qualified mortgages. I will talk through the requirements for each of those types and then talk overall about the broader distinction across all types of qualified mortgages between those that receive a safe harbor and those that receive a rebuttable presumption.

The general definition for qualified mortgage, the broadest category of qualified mortgage, has three main components. First, there are certain limits on the loan feature. Second, there is a cap on points and fees. And third, there are certain underwriting requirements with regard to this category of qualified mortgage.

Turning first to the limits on loan features, under Dodd-Frank this category of qualified mortgage cannot have negative amortization or interest only periods. Also, balloon payments are not permitted for the general definition of qualified mortgage. There is a separate category that applies to certain small creditors that operate predominantly in rural or underserved areas. And we will talk about that category of qualified mortgage a little later. Finally, the loan term may not exceed 30 years.

The second element of the requirements for the general qualified mortgage definition is the points and fees cap. Generally, these loans cannot have points and fees above 3% of the total loan amount. However, there are higher caps for loans that are under $100,000. Those caps go up to as much as 8% under certain circumstances. The Dodd-Frank Act also sets out a specific definition of points and fees for purposes of the qualified mortgage cap. For this purpose, it includes origination and other charges that are paid to the creditor or to an affiliate. It also includes compensation paid to loan originators and the definition of loan originator includes both brokers and individual loan officer employees that are employed either by a broker or by a retail creditor. Certain upfront private mortgage insurance premiums are also included in the definition of points and fees. At the same time, there are also some exclusions from the definition of points and fees. So up to two additional bona fide discount points are allowed, depending on the rate of the loan. Bona fide charges paid to third parties and certain mortgage insurance and guarantee fees for government programs are also excluded from the points and fees cap.

The third category of requirements for the qualified mortgage concern underwriting requirements. For the general definition, it's required that the creditor use the maximum rate in the first five years after the first payment to calculate the mortgage payment for purposes of determining if the consumer can pay the loan. It's also required to have full amortization. Secondly, creditors are required to consider and verify income or assets and current debt obligations, alimony, and child support. Finally, the rule requires that the consumer’s monthly debt to income ratio not exceed 43%. Appendix Q. of the rule defines debt and income for this purpose. It is based on FHA guidelines so it will be familiar to many creditors.

In addition to the general requirements for qualified mortgage that I just described, there is a second category of qualified mortgages. This is a temporary category that will go away over time. I will first explain what the requirements are for this category and then talk about how it will expire. Compared to the general definition we just went over, the limits on loan features and the points and fees cap are the same for the temporary alternative qualified mortgage. The difference concerns the underwriting requirements. In lieu of the underwriting requirements that we just discussed, this temporary category of qualified mortgage must be eligible for purchase, guarantee, or insurance either by the government-sponsored entities, Fannie Mae and Freddie Mac, or by HUD, the Department of Veterans Affairs, the Department of Agriculture, or the Rural Housing Service. So in lieu of the 43% DTI cap, and the other underwriting requirements, the simple requirement is that they be eligible for purchase guarantee or insurance by these entities. It is not required that they actually be purchased or guaranteed or insured by these entities.

As I mentioned, this category of qualified mortgage will expire over time so that new loans will not be eligible under this definition. First, the federal agencies that I just mentioned have their own rule writing authority under the Dodd-Frank Act to define which of their loans are qualified mortgages for themselves so this temporary provision will apply only until they issue their own rules and those rules take effect or seven years, whichever happens first.

Secondly, with regard to the GSEs, the provision will sunset or expire once their government conservatorship ends or seven years, whichever comes first, so that after that time this definition will no longer be available. But loans that were originated under the definition before it expired will continue to maintain their qualified mortgage status going forward.

The third category of qualified mortgage concerns balloon payment qualified mortgages that I mentioned at the top. This is a very limited category of qualified mortgage. It is created by the Dodd-Frank Act. Generally, the Dodd-Frank Act prohibited qualified mortgages from containing balloon payment features. But it did make an exception for small creditors that operate predominantly in rural or underserved areas under certain conditions. The requirements for this category of qualified mortgage are similar to what we have already talked about with regard to the limits on loan features. They are the same as the general definition of qualified mortgage except for the fact that balloon feature is permitted under certain circumstances. The points and fees cap also applies, just as it does in the other categories of qualified mortgage.

With regard to the underwriting requirements for the balloon payment qualified mortgage, there are several unique provisions. First, the loan term must be at least five years in length. Secondly, the creditor must use an amortization schedule that is no longer than 30 years. The rules require that creditors consider and verify debts, income, and either a debt to income ratio or residual income but there is no flat 43% DTI requirement.

Finally, there are a series of requirements concerning the creditor and the nature of their operations. First, the creditor must make at least 50% of its first lien mortgages in rural or underserved counties. The Bureau will publish a list on an annual basis of which counties receive this designation to make it easier for creditors to determine their eligibility. Secondly, the creditor's assets must be under $2 billion. Third, including originations by affiliates, the creditor must make no more than five hundred first lien mortgages per year. And finally, the balloon payment qualified mortgages must generally be held in portfolio for at least three years although there are certain provisions in the rules who allow earlier sales if for instance, one eligible creditor was transferring a balloon payment loan to another eligible creditor or there were mergers or other unusual circumstances. Finally, there is a requirement that the balloon payment qualified mortgages must generally be held in portfolio for at least three years. Specifically the rules require that the balloon payment qualified mortgages not be subject to a forward commitment at the time they are consummated. In addition, there are limits on transferring or assigning those qualified mortgage within the first three years after consummation. However, there are exceptions to allow transfers. For instance, in a situation where one eligible creditor is selling a loan to another creditor that itself is eligible to make balloon payment qualified mortgages. There are also exceptions for merger situations and situations where there is an agreement with a prudential regulator requiring the creditor to sell off loans for instance, for safety and soundness reasons. So those are the three types of qualified mortgages permitted under the rule.

Let's return to talk a bit more about the presumption of compliance that is afforded to these qualified mortgages. As I mentioned in the beginning, the Bureau defined the presumption of compliance that applies to a qualified mortgage but the statute did not explain how strong that presumption should be. The Bureau rule calibrates the level of protection afforded the creditor based on whether the loan is higher priced. The threshold is set out on this slide. So for loans that satisfy the qualified mortgage where the APR is less than the Average Prime Offer Rate plus 1.5 percentage points for a first lien or the Average Prime Offer Rate plus 3.5 percentage points for second liens, the loan receives a safe harbor. That means that a consumer cannot later show that the creditor did not comply with the ability to repay requirements when it originated the loan. For loans that satisfy the qualified mortgage criteria but equal or exceed these price thresholds, there is a rebuttable presumption that the creditor satisfied the ability to repay requirements. That means a consumer could bring a challenge for failure to comply but the challenge would be limited because the consumer would have to show that they were left with insufficient residual income to cover basic living expenses.

Before we turn to the last slide, I wanted to mention two other elements of the ability to repay rules. First, the rule set forth special provisions to cover situations in which a creditor is refinancing what is called a nonstandard mortgage under the rule into a standard mortgage. These provisions create an exception from the basic ability to repay requirements to facilitate the refinancing process. Under this, a nonstandard loan or a nonstandard mortgage is defined as an adjustable rate mortgage with an introductory fixed interest rate for a period of at least one year, an interest only loan, or a negative amortization loan. Standard mortgages are ones that do not have negative amortization, interest only payments or balloon payments. They are also certain limits on loan terms, and points and fees. The interest rate must be fixed for their first five years and there are limits of the loan on the use of loan proceeds. Finally, the monthly payment must be materially lower than the current payment, generally that would be 10% or more.

The other element of the ability to repay rules that I wanted to mention was prepayment penalty restrictions. The Dodd-Frank Act strictly limits the use of prepayment penalties on mortgages. Once the rules take effect, prepayment penalties will not be permitted except for certain qualified mortgages. The mortgages must either be fixed or step rate and not higher-priced mortgage loans. There are certain caps on the prepayment penalties that are permitted even for those loans and the creditor must offer an alternative loan with no prepayment penalty to the borrower.

I briefly wanted to describe the proposal that the Bureau issued in January to revise and supplement certain parts of the final rule. The comment period on this proposal closed February 25th and we are now in the process of going through the comments and hope it to issue a further final rule as quickly as possible. We want to issue it well before the implementation date so that people have sufficient time to adjust their planning for implementation accordingly.

The proposal had three main elements. The first is to exempt certain types of lending programs from the general ability to repay requirements. These include community development lending programs such as Community Development Financial Institutions and certain nonprofits and also government stabilization and refinancing programs. The second element of the proposal concerns possible fourth category of qualified mortgage. This category is somewhat similar to the balloon payment qualified mortgage in that it is focused on small creditors who hold their loans in portfolio. But it does not cover balloon payment loans and it is not restricted to creditors who operate predominantly in rural or underserved areas. Specifically this new fourth category of qualified mortgage would have the same limits on loan features as the general permanent definition of qualified mortgage. So this would not permit negative amortization, interest only periods or balloon payments. It would also be subject to the same points and fees cap that applies to the other categories of qualified mortgage. But similar to the balloon payment qualified mortgage, it would have more flexible underwriting standards. The payment calculations would have to be calculated using the maximum interest rate in the first five years of the loan. The creditor would have to consider and verify debts, income and either debt to income ratio or residual income. But there would be no specific 43% debt to income ratio required. Finally, there would be certain requirements based on the nature of the creditor. Specifically, the creditor would have to the assets of less than $2 billion with its affiliates. It would have to originate 500 or fewer first lien mortgages per year. And it would generally have to hold the qualified mortgages in portfolio for at least three years subject to the same exceptions I discussed earlier for the balloon payment qualified mortgage. However, there is no requirement that the creditor operate in any particular counties to be eligible for the proposed category of qualified mortgage.

The final set of issues addressed in the proposal concern the calculation of points and fees for purposes of the qualified mortgage definition. Specifically we were seeking comment on the treatment of the loan originator compensation. As you may remember, loan originator compensation is counted towards the points and fees cap but there are number of technical issues that arise in calculating that. In particular, we were seeking comment on situations where payments are passed from one party to another. For instance, from a consumer to a creditor and from the creditor to a broker, or to its own loan employees, and how those various payments should be calculated.

We also sought comment on definitions and whether any further guidance or harmonization would be required with other rules that the Bureau is issuing in January concerning loan originator compensation. We hope to tie this off as quickly as possible. We know that people are very concerned and want to understand how the further final rule will affect their implementation process.

That is the conclusion of our presentation on ability to repay. Thank you.