Consumer Financial Protection Bureau
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Factsheet: Prepaid Interest and the General Qualified Mortgage APR Special Rule for Adjustable Rate Mortgages

Creditors that wish to make qualified mortgages (QMs) under the price-based General QM definition must calculate the annual percentage rate (APR) for loans to determine whether they satisfy the price-based General QM definition. The priced-based General QM definition contains a special rule for calculating the APR for loans where the interest rate may or will change within the first five years after the date on which the first regular periodic payment will be due. These loans are sometimes referred to as "short-reset" adjustable-rate mortgages (ARMs) and step-rate loans. This factsheet describes the interest rate that is used for calculating prepaid interest for purposes of this special APR calculation rule.

Background

With certain exceptions, the Ability-To-Repay/Qualified Mortgage Rule (ATR/QM Rule or Rule) requires creditors to make a reasonable, good faith determination of a consumer's ability to repay

This is a Compliance Aid issued by the Consumer Financial Protection Bureau. The Bureau published a Policy Statement on Compliance Aids, available here, that explains the Bureau's approach to Compliance Aids.

a residential mortgage loan. 12 CFR 1026.43(c). The ATR/QM Rule also provides a presumption that a creditor has complied with the ability-to-repay (ATR) requirement if the creditor originates a qualified mortgage (QM). 12 CFR 1026.43(e)(1). The ATR/QM Rule establishes different categories of QMs. One QM category is the General QM category. The 2020 General Qualified Mortgage Final Rule[1] revised the General QM definition, creating the "price-based General QM" definition.[2]

For a loan to satisfy the price-based General QM definition, the loan's APR cannot exceed the average prime offer rate (APOR) for a comparable transaction by the amounts set forth in the Rule as of the date the interest rate is set.[3] 12 CFR 1026.43(e)(2)(vi). The difference between the loan's APR and APOR is sometimes referred to the loan's "rate spread." The rate spread is also used to determine whether the loan will receive a conclusive or rebuttable presumption of compliance with the ATR requirement.[4]

Interest rate used to calculate the APR under the General QM ARMs special rule

For most loans, the APR for the price-based General QM definition is calculated in the same manner as for APR disclosure requirements. *See* Comment 1026.17(a). However, the price-based

[1] 85 FR 86308 (Dec. 29, 2020).

[2] The General QM Final Rule took effect on March 1, 2021 but has a mandatory compliance date of October 1, 2022. For applications received between March 1, 2021 and September 30, 2022, the creditor may satisfy the DTI-based General QM definition or the price-based General QM definition to originate a General QM. For applications received on or after October 1, the creditor must satisfy the price-based General QM definition to originate a General QM. *See* 82 FR 22844 (Apr. 30, 2021).

[3] Generally, this threshold is 2.25 percentage points. However, the General QM Final Rule provides higher thresholds for loans with smaller loan amounts, for certain manufactured housing loans, and for subordinate-lien transactions.

[4] Whether the presumption of compliance is rebuttable or conclusive generally depends on whether the QM is a higher-priced covered transaction, which is defined by reference to the loan's rate spread. 12 CFR 1026.43(b)(4). If the QM is a higher-priced covered transaction, the creditor receives a rebuttable presumption of compliance for that loan. If the QM is not a higher-priced covered transaction, the creditor receives a conclusive presumption of compliance for that loan. 12 CFR 1026.43(e)(1).

General QM definition includes a special rule for calculating the APR for loans where the interest rate may or will change within the first five years after the date on which the first regular periodic payment will be due. 12 CFR 1026.43(e)(2)(vi). For loans with this characteristic, the creditor must treat the maximum interest rate that may apply during that five year period as the interest rate for the full term of the loan when determining the APR for purposes of the price-based QM definition. 12 CFR 1026.43(e)(2)(iv). This special rule also applies for the purpose of determining whether the loan receives a conclusive or a rebuttable presumption of compliance with the ATR requirement. 12 CFR 1026.43(b)(4) and 12 CFR 1026.43(e)(1).

Interest rate used to calculate prepaid interest under the General QM ARMs special rule

Under Regulation Z, the APR includes any prepaid interest, sometimes referred to as "odd-days" or "per diem" interest. Typically, mortgage interest is paid one month in arrears, meaning that, for example, if the first scheduled periodic payment due is on November 1st, it will cover interest accrued in the preceding month of October. In that example, if the consumer consummates the mortgage loan on September 20th, interest starts to accrue on September 20th and at consummation the consumer will typically prepay interest for the 11-day period through the end of September. That amount is prepaid interest. In some cases, a creditor may provide the consumer a prepaid interest credit, sometimes referred to as "negative prepaid interest." Negative prepaid interest can result if consummation occurs after interest begins accruing for periodic payments. In the example above, if the consumer instead consummates the mortgage loan on October 4th, but the first scheduled periodic payment is due on November 1st and will cover interest accrued in the preceding month of October, then at consummation the creditor will typically credit the consumer for the preceding three days in October to offset some of that first scheduled periodic payment. That prepaid interest credit is also a component of the APR.

For purposes of calculating the APR for the General QM ARMs special rule, the maximum interest rate that may apply during the five-year period after the date on which the first regular periodic payment will be due is used to calculate prepaid interest and negative prepaid interest. For example, if Ficus Bank is originating an ARM that has an interest rate of 2.5% in years 1-3 and 4.5% for the remainder of the loan term, Ficus Bank must use 4.5% as the interest rate when determining if the loan satisfies the price-based General QM definition, including for calculating any prepaid interest or negative prepaid interest as part of the APR calculation. A creditor must use the maximum interest rate in the first five years for calculating the APR for purposes of the special rule, even if the creditor will use a different rate for calculating prepaid interest due at consummation.