Financial Services Management

QM Status for Seasoned Loans

Cite

CFPB, Notice of Proposed Rulemaking, Qualified Mortgage Definition Under the Truth-in-Lending Act (Regulation Z) – Seasoned QM Loan Definition

Recommended Distribution:

Mortgage Finance, Capital Markets, Credit Insurance, Policy, Legal, Government Relations

Websites:

https://files.consumerfinance.gov/f/documents/cfpb_proposed-rule_seasoned-qm-loan-definition_2020-08.pdf

Impact Assessment

- The majority of non-QM loans may be eligible as QMs following seasoning, providing a far wider safe harbor for non-agency mortgage lending and securitization.
- QM relief would not be provided until spring of 2021, obviating any near-term benefit.
- Bank mortgage portfolios could increase, perhaps significantly, providing a new source of assets with relatively favorable capital treatment, especially for regional banks.
- MIs could gain new opportunities at bank mortgage lenders likely taking on larger portfolios of higher-risk loans.
- New private secondary markets for seasoned mortgages could develop based on the final status of the GSE patch and conservatorship.
- New options for covered bonds would be created.
- Commenters may need to move quickly to ensure that any issues are raised.

Overview

Despite its pending proposal to overhaul the entire definition of loans eligible for qualified-mortgage (QM) status,[1] the CFPB proposes also to establish an additional class of first-lien, fixed-rate mortgages that are QMs or given a rebuttable presumption of QM status. These loans must meet an array of restrictions, including those comparable to those otherwise governing QMs and those subject to rebuttable presumptions, except for a hard debt-to-income (DTI) ceiling and proposed pricing

[1] See *Client Report* **MORTGAGE110**, January 10, 2013.

constraints. Instead, these loans need only be held on a lender's portfolio for three years and meet performance criteria during that time.

Impact

This CFPB proposal aims at responding to pandemic-related mortgage-availability problems as well as more broadly to expand QM benefits to loans which, by virtue of time on a lender's portfolio, demonstrate the borrower's ability to repay (ATR). In 2018, Congress provided a broad QM safe harbor for portfolio mortgages but only if originated by banks with less than $10 billion in assets and held on portfolio for the life of the loan.[2] With numerous revisions and varying criteria, this NPR would expand the statutory portfolio exemption and another for far smaller banks to all lenders for eligible seasoned loans. As a result, it could provide a strong incentive for lenders to make more portfolio loans by virtue of reduced legal risk without reliance on Fannie Mae or Freddie Mac securitization. Because virtually all of the nonbanks now playing a major role in agency-mortgage origination lack portfolio capabilities, this proposal will largely benefit banks, reconfiguring mortgage finance into the more regulated model federal policy-makers have advocated.[3] However, based on the legal technicalities of when "origination" occurs, it may be possible for nonbanks to take on new functions as agents for banks, using their often more advanced digital systems to good effect.

The CFPB's broader QM proposal would end the GSE "patch" on its effective date or the end of the GSEs' conservatorship, whichever comes sooner. Without a replacement securitization window for loans not eligible for FHA insurance, the end of the patch could mean that loans now sold to Fannie and Freddie would not be originated or would cost considerably more. The CFPB believes that this would have adverse credit-availability impact and, with the restrictions in this NPR, that seasoning suffices for the discipline otherwise afforded by long-term portfolio lending or more stringent QM criteria. The agency's research finds that, even though a significant percentage of non-QM loans may go delinquent over time, the law's ATR requirements[4] are met by performance during the seasoning period. The scope of this simple seasoning requirement is said also to prevents reliance on a single factor that may or may not be sufficient to judge ATR, broadening a large volume of loans now not eligible QMs for initial portfolio lending. Regardless, adopting a seasoning – not long-term portfolio – requirement may permit lenders to add the liquidity needed on long-term obligations – especially thirty-year fixed-rate loans – essential to manage interest-rate and numerous other risks and thus encourage more long-term, fixed-rate mortgages outside the agency market. This liquidity would be significantly enhanced if the expanded safe harbor also leads to new private securitization channels that would add still more volume and less cost to qualified loan products. It is currently difficult to securitize non-QM loans other than through government channels due to assignee liability and thus the same compliance and legal risks that thwart portfolio lending.

The proposed approach may be particularly helpful for higher-DTI loans now considered QM only if sold to the GSEs or insured by FHA. Indeed, the Bureau

[2] See *Client Report* **REFORM147**, May 23, 2018

[3] See *Client Report* **FSOC25**, December 9, 2019.

[4] See **CONSUMER14**, *Financial Services Management*, July 19, 2010.

notes that the seasoning proposal creates an incentive for large banks now wary of lending outside the safe harbor to make higher DTI loans. While the broad QM proposal eliminates the current 43 percent DTI ceiling in favor a pricing threshold, the Bureau fears that higher-DTI loans might become scarce regardless of borrower ability to repay due to lender compliance and legal risk. As the Bureau notes, higher-DTI loans are particularly important for lower-income borrowers, emerging also as a larger market segment as workforces evolve to the gig economy and loan-platform innovation (e.g., alternative data) continues. Demand for private mortgage insurance or other forms of credit enhancement may grow in tandem with increased portfolio lending for high-DTI loans, especially those that also have high loan-to-value ratios.

When the CFPB suggested an approach along these lines,[5] consumer groups challenged it. They countered that the QM statute gives consumers an unlimited recoupment right in the event of foreclosure or similar action. However, the Bureau believes it has authority to do so noting that QM status is an effective defense against this right. Indeed, the Bureau believes that consumers will receive considerable benefit from the proposal by virtue of lower lender litigation risk resulting in greater credit availability for higher-risk mortgages.

What's Next

This NPR was issued on August 18; comments are due thirty days after *Federal Register* publication. It would be effective at the same time as the broader QM proposal, i.e., six months after *Federal Register* publication. Only loans applied for after the effective date would be eligible. This is based on the view that retroactive application to existing loans may create risks to consumers, but the agency seeks comment on this point. More rapid innovation in the midst of the pandemic could have significant market impact.

Analysis

A. Product Restrictions

Eligible loans would:

- be held on portfolio for no less than 36 months. CFPB analyses conclude that two years is sufficient to determine ATR, but the Bureau here proposes three to ensure it;
- meet performance criteria. These include no more than two thirty-day or longer delinquencies without consideration of escrow payments. No sixty-day delinquencies would be allowed. Payment tolerances (e.g., for disputed late fees) set the amounts that can be missed without being considered a delinquency. If there is a thirty-day delinquency at the end of the seasoning period, then the seasoning period is extended until there is no delinquency;
- have forbearance related only to a natural disaster or national emergency (e.g., the pandemic) and even then only if conditions (e.g., no fees) are met.

[5] See **MORTGAGE115**, *Financial Services Management*, July 30, 2019.

However, time spent in eligible forbearance does not count for the 36-month seasoning requirement. Loans may be modified during seasoning only in accordance with permissible terms ensuring affordability);
- be a first lien;
- have a fixed rate with fully-amortized payments without any balloons;
- have a term of thirty years or less;
- have points and fees generally less than three percent; and
- not be covered by any commitment for purchase after seasoning, nor may legal title be transferred except under limited circumstances.

Unlike the overall QM proposal, seasoned loans meeting the criteria above would be subject to no pricing thresholds. However, lenders would need to consider DTI or residual income and verify debt obligations and income. No DTI limit would apply.

B. Request for Comment

Views are sought on:

- alignment of this rule's effective date with that of the broader QM revisions. The Bureau tells commenters to address issues raised by this rule germane to the broader QM NPR in comments on that NPR but then also states that they may also be included in comments on the seasoning proposal;
- an alternative approach for seasoned loans such as only a rebuttable presumption after a seasoning period and a safe harbor after additional seasoning;
- the effective date, as noted above;
- whether additional restrictions should apply to seasoned loans;
- whether seasoned QM loans should include second liens or other products;
- implications for credit access;
- the duration of the seasoning requirement;
- whether all loans need to be held in the originator's portfolio during the seasoning period;
- all of the proposed definitions, including that for delinquency and exempted payments;
- treatment of forbearance; and
- the data and projections on which the Bureau's impact analysis is based.