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Qualified mortgages vs. qualified residential mortgages

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Overview

The Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”) contained two terms that will have a significant future impact on traditional elements of the mortgage lending business. The first term, “Qualified Mortgage” (QM), is contained in the recently issued Ability-to-Repay rule. Its purpose is to ensure that mortgage lenders extend credit based on a reasonable good faith determination of a consumer’s ability to repay. If a mortgage is deemed a “qualified mortgage,” the lender receives certain protection from liability. The second term, Qualified Residential Mortgage, relates to the proposed risk retention rule under the Securities Exchange Act of 1934 and its purpose is to require securitizers to retain no less than five percent of the credit risk when they create, sell, or transfer asset-backed securities to third parties except for securities wholly comprised of “Qualified Residential Mortgage(s)” (“QRM”).

As described in our February 4, 2013, Alert, the Consumer Financial Protection Bureau (“CFPB”) has defined QM in connection with its final Ability-to-Repay rules. Lenders are now awaiting a final rule defining QRM. However, the CFPB is not writing the QRM definition. Instead, the Federal Reserve Board (“Federal Reserve”), the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation (“FDIC”), the Securities and Exchange Commission, the Federal Housing Finance Agency, and the Department of Housing and Urban Development (collectively, the “QRM Agencies”) are responsible for issuing final rules.

At this stage, the recently issued final rule defining QM differs from the proposed rule defining QRM. This is significant because Dodd-Frank mandates that the QRM definition be “no broader” than the definition of QM in both law and regulation. As noted by the CFPB in its release on the Ability-to-Repay rule, while the QM definition will set the outer boundary of a QRM, the QRM Agencies have discretion under the Dodd-Frank Act to define QRM in a way that is stricter than the QM definition. However, as noted at a recent Senate Banking Committee Hearing, regulators with the responsibility for writing final risk retention rules recognize that different definitions for QM and QRM could impact the housing recovery and increase compliance costs.

Qualified mortgages

The CFPB Ability-to-Repay Rule established three categories of QM: (i) general qualified mortgages, (ii) balloon payment qualified mortgages made by certain lenders, and (iii) transitional qualified mortgages. The Ability-to-Repay Rule provides that general qualified mortgages, among other requirements may not
• have a term of more than 30 years;
• include points and fees equal to more than 3%;
• be granted to a borrower with a debt-to-income ratio greater than 43%;
• include “no-doc” loans where the lender does not verify income; or
• include certain characteristics of non-traditional mortgages, including interest-only and negative amortization loans.

While loans with balloon payments generally do not qualify as QMs, the CFPB provided an exception for loans made by small lenders (defined initially as having less than $2 billion in assets) in rural areas. The CFPB also established a transitional qualified mortgage category for a covered transaction where a borrower has a debt-to-income ratio above 43% but satisfies all other criteria of the general qualified mortgage as well as the underwriting criteria of the GSEs (i.e., Fannie Mae and Freddie Mac while they operate in a federal conservatorship) or the FHA, VA, or the USDA or Rural Housing Service. This transitional qualified mortgage category will expire on January 10, 2021.

Qualified residential mortgages

Under Dodd-Frank, securitizers of asset-backed securities are required to retain an economic risk (no less than 5%) in the assets collateralizing the asset-backed securities. However, among the exceptions in the proposed rule is that the risk retention requirements do not apply if all of the assets collateralizing the securities are QRMs. Dodd-Frank requires that the definition of QRM be “no broader” than the definition of QM adopted by CFPB. In the proposed rule, issued on April 29, 2011,\(^1\) the QRM Agencies defined QRM as “a closed-end credit transaction to purchase or refinance one-to-four family property at least one unit of which is the principal dwelling of a borrower” and that meets certain criteria. While the criteria for a QRM in the proposed rule are similar to the criteria for a QM set forth in the Ability-to-Repay Rule, there are some significant differences. In particular, the proposed rule defining QRM: (a) capped the interest rate increases for adjustable rate mortgages whereas the QM definition merely clarified how the adjustment should be factored into an Ability-to-Repay determination, (b) contains a maximum loan-to-value ratio of 80% for a purchase money mortgage whereas the QM definition does not establish loan-to-value limits, (c) required a 20% down payment for a purchase money mortgage whereas the QM definition does not require a specific down payment amount, and (d) required a debt-to-income ratio of 36% in contrast to the QM limit of 43%. These distinctions would become irrelevant if the QRM Agencies choose to adopt the QM definition as the QRM definition. However, if the six agencies adopt some but not all of QM as the definition of QRM, then mortgage lenders and securitizers may have to consider two underwriting standards to satisfy the ability to repay and credit risk retention rules.

Recent comments by regulators

During a recent Senate Banking Committee hearing, Chairman Tim Johnson (D-SD) asked panelists (Daniel K. Tarullo, Governor of the Federal Reserve; Martin J. Gruenberg, Chairman of the FDIC; and Thomas J. Curry, Comptroller of the Currency) if they would consider adopting the QM definition as the final QRM definition. The panelists acknowledged the benefit of congruent definitions and noted that they delayed final rulemaking defining QRM until the CFPB issued its final rule defining QM. Fed Governor Tarullo added that, given the state of the mortgage market, it is

\(^{1}\) Credit Risk Retention, 76 Fed. Reg. 24090 (April 29, 2011)
important that the agencies not inadvertently restrict credit for other than the most credit-worthy by adopting two varying definitions. Although the rules have different objectives, Governor Tarullo suggested that the CFPB release of the final rule defining QM should enable the QRM Agencies to quickly adopt a definition of QRM that was workable.

Readers are encouraged to monitor alerts from Nixon Peabody LLP for a comparison of the final Qualified Mortgage and Qualified Residential Mortgage definitions once the final rule is released and how these definitions may impact lending.

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