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Expansion of the Qualified Mortgage Safe Harbor under the Regulatory Relief Bill: Significant Help for Portfolio Lenders under $10 Billion in Assets

May 31, 2018

One of the most significant changes under the Economic Growth, Regulatory Relief and Consumer Protection Act (the "Act"), the regulatory relief bill signed into law on May 24, 2018, is the expansion of what constitutes a qualified mortgage for lenders under $10 billion in assets that keep mortgages in portfolio. A home mortgage loan made by a lender meeting the required criteria will be deemed a qualified mortgage even if the debt-to-income ratio of the borrower exceeds 43%.

I. Background

One of the main causes of the housing collapse in 2008 and the resulting recession was deemed to be a steady deterioration of credit standards in mortgage lending. One part of this deterioration in credit standards was the practice of certain lenders to base loans on a property's value, without consideration of a borrower's actual ability to repay a loan based on income and assets. The Dodd-Frank Act was enacted in 2010 in part to address this very practice by lenders. A key part of the Dodd-Frank Act is the Ability-to-Repay/Qualified Mortgage Rule (the "ATR/QM Rule") which requires lenders to make a reasonable, good faith determination that a consumer has a reasonable ability to repay a mortgage loan before making that loan.

Lenders may generally comply with the ATR/QM Rule in one of two ways: by following eight underwriting standards, or by originating a loan that meets the very specific requirements of a qualified mortgage. The requirements of a qualified mortgage are stricter than the eight underwriting standards, but there is a significant benefit to making a loan that is deemed a qualified mortgage: a higher level of protection from liability. A qualified mortgage that is not deemed to be a "higher-priced" mortgage provides the lender with a safe harbor – the loan is conclusively presumed to comply with the ATR/QM Rule. (If the loan is a "higher-priced" loan, the lender gets a rebuttable presumption of compliance instead of a safe harbor). If a loan is not a qualified mortgage, then a lender may be forced to defend its underwriting of the loan – that the lender did in fact follow the eight underwriting standards and properly concluded that the borrower had the ability to repay the loan. A borrower can contest the lender's ability-to-repay determination as a defense to a foreclosure action.

II. Expansion of Qualified Mortgage

The regulatory relief Act has in effect broadened the definition of qualified mortgage to include certain types of loans by certain types of lenders. The two primary requirements for this relief is that the lender (a) is a bank or credit union with less than $10 billion in assets (including the assets of all affiliates), and (b) originates and maintains the loan in the lender's portfolio (as opposed to selling the loan).

Assuming the lender meets those two requirements, then the loan itself must meet the following requirements:

- The loan cannot have an interest-only feature;
- The loan cannot have negative amortization;
- The total points and fees on the loan cannot exceed 3% of the total loan amount;
- The loan must be in compliance with limitations on prepayment penalties under Regulation Z; and
- The lender must consider and document the debt, income, and financial resources of the consumer.

The most significant aspect of this change is that a lender making a loan that meets these requirements is not subject to the 43% cap on the borrower's debt-to-income ratio. Prior to this change, a lender seeking the protection of a qualified mortgage generally could not make a loan if the borrower's total monthly debt to total monthly income at the time of consummation of the loan exceeded 43%. Many lenders believed that they were being restricted from making what otherwise appeared to be a very safe, sound mortgage loan because the borrower's debt-to-income ratio exceeded, in some cases by just a small amount, the 43% limit allowed for a qualified mortgage.

Please note that a loan meeting the new requirements for what is deemed a qualified mortgage will lose the qualified mortgage status if the loan is sold, assigned or transferred by the lender, unless such sale, assignment or transfer is: to another person by reason of the bankruptcy or failure of the lender; to another institution with less than $10 billion in assets and is retained in portfolio by that institution; in connection with a merger or acquisition of the covered institution; or to a wholly owned subsidiary of the covered institution.

If you have any questions regarding the Act, qualified mortgages or mortgage compliance issues in general, please feel free to contact Joseph D. Simon at (516) 357-3710 or via email at jsimon@cullenanddykman.com, Elizabeth A. Murphy at (516) 296-9154 or via email at emurphy@cullenanddykman.com, Diana Acosta at (516) 357-3739 or via email at dacosta@cullenanddykman.com, or Mandy Xu at (516) 357-3850 or via email at mxu@cullenanddykman.com.

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