TILA AND REGULATION Z ABILITY-TO-REPAY AND "QUALIFIED MORTGAGE" RULES

Overview

The Truth-In-Lending Act (TILA), in addition to requiring extensive consumer credit disclosures and credit advertising, also regulates certain "higher priced mortgage loans" considered as "subprime" (also known as "Section 35" loans). In response to events and mortgage lending practices leading up to the 2008 financial crisis or "Great Recession," the Federal Reserve Board of Governors adopted a requirement that creditors must assess the consumer's ability to repay for all Section 35 loan transactions starting October 2009. Then in 2010, the Dodd-Frank Act amended TILA to add more comprehensive Ability-to-Repay requirements on ***all closed-end residential mortgage loans***. Congress also established a presumption of compliance with the Ability-to-Repay requirements for a certain category of loans called "Qualified Mortgages." Congress left it to the Consumer Financial Protection Bureau to create and implement final **Ability-to-Repay Rules** and give definition to **"Qualified Mortgage."**

In January 2013, the CFPB issued its final "Ability-to-Repay and Qualified Mortgage Rule," a rule that **applies to transactions for which CMG Financial or a third party originator receives a mortgage application on or after January 10, 2014.** CFPB made further amendments to the Rule in June and July 2013.

Policy Statement

It is the policy of CMG Mortgage, Inc., dba CMG Financial (hereinafter referred to as "CMG Financial") to comply with the federal requirements set forth by the Truth In Lending Act and its implementing Regulation Z. To this end, it is CMG Financial's policy to purchase all closed-end residential mortgage loans in conformity with CFPB Ability-To-Repay Rule (the "Rule"), its Appendix Q Underwriting Guidelines, and "Qualified Mortgage" eligibility guidelines under the Rule, under Fannie Mae and Freddie Mac "Qualified Mortgage" Eligibility Guidelines (August, 2013), and similar guidelines to be issued by FHA and VA.

ABILITY TO REPAY RULE

Overview

The Rule describes the minimum standards creditors must use to make a reasonable, good faith determination before or when consummating a closed-end mortgage loan that the applicant(s) have the ability to repay the loan they are extended. The Rule specifies eight factors that must be considered in underwriting a consumer's ability to repay their mortgage and its Appendix Q, based on FHA underwriting guidelines, goes into great detail on how to underwrite each of the eight factors. The Rule also contains special requirements for creditors that are refinancing their own customers into more affordable loans in order to help them avoid payment shock.

Effective Date

The ATR Rule takes effect for applications for closed-end mortgage transactions received by a Correspondent Sellers whose closed loan CMG Financial is considering for purchase, on or after January 10, 2014. For FHA loan programs, the ATR Rule applies to loans assigned an FHA Case Number on or after January 10, 2014.

Loans that are Excluded from the ATR Rule **(12 CFR § 1026.45(a))**

- Open-end credit plans, including home equity lines of credit or HELOCs
- Time-share plans
- Reverse mortgages
- Temporary or bridge loans with terms of 12 months or less (with possible renewal)

- A construction phase of 12 months or less (with possible renewal) of a construction-to-permanent loan
- Loan modifications that do not constitute "refinancing" under Regulation Z Section 1026.20(a) and Staff Commentary

***Recordkeeping* (12 CFR § 1026.25(c)(3))**

The ATR Rule requires creditors to retain evidence of ATR Rule compliance for three (3) years after loan consummation. CMG Financial's general policy is to retain mortgage transaction records for a minimum of seven (7) years but for closed-end residential mortgage loan applications covered under the ATR/QM Rule, CMG Financial will retain those loan files for the life of the loan given revised TILA enforcement provisions affording borrowers the right to challenge ATR/QM rule compliance as a defense to foreclosure action.

***The Eight Underwriting Factors That Must Be Considered for Consumer Ability To Repay* (Comment 1026.43(c)(2)-4)**

1. <u>Current or reasonably expected income or assets</u> (other than the value of the subject residential property that is securing the mortgage loan) that the consumer will rely on to repay the loan. Include earned income (wages or salary), unearned income (interest and dividends), seasonal and bonus income, and other regular payments to the consumer such as alimony, child support, or government benefits.

2. <u>Current employment status</u>, if relying on employment income when assessing the consumer's ability to repay. Future income can be counted toward ATR if verified using reasonably reliable third party records, such as in the case where a consumer who accepts a new job in March but will not start until May. If the employer will confirm the job offer and salary in writing, that future income can be considered.

3. <u>Monthly mortgage payment for the subject loan.</u> Calculate using the introductory or fully-indexed rate, whichever is higher, and monthly, fully-amortizing payments that are substantially equal.

   For *Interest only loans:* Use the greater of the fully-indexed or introductory-rate and equal, monthly payments of principal and interest that will repay the outstanding loan amount on the date the loan recasts over the remaining term of the loan. *For Balloon loans:* the calculation depends on whether the loan is a **Section 35 Higher Priced Mortgage Loan (HPML).** For non-HPMLs, use the maximum payment scheduled during the first five years after the regular periodic payment comes due. For HPMLs, use the maximum payment in the payment schedule, including any balloon payment. *To be substantially equal,* no two monthly payments should vary by more than 1 percent. For loans paid quarterly or annually, convert the payments into monthly payments when determining ATR.

4. <u>Monthly payment on any simultaneous junior lien loans secured by the same residential property.</u>

   Simultaneous transactions that are not HELOCs: the ATR assessment should include a monthly payment on the simultaneous loan that is calculated using the appropriate calculation method for ARMs, interest-only loans, or other, depending on the type of loan is being simultaneously made.

   Simultaneous transactions that are HELOCs: the ATR assessment should include a monthly payment on the simultaneous loan that is calculated based on the amount of credit to be drawn down at or before consummation of the main loan.

5. <u>Monthly payments for property taxes and insurance, homeowners insurance and ground rents,</u> that the consumer will be required to pay under their mortgage loan terms.

6. <u>Debts, alimony and child-support obligations.</u>

7. <u>Monthly debt-to-income ratio or *residual income*</u>, calculated using the total of all of the mortgage and non-mortgage obligations listed above as a ratio of gross monthly income. Do include in the DTI ratio ongoing, required monthly, quarterly or annual debts of the consumer; do not include debts paid off at or before consummation.

8. <u>Credit history.</u>

When two or more consumers jointly apply for a mortgage loan, consider the debt obligations and credit histories of both of them in assessing their ability to repay the loan. This is not the case for guarantors and sureties named on a loan.

Sellers are encouraged to develop Standard Operating Procedures for documenting how each of the eight factors are to be considered in it's underwriting guidelines, including our methodology for calculating "residual income.". Use of mathematical models is optional under the Rule.

All Information Must be Verified – "No Doc", "Low Doc" Closed-End Mortgage Loans No Longer Permissible

All information supporting a mortgage loan application must be verified using reliable third–party records.

- A consumer's income must be verified using documentation such as W-2 or payroll statements, tax returns, bank statements, receipts from check-cashing or funds-transfer services, benefits- program documentation, or records from an employer. Tax return transcripts or payroll statements can be obtained directly from the consumer or from a service provider, rather than from a government agency or employer. *For self-employed borrowers:* the CFPB gives no clear guidance for the self-employed and independent contractor borrowers but the Rule does give lenders flexibility in determining what is suitable documentation to verify income. An updated profit-and-loss statement for the current year can be used to supplement tax returns in prior years if the P&L has been reviewed by a reliable third party (i.e., accountant).
- Verbal verifications of employment (VVOEs) are acceptable to document a consumer's employment status as long as the loan file contains a record of the information that was received from the employer during the call.
- Use a credit report to verify a consumer's debt obligations; individual debt statements need not be collected. If the Correspondent Seller knows or has reason to know that the credit report is inaccurate, it is acceptable to ignore the report in whole or in part, and rely on alternative verifiable records. If the consumer lists a debt obligation that does not show up on the credit report, the Correspondent Seller may accept the consumer's statement about the existence and amount of the obligation without further verification.
- If a consumer does not have a credit history from a credit bureau, verify credit history using documents that show nontraditional credit references such as rental payment history or utility payments.
- If financial records indicate there will be a change in the consumer's repayment ability after consummation, such as if they plan to retire and not obtain new employment, or they plan to transition from full-time to part-time work, creditors must consider that information. [Comment 43(c)(1)-2.]

Examples of reasonably reliable third party records (12 CFR §1026.43(c)(3))

- Records from government organizations
- Federal, state or local government agency letters detailing the consumer's income, benefits or entitlements
- Statements provided by a cooperative, condominium, or homeowners association
- A ground rent or lease agreement
- Credit reports
- Statements for student loans, auto loans, credit cards, or existing mortgages
- Court orders for alimony or child support
- Copies of the consumer's federal or state tax returns
- W-2, 1099 forms or other IRS forms for reporting wages or tax withholding
- Payroll statements
- Military leave and earnings statements
- Financial institution records, such as bank account statements or investment account statements reflecting the value of particular assets
- Records from the consumer's employer or a third party that obtained consumer-specific income information from the employer
- Check-cashing receipts
- Remittance-transfer receipts

Factors that may show an ATR determination was reasonable and in good faith (12 CFR §1026.43(c)(1)):

- Underwriting Standards – using underwriting standards that have historically resulted in comparatively low rates of delinquency and default during adverse economic conditions.
- Payment History – the consumer paid on time for a significant time after origination or reset of an adjustable rate mortgage.

Factors that may show an ATR determination was NOT reasonable and in good faith (12 CFR §1026.43(c)(1)):

- Underwriting Standards – Ignoring evidence that the creditor's underwriting standards are not effective at determining consumers' repayment ability.
- Payment History – The consumer defaults early in the loan, or shortly after the loan resets, without having experienced a significant financial challenge or life-altering event.**
- Inconsistency – Credit applies underwriting standards inconsistently or used underwriting standards different from those used on similar loans without having a reasonable justification.

*****Note:*** Compliance with the ATR requirements is based on the information available (known or should have been known) at or before loan consummation. Consumers who run into trouble repaying a Correspondent Seller's loan for reasons other than a sudden and unexpected job loss or other financial calamity, could claim that the Correspondent Seller failed to make a reasonable, good faith determination of their ATR before making the loan. Consumers have three years to file an affirmative claim in court, but can use ATR as a defense to foreclosure at any time during the life of the loan. If the consumer is successful in their affirmative claim, CMG Financial can be liable for up to three years of finance charges and fees the consumer paid (just like the TILA right of rescission on refinancing(s) plus legal fees. For successful claims as a defense to foreclosure, the consumer can only recover setoff/recoupment of finance charges; the foreclosure can proceed.

***Rule exception for consumers trying to refinance out of risky mortgage loans* (12 CFR §1026.43(d)(1)(ii)(A)**

Lenders that are refinancing borrowers out of a risky "non-standard" mortgage loan -- adjustable rate mortgages, interest-only loans, or a negative amortization loan -- to a standard 30-year fixed rate mortgage loan can do so without performing the above full underwriting process so long as all of the following conditions are met:

- The lender currently holds the risky mortgage,
- The monthly payment for the new standard mortgage is materially lower, **
- The borrower submits their written loan refinance application within two months after their non-standard loan's interest rate recast,
- The consumer has no more than one 30-day late payment during the twelve months prior to the date of written application AND no 30-day late payments during the six months prior to the date of written application,
- The lender has considered whether the loan refinance likely will prevent a loan default after the non-standard mortgage is recast.

***Note:* Section 1026.43(d)(5) specifies how to calculate payments when comparing non-standard loans to standard loans. First, calculate the payment the consumer will have to make if the non-standard loan reaches a **recast** point:

- For an ARM, the introductory fixed-rate period ends,
- For an IO loan, the interest-only period ends,
- For a negatively amortizing loan, the negatively amortizing payment period ends.

Then calculate the payment for the standard loan, using the fully-indexed rate and the monthly payment that will fully amortize the loan based on equal monthly payments. Finally, compare the two payments. A payment reduction of ten percent (10%) or more meets the "materially lower" standard. The payment calculation must be based on the maximum unpaid principal balance that will be outstanding at the time of recast, taking into account any principal payments the consumer will have made by that time.

The ATR Rule provides lenders a presumption of compliance against consumer affirmative claims and defense claims of Rule violation when the subject loan is a "Qualified Mortgage." In turn, a "Qualified Mortgage" standard helps protect consumers from unduly risky mortgages loan products and features like negative amortization and interest-only periods.

For "Qualified Mortgages" that do not fall within the Section 35 HPML category, the Rule affords an outright "Safe Harbor" from consumer claims of ATR violation. That means, a court will conclusively presume the lender complied with the ATR Rule and the consumer has no basis for asserting an affirmative claim or a defense to foreclosure. The burden will fall on the consumer to prove that their loan really is not a "Qualified Mortgage." [12 CFR §1026.43(e)(1).]

For "Qualified Mortgages" that fall within the newly defined Section 35 HPML category, there is a "Rebuttable Presumption" that the lender did comply with the ATR Rule and it is up to the consumer to produce evidence to the contrary. In order for a consumer to prevail on that argument, the consumer must show that based on the information available to the lender at the time the mortgage was consummated, the consumer did not have enough **residual income** left to meet living expenses after paying their mortgage and other debts. [12 CFR §1026.43(e)(1).]

The risks for originating a non-Qualified Mortgage are relatively high. The consumer is afforded a three- year private right of action to file a civil court action alleging ATR/QM Rule violation. The three years runs from the date of "loan consummation" – the date as defined by each state's mortgage lending laws, on which a consumer becomes contractually obligated on the loan transaction (ie, in California, the date of loan document signing). Alternatively, the consumer can assert ATR/QM Rule violations as a defense to foreclosure, at any time during the life of the loan. Either way, the consumer can assert that the Correspondent Seller did not underwrite their loan in accordance with Ability-To-Repay standards as of the date of loan consummation, did not adequately assess the consumer's residual income amount as of the date of loan consummation, or they can challenge the "Qualified Mortgage" status of their closed-end residential mortgage loan. Should the consumer win in court, they can be awarded three years' of paid interest and finance charge, attorney's fees and costs.

"Qualified Mortgage" Defined by the Rule **[12 CFR §1026.43(e)(2), (4)]**

The Rule defines **three types of "Qualified Mortgages."**

To be a "**Type 1 Qualified Mortgage**," the intended loan must contain ***all of the following features:***

- A back-end DTI of 43% or less. **Appendix Q** to the ATR Rule gives extensive guidance on calculating debt and income to derive the DTI ratio.
- The loan must be underwritten based on a fully-amortizing loan schedule using the maximum rate permitted during the first five years after the date of the first periodic loan payment.
- Consider and verify the consumer's income or assets, current debt obligations, alimony and child-support payments.
- Effective on loans with a consummation/signing date of 1/1/2015 or after: The loan's total points and fees cannot exceed the following thresholds:
  3 % of the total loan amount for a loan greater than or equal to $101,953;
  $3,059 for a loan amount greater than or equal to $61,172 but less than $101,953;
  5 % of the total loan amount for a loan greater than or equal to $20,391 but less than $61,172;
  $1,020 for a loan amount greater than or equal to $12,744 but less than $20,391; and
  8 % of the total loan amount for a loan amount less than $12,744
    - The previous thresholds were: Total points and fees are to be limited to 3% of loan amounts greater than $100,000. For loan amounts of $60,000 to $100,000, total points and fees cannot exceed $3,000 (indexed for inflation); and for loan amounts of $20,000 to $59,999, 5% of the loan amount.
- No risky "non-standard" features —
    - Interest only
    - NegAm
    - Loan term > 30 years
    - Prepayment penalties
    - Limited exemption for Balloon Loans for small creditors operating in rural or underserved areas under certain defined circumstances. If the Correspondent Seller does not meet this criteria and the Seller, cannot originate Balloon Loans in the "Qualified Mortgage" category.

To be a "**Type 2 Qualified Mortgage**," the loan must be originated in accordance with Fannie Mae and Freddie Mac's "Qualified Mortgage" Eligibility Guidelines (August, 2013) and must be eligible for sale to these GSEs (although actual sale to the GSEs need not occur). This is only a temporary provision; Type 2 QMs sunset on the date that the GSEs exit federal conservatorship or receivership, or on January 10, 2021, whichever occurs first. For more information on Type 2 QMs, refer to the discussion below and attachments.

Loans that are eligible for QM status under Agency FHA/RHS insurance and VA/USDA guarantee programs are classified **Type 3 Qualified Mortgages**. Each of these federal Agencies are to give their own definition to "Qualified Mortgage" by final published rulemaking. To date, RHS is the last agency to not issue a QM Definitional Rule. HUD issued its final defining rule on December 11, 2013 that encompasses FHA loan programs. VA published its final interim rule on May 9, 2014 with a shortened, 30-day comment period making their Definitional Rule enforcement effective for new VA loan applications taken on and after June 1, 2014 (*see,* VA published "QM FAQs").

According to the CFPB Guide, in order to meet the Type 2 or 3 "Qualified Mortgage" definition, the loans must be <u>underwritten</u> using the required guidelines of the government agencies above. Fannie Mae and Freddie Mac guidelines must follow Appendix Q; because of their respective special credit purposes, federal Agency loan programs do not need to follow Appendix Q but rather their own underwriting guidelines. In addition, Type 2 and 3 "Qualified Mortgages" need not adhere to the 43% DTI ratio cap threshold that applies to Type 1 or "General Qualified Mortgages."

Eligibility for purchase or guarantee by a GSE or guarantee by VA can be established based on the following methods:

> Valid confirmed eligibility for GSE purchase or VA guaranty from an established Automated Underwriting System (AUS) such as DU or LP.
>
> Complying with GSE or Agency credit risk and underwriting guidelines contained in official manuals
>
> Written agreements between a GSE or VA and the creditor (or a direct sponsor or aggregator of the creditor)
>
> Individual loan waivers from a GSE or VA

The creditor does not have to satisfy GSE or Agency standards which are wholly unrelated to the credit risk or underwriting of the loan or any standards which apply after the consummation of the loan.

<u>More on HUD's Final Qualified Mortgage Definition Rule</u>

On December 11, 2013, HUD issued its final rule, "Qualified Mortgage Definition for HUD Insured and Guaranteed Single Family Mortgages" [78 Federal Register 75215.]

HUD's Rule starts by defining what loan programs are exempted from compliance with HUD's "Qualified Mortgage" Definition. They are:

- Home Equity Conversion Mortgages (HECMs), FHA's reverse mortgage program.
- Temporary or "bridge" loans having a term of 12 months or less.
- Construction phase of 12 months or less of a construction-to-perm loan;
- Mortgages made by (a) a housing finance agency; (b) a creditor designated as a Community Development Financial Institution (12 CFR 1805.104(h)); (c) a creditor designated as a Down Payment Assistance through Secondary Financing Provider (24 CFR 200.194(a); (d) a creditor designated as a Community Housing Development Organization and approved as a participant in a local HOME Investment Partnerships program; or (e) a creditor with a tax exemption ruling or determination letter from the IRS.
- Loans made pursuant to Sections 101 and 109 of the Emergency Economic Stabilization Act of 2008.

Next, HUD is requiring that all of the following conditions be met for every covered FHA loan program in order to attain "Qualified Mortgage" status:

- The loan must meet **the CFPB's 3% cap on "points and fees"** as defined in the ATR Rule.
- The loan must be assigned a **FHA Case Number** on or after January 10, 2014.
- The loan must meet all of FHA underwriting guidelines and requirements, including FHA's new **Manual Underwriting Requirements** that were published on December 11, 2013 [78 Federal Register 75238]. These new underwriting requirements take effect March 11, 2014 unless extended longer by HUD Mortgagee Letter, and <u>they will apply to FHA-to-FHA rate and term refinance transactions (no cash-out) and credit qualifying FHA streamline refinance transactions</u>. HUD rejects the concept of "residual income" and will not be incorporating it into FHA loan program underwriting guidelines.

- **The loan must be insured by FHA**. AUS eligibility is insufficient for attaining “Qualified Mortgage” status. On the flip side, an FHA insured loan that is the subject of an Indemnification Letter from FHA is not automatically disqualified from “Qualified Mortgage” status. Only by final written determination by HUD (FHA) can a loan lose its “Qualified Mortgage” status.

There are two categories of QMs under HUD’s Rule –

(1) Safe Harbor –

- All Title II loans covered by HUD’s Rule, including streamline refinances, that meet the CFPB QM 3% points and fees limit AND has an APR for a first-lien mortgage relative to the APOR that is less than the sum of the annual mortgage insurance premium + 1.15 percentage points.
- Streamlined refinances must be originated consistent with FHA streamlined refinancing requirements: (i) the loan must be current, (ii) the loan is designated to lower the monthly principle and interest payment, and (iii) the loan involves no cash back to the borrower except for minor adjustments.
- All Title I (home improvement loans), Section 184 (Indian housing loans), and Section 184A (Native Hawaiian housing loans) that are insured or guaranteed by FHA/RHS, in keeping with its affordable lending mandate.

(2) Rebuttable Presumption (that the Mortgagee did make a reasonable and good faith determination of consumer ATR at time of loan consummation when underwriting in accordance with HUD requirements) –

- All Title II loans covered by HUD’s Rule, including streamline refinances, that meet the CFPB QM 3% points and fees limit AND have an APR for a first-lien mortgage relative to the APOR that is at or greater than the sum of the annual mortgage insurance premium + 1.15 percentage points.

Of Final Note: HUD will continue to use its existing and new manual underwriting and income verification requirements. HUD is not adopting CFPB’s 43% debt-to-income ratio cap, keeping consistent with the agency’s mission of lending to underserved borrowers. Aside from loan programs that are exempted from HUD’s Rule, HUD will not give “Qualified Mortgage” status to a loan it does not insure.

More on VA’s Final Qualified Mortgage Definition Rule

The final interim rule can be found at 79 Federal Register 26620. VA hopes to publish a final rule within ninety (90) days of May 9, 2014, again, the date on which VA published its final interim rule defining “Qualified Mortgage.” The Rule amends 38 CFR 36.4300(b).

The final interim VA Rule starts by defining **what loan programs are in and what programs are exempted** from compliance with VA’s “Qualified Mortgage” Definition, then divides VA loan programs into “Safe Harbor” and “Rebuttable Presumption” categories. VA loans fall under **“Safe Harbor” QM status** when they meet ATR requirements of TILA Sections 129B and C, regardless of whether they are considered to be “high cost mortgage transactions” under TILA (defined by CFPB to be Section 35

HPMLs). Subject to certain exceptions pertaining to IRRRLs, **any VA-guaranteed or insured loan** made in compliance with VA guidelines is a **“Safe Harbor” QM.** [*See,* 38 CFR 36.4300(b)(2).]

Next, the final interim VA Rule identifies what loan programs are excluded from “Qualified Mortgage” treatment. They are:

- **Temporary or “bridge” loans** having a term of 12 months or less;
- **Construction phase of 12 months or less** of a construction-to-perm loan;
- Loans made pursuant to Sections 101 and 109 of the Emergency Economic Stabilization Act of 2008 (ie, HARP); and
- Mortgages made by (and already excluded from CFPB rule QM coverage) a **housing finance agency;** a creditor designated as a **Community Development Financial Institution** (12 CFR1805.104(h)); a creditor designated as **a Down Payment Assistance** through Secondary Financing Provider (24 CFR 200.194(a); a creditor designated as a **Community Housing Development Organization** and approved as a participant in a **local HOME Investment Partnerships program**; or a creditor with a **tax exemption ruling or determination letter** from the **IRS**.

Given the VA’s special agency statutory authority purpose granted by Congress to support the housing/finance needs of our nation’s veterans, coupled with its extensive regulatory framework for determining whether a borrower is a satisfactory credit risk to obtain a loan guaranteed or insured by VA, **VA intends for its “Qualified Mortgage” definitional rules to preempt the CFPB Rules to the extent they are inconsistent.** To this end, VA is not adopting CFPB’s Appendix Q. Instead, VA lenders are instructed to follow **VA Underwriting and Loan Program Guidelines**, including the prescriptions for residual income analysis.

Turning to VA IRRRLs, while all VA IRRRLs will be considered “Qualified Mortgages” if they meet VA Underwriting and Loan Program

Guidelines, not all will fall under “Safe Harbor.” The IRRRL must meet all of the following three (3) requirements in order to be classified as “Safe Harbor:”

(1) The loan being refinanced was originated at least 6 months before the new loan’s closing date, and the veteran has not been more than 30 days past due during the 6 months preceding the new loan’s closing date;

(2) The recoupment period for all allowable fees and charges (38 CFR 36.4313) financed as part of the loan or paid at closing does not exceed 36 months; and

(3) The IRRRL is either exempt from income verification requirements under VA Guidelines, or it complies with other income verification requirements under VA Guidelines as well as TILA.

Failing any of these three components places the IRRRL into a “Rebuttable Presumption” QM category.

The final interim Definitional Rule also sets parameters for exempting IRRRLs from income verification requirements under 38 CFR 36.4340(b)(1). They are:

- ✓ The veteran cannot be 30 days or more past due on the prior existing mortgage loan;
- ✓ The IRRRL is either exempt from income verification requirements under VA Guidelines, or it complies with other income verification requirements under VA Guidelines as well as TILA.
- ✓ The loan must meet **the CFPB’s 3% cap on “points and fees”** as defined in the ATR Rule.
- ✓ The proposed IRRRL will have a **lower interest rate** than on the original loan, unless the borrower is refinancing an **ARM loan to a fixed rate loan** under VA Guidelines.
- ✓ The proposed IRRRL will be subject to a **fully amortizing repayment schedule** in accordance with VA regulations.
- ✓ The terms of terms of the proposed IRRRL will be **without balloon payment.**
- ✓ **Both the existing mortgage loan and the proposed IRRRL meet all VA Underwriting and Loan Guidelines.**

VA IRRRLs that fail to meet all the criteria for exemption from income verification must verify borrower’s income in accordance with standards set under 38 CFR 36.4340 and with those 8 underwriting standards that are generally applicable under CFPB’s ATR Rules, absent Appendix Q.

More on the 3% “Points and Fees” Cap **(12 CFR §1026.32(b)(1))**

To calculate the QM “points and fees” for the 3% cap, follow the same HOEPA formula for Section 32 loans. Unless specified otherwise, include amounts that are **known at or before consummation**, even if the consumer pays them after consummation by rolling them into the loan amount. In addition, unless specified otherwise, closing costs that the creditor (Correspondent Seller) pays and recoups from the consumer over time through the interest rate are **not** counted in points and fees.

To calculate points and fees, add together the amounts paid in connection with the transaction for the six categories of charges listed below:

a. Finance charge (Regulation Z § 1026.32(b)(1)(i))

Generally, all finance charge items listed in Regulation Z Section 1026.4(a)(b) get counted, *except for*:

- Interest or the time-price differential. *Note:* this exclusion does not include back-end lender and broker compensation that is built into the interest rate (ie, yield spread premium, lender credit). Instead, factor settlement costs and LLPAs into the rate sheet.
- Federal or state government sponsored Mortgage Insurance Premiums (MIPs). For example, exclude up-front annual, and life-of-loan FHA premiums, VA funding fees, and USDA guarantee fees.
- Only certain Private Mortgage Insurance (PMI) monthly or annual premiums. Exclude monthly or annual premiums. Also exclude up-front PMI premiums if the premium is refundable on a prorated basis (as defined under state law or contract) and a refund is automatically issued upon loan satisfaction, *only up to the level of up-front MIP for FHA loans.* Document each loan file with the comparable FHA loan MIP amounts as published in HUD Mortgagee Letters.
- *Bona fide* third party charges not retained by the creditor, loan originator, or an affiliate* of either (Regulation Z §1026.32(b)(1)(D). “Bona fide” refers to the RESPA treatment of “reasonable market value.” In general, creditors may exclude

these types of charges even if they would be included in the finance charge. For example, a *bona fide* charge imposed by a third- party settlement agent (for example, an attorney) may be excluded so long as neither the creditor nor the loan originator (or their affiliates) retains a portion of the charge. However, if the third party charge is specifically required to be included under other provisions of the points-and-fees calculation (for example, certain PMI premiums, certain real estate-related charges, and premiums for certain credit insurance and debt cancellation or suspension coverage), then creditors must include the charge in the 3% cap calculation.

Note that charging consumers up-front fees to recover the costs of **loan-level price adjustments** imposed by secondary market purchasers of loans, including the GSEs, are not considered *bona fide* third-party charges and must be included in the 3% points and fees cap if they are not already factored into the rate sheet for loan pricing.

b. ***Bona fide* discount points** (Regulation Z § 1026.32(b)(1)(i)(E), (F) and (b)(3)).

Exclude up to 2 *bona fide* discount points voluntarily paid by the consumer in connection with the loan transaction if the interest rate offered to that specific borrower without any discount (the "base rate") does not exceed the APOR for a comparable transaction by more than 1 percentage point.

Exclude up to 1 *bona fide* discount point if the base rate does not exceed the APOR for comparable transaction by more than 2%.

A) If a "base rate" includes a mandatory discount point or portion thereof, the required point(s) is included in "points and fees" calculation.

B) A discount point is deemed to be *bona fide* if it reduces the consumer's base rate based on a calculation that is consistent with established industry practices for determining the amount of reduction in the interest rate appropriate for the amount of discount points paid.

A "base rate" is the rate unique to the consumer's loan as a result of any number of credit factors that does not include discount points. "Base rate" is not simply the interest rate posted on a rate sheet.

December 2, 2013 – MBA secures Unofficial Guidance from CFPB on excluding Bona Fide Discount Points from "Points and Fees" calculations.

MBA Question: If there is no exact "zero point" rate (a rate without discount or premium) can the creditor choose one of the following options? A) The rate with the closest discount to zero; B) The rate with the closest premium to zero; C) The rate closest to zero points (regardless of premium or discount); or D) The rate determined by applying a linear interpolation calculation.

CFPB Answer: The "base rate" does not have to be a rate with zero points. However, the "base rate" used must actually be available to the consumer. This eliminates linear interpolation as an acceptable means of determining the starting adjusted rate, as well as using a hypothetical rate as a starting adjusted rate. Neither are rates available to the consumer.

Note: **CFPB indicated that retention of rate sheets helps prove "base rate" compliance if challenged.**

According to the CFPB in this same MBA publication, a "bona fide discount" is the dollar-for- dollar points actually paid up to the 1 or 2 points allowed by the rule. So if Consumer agrees to pay an additional 1.50 discount points on a loan with base rate not exceeding the APOR for a comparable transaction by more than 1 percentage point, Creditor can exclude the full 1.50 points from the "points and fees" calculation. But, if the base rate exceeds the APOR by more than 1, but less than 2 percentage points, the Creditor must count .50 points towards "points and fees."

c. **Loan Originator Compensation** (Regulation Z § 1026.32(b)(1)(ii))

Include compensation paid directly or indirectly by a consumer or creditor to a loan originator other than an employee of a creditor or of a mortgage broker. The term "mortgage broker" refers to both brokerage firms and individual brokers. Compensation paid by a mortgage broker to an employee is not included in "points and fees."

Include compensation that is attributable to the transaction, to the extent that such compensation is known as of the date the interest rate for the transaction is set. In general, include the following:

(1) Compensation paid directly by a consumer to a mortgage broker: Include the amount the consumer pays directly to the mortgage broker. If this payment is already included in points and fees because it is included in the finance charge under § 1026.32(b)(1)(i), it does not have to be included again as loan originator compensation under § 1026.32(b)(1)(ii).

(2) Compensation paid by a creditor to a mortgage broker: Include the amount the creditor pays to the broker for the transaction. Include this amount even if the creditor does not receive an up- front payment from the consumer to cover the broker's fee but rather recoups the fee from the consumer through the interest rate over time.

d. **Real estate-related fees** (Regulation Z § 1026.32(b)(1)(iii))

The following categories of charges are **excluded** from points and fees **only if:**

(a) The charge is reasonable (per RESPA Section 8);

(b) The creditor receives no direct or indirect compensation, such as overages, in connection with the charge; and

(c) The charge is not paid to an affiliate* of the creditor.

If one or more of those three conditions is **not** satisfied, the following charges must be included in points and fees even if they would be excluded from the finance charge:

Fees for title examination, abstract of title, title insurance, property survey, and similar purposes,

- Fees for preparing loan-related documents, such as deeds, mortgages, and reconveyance or settlement documents
- Notary and credit-report fees
- Property appraisal fees or inspection fees to assess the value or condition of the property if the service is performed prior to consummation, including fees related to pest-infestation or flood- hazard determinations
- Amounts paid into escrow or trustee accounts that are not otherwise included in the finance charge (except amounts held for future payment of taxes)
- **(c)(7) Fee Examples:** Application fees charged to all consumers; Fees or premiums for title examination, abstract of title, title insurance, or similar purposes of establishing valid title to the property; Property surveys; Fees for preparing deeds, mortgages, and reconveyance or settlement documents; Amounts required to be placed or paid into an escrow or impound account for T&I and other; Fees for notarizing deeds and other documents; Appraisal fees and property inspection fees if performed prior to loan closing; Credit reporting fees

e. **Premiums for credit insurance; credit property insurance; other life, accident, health or loss-of-income insurance where the creditor is beneficiary; or debt cancellation or suspension coverage payments** (Regulation Z § 1026.32(b)(1)(iv))

Include premiums for these types of insurance that are payable at or before consummation even if such premiums are rolled into the loan amount, if permitted by law. These charges need not be included if they are paid after consummation (*e.g.*, monthly premiums).

"Credit property insurance" is referred to by the CFPB as insurance that protects the creditor's interest in the property. It does not include homeowner's insurance that protects the consumer.

Do not include premiums for life, accident, health, or loss-of-income insurance if the consumer (or another person designated by the consumer) is the sole beneficiary of the insurance.

f. **Maximum prepayment penalty** (Regulation Z § 1026.32(b)(1)(v))

Include the maximum prepayment penalty that a consumer could be charged for prepaying the loan.

g. **Prepayment penalty paid in a refinance** (Regulation Z § 1026.32(b)(1)(vi))

If a creditor is refinancing a loan that their affiliate currently holds or is currently servicing, then include any penalties the affiliate charges consumers for prepaying their previous loans.

h. **For Open-End Loans add:** fees charged for participation in the credit plan payable at or before account opening (whether assessed annually or periodically); and any transaction fee, including a minimum fee or per-transaction fee, that will be charged for draw on credit line.

Appendix Q to the ATR Rule contains detailed rules regarding what and how to consider income and liability items for purposes of calculating the borrower's DTI ratio, a principal factor in meeting "Qualified Mortgage" criteria, as well as how such items must be verified. CFPB revised Appendix Q in July, 2013, to make major revisions to the methodology for determining a consumer's monthly debt and income for purposes of making a QM under the 43% debt-to-income ("DTI") underwriting alternative.

Appendix Q is attached. Here is the link to the *Federal Register*:
https://www.federalregister.gov/articles/2013/07/24/2013-16962/amendments-to-the-2013-mortgage-rules-under-the-real-estate-settlement-procedures-act-regulation-x#h-125

Among the more significant changes, the Amendments ease the general requirement that a lender determine that the consumer's income is "reasonably expected" to continue through at least the first three years of the loan.

When assessing the stability of a consumer's income, the Amendments also eliminate the requirements that a lender analyze both a consumer's probability of continued employment and the consumer's training, education, and qualifications for the job.

Other amendments to Appendix Q include:

- *Analyzing and Verifying a Consumer's Employment History.* At industry's urging, the Amendments eliminate the requirement that a lender obtain an employer's confirmation of the consumer's continued employment. Instead, the Bureau permits lenders to assume that employment is ongoing if the consumer's employer verifies his current employment and does not indicate that such employment has been, is set to be, or is likely to be terminated.
- *Salary, Wages and Other Forms of Income.* The Amendments revise the standards for bonus or overtime income, social security income and self-employment income:
- *Bonus and Overtime Income.* A lender will no longer be required to determine whether bonus or overtime income will continue, and may count such income provided it has not received documentation indicating that it will cease.
- *Social Security Income.* Appendix Q will only require a lender to obtain a benefit letter from the Social Security Administration ("SSA") to verify social security income. The QM / ATR Rule as promulgated in January required verification from the SSA and supporting tax returns. Lenders may also assume that social security benefits are ongoing absent evidence that it will expire within 3 years.
- *Self-employment Income.* The QM / ATR Rule issued in January would require lenders to analyze the business's source of income, obtain business credit reports for certain corporations, and the general economic outlook of similar businesses in the geographic region. In response to industry concerns that such analyses would be imprecise as well as difficult and costly to obtain, the Bureau eliminated each of these requirements.
- *Non-employment Related Consumer Income.* The Amendments revise the standards pertaining to trust income, notes receivable income and rental income for purposes of determining and verifying a consumer's DTI. Among these changes, lenders may count rental income from roommates or boarders in the consumer's primary residence as income. In contrast, the QM / ATR Rule issued in January prohibited inclusion of this income unless the boarders were related by blood, marriage or law.

Moreover, the Bureau permits creditors to rely on standards established by Fannie Mae or Freddie Mac (the "GSEs") or by the Department of Housing and Urban Development, Department of Veterans Affairs, Department of Agriculture, Rural Housing Service (the "Federal Agencies") as "a helpful resource in applying appendix Q" so long as those standards are consistent with Appendix Q's requirements. With respect to the treatment of items that are not covered by Appendix Q, the Bureau revised the introduction to Appendix Q to provide that a creditor may choose to "exclude the income or include the debt" or rely on GSE or Federal Agency guidance on how to resolve the issue.

General Comparison of Ability To Repay Requirements with Qualified Mortgages

Refer to CFPB website link:
http://files.consumerfinance.gov/f/201308_cfpb_atr-and-qm-comparison-chart_V2_final.pdf

The Temporary QM Classification for Loans Eligible for Sale to Fannie Mae, Freddie Mac

On August 20, 2013 Fannie Mae issued Announcement SEL-2013-06 and Freddie Mac published Bulletin 2013-16, both of which update numerous selling requirements in response to the CFPB's final Ability-to- Repay/Qualified Mortgage (ATR/QM) rule. As promised in their July 2013 notices to sellers, the issuances (i) detail new mortgage eligibility requirements (e.g., retirement of mortgages with original maturities in excess of 30 years and making mortgages with prepayment penalties ineligible for sale) (ii) revise thresholds for points and fees, (iii) revise higher-priced mortgage loans eligibility requirements, and (iv) remind sellers of other policies, including those related to the representation and warranty framework announced in September 2012. The changes take effect when the ATR/QM rule goes into effect on January 10, 2014.

Links to these GSEs guidelines are included.

Clarifications Related to the GSE / Federal Agency Alternative

In July 2013, the CFPB finalized amendments to Regulation Z Section 1026.43(e)(4) that provides guidance on when a loan is a QM because it meets the underwriting requirements to be purchased by the GSEs or insured or guaranteed by a Federal Agency (the "GSE / Federal Agency" alternative). To determine eligibility, the CFPB clarifies in its new Staff Comment 43(e)(4) the following:

- A lender may rely on a recommendation (presumably an approval) provided by a GSE or Federal Agency Automated Underwriting System ("AUS") or written guide.
- A lender may rely on a written agreement between it and the GSE or Federal Agency that permits variation from the standards of the written guides and/or AUSs (so-called "contract variances"). A correspondent lender in a direct relationship with a variance holder may also rely on negotiated contract variances.
- A lender need not satisfy GSE or Federal Agency requirements that are "wholly unrelated" to credit risk or the underwriting of the loan, including "requirements related to the status of the creditor rather than the loan, requirements related to selling, securitizing, or delivering the loan and any requirement the creditor is required to perform after the consummated loan is sold, guaranteed, or endorsed for insurance such as document custody, quality control and servicing." The Bureau states that requirements wholly unrelated to credit risk or the underwriting of the loan are wholly unrelated to a consumer's ability-to-repay.

The Preamble to the Amendments also states the CFPB's view that minor inaccuracies in input data that do not affect the loan's eligibility for purchase, guarantee or insurance should not affect its QM status, although this clarification is not expressed in the text of the amended regulation or commentary. Further, a repurchase or indemnification demand by a GSE or Federal Agency would not automatically strip a loan of its QM status because "[s]ome repurchase or indemnification demands are not related to eligibility criteria at consummation." [New Staff Comment 43(e)(5).]