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ANNOUNCEMENT
KPMG LLP (U.S.)

June 2013

Regulatory Alert – Ability-to-Repay and Qualified Mortgages: Industry Updates

What you need to know:

- The Consumer Financial Protection Bureau (CFPB or Bureau) released final rules on May 29, 2013 that amend the Bureau's rules to implement the Ability-To-Repay (ATR) provisions of the Dodd Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), which were released in January 2013 (ATR final rules). Among other things, the May final rules:
  - Modify the calculation of loan officer/broker compensation, making it easier for more loans to meet the 3 percent threshold set for points and fees under the qualified mortgage (QM) provisions.
  - Withdraw a proposed exemption from the ATR final rules for credit extended as a refinancing that is eligible to be purchased by Fannie Mae or Freddie Mac (the GSEs) or certain other federal agencies.
- Also in May, the Federal Housing Finance Agency (FHFA) publicly announced that it directed the GSEs to limit their future mortgage acquisitions (beginning January 2014) to loans that 1) meet the requirements for a QM, including those that meet the special or temporary QM definition detailed in the ATR rules, or 2) are exempt from the ATR requirements. The GSEs state they will rely on lender selling representations and warranties that the loans are QMs.
- A proposed rule released by the CFPB in April 2013 remains outstanding and would clarify certain provisions in the ATR rules including those related to the: determination of debt and income for purposes of originating QMs; and, use of GSE and federal agency purchase, guarantee or insurance eligibility for determining QM status.

Note: The ATR final rules generally require lenders to make a reasonable, good faith determination of a consumer's ability to repay before originating a mortgage loan and establish certain protections from liability for QMs. The ATR rules take effect for applications dated

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on or after January 10, 2014. The CFPB's ATR final rules present great challenges in adoption and implementation for institutions, mortgage brokers, and correspondent lenders alike, especially with regard to QMs.

What you need to consider:

Bank and nonbank mortgage creditors should be fully engaged in their preparation for implementation of the ATR final rules in January 2014. At this time, they should also consider:

- Many lenders are reevaluating their product offerings and business strategies with a critical examination of the product mix (e.g., should they offer only QMs), the investment/securitization market, and servicing options. The ATR final rules framework is larger than just QMs and lenders do not have to originate QMs.

- The QM guidelines have prescriptive components, such as the debt-to-income ratio and the income calculation, but there are other areas where the requirements are not as prescriptive and must be established by the lender, such as credit history and credit score cutoffs.

- The GSEs will be issuing their own QM eligibility and underwriting guidelines under the direction of FHFA. Most lenders will want to ensure that they have the ability to originate GSE-conforming loans according to the guidelines issued by the GSEs. However, lenders following the GSE QM guidelines do not have to sell these loans to Fannie Mae or Freddie Mac to gain the QM presumption.

- A key item in the ATR final rules is the requirement that lenders determine a consumer's ability to repay using verified and documented information – so document, document, document.

- Great market uncertainty continues to surround the potential impacts to QMs resulting from the anticipated final rules that will define Qualified Residential Mortgages (QRMs) under the risk retention provisions and that will implement the new Integrated Mortgage Disclosures.

From an operations perspective, bank and nonbank mortgage creditors should have begun to:

- Assess current mortgage processes and related systems; identify gaps in compliance practices; and develop controls/control enhancements to ensure alignment with new regulatory demands from the ATR rules, QM requirements, and customer expectations.

– Assess third-party vendor management oversight and conduct analysis and testing of vendor compliance, including changes to underwriting standards for ATR-QM requirements. Current and prospective vendors should be held to the same standards as bank and nonbank mortgage creditors.

– Conduct Fair Lending analysis and analysis of QM-related lending criteria, like "material non-debt obligations" and "residual income."

– Conduct analysis and testing of points and fees calculations for HOEPA (Home Ownership and Equity Protection Act), QM, and state high cost thresholds.

– Perform gap analysis in preparation of the general ATR-QM rule impact as well as temporary special QM eligible for purchase by the GSEs as directed by FHFA.

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