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CFPB Issues "Seasoned Qualified Mortgage" Rule

by Stephen Ornstein

On December 10, 2020, the Consumer Financial Protection Bureau (CFPB) issued an innovative final rulemaking that creates a pathway to "safe harbor" qualified mortgage (QM) status for performing non-QM and "rebuttable presumption" QM loans that meet certain performance criteria portfolio requirements over a seasoning period of at least 36 months and that satisfy certain product restrictions, points and fees limits, and underwriting requirements before consummation.

The CFPB promulgated this "seasoned QM" rulemaking simultaneously with the rule that terminates the "QM Patch" and amends the general QM rules.

The seasoned QM rule is effective for applications received on or after March 1, 2021.

Background

Under the revised general QM rule, for first-lien transactions, a loan receives a conclusive presumption that the consumer had the ability to repay (and hence receives the "safe harbor" presumption of QM compliance) if the annual percentage rate (APR) does not exceed the average prime offer rate (APOR) for a comparable transaction by 1.5 percentage points or more as of the date the interest rate is set.

A first-lien loan receives a "rebuttable presumption" that the consumer had the ability to repay if the APR exceeds the APOR for a comparable transaction by 1.5 percentage points or more but by less than 2.25 percentage points. The revised general QM rule provides for higher thresholds for loans with smaller loan amounts, subordinate-lien transactions, and certain manufactured housing loans. *Loans with higher APRs than these thresholds are designated as non-QMs*.

In order to qualify for QM status, the loan must meet the statutory requirements for the 3% points and fees limits and must not contain negative amortization, a balloon payment (except in the existing limited circumstances), or a term exceeding 30 years.

Pathway to Safe Harbor QM Status

In the seasoned QM rule, a non-QM loan or rebuttable presumption QM receives a safe harbor from ability-to-repay (ATR) liability at the end of a seasoning period of at least 36 months as a seasoned QM if it satisfies certain product restrictions, points-and-fees limits, and underwriting requirements and the loan meets the designated performance and portfolio requirements during the seasoning period. The CFPB's stated purpose of the rule is to "enhance access to responsible, affordable mortgage credit" and to incentivize "the origination of non-QM and rebuttable presumption QM loans that a creditor expects to demonstrate a sustained and timely mortgage payment history."

Criteria for a Seasoned QM

In order to become eligible to become a seasoned QM and receive a safe harbor from ATR liability at the end of the 36-month seasoning period, the loan must meet the following criteria:

- The loan is secured by a first lien.
- The loan has a fixed rate, with regular, substantially equal periodic payments that are fully amortizing and no balloon payments.
- The loan term does not exceed 30 years.
- The loan is not subject to the Home Ownership and Equity Protection Act.
- The loan's points and fees do not exceed the 3% threshold or other specified applicable limit.
- The creditor must *consider* the consumer's debt-to-income ratio or residual income, income or assets, other than the value of the dwelling, and debts, and *verify* the consumer's income or assets, other than the value of the dwelling, and the consumer's debts, using the same consider and verify requirements established for general QMs in the general QM rule.
- Subject to limited exceptions, the creditor must hold the loan for the entire 36- month seasoning period.
- The loan must meet certain performance criteria; namely, there must have been no more than two delinquencies of 30 or more days and no delinquencies of 60 or more days at the end of the seasoning period.

Seasoning Criteria

The CFPB defines the seasoning period as a period of 36 months beginning on the date the first periodic payment is due after consummation *unless* there is a delinquency of 30 days or more at the end of the 36th month of the seasoning period—then the seasoning period continues until this delinquency ends.

Further, the seasoning period is tolled (and hence, does not include) any period during which the consumer is in a "temporary payment accommodation" extended in connection with a disaster or pandemic-related national emergency as long as certain conditions are met. The rule clarifies that the seasoning period can only resume after the temporary accommodation if any delinquency is cured either pursuant to the loan's original terms or through a "qualifying change." The rule defines a "qualifying change" as an agreement entered into during or after a temporary payment accommodation extended in connection with a disaster or pandemic-related national emergency that ends any preexisting delinquency and meets certain other conditions such as not increasing the amount of interest charged over the full term of the loan as a result of the agreement or imposing fees on the consumer.

Portfolio Retention

The rule requires the creditor that originates the loan to hold it in its portfolio for the entire 36-month seasoning period unless one of the limited exceptions applies. Notably, the rule permits the creditor to sell or assign a *single* loan as long as the assignee retains the loan for the remainder of the seasoning period and the loan is not securitized. The two other exceptions to the portfolio are (1) sales or assignments of loans during a merger involving the creditor and another party; and (2) transfers of ownership pursuant to certain supervisory sales such as a conservatorship or bankruptcy.

Loan Performance

To be eligible as a seasoned QM, the loan must have no more than two *delinquencies* of 30 or more days and no *delinquencies* of 60 or more days at the end of the 36-month seasoning period. Under the rule:

> Delinquency means the failure to make a periodic payment (in one full payment or in two or more partial payments) sufficient to cover principal, interest, and escrow (if applicable) for a given billing cycle by the date the periodic payment is due under the terms of the legal obligation. Other amounts, such as any late fees, are not considered for this purpose.
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> (1) A periodic payment is 30 days delinquent when it is not paid before the due date of the following scheduled periodic payment.
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> (2) A periodic payment is 60 days delinquent if the consumer is more than 30 days delinquent on the first of two sequential scheduled periodic payments and does not make both sequential scheduled periodic payments before the due date of the next scheduled periodic payment after the two sequential scheduled periodic payments.

Further, notably, except for purposes of making up nominal deficiency amounts (i.e., $50 or less) no more than three times during the seasoning period, payments from the following sources may *not* be considered in assessing “delinquencies”:

- Funds in escrow in connection with the loan.
- Funds paid on behalf of the consumer by the creditor, servicer, or assignee.

The CFPB has indicated that payments made from escrow accounts established in connection with the loan or from third parties on the consumer’s behalf should not be considered in assessing performance for seasoning purposes because, for example, a creditor could escrow funds from the loan proceeds to cover payments during the seasoning period even if the loan payments were not actually affordable for the consumer on an ongoing basis. The CFPB reasons that if a creditor needs to take funds from an escrow account or from a third party to cover an outstanding periodic payment, the payment from the escrow or third party raises doubt about the consumer’s ability to make the periodic payment.

GSE and Insurers Warranty Framework

In devising the performance framework for the 36-month seasoning period, the CFPB looked to the existing standards of the government-sponsored enterprises (GSEs) and certain mortgage insurers. The CFPB observed that each GSE generally provides creditors relief from its enforcement for certain representations and warranties a creditor must make to the GSE regarding its underwriting of a loan after the first 36 monthly payments if the borrower had no more than two 30-day delinquencies and no delinquencies of 60 days or more. Similarly, the CFPB noted that the master policies of mortgage insurers generally provide that the mortgage insurer will not issue a rescission for certain representations and warranties made by the originating lender if the borrower had no more than two 30-day delinquencies in the 36 months following the borrower's first payment, among other requirements.

Takeaways

The CFPB believes that the creation of a special seasoned QM is warranted because, in its view, many loans made to creditworthy consumers that do not fall within the existing QM loan definitions at consummation may be able to demonstrate through sustained loan performance compliance with the ATR requirements. In considering the GSEs' warranty frameworks, the CFPB noted that in most, albeit not all, instances, a default after 36 months of loan performance is usually *not* attributed to deficient loan underwriting but rather to a change in the consumer's circumstances that the creditor could not have reasonably anticipated before consummation.

Further, the statute of limitations period for an affirmative private right of action for damages for an ATR violation is generally three years from the date of the violation. Consequently, a consumer would not be prevented from bringing an ATR claim during the contemplated seasoning period.

Nevertheless, conferring safe harbor QM status on a loan that was originated as a non-QM or a rebuttable presumption QM after the requisite seasoning period would curtail the consumer's ability to invoke an ATR violation as a defense to foreclosure or assert civil damages as a recoupment claim after 36 months unless the seasoning period is extended. Therefore, the CFPB contends that the special seasoned QM category will incentivize the origination of non-QM loans that otherwise may *not* be made—or made at a significantly higher price—due to perceived litigation, civil liability exposure, or other defense to foreclosure risks, even if a creditor has confidence that it can originate the loan in compliance with the ATR requirements.

Not surprisingly, while the residential mortgage industry strongly supported the rulemaking, consumer advocacy groups generally opposed not only significant aspects of the rule but also the concept of a seasoned QM notwithstanding the many concessions that the CFPB made to them. Although the rule has limited applicability given its many requirements, it is uncertain whether a new CFPB director appointed in the Biden Administration will retain the rule in its present form.

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