



Financial Services & Products ADVISORY ■

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The QM Patch Is Down for the Count

by [Stephen Ornstein](#)

Whether they realize it or not, absent a last-minute intervention from the Federal Housing Finance Agency (FHFA), effective July 1, 2021, creditors will no longer be able to originate qualified mortgage loans using the “QM Patch.” The reason for this dramatic event is that on April 8, 2021, Fannie Mae and Freddie Mac [announced in separate pronouncements](#) that effective for loans with application dates after June 30, 2021 (for Fannie Mae; for Freddie Mac, applications received on or after July 1, 2021), the loans must conform with the revised qualified mortgage (QM) loan rules—and cannot be QM Patch loans. Stated another way, since the FHFA is terminating the QM Patch, loans underwritten to the QM Patch after July 1, 2021 will no longer be eligible for sale to the government-sponsored enterprises (GSEs), and in effect, the QM Patch disappears after that date. This development *contradicts* the Consumer Financial Protection Bureau’s (CFPB) final rulemaking delaying the mandatory effective date of the revised QM rules until October 1, 2022. Under that CFPB rulemaking, during the period between March 1, 2021 and October 1, 2022, the CFPB intends for creditors to have the option of originating QM loans either under the legacy QM rules, including the QM Patch, or the revised QM rules.

Background

On December 10, 2020, former CFPB director Kathy Kraninger [issued the revised QM rules](#) that replaced Appendix Q and strict 43% debt-to-income ratio (DTI) underwriting threshold with a priced-based QM loan definition. The revised QM rules also terminated the QM Patch, under which certain loans eligible for purchase by Fannie Mae and Freddie Mac do not have to be underwritten to Appendix Q or satisfy the capped 43% DTI requirement. The rule was to take effect on March 1, 2021, but compliance would not be mandatory until July 1, 2021. Under the rulemaking, the QM Patch would have expired on the earlier of July 1, 2021 or the date that the GSEs exit conservatorship.

On April 27, 2021, the CFPB promulgated a final rule delaying the mandatory compliance date of the revised QM rule from July 1, 2021 to October 1, 2022. Notably, under this rule, the QM Patch is extended to October 2022, which gives creditors the option of originating QM rules under either the legacy QM rules or the revised QM rules between March 1, 2021 and October 1, 2022.

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This “optionality” has been partially negated by the GSEs’ April 2021 pronouncements in which they announced that they, in effect, will adhere to the mandatory effective date of the revised QM rules as originally promulgated by Kraninger in December 2020. In particular, in Fannie Mae Lender Letter 2021-09, Fannie Mae indicated it will no longer acquire loans that are QM Patch loans that do not meet the revised QM rules.

To be eligible for purchase by Fannie Mae, QM Patch loans must:

- have application dates on or before June 30, 2021, and
- be purchased as whole loans on or before Aug. 31, 2021, or in MBS pools with an issue date on or before Aug. 1, 2021.

Similarly, in Freddie Mac Bulletin 2021-13, Freddie Mac noted that it will no longer purchase QMs under the QM Patch effective for mortgages with “Application Received Dates” on or after July 1, 2021 and all mortgages with “Settlement Dates” after August 31, 2021.

On May 26, 2021, Fannie Mae and Freddie Mac issued [additional guidance](#) reiterating that QM Patch loans that do not meet the revised QM rule must have application dates on or before June 30, 2021. This GSE guidance indicates that single-closing construction-to-permanent loans with application dates before July 1, 2021 that meet the QM Patch (and do not meet the revised QM rules) can be purchased or securitized on or before February 28, 2022.

Under the [relevant CFPB regulations governing the QM Patch](#), a loan must, among other things, be *eligible* to be “purchased or guaranteed” by Fannie Mae or Freddie Mac. Stated another way, if the loan is not *eligible* for purchase or guarantee by Fannie Mae or Freddie Mac, the creditor may not avail itself of the QM Patch. Therefore, the GSEs’ April 2021 pronouncements indicating that effective July 1, 2021, QM Patch loans would no longer be *eligible* for sale to Fannie Mae and Freddie Mac sounds the death knell for the QM Patch notwithstanding the CFPB’s intention to extend it to October 2021.

The Takeaway

Therefore, absent a last-minute amendment by the FHFA, creditors have the following options for originating QM loans:

- Commencing March 1, 2021, creditors may underwrite to the revised QM rules.
- At this juncture, for non-agency loans, the revised QM rules become mandatory on October 1, 2022.
- For Fannie Mae and Freddie Mac, however, the revised QM rules become mandatory on July 1, 2021, meaning that the QM Patch effectively terminates on July 1, 2021—and that all loans sold to Fannie and Freddie must comply with the revised QM rules, effective July 1, 2021.
- From March 1, 2021 until October 1, 2022, creditors *not* selling loans to Fannie and Freddie may continue to underwrite to the legacy QM rules; however, commencing July 1, 2021, legacy QM loans must be underwritten to Appendix Q and *NOT* to the QM Patch. Stated another way, since the FHFA is terminating the QM Patch, loans underwritten to the QM Patch after July 1 will no longer be eligible for sale to the GSEs, and in effect, the QM Patch disappears after that date, notwithstanding the CFPB’s intent for it to continue until October 1, 2022.
- Hence, for non-agency loans, from July 1, 2021 until October 1, 2022, legacy QM loans must be underwritten in accordance with Appendix Q.

Consider and Verify Requirements

Creditors originating loans under the revised QM rules should recognize that they will no longer be able to rely on a valid underwriting recommendation provided by a GSE automated underwriting system (AUS) or an AUS that relies on an agency underwriting tool to satisfy the “consider” and “verify” components of the new QM underwriting requirements. In lieu of underwriting to Appendix Q, the revised QM rules require that the creditor *consider* the consumer’s current or reasonably expected income or assets other than the value of the dwelling (including any real property attached to the dwelling) that secures the loan, debt obligations, alimony, child support, and DTI ratio or residual income as well as *verify* the consumer’s current or reasonably expected income or assets other than the value of the dwelling (including any real property attached to the dwelling) that secures the loan and the consumer’s current debt obligations, alimony, and child support.

As part of the *consider* requirement, a creditor must maintain *policies and procedures* for how it takes into account the underwriting factors enumerated above, as well as *retain documentation* showing how it took these factors into account in its ability-to-repay determination.

The CFPB indicates that this “documentation may include, for example, an underwriter worksheet or a final automated underwriting system certification, in combination with the creditor’s applicable underwriting standards and any applicable exceptions described in its policies and procedures, that shows how these required factors were taken into account in the creditor’s ability-to-repay determination.”

The revised QM rules do not prescribe specific methods of underwriting that a creditor must use, as long as the creditor uses third-party records that provide reasonably reliable evidence of the consumer’s income or assets. Indeed, the rule permits the creditor to use any “reasonable verification method and criteria.”

Nevertheless, the CFPB provides a “safe harbor” to creditors using verification standards from relevant provisions from Fannie Mae’s Single Family Selling Guide, Freddie Mac’s Single-Family Seller/Servicer Guide, FHA’s Single Family Housing Policy Handbook, the VA’s Lenders Handbook, and the Field Office Handbook for the Direct Single Family Housing Program and Handbook for the Single Family Guaranteed Loan Program of the USDA. In other words, under the rule, a creditor is deemed to have complied with this verify requirement if it complies with the verification standards in one or more of these agency manuals.

To comply with these “consider” and “verify” requirements, we recommend that the creditor promulgate the requisite written policies and procedures and related documentation such as underwriter worksheets, and that if the creditor intends to use the verification safe harbor, its written policies and procedures specify the precise agency handbooks that it is relying on with specific references to the particular provisions addressing income, assets, debt obligations, alimony, and child support using specified documents or to classify and count particular inflows, property, and obligations as income, assets, debt obligations, alimony, and child support.

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