Division of Depositor and Consumer Protection

National Banker Teleconference
Common Questions & Answers Pertaining to Implementation of the CFPB's Ability-to-Repay/Qualified Mortgage and Loan Originator Compensation Final Rules

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Agenda

- Ability-to-Repay/Qualified Mortgage Rule (“ATR/QM Rule”)
- Loan Originator Rule (“LO Rule”)
- Submitted Q & A’s

Questions?

If you have any questions please email them to:

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Ability-to-Repay/ Qualified Mortgage Rule (ATR/QM Rule)

ATR/QM Rule

Refresher

- Creditors must make a "reasonable, good faith determination" that the consumer, at the time of consummation, has a reasonable ability to repay a loan according to its terms.

- To make the determination, either
  - "Consider and verify" 8 underwriting factors, or
  - Write one of several types of Qualified Mortgages ("QMs")
    - *QMs also have underwriting requirements.*

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ATR/QM Rule

- **“8 Factors” compliance for non-QMs**
  - No special non-QM product or loan feature limitations

    (*Note*: Prepayment penalties are banned on non-QM’s <u>and</u> some QM’s)
  - No specific limit on DTI, LTV or credit score
- **QMs**
  - Some product and loan feature limitations plus underwriting requirements
  - Available for <u>all</u> creditors
    - “General” QM
    - Temporary government (“government patch”) QM
    - HUD/FHA QM; VA QM
  - Special QMs for “small creditors” holding loans in portfolio for at least 3 years
    - Small creditor portfolio QM (non-balloon)
    - Small creditor portfolio balloon QM (*after 1/10/16, rural/underserved only*)

ATR/QM Rule

Question # 1: Are community banks limited to a 43% DTI?

Answer: The special small creditor QMs do not include a 43% DTI limit.

- Must consider or verify DTI, but no specific DTI limit.
- Government-related QMs also available; subject to applicable program DTI & underwriting standards, 43% QM DTI limit does not apply.
  - (Look to applicable government program DTI standards, if any.)

*A majority of active mortgage lending community banks responding to a survey reported that **90% or more of their 2013 portfolio loans would have qualified for QM**.*

Community Banking in the 21st Century. (Federal Reserve CSBS, Sept, 2014)

http://www.csbs.org/news/csbswhitepapers/Documents/FINALPUBLICATION.pdf

ATR/QM Rule

Question # 2: We are concerned that there is not sufficient flexibility in the ATR/QM rule for community banks in connection with Home Equity Lines of Credit or balloon loans that were made prior to the rule's implementation when they come due. What are our options?

Answer: Banks have considerable flexibility.

- Repayment phase of a HELOC is not a "new transaction" subject to ATR/QM.
  - Section 1026.40, regarding modifications of HELOCs, is unchanged.
- Loan modifications are not new transactions subject to ATR.
  - Definition of refinancing in 1026.20 is unchanged.
- Some loss mitigation, foreclosure prevention programs are exempt from ATR. (1026.43(a)(3)(vi))
- "Non-standard" to "standard" refinances are exempt from ATR requirements (1026.43(d))
- Check government QMs, *e.g.* HARP, FHA.

ATR/QM Rule

Question 3: Can community banks still write balloons and other alternative products?

Answer: Community banks can make balloon loans.

- Non-QM balloons permitted, as are other alternative products, *e.g* non-QM interest-only loans.
  - Check requirements for what payments to underwrite to for ATR.
- “Small creditor” portfolio balloon QMs.
  - Must qualify as “small creditor”.
  - Must hold loan in portfolio for 3 years (some exceptions).
  - Some underwriting and loan feature limitations apply to the balloon QM.

ATR/QM Rule

QUESTION # 4: How can we qualify self-employed borrowers?

Answer:

- For non-QMs & small creditor QMs:
  - Consider and verify current and reasonably expected income and assets.
  - Third-party records to verify can include –
    - Records of financial institutions & tax returns, etc.
      - You can use your own records of accounts with the customer.
- For "standard QM"
  - Use Appendix Q
- For government QMs
  - Look to the relevant program guidelines

ATR/QM Rule

Question # 5: Are we at risk of potential fair lending violations from our regulators if we only write QM's?

Answer: A bank's decision to write only QM loans would not, absent other factors, elevate a bank's fair lending risk. The agencies believe that QM is compatible with fair lending.

-Interagency Statement on Fair Lending Compliance and the Ability-to-Repay and Qualified Mortgage Standards Rule

October 22, 2013

-FDIC FIL 59-2013

December 13, 2013

ATR/QM Rule

Question # 6: Will the FDIC criticize banks or increase supervisory scrutiny on non-QM's?

Answer: No. Bank's decisions to write QM's or Non-QM's may be based on their risk strategies and risk appetite. Mortgage loans will not be subjected to safety and soundness criticism based solely on their status as QM or Non-QM.

-FDIC FIL 59-2013

December 13, 2013

Loan Originator Rule
(LO Rule)

Loan Originator Rule

Refresher:

- The Mortgage Loan Originator Rule, originally issued by the Federal Reserve, became effective in April 2011.

- The CFPB issued a final rule in 2013 to implement the remaining Dodd-Frank provisions and provided revisions and additional commentary to address existing provisions.

Loan Originator Rule

Question # 7: If we vary compensation based on whether the loan is held in portfolio vs. sold into the secondary market, would this constitute a factor that is a proxy for a loan term, and therefore prohibited by the rule?

Answer: *It depends.* To answer this we must perform a proxy analysis. If the answer to both questions of the two-part proxy analysis is "yes," then the factor is a proxy for a term and any compensation based on this factor would be in violation of the rule. If the answer to either or both questions is "no," then the factor is not a proxy for a term of a transaction and compensation based on this factor would not be prohibited.

Loan Originator Rule

Proxy Analysis Flowchart

START

Complete two-part proxy analysis

1) Does the factor consistently vary with a term or terms over a significant number of transactions?

<u>**AND**</u>

2) Does the LO have the ability, directly or indirectly, to add, drop, or change the factor when originating the transaction?

Yes to both

Violation. Does not comply because compensation is based on a proxy for a term of a transaction.

No to 1, 2, or both

No violation. Complies because compensation is based on a factor that is not a proxy for a term of a transaction.

Loan Originator Rule

Proxy Example: Comment 1026.36(d)(1) – 2.ii.A

Assumptions:

- Creditor pays the LO higher compensation for loans held in portfolio than for loans it sells into the secondary market.
- Creditor only holds 5-year, fixed-rate balloon loans in portfolio, selling all other loans.
- Loans sold in secondary market typically have a higher fixed interest rate and longer loan terms.

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Loan Originator Rule

Portfolio vs. Secondary Market Proxy Analysis Conclusion:

If compensation varies based on the factor of whether the loan is held in portfolio vs. sold into the secondary market, using the aforementioned assumptions, the factor would be a proxy for a loan term, and therefore prohibited by the rule.

(1) First prong of the analysis is met: The factor consistently varies with one or more terms of the transaction (portfolio loans have lower rate and shorter term) over a significant number of transactions.

(2) Second prong of the proxy test is met: The loan originator has the ability to add, drop or change the factor in originating the transaction because the loan originator has the ability to direct the consumer to choose a five-year balloon loan over a 30-year fixed-rate loan.

Loan Originator Rule

Don’t combine the analysis!

The steering prohibition and the prohibition on paying compensation on a term or proxy for a term of transaction are separate and each have their own independent analyses.

Loan Originator Rule

Question # 8: Is varying compensation to a loan originator-employee based on the loan originator-employee's "source of the lead" (whether provided by the bank to the loan originator-employee or self-generated by the loan originator-employee outside of the bank) permissible under the rule?

Answer: Likely yes. First, the "source of the lead" is not a term of a transaction. Second, the "source of the lead" is not a factor that is a proxy for a term because this method of compensation does not meet the second part of the proxy analysis, as there is no ability to change the number of bank provided leads. Thus, compensation based on this factor would be permissible under the rule.

Loan Originator Rule

Question # 9: Can banks pay bonuses based, in whole or in part, on profitability derived from a bank's mortgage origination activities?

Answer: Yes, though there are some limits. The Rule allows for this compensation to be paid in two forms:

- under "designated tax-advantaged" plans; and
- under "non-deferred profits-based" plans, when certain conditions are met.

Loan Originator Rule

In order to pay compensation under the “non-deferred profits-based” plan exemption, at least one of the following conditions must be met:

(1) The compensation paid may not exceed 10 percent of the loan originator’s total compensation for the applicable period;

or

(2) The individual was a loan originator for 10 or fewer transactions subject to 1026.36(d) consummated in the 12-month period preceding the date of the compensation determination.

Loan Originator Rule

Profit-Based Compensation Analysis Flowchart

Does the profit-based compensation depend only on profits from business other than mortgage related business?

Yes → This compensation is **permitted**, as it is not based on the terms of mortgage transactions.

No ↓

Is the compensation based on the terms of the individual LO's covered transactions?

Yes → This compensation is **prohibited** under 1026.36(d)(1).

No ↓

Did the individual LO originate **more than 10** covered transactions during the 12-month period preceding the compensation determination?
OR
Does the profits-based compensation paid to the individual LO **exceed 10%** of the LO's total compensation for the time period in which the bonus is being considered?

Yes to both → This compensation is **prohibited** under 1026.36(d)(1).

No to at least one → This compensation is **permitted** under 1026.36(d)(1)(iv).

Loan Originator Rule

Total Compensation:

(a) Wages and tips from W-2, box 5 (or IRS Form 1099-MISC if the originator is an independent contractor)

\+ (b) All contributions that are actually made to the individual loan originator's defined contribution tax-advantaged plans

\+ (c) All compensation under a non-deferred profits-based compensation plan that is earned during the relevant time period (including the cash value of awards)

= Total Compensation

***Comments 1026.36(d)(1) – 3.v.F. 1 & 2 provide examples for calculating total compensation**

Loan Originator Rule

Question # 10: When is an individual or organization considered a loan originator, and therefore subject to the rule?

Answer: An individual or organization is considered a loan originator when two conditions are met:

(1) certain activities are engaged in by that individual or organization; and

(2) such activities are engaged in for, or in expectation, of compensation or other monetary gain.

Loan Originator Rule

A **“loan originator”** is a person who:

“In expectation of direct or indirect compensation or other monetary gain or for direct or indirect compensation or other monetary gain, performs any of the following activities:

- *takes an application;*
- *offers, arranges, assists a consumer with obtaining or applying to obtain, negotiates, or otherwise obtains or makes an extension of consumer credit for another person; or*
- *through advertising or other means of communication represents to the public that such person can or will perform any of these activities.”*

Loan Originator Rule

Let's illustrate with an example of a table-funded transaction:

- Entity closes transaction in its own name;
- Does not fund the transaction from its own resources; and
- Assigns the transaction after consummation to the organization providing the funds.

The originating entity, who closes the transaction in their own name, is considered a loan originator organization for purposes of §1026.36 and is subject to compensation restrictions.

Loan Originator Rule

Question # 11: Is it true that the LO who begins the application process should also close the loan?

Answer: No. This is not a requirement of the regulation. If more than one individual meets the definition of a loan originator for a transaction, the name and NMLSR ID (Unique Identifier Number) must be included on the application, note, and security instrument for the individual LO with primary responsibility for the transaction at the time the loan document is issued. *(See Comment 1026.36(g)(1)(ii)-1 of the Official Interpretations)*

Loan Originator Rule

Question # 12: What is the scope of the requirement to maintain written policies and procedures with respect to the LO rule?

Answer: Written policies and procedures to monitor compliance with the provisions of 1026.36(j) on compensation, qualification, identification, and steering must be maintained. They must be appropriate to the nature, size, complexity, and scope of the mortgage-lending activities of the institution as well as its subsidiaries.

Loan Originator Rule

Consider <u>how</u> your institution:

- Avoids prohibited payments to loan originators;
- Prevents steering;
- Establishes loan originator qualification requirements; and
- Ensures name and NMSLR ID are properly included on loan documents.

ATR/QM & Loan Originator Rules

Question # 13: What are some best practices that you recommend to help improve our compliance management program to address issues with LO comp and ATR/QM rules?

Answer: We recommend banks adopt clear policies and procedures and maintain documentation within your institution.

Questions?

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