News Analysis

On December 10, the Consumer Finance Protection Bureau (CFPB) issued the final rule for the criteria which define a Qualified Mortgage, and the introduction of an innovative seasoned loan category could provide a route for increased lending and greater MBS issuance, say market observers.

Under the new ruling, mortgages which do not initially meet the qualification benchmarks for QMs may become a QM if, over a 36-month period, they demonstrate the capacity for full and timely repayment. The loan must not have been delinquent for more than two 30-day periods and cannot have been delinquent for more than 60 days in the previous 36 months.

But there are exceptions. For example, if the loan is considered to have become delinquent due to a disaster or pandemic-related national emergency, then the borrower may be allowed an accommodation and his or her loan still considered a QM.

To be eligible to become a seasoned QM, a loan must be a first-lien, fixed-rate loan with no balloon payments and must meet certain other product restrictions. “This seasoned QM Final Rule will ensure access to responsible, affordable credit in the mortgage market through responsible innovation,” says CFPB director Kathleen Kraninger.

“The big unknown is the seasoned QM status. This is a new category which has been carved out and which has the potential for growth. If people have a lot of seasoned loans they are looking to get off their books through securitization, this gives them an avenue,” says Timothy Willis, an md and head of the governance and controls practice at RiskSpan, the data analysis and risk consultancy firm.

Moreover, the abolition of Appendix Q will perhaps increase ease of access to mortgage credit to a wider range of borrowers, thus increasing the pool of assets for the MBS market. The original ruling that defined QMs, as part of the Dodd-Frank legislation conceived in the aftermath of the financial crisis of 2008/2009, stipulated a wide range of detailed documentary evidence the creditor had to gather from the borrower before QM status was granted, known as Appendix Q.

This ruling tended to discriminate against those in self-employment or part of what has become called the gig economy, and also those who are asset rich but income poor. "Appendix Q was outdated and had lots of holes. It was stifling for many borrowers and prevented consideration of many types of stable income," says Kris Kully, a partner in Mayer Brown's Washington DC office.

Replacing Appendix Q is the new Regulation Z, which throws the onus for determination of capacity to repay upon the creditor. The latter must now "consider and verify" loan underwriting requirements. This means the borrower's assets and expected income should be assessed and verified, but it is not nearly as prescriptive as the former ruling.

So, once again, this could open the door to increased lending. Additionally, MBS deals which incorporate only QM loans are exempt from risk retention rules. This would be an incentive to greater issuance. "There could be greater creativity and variability in the types of loan that are included in MBS deals which are exempt from risk retention rules," suggests Kully.

One of the central platforms of the new rules is the removal of the so-called GSE Patch. This allowed all loans that were sold to Fannie Mae and Freddie Mac to be considered QM whether or not they satisfied the criteria for QM status that applied to private label bonds. From now on, all mortgages will considered alike, whether or not they are sold to a GSE or not. From June 30, all loans sold to the GSEs will be subject to the general QM rule.

"My sense is that if I were a regulator my concern with the Patch was that it basically outsourced responsibility for confirming what a QM is and just said 'whatever Fannie and Freddie say, that's good.' The CFPB has got out from under that," says Willis.

The great advantage of QM qualification is that it provides a shelter for the creditor against possible legal action by borrower for non-compliance. In the febrile post-crisis climate, with legal suits for unfair selling abounding, this was an important consideration for lenders.

Hand in hand with the elimination of the GSE Patch is the replacement of the 43% debt-to-income (DTI) ratio established in the 2010 rules and its replacement by a pricing criterion. Hitherto, a mortgage with an annual percentage rate (APR) of 225bp or less over the average prime offer rate (APOR) meets the threshold for QM status. This is the level beyond which loan performance deteriorates, according to ample statistical research conducted by the CFPB.

The substitution of the DTI ratio qualification with the pricing qualification addresses the concern that the removal of the GSE Patch would mean reduced availability of mortgage credit as the GSEs buy loans in which the DTIs are above 43%. Some of these loans may have an APR of less than 225bp over APOR and so will now qualify as QMs.

Of course, new White House administration might extend the GSE Patch beyond the slated June 30 expiration. The incoming government is perhaps less likely to want to reduce the role of the GSEs in the US mortgage market and create a level playing field - but this remains to be seen.

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