Process Improvement

The Truth About QM

Finally, the Consumer Finance Protection Bureau has defined what a Qualified Mortgage is. But now that the definition is out there what does it mean for mortgage technology?

By Tony Garritano

At long last, the Consumer Finance Protection Bureau has defined what a "Qualified Mortgage" really means. A lot of pundits were predicting a much more harsh definition, which would mean Armageddon for the mortgage industry. Much to the delight of many, that's just not what we got. To date there has been a flurry of coverage of what this new rule will mean for the space. Is it a positive? Is it a negative? In my column this week I decided to take a different approach. I decided to go out to mortgage technologists to get their two cents on QM.

First, enterprise lending solution provider Mortgage Cadence LLC was quick to praise the CFPB's take on QM and announce the company's readiness to meet the new Qualified Mortgage (QM) Rules released on January 10, 2013 by the Consumer Finance Protection Bureau. The Rules are slated to go into effect on January 1, 2014.

"The ability to repay and QM requirements have effectively forced credit underwriting guidelines into a regulatory compliance obligation," said Mortgage Cadence's Chief Legal and Compliance Officer, John Levonick. "While compliance with them appears cumbersome, and could be, lenders that have tight origination and quality control processes supported by the proper QM configuration within their loan origination system of record should not have any issues with these new requirements," he continued.

"Compliance, specifically, ensuring that the systems our customers use throughout the mortgage cycle are compliant, is one of our main guiding principles," said CEO of Mortgage Cadence Michael Detwiler. "Today's regulatory environment is more dynamic than at any time in the past. Our systems and our approach to compliance let our customers concentrate on lending, ensuring borrowers close on time. That's what mortgage finance is all about," he stated.

So, what does the new QM rule say exactly? In a brief supplied by the CFPB, the consumer watchdog explained it this way:

No excess upfront points and fees: A Qualified Mortgage limits points and fees including those used to compensate loan originators, such as loan officers and brokers. When lenders tack on excessive points and fees to the origination costs, consumers end up paying a lot more than planned.

No toxic loan features: Qualified Mortgages can't have the loan features that were associated with risky mortgages in the lead up to the crisis. Certain loans cannot be Qualified Mortgages:

>> No interest-only loans, which are when a consumer only pays the interest for a specified amount of time so the principal does not decrease with payments;

>> No loans where the principal amount increases, such as a negative-amortization loan; and

>> No loans where the term is longer than 30 years.

Cap on how much income can go toward debt: Qualified Mortgages generally will be provided to people who have debt-to-income ratios less than or equal to 43 percent. This cap on debt ensures consumers are only getting what they can likely afford. Before the crisis, many consumers took on mortgages that raised their debt levels so high that it was nearly impossible for them to repay the loan considering all their financial obligations. For a temporary, transitional period, loans that do not have a 43 percent debt-to-income ratio but meet government affordability or other standards, such as that they are eligible for purchase by the Federal National Mortgage Association (Fannie Mae) or the Federal Home Loan Mortgage Corporation (Freddie Mac) will be considered Qualified Mortgages.

No loans with a balloon payment except those made by smaller creditors in rural or underserved areas: The law generally prohibits loans with balloon payments from being Qualified Mortgages. Balloon-payment loans require a larger-than-usual payment at the end of the loan term. A small creditor operating in rural or underserved areas is permitted to originate such loans as Qualified

Mortgages under certain defined circumstances.

To put the rule into context, Marsha L. Williams, an attorney with Middleberg, Riddle & Gianna, which is affiliated with doc prep vendor MRG Document Technologies, added, “Although the Qualified Mortgage (“QM”) rule’s ability to repay requirements may result in a return to a somewhat “old fashioned” method of underwriting which involves a personal, deeper probing into the loan applicant’s living standards, technology will definitely be an integral part of lenders’ compliance with the QM rule.

The new QM rule introduces **definitive features and minimum requirements** that support mortgage products that **ensure “ability-to-pay.”**

“Compliance with the QM rule will include the use of technology to ensure that the mortgage term does not exceed 30 years and that negative amortization, interest-only or balloon payments are not features of the QM,” she continued. “The 3% limitation on points and fees on a $100,000 or more loan and greater limitations for smaller loans will be calculated using technology.

“The “conclusive presumption of compliance” or “legal safe harbor” includes the mortgage loan’s Annual Percentage Rate (“APR”) not exceeding the Average Prime Offer Rate by 1.5 percentage points for a first lien loan or 3.5 percentage points for a subordinate lien transaction. Technology calculations will determine if this APR limitation is exceeded,” Williams calculated.

Prior to the ruling our industry was crying out for clarity and consistency, which is in fact what the new QM Rule supplies. “The new QM rule introduces definitive features and minimum requirements that support mortgage products that ensure “ability-to-pay.” From a technology perspective, many of these features will need to be accommodated by origination and underwriting technology,” pointed out Andy Crisenbery, Senior Vice President of Business Operations at electronic collaboration vendor eLynx. “Requirements for debt-to-income ratios, teaser interest rates and other mortgage product features are controlled within the domain of the LOS.

“Technology is further implicated to ensure that requirement financial information from the borrowers are collected and validated. There has been a focus on this area for the past several years, but the new QM rule further underlines the importance that these evaluations take place and an audit history is provided with all of the changes throughout the lifecycle of the loan.

“Lastly,” concluded Crisenbery, “technology can help make these new QM rules – as well as further regulatory changes anticipated, consumable from a deployment perspective. The one benefit that is often overlooked is that a technical solution for these rules should enforce standardization across the lenders business processes.”

So, with QM defined and behind us, what will the next big debate be? “With QM, the big debate will be around how to protect consumers but still not shut out reasonable borrowers,” answered Lisa Weaver, senior vice president of Mortgage Solutions for ISGN. “The new QM rule brings stability to loan performance by discouraging risky loan products and ensuring borrowers qualify for mortgages. Poorly documented loans, loose underwriting criteria and irresponsible loan products contributed to historic levels of foreclosures and home value loss. While the new QM rule brings safety and soundness, the industry faces the challenge of addressing the needs of all credit-worthy consumers. Lenders will be faced with deciding how to provide mortgages to borrowers that do not meet the new parameters. In order to get to market equilibrium, as an industry we will need to address the rising cost of making loans. Playing it safe comes at a price as compliance and loan requirements have doubled the cost to originate a loan.”

And I think we can all agree, that’s where technology comes in. ❖

Tony Garritano is Chairman and Founder of PROGRESS in Lending. As a speaker Tony has worked hard to inform executives about how technology should be a tool used to further business objectives. For over 10 years he has worked as a journalist, researcher and speaker. He can be reached via e-mail at tony@progressinlending.com.