CFPB Establishes Four Paths to Qualified Mortgage Status

September 11, 2013 CRL Fact Sheet

In order to create a rule that meets consumer protection goals while also providing flexibility, the CFPB has established four different paths for loans to gain QM status. Each is detailed below:

1. **General Definition:**

The general Qualified Mortgage definition requires eligible loans to not exceed the points and fees threshold, not have negative amortization or interest-only payments, not be a balloon and have a term that does not exceed 30 years. In addition, borrowers must have a back-end debt-to-income ratio at 43% or below. Lenders must collect and verify a borrower's income, assets, debts and other obligations according to standards established in the regulation, which are found in Appendix Q of the regulation, in order to calculate the borrower's debt-to-income ratio.

2. **Compensating Factors Definition:**

The CFPB also created a temporary definition that allows loans eligible for insurance or guarantee by Fannie Mae, Freddie Mac, the Federal Housing Administration (FHA), the Rural Housing Service (RHS), and the Veterans Administration (VA) to gain Qualified Mortgage status. The CFPB created the temporary QM definition in order to "preserve[] access to credit in today's market by permitting a loan that does not satisfy the 43 percent debt-to-income ratio threshold to nonetheless be a qualified mortgage based upon an underwriting determination made pursuant to guidelines created by the GSEs while in conservatorship or one of the Federal agencies." These agency guidelines include additional underwriting standards – often called "compensating factors" – in order to approve a borrower with a debt-to-income ratio above 43 percent.

This temporary definition (available for a maximum of seven years) does not require that the GSEs or government agencies actually insure or guarantee loans under this category – only that loans would be eligible under the specified underwriting requirements for one of the GSEs or government agencies.

3. **Portfolio Loans Originated by Small Creditors Definition:**

This definition is not required in the Dodd-Frank Act, but the CFPB created the definition using its regulatory authority with the goal of preserving access to credit. Under this definition, lenders need to meet two criteria to count as a small creditor: first, have assets of no more than $2 billion and second, originate no more than 500 first-lien mortgages per year. Mortgages originated by an eligible small creditor can obtain QM status if they meet the points and fees threshold, there is no negative amortization, no interest-only payments, and the loan has a term of no more than 30 years. In addition, the lender is also "required to consider the consumer's debt-to-income ratio or residual income and to verify the underlying information." However, borrowers do not need to meet the 43% debt-to-income ratio threshold or use the debt-to-income ratio standards in Appendix Q.

4. **Balloon-Loan Definition:**

The CFPB also created a Qualified Mortgage definition specific to balloon loans. This designation is required by the Dodd-Frank Act for small lenders operating predominantly in rural or under-served areas; but the CFPB also used its regulatory authority to establish a two-year transition period that allows all small creditors – regardless of whether they operate in rural or underserved areas – to obtain QM status for balloon loans that are held in portfolio. After the transition period, the balloon loan definition only applies to those lenders who operate in rural or underserved areas under a definition that CFPB will continue to study. Both during the transition period and afterwards, balloon loans must meet the points and fees threshold, have no negative amortization, "have a term of at least five years, a fixed-interest rate, and meet certain basic underwriting standards; debt-to-income ratios must also be considered but are not subject to the 43 percent general requirement."