

FAQs On ATR & QM Rules For Small Entities – Part Two

By

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Introduction. *The FAQs below come directly from the most recent CFPB guidelines for January 2014. As I go through the rules I will supplement the FAQs. This information does not apply to the Big Banks, e.g. B of A, Morgan Stanley, JPMorgan, etc. Rather, it applies to “small creditors” such as community banks. Unfortunately, the regulators have sought to apply the ATR/QM rules even to Mom and Pop who may sell an occasional rental unit or two.¹ The CFPB gives “small creditors” or “small entities” certain underwriting latitude in the application of the ATR/QM rules. Generally, these are persons or entities with no more than \$2 billion in assets that make no more than 500 mortgage loans per year. Originally, the small entity exceptions were intended to apply only to “rural or underserved counties,” but until January 10, 2016, the exceptions will apply to all small creditors, regardless of location. Caveat: This material below is informational only and does not constitute “legal advice.” Moreover, it is summary only, and for more information, the actual regulations should be reviewed. [\[For Part One, go to link here.\]](#) ~PCQ*

11) How do I determine ATR? *Your organization is responsible for developing internal policies and underwriting standards and making changes to those standards over time in response to observable information as well as changing economic and other conditions. You must be familiar with the facts and circumstances relevant to your market, your organization, and your individual consumers. The CFPB has prepared some examples that illustrate how your internal policies can influence your ATR determinations. The list below is not intended to be comprehensive, but provides some factors that may show that your ATR determination was reasonable and in good faith:*

- *Underwriting standards: You have previously used standards to underwrite transaction that have historically resulted in comparatively low rates of delinquency and default during adverse economic conditions;*
- *Payment history: The consumer remained current for a significant time after origination or reset of an adjustable-rate mortgage;*
- *Here are factors that may show that your ATR determination was not reasonable and in good faith:*
 - *Underwriting standards: You ignored evidence that your underwriting standards are not effective at determining consumers’ repayment ability;*
 - *Inconsistency: You applied underwriting standards inconsistently or used underwriting standards different from those you used for similar loans without having a reasonable justification;*

¹ I maintain vehemently that on the state and federal levels, the CFPB rules do *not* apply to the occasional sale of residential property owned by persons who are not in the business of making such loans, when they “carry back the paper,” e.g. on a contract or note and trust deed. The fact that Oregon’s DFCS insists otherwise is a sad and disturbing commentary on the uber-regulatory mindset of governmental bureaucrats who would rather regulate than cogitate. Any sentient human being who has a passing familiarity with the housing and credit crisis would know that the occasional sale of residential property by Mom and Pop who carry back the paper, was never meant to be subject to the ATR/QM and mortgage loan originator laws.

- *Payment history: The consumer defaults early in the loan, or shortly after the loan resets, without having experienced a significant financial challenge or life-altering event.*
- *The reasonableness and good faith of your determination of ATR depends on the facts and circumstances relevant to the particular loan. [E.g. a particular ATR determination may be reasonable and in good faith even though the consumer defaulted shortly after consummation if, for example, they experienced a sudden and unexpected loss of income.]*
- *If the records you review indicate there will be a change in the consumers' repayment ability after consummation [e.g. they plan to retire and not obtain new employment, or they plan to transition from full-time to part-time work] you must consider that information.*

12. Do loans originated under these general ATR standards have to comply with certain debt-to-income ("DTI") thresholds? *The general ATR standard requires creditors to consider DTI or residual income, but does not contain specific DTI or residual income thresholds.*

13. What do I include on the income side of the DTI ratio when determining ATR? *You can include earned income, such as wages or salary; passive investment income, such as interest and dividends; and other regular payments to the consumer such as alimony, child support, or government benefits. In all cases, the amounts you rely upon to determine ATR must be verified. Once you have information about the consumers' income, you are expected to use it, along with the consumers' debt information, to calculate the DTI ratio or residual income.*

14. How do I calculate, consider, and confirm income, assets, employment, and credit history? *When you are evaluating the consumer's employment history, credit history, and income or assets to determine ATR, you need only verify only what is relied on to determine ATR. [E.g. if a consumer has a full-time job and a part-time job and uses only the income from the full-time job to pay the loan, you do not need to verify the income from the part-time job. If two or more consumers apply for a mortgage, you do not have to consider both incomes – unless both incomes are required to qualify for the loan and demonstrate ATR.]*

- *The same principles apply to a consumer's assets, as well. Income does not have to be full-time or salaried for you to consider it in your ATR determination;*
- *You can consider seasonal or bonus income;*
- *Remember that income relied on has to be verified using reasonably reliable third-party records;*
- *Future income can count toward ATR if you verify it using reasonably reliable third-party records. [E.g. if you have a consumer who accepts a job in March, but will not start until he/she graduates from school in May. If the employer will confirm the job offer and salary in writing, you can consider the future expected income in your ATR determination.]*

15. In determining ATR, may I rely upon consumer-supplied documents? *Sometimes you may have to rely on the consumers' report of their own income. [E.g. a cattle rancher might give you an updated P&L for the current year to supplement his tax returns from prior years. These records are reasonably reliable third-party records to the extent that an appropriate third party, such as an independent accountant, has reviewed them. In such case, you can use the statement to verify the rancher's current income.]*

16. What type of employment information may I consider in determining ATR? *You may consider and verify many types of employment to use in making your ATR determination. This includes: Full-time;*

Part-time; Seasonal; Irregular; Military; Self-employment. You can verify the consumer's employment by calling the employer and obtaining oral verification, so long as you make a written record memorializing the verification.

17. In determining DTI Ratio for ATR, what do I include on the debt side? *In assessing a consumer's ATR, there are four (4) underwriting factors to evaluate. You will need to find out the consumer's total monthly payments for:*

- *The loan you are underwriting;*
- *Any simultaneous loans secured by the same property [e.g. piggy-backs];*
- *Mortgage-related obligations – property taxes; lender required insurance; fees owed to a condominium, cooperative, or homeowners association; ground rent or leasehold payments; and special assessments; and*
- *Current debt obligations, alimony, and child support.*

*Once you have the total debt figure, you will use it, along with the consumer's total monthly income, to calculate the monthly debt-to-income ratio or residual income. **Include** ongoing, required monthly, quarterly, or annual debts of the consumer. **Do not include** debts paid off at or before closing of the loan.*

18. How do I calculate, consider and confirm debt information? *Calculating payments under the ATR standard for the loan you are underwriting:*

- **General rule:** *If the interest rate on the loan can vary during the term of the loan, as with an adjustable-rate or step-rate mortgage, when you calculate the monthly payment the consumer will have to make for the new loan, you will usually use the greater of the fully-indexed rate or the introductory rate.*
 - *You must base your calculations on **substantially equal monthly payments that would fully amortize** the loan.*
- **Special rules:** *There are also special rules and guidance provided for certain types of loans:*
 - *For balloon loans, the calculation depends on whether the loan is a higher-priced loan. Higher-priced loans are generally defined as having an annual percentage rate (APR) that, as of the date the interest rate is set, exceeds the Average Prime Offer Rate (APOR) by 1.5 percentage points or more for first-lien loans and 3.5 percentage points or more for subordinate-lien loans. APOR is published weekly at [this link](#);*
 - *For non-higher-priced balloon loans: Use the maximum payment scheduled during the first five years after the first regular periodic payment comes due;*
 - *For higher-priced balloon loans: Use the maximum payment in the payment schedule, including any balloon payment;*
 - *For interest-only loans: Use the greater of the fully-indexed or introductory rate and equal, monthly payments of principal and interest that will repay the outstanding loan amount on the date the loan recasts over the remaining term of the loan;*
 - *For negative-amortization loans: Calculate the maximum loan amount, which will include the potential added principal assuming the consumer makes the minimum required payments until the date the loan recasts. Use the greater of the fully-indexed or introductory rate and equal, monthly payments of principal and interest that will repay that maximum loan amount on the date the loan recasts over the remaining term of the loan;*

- To be **substantially equal**, no two monthly payments should vary by more than 1 percent. For loans paid quarterly or annually, convert the payments into monthly payments when you determine ATR.
- Calculating payments for simultaneous loans secured by the same property:
 - A simultaneous transaction, such as a piggy-back or silent second, can influence a consumer's ATR. A transaction that recently closed or will close around the same time as the mortgage you are originating may not show up on the consumer's credit report.
 - But if you know, or have reason to know, that there is going to be a simultaneous transaction around the time your transaction consummates, you need to consider the monthly payment on that transaction in accordance with the following requirements
 - ❖ For simultaneous transactions that are not HELOCs - Your ATR assessment should include a monthly payment on the simultaneous loan that is calculated using the appropriate calculation method for adjustable-rate mortgages, interest-only loans, or other categories discussed above, depending on what type of simultaneous loan is made.
 - ❖ For simultaneous transactions that are HELOCs - Your ATR assessment should include a monthly payment on the simultaneous loan that is calculated based on the amount of credit to be drawn down at or before consummation of the main loan.
- Mortgage-related obligations. You can get records for the consumer's mortgage-related obligations from many sources including:
 - Property taxes: government entities or the amount listed on the title report (if the source of the information was a local taxing authority)
 - Cooperative, condominium, or homeowners associations: a billing statement from the association
 - Levies and assessments: statement from the assessing entity (for example, a water district bill)
 - Ground rent: the current ground rent agreement
 - Lease payments: the existing lease agreement
 - Other records: can be reasonably reliable if they come from a third party
- Other recurring debts of borrower. The rule requires you to consider a consumer's current debt obligations and any alimony or child support the consumer is required to pay. Typical recurrent monthly **debts** include:
 - Student loans
 - Auto loans
 - Revolving debt
 - Existing mortgages not being paid off at or before consummation
- You can generally verify such obligations based on the consumer's credit report or based on other items reported on the consumer's application. Creditors have significant flexibility to consider current debt obligations in light of facts and circumstances, including that an obligation is likely to be paid off soon after consummation. Similarly, creditors should consider whether debt obligations in forbearance or deferral at the time of underwriting are likely to affect the consumer's ability to pay after the expiration of the forbearance or deferral period.
- When two or more customers apply as joint obligors with primary liability

on a loan, consider the debt obligations and credit histories of both of them in assessing their ability to repay the loan. But you do not have to include in your ATR consideration the debt obligations or credit history of someone who is merely a guarantor or surety on the loan.

19. How Calculating payments under ATR. Does the Rule ban certain loan features? *The ATR rule does not ban any particular loan features or transaction types, but a particular loan to a particular consumer is not permissible if the creditor does not make a reasonable, good-faith determination that the consumer has the ability to repay. Thus, the rule helps ensure underwriting practices are reasonable.*

- It is no longer be possible to originate loans based on stated income. You must now verify the consumer's income or assets and employment relied on in order to comply with the ATR rule.
- Likewise, the ATR rule also requires you to underwrite loans with "nontraditional features," such as interest-only or negative-amortization periods, by considering the consumer's ability to repay the loan after the initial period.
- For higher-priced balloon loans that do not meet the requirements of a balloon-payment QM, you will need to underwrite the balloon payment itself, though balloon loans that are not higher-priced do not have this requirement.

20. What happens if a consumer has trouble repaying a loan originated under the general ATR rule? *Whether or not you complied with the ATR requirements is based on the information available during origination.*

- *For example, you are not in violation of the ATR requirements if consumers cannot repay their mortgage loans solely because they experienced a sudden and unexpected job loss after you originated the loan. The ATR determination applies to information known at or before closing of the loan.*
- *However, if consumers have trouble repaying a loan you originate, they could claim that you failed to make a reasonable, good-faith determination of their ATR before you made the loan. If the consumers prove this claim in court, you could be liable for, among other things, up to three years of finance charges and fees the consumers paid as well as the consumers' legal fees.*
- *There is a three (3) year statute of limitations for borrowers to bring claims that you violated the ATR rules. After the three year period, they may bring an ATR claim only as setoff or recoupment claims as a defense to a foreclosure.*

[To be continued]