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## OVERVIEW

Franklin American Mortgage Company (FAMC) purchases loans that are in compliance with all applicable laws and regulations. All covered loans must comply with the Ability-to-Repay and Qualified Mortgage Standards under the Truth in Lending Act (TILA). FAMC will only purchase loans that meet the definition of a Qualified Mortgage and certain loans that are exempt from this rule, as specified below. This applies to applications dated on and after January 10, 2014.

In the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Congress adopted Ability-to-Repay (ATR) requirements for virtually all closed-end residential mortgage loans. Congress also established a presumption of compliance with the ATR requirements for a certain category of mortgages, called Qualified Mortgages (QMs).

In January 2013, the Consumer Financial Protection Bureau (CFPB) adopted a rule that implements the ATR/QM provisions of the Dodd-Frank Act. In May, June, July, and October 2013, the Bureau issued rules amending certain provisions of the January 2013 rule. The final rule and amendments, as well as a compliance guide and other useful tools, can be found on the CFPB website by using the following link: [Link to the CFPB ATR and QM Rule](#).

On December 11, 2013, the Department of Housing and Urban Development (HUD) released a final rule establishing the definition of a qualified mortgage for HUD insured and guaranteed single family mortgages. The rule was effective for case numbers assigned on or after January 10, 2014. A description and link to the final rule can be found using the following link: [HUD Final QM Rule](#).

On May 9, 2014, the Department of Veterans Affairs (VA) issued an interim final rule establishing the definition of qualified mortgage for VA insured loans. Subsequent guidance from VA clarified that the rule was effective for applications taken June 1, 2014. The interim final rule can be found using the following link: [VA QM Interim Final Rule](#).

## APPLICABILITY/ELIGIBILITY

The ATR/QM Rule applies to almost all closed-end consumer credit transactions secured by a dwelling and is not limited to first liens or to loans on primary residences.

The rule applies to:

- Primary Residences (1-4 Unit); and
- Second Homes (1-4 Unit).

There are several types of transactions that are exempt from the rule. Below are the only types of exempt transactions that will be purchased by FAMC.

- Extensions of credit made by creditors pursuant to a program administered by a housing finance agency (i.e. State Housing Programs); and

- Investment Properties, which are for business purposes (borrower does not intend to occupy for greater than 14 days in the year.)

## ABILITY-TO-REPAY REQUIREMENTS

### Ability-to-Repay Summary

The rule requires that lenders make a reasonable, good-faith determination prior to a mortgage loan consummation that the applicant/borrower has a reasonable ability-to-repay the loan, utilizing the minimum underwriting factors as specified below.

### Underwriting Factors

A reasonable and good faith evaluation regarding the applicant's ability-to-repay must use a minimum of eight (8) underwriting factors, including:

1. The consumer's current or reasonably expected income or assets (other than the value of the property that secures the loan) that the consumer will rely on to repay the loan;
2. The consumer's current employment status (if you rely on the consumer's employment income when assessing the consumer's ability-to-repay);
3. The consumer's monthly mortgage payment for this loan; you calculate this using the introductory or fully-indexed rate, whichever is higher, and monthly, fully-amortizing payments that are substantially equal;
4. The consumer's monthly payment on any simultaneous loans secured by the same property;
5. The consumer's monthly payments for property taxes, and insurance that you require the consumer to buy, and certain other costs related to the property such as homeowner's association fees or ground rent;
6. The consumer's debts, alimony, and child-support obligations;
7. The consumer's monthly debt-to-income ratio, that you calculated using the total of all of the mortgage and non-mortgage obligations listed above as a ratio of gross monthly income, or residual income, that you calculated using the consumer's remaining income after subtracting the consumer's total monthly debt obligations from the consumer's total monthly income; and
8. The consumer's credit history.

### Verification Using Third Party Records

The documents used when determining ATR must be reasonably reliable third-party records that provide reasonably reliable evidence of the consumer's income and assets. A "third-party record" means:

- A document or other record prepared or reviewed by an appropriate person other than the consumer, the creditor, the mortgage broker, or an agent of the creditor or mortgage broker;
- A copy of a tax return filed with the IRS or a state taxing authority;
- A record the creditor maintains for an account of the consumer held by the creditor; or

- If the consumer is an employee of the creditor or the mortgage broker, a document or other record maintained by the creditor or mortgage broker regarding the consumer's employment status employment income.

The following are considered reasonably reliable third-party records:

- Records from government organizations;
- Statements provided by a cooperative, condominium, or homeowners association;
- A ground rent or lease agreement;
- Credit reports;
- Statements for student loans, auto loans, credit cards, or existing mortgages;
- Court orders for alimony or child support;
- Copies of the consumer's federal or state tax returns;
- W-2 or other IRS forms for reporting wages or tax withholding;
- Payroll statements;
- Military leave and earnings statements;
- Financial institution records;
- Records from the consumer's employer or a third party that obtained consumer specific income information from the employer;
- Check-cashing receipts; and
- Remittance-transfer receipts.

## QUALIFIED MORTGAGE REQUIREMENTS

### Qualified Mortgages Summary

Under Dodd-Frank, Congress established a category of mortgages titled Qualified Mortgages. The rule provides a presumption that a lender has complied with the ATR rule if the loan meets the definition of a QM. In order to meet the definition of a QM, a loan may not contain certain loan terms and features such as negative amortization, interest-only payments, balloon payments, a term greater than 30 years, and points and fees exceeding established thresholds (as described in "Points and Fees Limits" section below).

### Eligible QM Types

FAMC will purchase loans defined as a Qualified Mortgage under the following four definitions, regardless of whether they meet the Safe Harbor or Rebuttable Presumption thresholds described below:

1. **General QM** – In addition to the restrictions on certain loan features and points and fees, in order for a loan to be a General QM loan, the lender must:
  - Underwrite based on a fully-amortizing schedule using the maximum rate permitted during the first five years after the date of the first periodic payment; and
  - Consider and verify the consumer's income or assets, current debt obligations, and alimony and child support obligations; and

- Ensure that the consumer's total monthly debt-to-income ratio is no more than 43%, using the definitions and other requirements provided in Appendix Q – Standards for Determining Monthly Debt and Income ([link to Appendix Q](#)).
2. **Temporary QM (Agency/GSE)** – The rule also grants QM status to loans originated during an established transitional period if they are eligible for purchase by a GSE or if they are eligible for guarantee insurance as required by Rural Housing Service (RHS). These loans must meet all general QM requirements but not the 43% DTI ratio limit. To qualify for this temporary status, loans must meet the eligibility requirements of Fannie Mae, Freddie Mac, or RHS, other than requirements wholly unrelated to the consumer's ability to repay the loan (such as requirements concerning the delivery of loan documents to the relevant agency).
    - a. The temporary provision expires on the earliest of:
      - January 10, 2021; or
      - The date that the GSEs exit federal conservatorship or receivership; or
      - The date that the relevant agency's own QM rules take effect.
  3. **HUD QM** – Effective January 10, 2014, HUD has defined all FHA-insured single family mortgages to be qualified mortgages, with the exception of reverse mortgages insured under HUD's Home Equity Conversion Mortgage (HECM) program and loans exempted from the CFPB's Ability to Repay Rule under 12 C.F.R. 1026.43(a)(3) as such regulation existed on January 10, 2014 (such as reverse mortgages and certain temporary, "bridge," or construction loans). For an FHA loan to be considered a HUD QM it must also meet the points and fees limit adopted by the CFPB.
  4. **VA QM** – Effective June 1, 2014, VA defined all VA-guaranteed purchase money origination loans and refinances, other than certain interest rate reduction refinance loans (IRRRL), as safe harbor QM loans. In addition, VA IRRRLs are excluded from the CFPB's income verification requirements if certain criteria are met, including the condition that the total points and fees do not exceed 3% of the total loan amount.
  5. **RHS QM** – Effective June 2, 2016, RHS defined a QM loan as a guaranteed loan meeting RHA guidance and the requirements in 12 CFR 1026.43(e)(2)(i) through (iii) and the points and fees limitation under CFR 1026.43(e)(3). Unintentional errors may be cured if the conditions in 12 CFR 1026.31(h) are met.
    - a. An extension of credit made pursuant to a program administered by a State Housing Finance Agency is exempt from this requirement as defined in 12 CFR 1026.43(a)(3)(iv).

## Safe Harbor and Rebuttable Presumption of Compliance for Qualified Mortgages

Qualified Mortgages can have two levels of liability protection: Safe Harbor and Rebuttable Presumption. The level of protection is determined by comparing a loan's APR with the Average Prime Offer Rate (APOR) at the time the rate is set.

The Safe Harbor threshold for General and Temporary Qualified Mortgages aligns with the established Higher Priced Mortgage Loan (HPML) threshold of APOR plus 1.50%.

The Safe Harbor threshold for HUD Qualified Mortgages is APOR plus the sum of the annual mortgage insurance premium and 1.15 percentage points.

Loans exceeding the Safe Harbor threshold are considered Rebuttable Presumption Qualified Mortgages.

In order for a VA IRRRL to be considered a safe harbor QM, the loan must meet the following conditions:

- a. The loan being refinanced was originated at least six (6) months before the new loan's closing date;
- b. The veteran has not been more than 30 days past due during the six (6) months preceding the new loan's closing date;
- c. The recoupment period for all allowable fees and charges financed as part of the loan or paid at closing does not exceed thirty-six (36) months; and
- d. All other VA requirements for guaranteeing an IRRRL are met.

### **Points and Fees Limits**

For a loan to be a Qualified Mortgage, the points and fees may not exceed certain caps which vary by loan amount. The dollar amounts will be adjusted annually for inflation and published each year in the commentary to Regulation Z. These amounts can be located using the following link: [\(ATR and QM Annual Threshold Adjustments\)](#).

For a loan amount that has a percentage cap, the "total loan amount" equals the "amount financed" from the Closing Disclosure minus any real estate related fees payable to the creditor or affiliate of creditor, premiums and other charges for certain credit insurance and/or debt cancellation or suspension products, and prepayment penalties in a "same-creditor" refinancing, that are both included in the QM points and fees test and financed by the creditor.

### **Points and Fees Calculation**

#### ***Items included in the points and fees calculation***

1. Generally all fees included in the finance charge (specific exclusions are listed below)
  - a. Note: Seller-paid items from this category only are excluded from the Points and Fees test.
2. Compensation paid directly or indirectly by a consumer to a mortgage broker (i.e. Lender and Borrower Paid Compensation).
3. Amount of refundable upfront private mortgage insurance paid by the borrower that exceeds the upfront MIP for FHA loans. Entire upfront premium paid by the borrower is included regardless of the amount if the premium or charge is not refundable on a pro rata basis.
4. Real estate related fees or charges that are either paid to an affiliate of the creditor/result in direct or indirect compensation to the creditor, or are not reasonable. This would include any amounts escrowed for insurance that are paid to an affiliate of the creditor.
5. Prepayment Penalties (under the subject transaction or payable in same-creditor refinancing).

6. Premiums or other charges for certain credit insurance and/or debt cancellation or suspension products.

### ***Items excluded from the points and fees calculation***

- Interest or time price differential
- Federal or state government sponsored MIP
- Private Mortgage Insurance may be excluded as follows:
  - Monthly or annual PMI premiums
  - The amount of up front PMI premiums that does not exceed the upfront MIP for FHA loans and is refundable on a pro rata basis
  - The amount of up front PMI premiums paid by the seller or lender
  - As indicated in Correspondent FAQ Q9, “FAMC will be to include the entire amount of borrower-paid, single premium mortgage insurance into the Points and Fees test.”
- Bona Fide\* Discount Points may be excluded as follows:
  - Up to two bona fide discount points if the interest rate before the discount does not exceed Average Prime Offer Rate (APOR) by 1%.
  - Up to one bona fide discount point if loan’s interest rate before the discount does not exceed APOR by 2%.
    - \*Refer to the FAMC [Discount Points](#) chapter for additional information regarding exclusion of bona fide discount points.
- Real estate related fees or charges that are reasonable and not paid to an affiliate of the creditor/result in direct or indirect compensation to the creditor (i.e. title insurance, appraisal fee, etc.).
- Items generally included in the finance charge that are bona fide third party charges and are reasonable and not retained by the creditor, loan originator, or an affiliate of either (i.e. settlement fee or closing fee, etc.).
- Lender Paid Charges (other than loan originator compensation).
- For seller-paid charges, only seller points, as defined in commentary to 12 C.F.R. 1026.4(c)(5), that fall into the “*Generally all fees included in the finance charge*” category above may be excluded (if seller paid fees are used for any other charges, those amounts are *included* in the QM Points and Fees test) if the fee is of a type that would be included in Points and Fees if paid by the borrower.

### **Points and Fees Cures**

On November 3, 2014, the Consumer Financial Protection Bureau (CFPB) issued a final rule to amend ATR/QM Rule to allow a limited cure mechanism for closed loans discovered to exceed the points and fees limits for Qualified Mortgages. A lender or assignee would be able to refund the excess amount to the consumer under the following conditions:

- The loan meets all other requirements of the Qualified Mortgage rule;
- The consumer has not instituted a legal action in connection with the loan;
- The consumer has not provided written notice to the creditor, assignee, or servicer that the loan’s points and fees exceeded the QM limit;

- The consumer has not become sixty (60) days past due on the mortgage;
- The refund of the excess is provided within 210 days after consummation and includes interest on the dollar amount by which the points and fees exceed the QM limit for the period from consummation until the cure payment is made;
- The lender or assignee follows procedures for post-consummation review of points and fees and for making cure payments.

The rule became effective on November 3, 2014 and will expire on January 10, 2021.

On November 3, 2014, the Department of Housing and Urban Development (HUD) issued a final rule stating that HUD will not allow for QM points and fees cures under the rule issued by the CFPB for FHA loans. Origination errors for FHA mortgages may only be cured under the existing Notice of Return/Notice of Non-Endorsement (NOR) process prior to endorsement.

## **PREPAYMENT PENALTY RESTRICTIONS**

The rule implements the Dodd-Frank Act provisions that generally prohibit prepayment penalties except for certain fixed-rate, qualified mortgages where the penalties meet certain restrictions and the creditor has offered the consumer an alternative loan without such penalties.

FAMC does not purchase loans with prepayment penalties.