

# CFPB Issues Two Final Rules: A Change to the General Qualified Mortgage Rule and the Seasoned Qualified Mortgage Rule

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The Consumer Financial Protection Bureau (“CFPB”) recently issued two final rules aimed at bolstering the Qualified Mortgage (“QMs”) market. The first final rule amends the general eligibility category of QMs (“General QMs”) under Regulation Z to eliminate the debt-to-monthly-income (“DTI”) ratio requirement in favor of a price-based model. The second final rule adds an additional category of QMs, the Seasoned QM. Both final rules will become effective within 60-days of being entered into the Federal Register. The General QM rule will have a mandatory compliance date of July 1, 2021.

### General QM Rule

On December 10, 2020, the CFPB issued a final rule<sup>1</sup> amending the definition of QM to expand the definition of General QMs. In addition to changes regarding how consumer income and debt are weighed and verified, the final rule eliminated the use of a borrower’s DTI ratio to satisfy the General QM ability-to-repay (“ATR”) requirement. Previously, for a loan to qualify as a General QM, a borrower’s DTI ratio could not exceed 43% as determined in accordance with appendix Q of Regulation Z.<sup>2</sup> Going forward, in lieu of the DTI requirement, ATR will be determined according to price-based thresholds. Under the price-based model, a creditor that makes a QM where the annual percentage rate (“APR”) does not exceed the average prime offer rate (“APOR”) for a comparable transaction by 1.5 percentage points or more will now be entitled to a conclusive presumption of compliance with the ATR and QM Rules. A creditor that makes a QM that is higher priced, with an APR that exceeds the APOR for a comparable transaction by 1.5 percentage points or more but by less than 2.25 percentage points (or 3.5 percentage points for subordinate lien transactions), will be entitled to a rebuttable presumption that it has complied with the ATR and QM Rules.

The genesis for the rule change is related to the looming expiration of the GSE Patch on July 1, 2021. The “GSE Patch” is a temporary rule promulgated by the CFPB in 2013 that established a separate QM category for loans that are eligible for purchase or guarantee by either the Federal National Mortgage Association (“Fannie Mae”) or the Federal Home Loan Mortgage Corporation (“Freddie Mac”). Unlike General QMs, loans in this category of QMs, also called “Temporary GSE QMs”, are not subject to the 43% DTI ratio requirement. The Temporary GSE QM loan category reflected the CFPB’s belief that the 43% DTI ratio did not represent “the outer boundary of responsible lending” and recognition that, even after the financial crisis, over 20% of mortgages exceeded the 43% DTI threshold.<sup>3</sup>

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<sup>1</sup> [https://files.consumerfinance.gov/f/documents/cfpb\\_atr-qm-general-qm-final-rule\\_2020-12.pdf](https://files.consumerfinance.gov/f/documents/cfpb_atr-qm-general-qm-final-rule_2020-12.pdf)

<sup>2</sup> Regulation Z, 12 CFR Part 226

<sup>3</sup> See, BCFP, Qualified Mortgage Definition under the Truth in Lending Act (Regulation Z): General QM Loan Definition, Final Rule (Dec. 10, 2020), pg. 12.

Despite being intended as a stop-gap measure, Temporary GSE QMs continue to represent a “large and persistent” portion of the mortgage market.<sup>4</sup> Based on 2018 data, the CFPB concluded approximately 943,000 loans with DTI ratios above 43% were originated as QMs in 2018 in reliance of the Temporary GSE QM definition and would otherwise fall outside the definition of QM.<sup>5</sup> According to analysis by the CFPB, after the expiration of the GSE Patch, without modification to the definition of General QM, loans that would have qualified as Temporary GSE QMs will cost “materially” more or might not be originated at all.<sup>6</sup> Further analysis of application level data obtained from lenders confirmed that without expanding the definition of General QM to encompass some portion of loans formerly classified as Temporary GSE QM, there would be significant reduction in access to credit for otherwise credit-worthy borrowers who do not meet the 43% DTI ratio when the GSE Patch expires.<sup>7</sup>

Thus, the final rule change expands the definition of General QMs to include most loans that would currently qualify as Temporary GSE QMs by eliminating the DTI ratio requirement in favor of a pricing model. Analysis by the CFPB in favor of replacing the DTI threshold with a pricing model showed that the pricing of a loan is a “strong indicator” of ability to repay. For example, data showed delinquencies rise with rate spread and that loans with higher rate spreads have higher delinquency rates within a given DTI ratio range.<sup>8</sup> The CFPB’s analysis also suggested the pricing model is a more appropriate ATR standard for General QM loans than DTI because it captures a more fulsome view of borrowers’ financial capacity for debt.<sup>9</sup> Conversely, the CFPB conceded that while DTI ratios also generally correlate with loan performance, the DTI ratio paints a narrower picture of financial capacity that is particularly acute among non-traditional employees such as gig workers and the self-employed.

In assessing the proposed rule change, the CFPB reviewed comments from industry commenters, consumer advocates, research centers, joint industry and consumer advocate groups, and two GSE commenters. Comments in favor of the proposed shift to a pricing model noted that while DTI correlates with loan performance, it is relatively poor at predicting it. One commenter cited analysis showing the 90-day delinquency rate for loans with a DTI ratio over 45% is less than that for loans with DTI ratios between 30 and 45%.<sup>10</sup> Other commenters agreed with the CFPB’s assertion that a DTI limit for all QM loans would restrict access to credit for otherwise creditworthy customers and argued requiring a DTI ratio of 43% for all QMs would disproportionately affect low-income and low-wealth families, including families of color.<sup>11</sup>

Another advantage of the price-based model identified by commenters is its simplicity and ease of adoption since rate spreads are already required to be calculated for other regulatory purposes. Others in favor of the pricing model argue the bright-line simplicity of the rule will result in better pricing for consumers by reducing litigation risk for lenders. Finally, commenters also generally favored the shift to a price-based model because the DTI ratio-related

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<sup>4</sup> Id. at 19

<sup>5</sup> Id. at Fn 116

<sup>6</sup> Id. at 100

<sup>7</sup> Id. at 96

<sup>8</sup> Id.

<sup>9</sup> Id. at 38

<sup>10</sup> Id. at 80

<sup>11</sup> Id. at 82

definitions in appendix Q were rigid and difficult to apply. As a result, Lenders calculating DTI ratios in reliance on appendix Q were reluctant to offer loans due to compliance uncertainty.

Commenters who opposed the shift to a pricing-based model generally argued that pricing is not an adequate measure of ATR and pointed out that creditors do not necessarily consider ATR when deciding price. Others noted pricing may be determined based on factors that are not specific to the consumer and that pricing measures risk to the creditor and not the borrower's ability to repay the loan. Additionally, some commenters raised the possibility that creditors may use a price-based model to manipulate APOR or adjust their prices to fit just under the rate-spread thresholds to gain safe harbor protection. Finally, some commenters were critical of the methodology of the CFPB's analysis supporting the price-based model, which compared pricing and 60-day delinquencies during the first two years of the loan as a proxy for ATR to price. According to this commenter's analysis, for loans with identical rate spreads, early delinquency rates varied with other characteristics such as LTV ratios, DTI ratios, and credit scores.<sup>12</sup> One commenter noted 60-day delinquency is not an accurate measure of affordability because of the extreme short-term measures to which borrowers will go to make timely mortgage payments at the expense of other liabilities.

While comments in response to the adopted proposal were mixed, the transition to a price-based ATR requirement should be smooth for two reasons. First, as noted above, the final rule change and shift to a price-based model should ensure continued access to credit for otherwise credit-worthy borrowers who would not meet the 43% DTI requirement after the expiration of the GSE Patch. Second, the rule change ensures lenders seeking to afford themselves the protection of the QM safe harbor have a simple bright-line standard to apply when making a determination regarding whether a borrower has the ability to repay. This certainty should encourage lenders to continue to offer or even expand their offerings of credit to affected borrowers.

## Seasoned QM Rule

In addition to the General QM rule change, the CFPB also created a new category for QMs: Seasoned QMs.<sup>13</sup> Seasoned QMs have eligibility rules similar to General QMs, with some variations. Specifically, a "Seasoned QM" is a first-lien covered transaction with a mortgage that has a fixed rate and fully amortizing payments and has not experienced more than two 30-day delinquencies or one or more 60+ day delinquencies during the 36 months since the first periodic payment was due. In addition to the duration and performance requirements, a Seasoned QM must also satisfy many of the same requirements as General QMs, including: (1) the covered transaction provides for regular periodic payments that are substantially equal; (2) there is no negative amortization and no interest-only or balloon payment; (3) the loan term does not exceed 30 years; (4) the total points and fees do not exceed specified limits; (5) the transaction is not a high-cost mortgage<sup>14</sup>, and (6) the creditor's underwriting considers the consumer's DTI ratio or residual income, income or assets other than the value of the dwelling, and debts and verifies the consumer's income or assets other than the value of the dwelling and the consumer's debts.<sup>15</sup> In addition, legal title to the loan cannot be transferred to another person before the end of the 36 month seasoning period, although in some cases there are exceptions for small creditors or single transfers. If a loan meets the requirements to be a Seasoned

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<sup>12</sup> Id. at 85

<sup>13</sup> [https://files.consumerfinance.gov/f/documents/cfpb\\_atr-qm-seasoned-qm-final-rule\\_2020-12.pdf](https://files.consumerfinance.gov/f/documents/cfpb_atr-qm-seasoned-qm-final-rule_2020-12.pdf)

<sup>14</sup> As defined in 12 CFR 1026.32(a).

<sup>15</sup> Certain additional exceptions applicable to General QMs which are set forth in 12 CFR 1026.43 are also applicable to Seasoned QMs.

QM, the CFPB will presume conclusive compliance with the ATR requirements. Loans that were originated before the effective date of the Seasoned QM rule will not be eligible for Seasoned QM status.

The CFPB developed the Seasoned QM definition to complement the General QM rule change to further ensure access to affordable mortgage credit. It concluded that there are many loans that could be made to credit worthy consumers that would not meet the current QM definitions, and the CFPB's primary objective in creating Seasoned QMs was to create an alternative pathway to QMs in order to safely expand access to mortgage credit. This new definition will facilitate innovation in underwriting in the market to better serve consumers with non-traditional credit profiles, allow for more flexibility to adapt to future changes in the work force and support alternative pathways to assess a consumer's ability to repay. While industry groups have been advocating for the addition of a safe harbor for seasoned loans prior to the pandemic, the CFPB also sought to combat COVID-19's negative effects on the market in addressing this change now. Overall, allowing for Seasoned QMs will create another pathway to a QM safe harbor and incentivize the origination of responsible non-QM loans that would otherwise not be made due to perceived litigation or risks.

The CFPB reported that it is comfortable expanding the QM safe harbor through this new definition because a loan's performance over an extended period of time is sufficient to show that a creditor properly assessed a consumer's ATR. During the rulemaking process, the CFPB analyzed rejected loan applications and found that non-QM loans were being rejected despite having traditional indicators of creditworthiness like credit score, income and down payment. This supports the notion that the perceived risks associated with non-QM loans may be preventing creditors from making non-QM loans, and thus limiting access to credit for consumers.

Lastly, the CFPB acknowledged that the QM definitions may cause creditors to be uncertain about whether loans may fall within that category. Various state agencies and departments have promulgated additional QM definitions based on their state specific mortgage insurance or guarantee programs. This could cause creditors to be uncertain about whether a State court would give a loan QM status. The addition of a Seasoned QM definition will provide additional legal certainty by supplying an alternative way to achieve QM status, which will give state courts an additional rationale for providing a conclusive presumption of ATR compliance.

Just as it did for the new General QM rule, the CFPB reviewed comments from industry commenters in order to assess the proposed Seasoned QM rule. Commenters who supported a Seasoned QM rule agreed with the CFPB that if a loan is performing well for years, it is reasonable to conclude that a default was not caused by the creditor's failure to determine the consumer's ATR at origination. Further, supporters expressed that a Seasoned QM rule would benefit the mortgage market by broadening the compliance requirements for QM status, which would improve investor confidence, and in turn enhance capital liquidity in the market. The required duration to be considered "seasoned" varied among supporters with some proposing as few as 12 months while others recommended up to five years. Some supporters also suggested gradual or step approaches instead of a process that provides for instant Seasoned QM status.

While many industry commenters expressed enthusiasm about the proposed Seasoned QM rules, there were also those who expressed concern. Consumer advocate groups argued that seasoning could wrongfully prevent consumers from bringing affirmative claims against creditors for ATR requirement violations. Specifically, they argued that because there is a three-year statute of limitations from the time of violation for consumers to bring these claims, the seasoning period could not be less than three years or it would be contrary to Congressional intent. If loans could season during pending litigation, affirmative claims filed within the statute of limitations would be cut off. Another group responded by explaining that the three-year statute of limitations may be extended if equitable tolling applies and consumers may pursue affirmative claims for ATR requirement violations beyond the three-years. Two dissenting

groups also recommended that loans receiving a rebuttable presumption of compliance with the ATR requirements should not be allowed to season into QM safe harbor loans. Critics of the Seasoned QM rule also stated that certain types of mortgages that are currently disqualified from being QM loans, such as interest-only and negative amortization mortgages, should never be allowed to gain Seasoned QM status.

Although comments to the Seasoned QM proposal were mixed, the rule adoption should be met with positive feedback overall. The rule's original supporters should be pleased as the framework will allow for positive growth and innovation by opening up the requirements for QM status. The 36-month seasoning period is right at the 3 year statute of limitations mark, close to the average of what supporters asked for, and should be enough time to properly assess a borrower's ATR without concern of lenders gaming the system. Interest-only and negative-amortization mortgages will not be eligible to receive Seasoned QM status, which should please critics as well.

## Conclusion

As noted above, both rules are aimed at supporting the mortgage market and ensuring consumer access to credit. These rules should help further the CFPB's objective of ensuring that credit-worthy borrowers have access to affordable and accessible mortgage loans while continuing to protect consumers.

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