News From the FAMP Government Affairs Committee

Six Months Later, Does the QM Rule Still Matter?

By Kate Berry
JUN 17, 2014 12:22pm ET

When a sweeping set of mortgage regulations took effect in January, many predicted a credit crunch. Millions of potential homeowners, particularly low-income borrowers, blacks and Hispanics, would be shut out of the mortgage market, unable to qualify for a home loan, industry representatives and others warned.

Those predictions never materialized. To be sure, lending is down across the board for a variety of factors ranging from the weak economy to student loan debt, anemic income growth to borrowers trapped in underwater mortgages.

But six months after the Consumer Financial Protection Bureau's qualified mortgage rule went into effect, some lenders and industry experts say the impact has been minimal.

The QM rule created basic underwriting standards and gave strong legal protections - known as a safe harbor - to lenders that adhere to them. A key requirement is that borrowers have a debt-to-income ratio of 43% or less. Lenders also have to document a borrower's ability to repay a loan.

CFPB Director Richard Cordray repeatedly said the agency did not want to stifle a nascent housing recovery. So the CFPB gave a seven-year exemption from the QM rule to Fannie Mae and Freddie Mac (provided the GSEs are not removed from conservatorship sooner). Any loan that is accepted by the government-sponsored enterprises' automated underwriting engines is automatically considered a qualified mortgage even if the DTI ratio is above 43%.

Meanwhile, the Department of Housing and Urban Development, which oversees that Federal Housing Administration, created its own QM rule with no DTI ceiling.

Because of the exemptions, the roughly 95% of loans originated today that are backed or insured by the federal government are not affected by QM.

"QM is a lot of noise and paperwork, but at the end of the day as long as Fannie and Freddie are in [conservatorship], it almost doesn't matter," says Michael Kime, the chief operating officer at W.J. Bradley Mortgage, a Colorado lender.

The CFPB watered down the rule on purpose, says Scott McNulla, a vice president of regulatory compliance at Clayton Holdings, a loan due diligence and surveillance firm.

"QM didn't have nearly the impact [expected] because of Fannie and Freddie's exemptions," McNulla says. "The CFPB wanted to allow the free market to continue with minimal constraints so they left it pretty wide open and nebulous. It was mostly a hiccup for smaller lenders and brokers."

Since the vast majority of lending is going through the GSEs and FHA, the QM rule's impact on the markets today "is really very little," says Mark Fleming, the chief economist at the analytics firm CoreLogic.

"It was quite a smart design in that the regulation had very little disruptive impact when it was enacted," Fleming says, adding that even the 43% debt-to-income ratio "is still pretty loose" by most traditional standards, "so it would be hard to argue that the QM rule stifled credit."

"Lots of other things are causing the lack of loans being originated," Fleming says.

Lawmakers are still trying to further loosen the QM rule, again citing concerns about credit availability.

Last week, the House approved a bill that would modify the QM rule's 3% cap on points and fees, based on the total loan amount. The legislation would exclude fees paid to affiliated businesses, which would be a boon to banks that have related escrow, title and settlement services companies.

The 3% points and fees cap has been a sore spot for community banks because it disproportionately affects smaller loans, says Pete Mills, a senior vice president of residential policy at the Mortgage Bankers Association.

Russ Tolleson, a senior compliance officer at the Compliance Group, a San Marcos, Calif., company that helps lenders track regulations, says the points and fees cap has disproportionately hurt mortgage brokers. Limiting their fees has cut significantly into their profits. With the dearth of lending so far this year, Tolleson expects 30% fewer mortgage originators, including brokers, to be in business by the end of 2015.

"I don't think QM itself is what constrained credit but rather the fact that we've done away with all the fancy loans," Tolleson says. Nor does he think a large percentage of borrowers have been knocked out of the market.

Rather, the brunt of the QM rule has been the cost of complying with it, something lenders have complained about endlessly.

"You have to pay an outside firm or have someone in-house, full-time whose job is to stay abreast of compliance changes and how the new regulations are applied within a company," says Tolleson. "I think everyone thought QM was going to be a bigger deal but lenders have adapted to the guidelines."

Not everyone thinks the QM rule's imprint on the market so far has been nominal.

Scott Moriarty, the head of the mortgage division at Affinity Federal Credit Union in Basking Ridge, N.J., put together a team of 15 to 20 employees who spent a year just implementing the CFPB's mortgage rules. The QM rule was supposed to provide uniformity for the secondary market, which has yet to rebound, he says.

"Philosophically, the focus was to create a standardized secondary market that would allow lenders to have uniformity, like a Good Housekeeping Seal of Approval," Moriarty says. "But from the secondary market perspective, it may never have had an impact. That's because what has to change is Fannie and

Freddie and that hasn't happened yet."

Meanwhile, "the cost to originate a loan has skyrocketed," because of the new regulations, he says.

Banks and mortgage lenders spent massive amounts of money preparing for the rules and testing their loan operating systems.

"It was all a significant cost but I don't know that it curtailed credit significantly," says McNulla at Clayton.

A bigger worry for lenders is whether loans that initially received QM status, and with it a safe harbor from litigation, are found not to qualify down the road.

"I think there's a risk that is probably unseen in the marketplace where folks are originating loans that would not be QM if not for Fannie and Freddie," says Kime, at W.J. Bradley.

He described a scenario in which a loan receives automated underwriting approval from Fannie or Freddie even if the debt-to-income ratio is 44%. The GSE could later say the lender "counted income we shouldn't have and the AU is not valid, so it's not QM and I have to buy the loan back," Kime says. "It's a virtual certainty that will happen."

Such concerns have caused lenders to be skeptical, Moriarty says.

"The No. 1 thing we're seeing is hesitation, a pause," he says. "The lead-up to this has been incessant, overbearing regulation."