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Preventing Wealth Destruction: Protecting Latino Homeownership through Qualified Mortgages

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Abstract

Following the collapse of the housing market in the United States, a push towards stricter federal legislation on lending has occurred. The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) was signed into law on July 2010 and is geared toward increasing financial oversight, promoting transparency and reducing systemic risk. Over the past two years, the Consumer Financial Protection Bureau (CFPB) has been working on the definition and implementation of the Dodd-Frank provision on Qualified Mortgages (QM). The QM rule could potentially establish new national underwriting standards and eliminate current "common-sense" lending and investors' reliance on strict credit overlays. In addition, the QM rule can aid the CFPB's decision to enforce disparate impact discrimination under the Fair Housing Act and the Equal Credit Opportunity Act (ECOA). If the QM rule is defined too narrowly however, it can then marginalize borrowers that do not meet QM standards but may still be considered "credit-worthy" by previous standards. Latinos and other people of color are especially at risk of being marginalized by a narrow definition. Latinos' wealth-building abilities requires that the QM rule definition not only prevent risky and predatory lending but that it establishes inclusive national underwriting standards to fight disparate impact discrimination and ensure Latinos' accessibility to affordable mortgage markets. In order for the QM ruling to promote and protect Latino homeownership, it is essential that the CFPB release a QM ruling that is broad and clear, allows for a rebuttable presumption approach and offers exemptions to state and non-profit approved loan programs to encourage innovative housing programs that will promote homeownership among low-income communities.

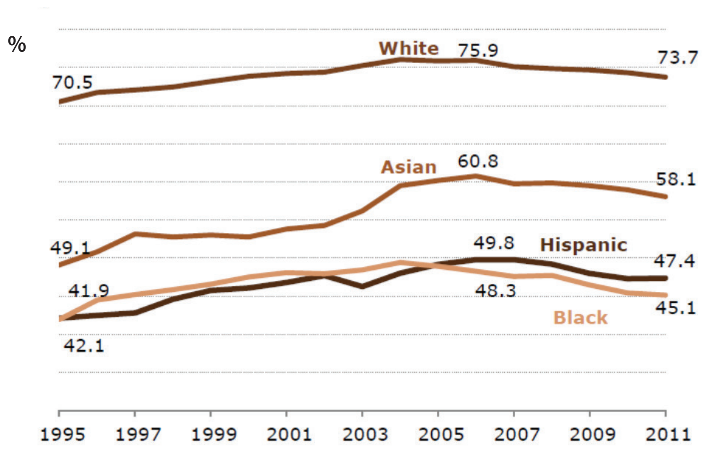
Introduction

Increase in Latino Homeownership and Predatory Lending

The 2008 housing market collapse adversely and disproportionally affected Latino homeowners, causing 1.3 million Latino household foreclosures[1]. The amount of family wealth drained by foreclosures for African-Americans is estimated at $194 billion and for Latinos $177 billion [2]. This tremendous wealth loss not only cause present day ramifications but will also affect future generations' well-being, financial security and wealth building capacity. According to demographic trends, families of color will move from being the minority to the future majority; therefore it is of utmost importance that current mortgage legislation be designed and implemented in a manner that prevents future housing discrimination while also rectifying predatory lending which became all too visible during the 2008 housing bubble.

Prior to the 2008 housing market collapse, Latino homeownership hit a historical all time high. Chart 1.1 demonstrates that the Latino homeownership rate peaked around 2007 with a rate of 49.8 percent;

Chart 1.1 Homeownership Rates 1995–2011



Source: Pew Hispanic Center analysis of Current Population Survey (CPS) data, 1995–2011[3]

Although some Latino homeowners purchased their homes by obtaining a Prime loan, a vast majority of the new Latino homeowners purchased their new homes through Subprime loans. While many of these minority families were credit worthy enough to qualify for Prime loans, they were instead steered towards obtaining Subprime loans by predatory lenders[4].

this rate also peaked for Whites at a rate of 75.9 percent. Although some Latino homeowners purchased their homes by obtaining a Prime loan, a vast majority of the new Latino homeowners purchased their new homes through Subprime loans. While many of these minority families were credit worthy enough to qualify for Prime loans, they were steered towards obtaining Subprime loans by predatory lenders[4]. Qualifications for Subprime loans were few, and in some instances non-existent, which permitted predatory lenders to target minority populations that historically faced additional challenges in obtaining mortgages, oftentimes because they did not meet mortgage-underwriting qualifications. As a result, communities of color had higher instances of Subprime loans.

Subprime Loans and Minimal Accountability

The lax Subprime loan underwriting standards allowed for mortgage originators to issue loans without verifying if families could repay the loan in the short or long term. The financial system at the time offered no incentives for lenders to verify ability to repay and required no "skin in the game" from loan originators since these lenders could package Prime and Subprime loans into groups and resell them to the Secondary Mortgage Market. These conditions passed the risk to other investors and avoided accountability for poorly underwritten mortgage loans.

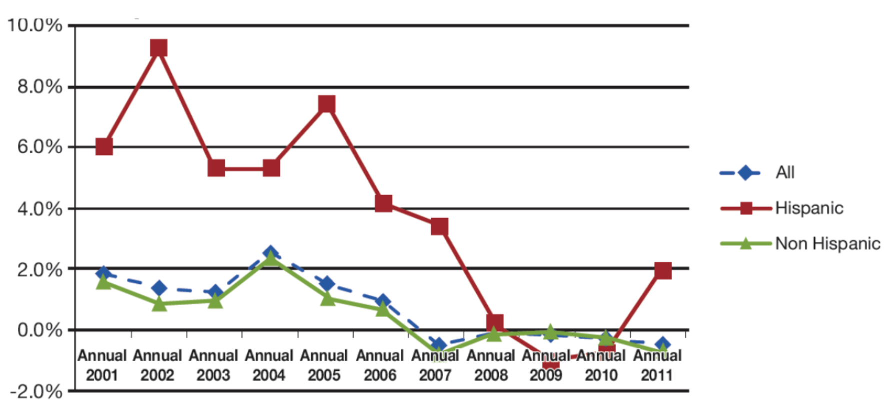
The Homeownership Gap, Racial Inequity and Post-Recession Recovery

Despite reports that minority homeownership has increased, the homeownership gap between whites and people of color has continued to grow as white homeownership increases more quickly. For African-Americans, the gap has increased from 22.8 percent in 1940 to 28.5 percent in 2010; for Latinos the gap has not widened but has marginally improved by two points with a gap of 28.9 percent in 1995 and a reduced gap of 26.9 percent in 2010.[5] These statistics show there is still unequal racial representation in the mortgage market and that current and future housing legislation needs to create more access and affordability in order to reduce racial inequity in homeownership. Combating racial inequality in the mortgage market will further facilitate Latino family wealth building and in turn continue to fight disparities and inequality beyond the housing realm.

A recent study by the Pew Hispanic Center demonstrated that Latino homeownership is recovering much faster compared to other groups. As Chart 1.2 shows, Latinos had a 2 percent growth in homeownership in 2011 while the rest of the population remained stagnant. Mortgage reform legislation needs to be implemented in a fashion that encourages this rapid recovery and does not inhibit current Latino homeownership progress.

The 2008 housing collapse confirmed the intricacies and interdependence of the US financial system. Although people of color were the primary targets of predatory lending and had greater numbers of Subprime loans and foreclosures, the housing market collapse effects rippled past communities of color and into the mainstream economy resulting in a full fledge recession. The Great Recession proved to be devastating by causing overnight property devaluations resulting in wide spread underwater-mortgages and a foreclosure epidemic that affected all homeowners and communities regardless of race or loan type. Furthermore, the recession disrupted businesses across different economic sectors resulting in company closures and mass layoffs, which led to a sharp increase in unemployment throughout the country. Unfortunately, many historically responsible, credit worthy and long term homeowners suddenly became unemployed and could no longer afford paying their Prime loan mortgages; as a result, these families also became victims of the nationwide foreclosure epidemic.

Chart 1.2 Percentage Changes in Owner Occupied Units, 2000–2011



Source: U.S. Census, 2000–2011[6]

A recent study by the Center for Responsible Lending found that if home buyers were required to come up with a down payment of 20 percent it would prevent 75 percent of African-Americans, 70 percent of Latinos and 60 percent of non-Hispanic Whites borrowers from obtaining fairly priced mortgages and achieving sustainable homeownership[11].

In response to the housing market collapse, foreclosure epidemic, widespread unemployment and persistent recession, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) geared toward increasing financial oversight, promoting transparency and reducing systemic risk in 2010. The Dodd-Frank Act spans across different areas of the US financial system, but one of its major objectives is for mortgage reform aimed at protecting and informing consumers. Home equity is still one of the most important aspects of family wealth, representing nearly half of total family assets among all but the highest earners.[7]

Background

U.S. Housing Policy and Historical Housing Discrimination

Housing policy in the U.S. has evolved from initially reinforcing and rewarding mortgage lending discrimination and racism to currently fighting discrimination through newer legislation. The Home Mortgage Disclosure Act (HMDA), The Community Reinvestment Act (CRA), and the Equal Opportunity Act (ECOA) all focused on creating housing access, rewarding responsible credit and combating discrimination in mortgage lending. Government reinforced lending practices stemmed from the National Housing Act of 1934, which created the Federal Housing Administration (FHA). The FHA established underwriting criteria that steered investors away from investing in minority communities. Banks and lenders went a step ahead by clearly and physically demarking minority dominated neighborhoods as areas that did not qualify for loans and bank services, a practice commonly referred to as redlining. As a result, minority communities living within redlined neighborhoods were considered too high risk to receive a loan and therefore were unable to become homeowners. Preventing homeownership in these minority communities also disabled them from accumulating family wealth that could be transferred to subsequent generations.

The Fair Housing Act of 1968 outlawed redlining and aimed to increase housing accessibility by prohibiting discrimination in dwelling sales, rentals and refinancing. Subsequently, the Equal Credit Opportunity Act enacted in 1974 tackled discrimination by guarantying equal opportunity to all credit company customers regardless of race, sex and religion. The Community Reinvestment Act of 1977 further rectified previous redlining discrimination by providing incentives to banks that invested and provided services to all of their local customers, specifically individuals from moderate to low income backgrounds.

Despite anti-discriminatory legislation, racial inequity in the mortgage market continues. Findings from a 2010 California Reinvestment Coalition study verified the unequal provisions of prime mortgages to communities of color. The study results indicate that mortgage lenders continue to use redlining and mortgage steering techniques when dealing with communities of color[8]. Furthermore, the study also showed that home-owners of color were three times more likely to obtain government-backed refinance loans compared to their white counterparts[9]. The overrepresentation of minority borrowers in government-backed loans further exemplifies the racial inequity in the mortgage markets.

Current Underwriting Standards and Latino Homeownership Foreclosures

Following the 2008 recession, mortgage lenders have originated loans more cautiously by employing stricter underwriting standards than those listed by the Federal National Mortgage Association (Fannie Mae). As a result, many Latinos and people of color have been deemed non-creditworthy by these stricter standards and in order to obtain homeownership, these marginalized populations have been relying on the Federal Housing Agency (FHA) loans to purchase homes. FHA loans customarily only require a three percent down payment and also provide other services that aid first time homeownership for low-income families. Despite that these low down payment FHA loans have been successful at increasing sustainable homeownership and have low rates of default and foreclosure, mortgage lenders and banks have continued to increase their underwriting standards and some lenders have started to consider increasing down payment requirements up to 20 percent[10]. A recent study by the Center for Responsible Lending found that if home buyers were required to come up with a down payment of 20 percent it would prevent 75 percent of African-Americans, 70 percent of Latinos and 60 percent of non-Hispanic Whites borrowers from obtaining fairly priced mortgages and achieving sustainable homeownership[11].

Latino homeownership hit an all time high between 2000 and 2006[12]. Despite the significant increase in homeownership, Latino households also faced higher rates of foreclosures on loans originated between 2004 through 2008[13]. In addition, Latinos faced foreclosure rates of almost 12 percent, double the rate of their White counterparts. The higher foreclosure rates can be attributed to the fact that during the housing boom Latino borrowers were 30 percent more likely to receive non-prime loans than non-Hispanic borrowers[14]. Latinos also experienced more lending discrimination since families with good credit scores, con-

In addition, Latinos faced foreclosure rates of almost 12 percent, double the rate of their White counterparts. The higher foreclosure rates can be attributed to the fact that during the housing boom Latino borrowers were 30 percent more likely to receive non-prime loans than non-Hispanic borrowers[14].

sisting of a 660 FICO score and above, were three times more likely to receive higher interest rates than their White counterparts[15]. Furthermore, post the economic recession Latino homeowners are twice as likely to claim they have underwater mortgages when compared to other non-Hispanic homeowners[16]. Despite the steady decline in Latino homeownership since 2008, Latino homeownership began to increase once again during the third quarter of 2011. Latino homeownership increased to a rate of 47.6 percent, resulting in 288,000 new units, versus non-Hispanic White households, which only grew by 18,000 units[17].

Policy Analysis

The Dodd-Frank Act

The 2008 housing market collapse exposed the common usage of deteriorated loan underwriting standards that ultimately led to the housing bubble, the housing market collapse and subsequently the Great Recession that the US has not fully recovered from as of today. In light of the financial system failures, the Dodd Frank Act aims to increase accountability and regulation of Wall Street and the U.S. financial system[18]. Highlights of the Dodd Frank Act include the creation of a new independent watchdog known as the Consumer Finance Protection Bureau (CFPB), housed within the Federal Reserve. The CFPB has the responsibility and authority to protect Americans from deceptive practices while informing consumers and promoting education regarding mortgages, credit cards and other financial products and services[19]. The Dodd Frank Act also has several sections dedicated to Mortgage Reform and in Section 1412, the act assigns the CFPB with the task of defining "Qualified Mortgages" in an attempt to identify and label safe mortgages that bankers can issue to consumers.

The Dodd-Frank Act's Mortgage Reform section focuses on protecting borrowers against foreclosures by establishing home loan federal standards that financial institutions need to abide by in order to validate a borrower's ability to repay loans. Moreover, the Act prohibits and eliminates financial incentives that previously encouraged Subprime loan steering. The Act also stipulates that if lenders and mortgage brokers fail to comply with the new standards they may face penalties and be forced to pay consumers for any damages and attorney fees incurred by the financial institution's negligence. In an attempt to create more awareness and consumer education, the Act also establishes an Office of Housing Counseling within the Department of Housing and Urban Development (HUD) to boost homeownership and rental housing counseling[20].

Ability to Pay and Qualified Mortgages

The Dodd Frank Act established the "Ability to Pay" provision in Section 1411[21] which specifies that loan originators need to verify the following items to assess a borrower's ability to repay: consumer's credit history, current income, expected income the consumer is reasonably assured of receiving, current obligations, debt-to-income ratio (DTI) or the residual income the consumer will have after paying non-mortgage debt and mortgage-related obligations, employment status, and other financial resources other than the consumer's equity in the dwelling or real property. In case loan originators do not want to go through the Ability to Pay verification requirements, section 1412[22] also allows for lenders to issue a "Qualified Mortgage" (QM) and bypass Ability to Pay requirements.

Safe Harbor versus Rebuttable Presumption

Per the Act, the CFPB has the task of issuing a rule regarding the QM definition by January 2013. The CFPB underwent a review period that allowed stakeholders to submit comments on how QM should be defined. The CFPB revealed that the QM definition would take one of two interpretations that had been identified per the Act's language. The CFPB identified the first alternative as the "Safe Harbor" approach and the second alternative as the "Rebuttable Presumption".

The first alternative is the Safe Harbor approach. Safe Harbor protects banks, creditors and loan originators from future litigation if they issue a QM loan. Essentially, the QM definition offers lenders a checklist of requirements that they have to verify and that borrowers need to meet in order qualify for a QM. Once a borrower meets the QM requirements and a lender does its due diligence in verifying the borrower's information, then the lender can issue the QM. According to the Safe Harbor approach, once the borrower receives the QM, the borrower cannot sue the lender for being issued a loan they were unqualified for or for any wrongdoing. Safe Harbor fundamentally provides lenders immunity from future litigation. By and large, almost all banks and creditors side with the Safe Harbor alternative.

Safe Harbor supporters argue that this definition will create an incentive for banks and lenders to issue QMs versus other types of loans. Many banks and creditors are still skittish from the backlash they encountered after the housing market collapse. Some creditors faced costly litigation for wrongdoing and for issuing unsuitable loans to borrowers. As a result, current common practice allows banks to have stricter underwriting standards compared with government established standards, which ensures that loans are only issued to the most credit worthy borrowers. By only providing loans to the most credit worthy, creditors are

Other characteristics are examined to determine a borrowers ability to endure external shocks and life changing events, such as unemployment or illness. However, concerns have been raised as to how these telling factors adversely impact some groups while they benefit other groups.

reducing risk for future costly litigation. Therefore, Safe Harbor advocates argue that if QMs do not provide a Safe Harbor from costly litigation, then there is no incentive for banks to leave behind their current cautious underwriting standards if the possibility of future litigation still exists. Furthermore, banks will continue to only issue loans to the most credit worthy and continue denying loans to the rest of the credit worthy people that fall below the top credit category. This current credit denying practice is adversely and disproportionately affecting low-income and communities of color. Safe Harbor supporters argue that a non-Safe Harbor QM approach will not stop the denial of credit to lower income and minority groups, that it will be irrelevant in the larger picture and make no impact on decreasing the minority homeownership gap nor reducing racial inequity in the mortgage market, due to the fact that risk is not reduced for future costly litigation without a Safe Harbor.

The second alternative is the Rebuttable Presumption. Many fair housing advocates and supporters of Rebuttable Presumption, say that based on the Act's language and Congress' intentions with the Dodd-Frank Act, a Safe Harbor approach would undermine any progress made of increasing accountability and regulating Wall Street. Rebuttable Presumption advocates argue that the Safe Harbor interpretation comes from an overlooked 2007 legislation vestigial caption in the Act that previously had not passed. Giving banks and creditors any type of immunity would reduce the Act's focus of increasing accountability. Furthermore, the previous lack of regulation and absence of accountability proliferated appalling practices industry wide. The focus of QMs are to lower not eradicate litigation risk as an incentive to avoid making risky loans; furthermore the QM definition should not be reducing responsible underwriting standards.
The Safe Harbor critics also point out that the Safe Harbor definition, which provides immunity to creditors, has weaker underwriting standards by sidestepping the Ability-to-Pay qualifications. Furthermore, the Safe Harbor definition does not require core common sense underwriting standards such as: employment status, monthly payments on second liens, current debt obligations, DTI, residual income and credit history. Critics argue that a QM that doesn't confirm a capacity to repay will not create a positive market incentive for which it was designed. Likewise, they also argue that the only way QMs will benefit the mortgage market is if the definition has solid underwriting standards that will increase consumer and investor confidence in the housing market.

The Rebuttable Presumption definition incorporates more requirements, making it a stronger underwriting standard option than the Safe Harbor alternative. Therefore, adopting a Safe Harbor QM approach will be detrimental since it is less likely to restore confidence in consumers, investors and the financial sector itself. Rebuttable Presumption advocates argue that QMs are meant to protect consumers, investors and markets from unsustainable and unsuitable loans even if the outcome is considered a "standard". The intention of the Ability-to-Pay provision, the Qualified Mortgage and other Dodd-Frank reforms is to prevent the abundance of precarious lending, ironically warranted as providing access to credit and creating access to homeownership. A strong and significant Ability-to-Pay provision along with a well-designed QM definition is essential in order to put the US financial system back on track and in order for creditors to generate sensible an affordable loans.

Some critics of the Dodd-Frank Act point out that although the Act did set forth basic financial information and borrower qualifications, lenders should consider that these factors do not provide a satisfactory picture of a borrower's ability to repay. Furthermore, these critics argue that the QM definition should incorporate other factors for it to have solid underwriting.

Current Factors Affecting Latino Homeownership

Considering that repayment of a loan cannot be entirely determined by the borrower's financial means at the time of the loan origination, the lending industry has used other borrower characteristics to estimate the risk of a borrower defaulting. Lenders use certain characteristics, such as credit score, as proxy for a borrowers propensity to repay or not repay obligations. Other characteristics are examined to determine a borrowers ability to endure external shocks and life changing events, such as unemployment or illness. However, concerns have been raised as to how these telling factors adversely impact some groups while they benefit other groups. Furthermore, mortgage underwriting critics have raised questions as to how these factors are measured, their level of reliability and validity when informing on risk and determining qualified borrowers.

Credit Score and FICO

The FICO score, also known as "credit score" is a common tool employed by the mortgage industry in the initial process of gauging a borrower's risk profile. Starting in the 1990s, Fannie Mae and Freddie Mac began using credit scores to evaluate borrowers and adopted a FICO score of 620 as the deciding bound for subprime loans. Although, there was never any justification as to why this cutoff score was selected, the rest of the mortgage market followed suit[23]. Today, lenders generally consider a

According to a 2011 Department of Labor (DOL) report, Latinos only earn 71 percent of the median weekly income earned by non-Hispanic whites[27]. The DOL report exemplifies the financial disadvantages many Latino borrowers face when seeking a mortgage loan.

score less than 620 to be high-risk or subprime, a score between 620 and 660 to be suspect and score over 660 as qualifying for prime loans[24]. According to a 2008 Federal Reserve study, credit scores varied significantly across racial groups, even after controlling for other demographic characteristics such as age, marital status, and estimated income. The study determined that blacks and Hispanics have lower credit scores than other racial groups[25]. Since Latinos historically have had lower credit scores compared to their counterparts, the credit score factor has become and impediment for many Latino borrowers.

Debt-to-Income Ratio

The "debt-to-income"(DTI) ratio is calculated by taking the sum of the monthly mortgage payment and all other recurring non-mortgage debt divided by monthly income. Lenders use DTI ratios to determine if sufficient income remains for living expenses. DTI is susceptible to error if Lenders fail to take into account certain debt or if borrowers do not reveal all their financial obligations, such as a car payment. Recent research indicates that a 45 percent DTI cap may be successful in curtailing risky mortgages.[26] Nevertheless, borrowers with low monthly incomes may require a greater proportion of their income to cover living expenses and emergencies therefore their DTI may fall way above the CAP requirements. According to a 2011 Department of Labor (DOL) report, Latinos only earn 71 percent of the median weekly income earned by non-Hispanic whites[27]. The DOL report exemplifies the financial disadvantages many Latino borrowers face when seeking a mortgage loan. The wide discrepancy in wages has resulted in a DTI barrier for Latino homeownership.

Employment and Expected Income

Verifying a borrowers employment status proves important for a Lender to ensure that the borrower will be able to continue making loan payments in the foreseeable future. Difficulties exist for borrowers who work seasonal jobs or are self-employed to meet loan employment standards. According to a report released by the California Immigration Policy Center, Hispanic immigrants have a higher rate of self-employment than nonimmigrant Hispanics and even native-born U.S. citizens[28]. Furthermore, according to the U.S. Bureau of Labor Statistics (BLS) 2010 report, Latinos are highly concentrated in seasonal jobs, such as Agriculture (45%) and Construction (44%) occupations[29]. Latinos are overrepresented in seasonal and self-employed occupations and this has also created a barrier for homeownership.

Policy Recommendations

The QM definition is one example of how housing policy can be used to encourage and promote Latino homeownership. However, it is important that public agencies and policy makers adopt legislation that will not adversely effect Latino homeownership and cripple Latino wealth building capacity. Furthermore, it is important that future policy addresses the fine balance between promoting financial markets and protecting consumers. The original housing market collapse stemmed from a lack of oversight, insufficient transparency and non-existing accountability. Nevertheless, it is important that future policy not be too restrictive and narrow that it marginalizes already disadvantaged communities. In order for the housing market and fragile economic recovery to continue on their positive course, housing policy needs to be inclusive and promote social equity among minority populations.

The CFPB needs to incorporate the following recommendations in their final QM ruling. Based on interviews and suggestions from industry and community leaders, incorporating the following recommendations in the QM definition can further prevent risky and predatory lending, establish inclusive national underwriting standards and ensure Latinos' accessibility to affordable mortgage markets.

At the time of publishing of this paper the QM ruling had not been released. The CFPB released its final QM ruling on January 10th, 2013. The ruling is over 800 pages long and will go into effect as of January 1st, 2014. Below are the most important features of the QM definition[30]:

QM needs to be broadly and clearly defined

A narrowly defined QM ruling could push a majority of today's loans and borrowers into a non-QM market. As a result, any lenders or investors willing to originate non-QM loans to these marginalized populations will face higher risks of ability-to-pay violations and possibly even steering violations. The increased risk associated with non-QM loans will discourage lenders from originating these types of loans and in the event that they are originated, they will be far more costly, and further burden disadvantage borrowers. Furthermore, these higher-priced non-QM loans would not include important protections embedded in QM. Therefore, the CFPB must release a broad QM definition that should include sound underwriting requirements and exclude risky loan features.

The QM ruling should be clearly defined. Any vague parameters can raise legal uncertainty, increase cost and limit access to credit. If lenders feel that the QM parameters are not clear, they will assume that risk is unpredictable and be forced to operate well within the standards. Such an outcome will reduce credit availability and

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affordability for many borrowers. For these reasons, the CFPB should establish clear and well-defined QM standards that are objectively determinable at origination.

QM should be designed with a Rebuttable Presumption

The Rebuttable Presumption definition incorporates more requirements, making it a stronger underwriting standard option than the Safe Harbor alternative. Adopting a Safe Harbor QM approach will be detrimental since it is less likely to restore confidence in consumers, investors and the financial sector itself. A QM designed with rebuttable presumption will protect consumers, investors and markets from unsustainable and unsuitable loans. The intention of the Ability-to-Pay provision, the Qualified Mortgage and other Dodd-Frank reforms is to prevent the abundance of precarious lending. A strong and significant Ability-to-Pay provision along with a well-designed QM definition is essential in order to put the US financial system back on track and in order for creditors to generate sensible and affordable loans.

QM should encourage innovative homeownership programs for low-income families

Currently, a majority of state run loan programs and non-profit organizations offer non-prime mortgage loans in order to make homeownership more accessible to low-income and first time buyers. Many of these non-prime loans will not qualify as QMs because they use interest-only features, borrowers do not always qualify for these loans using the fully amortizing substantially equal payment standard and the repayment period can be extended to 40 years instead of the traditional 30-year repayment period. Local and state programs generally target low and moderate-income communities and include credit education courses, home-ownership counseling and post-purchase support as part of their homeownership programs.

The CFPB needs to use its authority under TILA to allow state-approved mortgage loan products for low and moderate-income homebuyers to qualify as QMs. Provisions should also be made to encourage new state-approved programs in order to preserve public agencies' ability to continue to respond to the evolving mortgage market with new loan innovations.

APPENDIX I

Discussion of the CFPB's Final QM Ruling

The CFPB released it final QM ruling on January 10th, 2013. The ruling is over 800 pages long and will go into effect as of January 1st, 2014. Below are the most important features of the QM definition[31]:

No toxic loan features:

QMs cannot have:

- Terms that exceed 30 years,
- Interest-only payments, or
- Negative-amortization payments where the principal amount increases

Cap on how much income can go toward debt:

- Borrowers need to have debt-to-income ratios less than or equal to 43
- For a temporary period, loans that do not have a 43 percent debt-to-income ratio but meet government affordability or other standards — such as that they are eligible for purchase by Fannie Mae or Freddie Mac will be considered QMs.

The CFPB, decided to use both a safe harbor and rebuttable presumption approach in the QM ruling. They defined two kinds of Qualified Mortgages with different protective features:

Qualified Mortgages with a rebuttable presumption:

- Higher-priced loans
- Given to consumers with insufficient or weak credit history
- Lenders that offer these loans are presumed to have determined a borrower ability to repay the loan
- Consumers can challenge that presumption by proving that they did not have sufficient income to pay the mortgage

Qualified Mortgages that have a safe harbor:

- Lower-priced loans
- Prime loans given to consumers considered to be less risky

Proposed Amendments:

- Exempt certain nonprofit creditors that work with low- and moderate-income consumers, except homeownership stabilization programs,
- Give QM status to certain loans made and held in portfolios by small creditors, such as community banks and credit unions.
- The proposed amendments, if adopted by spring 2013 will go into effect at the same time as the Ability-to-Repay rule in January 2014.

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