14-CU-01 Supervisory Guidance on Qualified and Non-Qualified Mortgages

Summary

Prepared by NASCUS Legislative & Regulatory Affairs Department
January 2014

NCUA has issued Letter to Credit Unions 14-CU-01 (LTCU 14-CU-01) to provide credit unions with guidance the agency had prepared for its field staff on how credit union mortgage lenders will be expected to comply with the Consumer Financial Protection Bureau (CFPB)'s recently finalized rule on Ability-to-Repay (ATR) and Qualified Mortgages (QMs). The rule became effective January 10, 2014, and applies to all federally insured credit unions.

NCUA's guidance to its examiners outlines the requirements of the new rule. NCUA had previously discussed the new rule directly with credit unions in Regulatory Alert 14-RA-01 issued earlier in January. NCUA stresses that under the CFPB rule, a loan is not permissible if the credit union does not make a reasonable, good-faith determination that the member has the ability to repay the loan. NCUA notes that credit unions are responsible for developing and applying their own underwriting standards and establishing their own ability-to-repay criteria relative to their specific circumstances.

NCUA's guidance to its examiners contains a helpful chart presenting the three general ways in which a loan may meet QM status: general, temporary, and small creditor.

The guidance reminds examiners that **credit unions may offer loans that do not qualify as a QM** ("non-QM" loans) as long as a reasonable, good-faith determination is made that the member is able to repay the loan based on common underwriting factors in compliance with the ability-to-repay rule. Credit unions can continue to rely on existing underwriting guidelines that are sound and tested, resulting in loans that have generally performed well, as long as:
(1) the ability-to-repay rule requirements are met
(2) the credit union documents the information it has considered to make its determination

NASCUS note: Under the new CFPB rule, ALL lenders are generally prohibited from charging prepayment penalties, with a few exceptions. The rule also requires a 3 year record retention of compliance with the ATR aspects of the rule for each loan originated.

NCUA's guidance tells its examiners that most credit unions will need to enhance their written loan policies, procedures, and processes with regard to mortgage lending and then conduct periodic reviews to ensure that the rule requirements are consistently met. With respect to the safety and soundness implications of both QM, and non-QM, lending, NCUA notes:

- Even a QM loan with an ATR analysis might be at risk for default due to unforeseen circumstances.
- Non QM loans carry additional risks such as negative amortization, interest-only or balloon payments, and "no-doc" (no verification of income) loans.
- The potential difficulty in finding a secondary market for non-QM loans might in turn trigger a liquidity crisis at a credit union originating non-QMs.

- Concentration risk is always a factor and credit unions should be closely monitoring the size their QM and non-QM portfolios.
- Legal risks are present if a borrower, or class of borrowers, successfully challenges the lender's QM calculations or non-QM ATR analysis. If the borrower proves in court that the credit union failed to make a reasonable, good faith determination of the ability to repay during loan origination, the credit union could be liable for legal fees and up to three years of finance charges and fees.

NCUA makes clear to its examiners that the examiner should not make safety and soundness criticisms based on a mortgages status as QM or non-QM. However, NCUA does states that it expects credit unions to underwrite residential mortgage loans in a prudent fashion and address key risk areas, including loan terms, borrower qualification standards, loan-to-value limits, documentation requirements, and portfolio- and risk-management practices, regardless of whether a residential mortgage loan is a QM or non-QM. Improperly underwritten or past-due residential mortgage loans may be subject to criticism at origination or afterward. NCUA expects credit unions will:

- Review and updates its policies, procedures, and internal controls directly related to ensuring compliance with the ATR requirement (including the 8 required factors).
- Verify all the information used to determine a consumer's ability to repay using reasonably reliable third-party records and retain its documentation for 3 years.
- Periodically evaluate the program and Allowances for Loan and Lease Losses (ALLL) funding in response to empirical results (based on actual delinquency and loss history) and current economic conditions.
- Establish concentration limits for the overall real estate portfolio as well as concentration limits for any non-QM mortgages.
- Price non-QM mortgages adequately to address the additional risk.
- Retain knowledgeable and experienced personnel who understand the risks related to the mortgage lending engaged in by the credit union.
- Determine how providing non-QMs will fit into their strategic plan and benefit their members.
- Identify and track non-QMs in the loan portfolio and adequately monitor the portfolio for loan performance, loss ratio, and ALLL funding pools.
- Address legal risks, including having qualified legal counsel review non-QM mortgage loan programs.
- Account for the impact these loans will have on Asset/Liability Management (ALM) modeling and liquidity management.