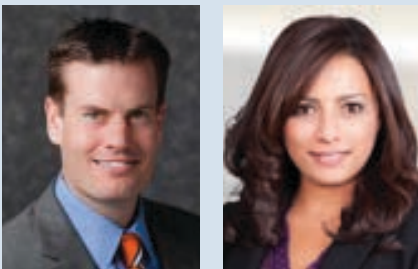


The New Qualified Mortgage (QM) Requirements

NEGATIVELY AFFECT AFFILIATE SETTLEMENT SERVICE PROVIDERS

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After considering a proposed rule and numerous comments, on January 10, 2013, the CFPB issued its long-awaited Ability-to-Repay rule (Rule). Generally, the Rule sets forth strict underwriting standards that require a lender to obtain and verify information to support a consumer's ability-to-repay. The Rule also defines qualified mortgages (QM), which are a subset of mortgages presumed to satisfy the ability-to-repay requirement. A mortgage will be deemed a QM, and thus entitled to a safe harbor, only if it satisfies certain product, underwriting, and points and fees requirements set forth in the Rule.¹

To be a QM, among other things, the points and fees payable in connection with the loan cannot exceed 3% of the total loan amount for loans over \$100,000.² Generally, real-estate related fees paid to third parties are not included in the points and fees calculation if the fee is bona fide and reasonable. Examples

of real-estate related fees include title examination fees, title insurance fees, fees for preparing loan-related documents, notary fees, credit report fees, and property appraisal fees.³

However, if a real-estate related fee is paid to an affiliate of the creditor (or the creditor itself), then the fee is counted towards the 3% cap on points and fees. Specifically, the Rule provides that real-estate related fees must be included in the points and fees calculation if: (1) the charge is unreasonable, (2) the creditor receives direct or indirect compensation in connection with the charge, or (3) *the charge is paid to an affiliate*.⁴ This means that a fee paid to an affiliate must be included in the points and fees calculation even though an identical fee (or a higher fee) paid to an unaffiliated third-party is excluded from the calculation, assuming that the charge is "reasonable." Therefore, any fees paid to affiliate appraisal management companies, affiliate title companies, and affiliate insurance companies now count toward the 3% points and fees QM limit.

An affiliate relationship is determined based on the level of control in the business relationship. It is "any company that controls, is controlled by, or is under common control with another company, as set forth in the Bank

Holding Company Act of 1956."⁵ Under that Act, one company "controls" another company if it (1) directly or indirectly owns or controls 25% or more of any class of voting securities of the other company, (2) controls in any way the election of a majority of the other company's directors, or (3) directly or indirectly exercises a controlling influence over the management or policies of the other company.⁶ The definitions of "control" and "controlling influence" are very broad and any determination of control is based on a fact-specific analysis of all aspects of the business relationship.⁷ Without more direction from the CFPB, it is possible that a creditor that has a significant business relationship with a settlement services provider may be deemed an affiliate of that provider depending on the creditor's level of "control" or "controlling influence." As a result, lenders may wish to evaluate their relationships with service providers to determine whether the service provider could be deemed an "affiliate."

When the final Rule was issued, the CFPB was aware that the QM requirements would negatively affect affiliate settlement service providers. The proposed rule's treatment of affiliate fees was criticized because such a settlement

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service provider's status as an affiliate does not appear to impact the consumer's ability-to-repay or otherwise harm consumers. Rather, the use of affiliates allows creditors to impose higher compliance standards and exercise greater control over their settlement service providers. It was also argued that many third-party fees are mandated by State law or required to be filed with the relevant State authority and do not vary. As a result, the rates tend to be nearly identical among providers and are not subject to manipulation.⁸

The CFPB acknowledged that including fees paid to affiliates in the points and fees calculation could make it more difficult for creditors using affiliated service providers to stay under the points and fees cap, and, as a result, that creditors could be deterred from using affiliates. Despite this argument, there were concerns raised that fees paid to affiliates pose a greater risk to consumers because affiliates may not have to compete with other providers, which potentially may result in affiliates charging higher fees. Ultimately, the CFPB did not think it was appropriate to exercise its exception authority to exclude affi-

ate fees from the points and fees calculation and it noted that Congress appeared to have rejected excluding such fees from points and fees.⁹

Counting affiliate fees in the points and fees calculation may have unintended consequences, including reducing competition among settlement service providers¹⁰ because the use of affiliate settlement service providers may decrease as a result of the Rule. Furthermore, if a lender uses an affiliate, it could negatively affect the lender because it may cause the loan to exceed the points and fees cap. This may result in more costs to the lender, which could be passed on to the consumers through higher interest rates or restrictive credit terms.¹¹

Lenders have until January 10, 2014 to comply with the new Rule. Until then, lenders may wish to examine their current practices to assess whether loans made after that date may run afoul of the 3% points and fees cap as a result of using affiliates, and compare available options going forward.



- 1 New 12 C.F.R. § 1026.43(e)(1)(i), (ii)(A).
- 2 New 12 C.F.R. §§ 43(e)(2)(iii), (e)(3)(i)(A).
- 3 12 C.F.R. § 4(c)(7).
- 4 New 12 C.F.R. § 32(b)(1)(iii).
- 5 New 12 C.F.R. § 32(b)(5).
- 6 12 U.S.C. § 1841(a)(2).
- 7 Board of Governors of the Federal Reserve System, Policy Statement on Equity Investments in Banks and Bank Holding Companies, p. 4, available at <http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20080922b1.pdf> (last visited Feb. 24, 2013).
- 8 Bureau of Consumer Financial Protection, Final Rule, Ability-to-Repay and Qualified Mortgage Standards under the Truth in Lending Act (Regulation Z) ("Final Release"), p. 111 (Jan. 10, 2013), available at http://files.consumerfinance.gov/f/201301_cfpb_final-rule_ability-to-repay.pdf (last visited Feb. 24, 2013).
- 9 Final Release, p. 111.
- 10 Final Release, p. 112.
- 11 Final Release, p. 112.



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