Qualified, Schmalified - Is the QM Safe Harbor Really Safe?

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After the Consumer Financial Protection Bureau (CFPB) implemented new rules regarding Ability to Repay (“ATR”) and Qualified Mortgages (“QM”), many lenders and servicers took at least some comfort in the belief that QM loans fell within a safe harbor for ATR compliance. Indeed, many lenders may be relying on the safe harbor as their primary protection against claims that a lender failed to properly assess a borrower’s ability-to-repay. The safe harbor, however, may not provide the level of protection that many originally thought.

For example, not all QMs conclusively comply with ability-to-repay requirements. For “higher-priced covered transactions” – defined as loans with a specified higher APR – a QM is only presumed to be ATR compliant. § 1026.43(e)(1)(ii). A consumer can still file a lawsuit and attempt to rebut that presumption. Such lawsuits may be costly to defend and will require potentially expensive discovery regarding whether the applicable ATR rules were properly followed.

Moreover, even if a QM loan is not “higher-priced,” a creditor may still face litigation regarding whether a given loan, in fact, meets the QM standards. In fact, the CFPB has publicly advised consumers that they “can still legally challenge your lender under [the QM] rule if you can show that the loan does not meet the definition of a Qualified Mortgage.” “Shopping for a mortgage? What you can expect under federal rules,” CFPB, January 2014. If a lender cannot show that a particular loan qualifies as a QM (perhaps there was an error in the way fees or interest rates were calculated), extended litigation and costly discovery regarding compliance with ATR may follow.

Lenders should also be prepared for consumer claims and litigation arising from new rules regarding unfair and deceptive practices and related theories, which may be used in an indirect attempt to circumvent the ATR/QM safe harbor. Stated differently, even if the ATR/QM Rule appears facially to have been satisfied, a borrower could still assert that the lender engaged in certain unfair or deceptive practices, and that the borrower was “duped” as a result. As the legal system begins to sort out these challenges, there is no guarantee that every jurisdiction will conclude that the safe harbor bars such claims.

So, what should a lender do? At a minimum, lenders must fully document and maintain all records relating to its analysis regarding whether a borrower satisfies the ATR standard. This information should be documented contemporaneously throughout the origination process, from application to closing, such that an independent observer can easily see how the ATR standards were applied and evaluated. The documentation should be kept for at least three years. § 1026.25(c)(3). Careful documentation is the lender's best tool for successfully (and economically) defending against inevitable borrower litigation.

Lenders must also work with their compliance officers and legal counsel to create and implement policies and procedures that assure institutional compliance with the ATR/QM rules. Establishing proper policies, procedures, and practices for compliance is the best protection against costly litigation in the future. An ounce of prevention is truly worth a pound of cure.

If you would like to discuss these concepts further, please do not hesitate to contact Marty Frenkel (248-827-1891; mfrenkel@maddinhauser.com) or Brian Nettleingham (248-359-7503; bnettlelingham@maddinhauser.com).