

Selling Guide Announcement SEL-2013-06

August 20, 2013

***Selling Guide* Updates Related to Ability to Repay and Qualified Mortgages**

The Consumer Financial Protection Bureau (CFPB) issued a final rule on January 10, 2013, and subsequent amendments on May 29, 2013 and July 10, 2013, implementing the “ability to repay” (ATR) provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which amended the Truth in Lending Act (TILA). The rule generally requires lenders to make a reasonable, good faith determination of a consumer’s ability to repay before originating a mortgage loan and establishes certain protections from liability for “qualified mortgages.”

At the direction of the Federal Housing Finance Agency (FHFA), Fannie Mae and Freddie Mac have worked together to formulate and align on certain requirements that address the CFPB rule. Fannie Mae is updating the *Selling Guide* to implement these requirements and as a follow-up to Lender Letter LL-2013-06, *Additional Information about Ability to Repay and Qualified Mortgage Requirements*. In addition, Fannie Mae is making a number of other related policy changes.

The *Selling Guide* has been updated for the following:

- Ability to Repay and Qualified Mortgages
- Other Related *Selling Guide* Updates Not Subject to Alignment

Each of the updates is described below. The affected topics are dated August 20, 2013, and are listed in the Attachment to the Announcement. Lenders should review each topic to gain a full understanding of the policy changes.

Effective Date

The new and updated policies are effective for mortgage loans with application dates on or after January 10, 2014.

Ability to Repay and Qualified Mortgages

ATR Covered Loan Eligibility Requirements

An ATR Covered Loan is a mortgage loan that is subject to the TILA’s ability to repay requirements under Regulation Z, and is otherwise not an ATR Exempt Loan (defined below), with an application date on or after January 10, 2014. An ATR Covered Loan must meet the following requirements, in addition to the other underwriting and eligibility requirements in the *Selling Guide*:

- have a loan term not exceeding 30 years;
- be a fully amortizing loan, as defined in Regulation Z; and
- have total points and fees not in excess of 3% of the total loan amount (or such different amount as provided in 12 CFR §1026.43(e)(3)), all as determined in accordance with Regulation Z.

Exception: The only exception to these requirements is for single-closing construction-to-permanent loans, which may have a loan term that exceeds 30 years including the construction period. See the Construction-to-Permanent Transactions section of this Announcement for additional information.

The ATR Covered Loan requirements have been added to the *Selling Guide* as mortgage eligibility requirements for acquisitions of newly originated loans (including government mortgage loans). These new eligibility requirements do not apply to an assumption or modification of an existing Fannie Mae mortgage loan regardless of the date on which such loan being assumed or modified was originally closed.

ATR Exempt Loan Eligibility Requirements

An ATR Exempt Loan is, with certain exceptions, a loan that either is not subject to TILA or is exempt from the ability to repay requirements in Regulation Z (12 CFR §1026.43(a) or (d)). Fannie Mae will purchase ATR Exempt Loans as long as such loans meet the other eligibility and underwriting requirements described in the *Selling Guide* (including the term and amortization requirements noted above). For purposes of determining whether a loan is an ATR Exempt Loan, lenders must follow the TILA and Regulation Z definitions.

NOTE: The classification of certain transactions for TILA purposes and for eligibility and underwriting purposes by Fannie Mae do not always align. For example, Fannie Mae defines a four-unit property where the borrower occupies one of the units as a "principal residence." If under TILA such a loan is considered to be for commercial or business purposes, it will be exempt from TILA and therefore considered an ATR Exempt Loan by Fannie Mae.

Exceptions: To maintain consistency with current practice, Fannie Mae requires loans to an *inter vivos* revocable trust to be underwritten as an ATR Covered Loan to be eligible for sale to Fannie Mae. In addition, "non-standard mortgage" to "standard mortgage" refinance transactions under Regulation Z must also be underwritten as ATR Covered Loans to be eligible for sale to Fannie Mae.

Points and Fees Limitations

The points and fees limitation formerly described in B2-1.4-03, Legal Requirements, has been eliminated. Fannie Mae is adopting the following requirements for points and fees charged by the lender. For purposes of these requirements, "total points and fees" and "total loan amount" must be calculated in accordance with Regulation Z (12 CFR §1026.32).

- ATR Covered Loans: Total points and fees may not exceed 3% of the total loan amount or such different amount in accordance with the qualified mortgage provisions of Regulation Z (12 CFR §1026.43(e)(3)).
- ATR Exempt Loans: Total points and fees may not exceed 5% of the total loan amount.

Mortgage Loans with Prepayment Penalties

Mortgage loans subject to prepayment penalties will be ineligible for sale to Fannie Mae.

Refi Plus® Higher Priced Mortgage Loans

The *Selling Guide* currently requires that Refi Plus loans with a payment change of less than or equal to 20%, that are also Higher Priced Mortgage Loans (HPML) under Regulation Z, be qualified using the stricter guidelines for Refi Plus loans with payments increases greater than 20%. While the substance of this provision remains unchanged, the provision was updated to refer to the ability to repay requirements under Regulation Z.

Qualifying Interest Rate for Seven-Year and Ten-Year ARMs

The qualifying payment for all seven-year (including step-rate ARMs) and ten-year ARM loans must be based on the greater of the note rate or the fully indexed rate. This change will apply to all seven-year and ten-year ARM loans, including Refi Plus and DU Refi Plus® loans.

Retirement of Product Features

Fannie Mae is retiring the following mortgage loan features:

- loan terms in excess of 30 years,
- loans with an interest-only feature, and
- growing-equity mortgages (GEMs).

Fannie Mae will no longer purchase loans, including ATR Exempt Loans, with these product features that have application dates on or after January 10, 2014. In a change from what was initially stated in Lender Letter LL-2013-06, due to market and operational considerations, Fannie Mae is implementing a flow delivery cut-off for mortgage loans with a retired product feature. All whole loans must be committed in eCommitting™ or eCommitONE® on or before June 30, 2014, and purchased by Fannie Mae on or before July 31, 2014. All loans in MBS must have issue dates on or before July 1, 2014. After this time, Fannie Mae will consider deliveries of loans with these product features on a negotiated basis only.

NOTE: Because lenders will continue to deliver mortgage loans with these features for a number of months, references to the above product features were not removed from the Selling Guide, Part C, Selling, Securitizing, and Delivering Loans. (These references will be removed later in 2014.)

Representations and Warranties

FHFA has directed Fannie Mae to incorporate new ATR Covered Loan eligibility requirements as part of its mortgage product eligibility requirements; thus, these eligibility requirements fall under the life of loan representations and warranties that apply to certain single-family mortgage products or features, as well as to directive-required standards. Separately, the ability to repay requirement is a statutory obligation under TILA, any breach of which would violate a lender's representation and warranties regarding compliance with laws.

NOTE: Additional details will be provided in the September Selling Guide Announcement regarding how Fannie Mae will perform quality control reviews, testing of lender compliance, and the interplay with the representations and warranty framework.

Compliance with Laws

The *Selling Guide* currently requires that the lender (or any subservicer or third-party originator it uses) be aware of, and in full compliance with, all federal, state, and local laws that apply to any of its origination, selling, or servicing practices or other business practices that may have a material effect on Fannie Mae. This provision in the Guide has been updated such that lenders must comply with any applicable law that addresses the "ability to repay."

Desktop Underwriter

The *Selling Guide* stipulates that Desktop Underwriter® (DU®) does not evaluate a loan's compliance with federal and state laws and regulations or whether it meets certain legal standards. DU will not consider a loan's potential status as a qualified mortgage. Lenders bear sole responsibility for that determination and for compliance with applicable requirements.

Updates to Desktop Underwriter

DU will be updated to remove interest-only and 40-year term loan eligibility, and to change the ARM qualifying for seven- and ten-year ARMs. These changes will apply to loan casefiles underwritten with DU Version 9.1, which will be released the weekend of November 16, 2013. The DU Version 9.1 Release Notes (to be published today) contain additional information.

Glossary Updates

- A glossary term has been added for “application date” - the date on which receipt of the borrower’s financial information first triggers the federal TILA disclosure requirements to the borrower in connection with the mortgage loan.
- The term “bona fide discount point” has been removed. This term is no longer used in the *Selling Guide*.
- The current glossary term “prepayment premium” has been removed. This term is no longer used in the *Selling Guide*.
- The term “prepayment penalty” has been added to the glossary with the following definition: A charge imposed for paying all or part of the transaction’s principal before the date on which the principal is due, other than a waived, bona fide third-party charge that the lender imposes if the borrower prepays all of the transaction’s principal sooner than 36 months after loan closing.

Other Related *Selling Guide* Updates Not Subject to Alignment

Responsible Lending Practices

A number of specific responsible lending policies have been updated, including:

- **Steering:** Lenders may not steer a borrower toward a particular loan program in an effort to misrepresent the borrower’s true credit and/or income related qualifications. Additionally, lenders must ensure that their loan originator compensation practices comply with the provisions of the TILA and Regulation Z and that loan originators comply with these requirements when presenting loan options to consumers.
- **HOEPA Loans:** A mortgage loan that is part of a larger transaction structured in a manner intended to circumvent the requirements of the Home Ownership Equity Protection Act of 1994 (HOEPA) and Section 32 of Regulation Z is ineligible for delivery to Fannie Mae. The “HOEPA Threshold” requirement was removed as a separate line item and subsumed into the HOEPA Loans provision.
- **Higher-priced Mortgage Loans:** This policy has been removed as a responsible lending practice because it is already covered by compliance with laws.
- **Lender Hiring Requirements:** This policy has been moved from A3-2-02, Responsible Lending Practices to [A3-4-03](#), Preventing, Detecting, and Reporting Mortgage Fraud, but no changes were made to the text.
- **Underwriting Standards:** This section within responsible lending has been updated to specifically reference compliance with applicable legal obligations regarding a borrower’s ability to repay. Language pertaining to allowance for reduced verification and documentation of income, assets, and liabilities has been removed, and minor updates were made to the general underwriting requirements to align with other underwriting topics in the *Selling Guide*.

Multiple Appraisals

If an applicable law, regulation, or lender's policy requires the lender to obtain more than one appraisal in connection with a mortgage loan, for loans delivered to Fannie Mae, the lender must select and use the single most accurate appraisal for underwriting purposes and that appraisal must be delivered through the Uniform Collateral Data Portal.

Construction-to-Permanent Transactions

For all single-closing construction-to-permanent transactions, the construction loan must be structured as a temporary loan exempt from the ability to repay requirements under Regulation Z. The construction loan period may have no single loan period of more than 12 months and the total construction loan period may not exceed 18 months. After conversion to permanent financing, the loan must have a loan term not exceeding 30 years (disregarding the construction period).

Two-closing construction-to-permanent transactions must utilize two separate sets of legal documents. A modification may not be used to update the original note; rather a new note must be completed and signed by the borrower(s).

Capacity to Repay the Mortgage Loan

The *Selling Guide* currently has a number of references to "the borrower's ability to repay the mortgage loan." In order to avoid confusion with the legal requirement set forth in the ability to repay rule, this phrase has been replaced with "the borrower's capacity to repay the mortgage loan."

Government Loans

Fannie Mae is discontinuing the purchase of VA-guaranteed graduated-payment mortgage loans.

As a reminder, all eligible government mortgage loans purchased or securitized by Fannie Mae must comply with the requirements of the respective government agency. Those loans must also comply with Fannie Mae requirements for government mortgage loans as specifically addressed in the *Selling Guide*, including the requirement that government mortgage loans can only be delivered on a negotiated basis. In the event that a government agency adopts its own qualified mortgage eligibility provisions, Fannie Mae may update the government loan requirements accordingly.

Subordinate Financing

As a result of the new prepayment penalty definition in the glossary, Fannie Mae has removed the reference in B2.1-1-04, Subordinate Financing (Unacceptable Subordinate Financing Terms) to prepayment penalties.

ULDD Data Points

Fannie Mae is continuing to assess potential new delivery data points as part of future Uniform Loan Delivery Dataset (ULDD) data requirements that will help Fannie Mae determine if mortgages meet points and fees thresholds and the other new eligibility requirements. Any new ULDD data points will not be included in ULDD Phase 2 but added to a future phase. As with all ULDD data requirement updates, Fannie Mae will provide lenders with sufficient lead time to update their systems and processes to comply with the new requirements.

Treatment of Fannie Mae's Loan Level Price Adjustments

Lenders may decide to recover the costs of loan level price adjustments (LLPAs) by either including the LLPAs in the calculation of points and fees or in the interest rate. If the lender chooses to pass some or all of those LLPAs through to borrowers, it is the lender's responsibility to comply with applicable requirements to determine the total amount of points and fees and annual percentage rate consistent with Fannie Mae's eligibility requirements.



Lenders who have questions about this Announcement should contact their Account Team.

John Forlines
Senior Vice President
Chief Credit Officer for Single-Family

Attachment

This table lists the topics that have been updated in the August 20, 2013, *Selling Guide* update. For many of the topics, the specific paragraph that has been updated has also been identified in parenthesis. Refer to the specific topics in the *Selling Guide* to see the actual changes.

Section of the Announcement	Topic Number and Title
ATR Covered Loan Eligibility	<ul style="list-style-type: none"> ▪ B2-1.4-02, Mortgage Loan Eligibility (Ability to Repay Loan Eligibility Requirements)
ATR Exempt Loan Eligibility	<ul style="list-style-type: none"> ▪ B2-1.4-02, Mortgage Loan Eligibility (Ability to Repay Loan Eligibility Requirements)
Points and Fees Limitations	<ul style="list-style-type: none"> ▪ B2-1.4-02, Mortgage Loan Eligibility (Points and Fees Limitations) ▪ B2-1.4-03, Legal Requirements (Points and Fees Limitation removed from this topic)
Mortgage Loans with Prepayment Penalties	<ul style="list-style-type: none"> ▪ B8-3-02, Special Note Provisions and Language Requirements (Notes Subject to Prepayment Premiums removed)
Refi Plus[®] Higher Priced Mortgage Loans	<ul style="list-style-type: none"> ▪ B5-5.2-02, DU Refi Plus and Refi Plus Underwriting Considerations (Underwriting and Documentation Requirements)
Qualifying Interest Rate for Seven-Year and Ten-Year ARMs	<ul style="list-style-type: none"> ▪ B3-6-04, Qualifying Payment Requirements
Retirement of Product Features	<ul style="list-style-type: none"> ▪ A2-2.1-03, Document Warranties (Nonstandard Documents) ▪ B2-1.3-01, Fixed-Rate Mortgages (Fixed-Rate Mortgage Eligibility) ▪ B2-1.3-02, Adjustable-Rate Mortgages ▪ B2-1.3-05, Growing-Equity (GEM) Loans (topic was retired) ▪ B2-1.4-02, Mortgage Loan Eligibility (Acceptable Mortgage Loan Terms) ▪ B2-3-03, Co-op Properties (Eligible Products and Repayment Terms) ▪ B3-2-02, Risk Factors Evaluated by DU (Loan Amortization Type) ▪ B3-5.1-01, General Requirements for Credit Scores (Minimum Credit Score Requirements) ▪ B3-6-04, Qualifying Payment Requirements ▪ B4-2.3-04, Loan Eligibility for Co-op Share Loans (Acceptable Repayment Terms for Co-op Share Loans) ▪ B5-2.1-01, Mortgages with an Interest-Only Feature (topic was retired) ▪ B5-2.1-02, Interest-Only Pricing, Mortgage Insurance and Special Features Codes (topic was retired) ▪ B5-2.2-02, Manufactured Housing Loan Eligibility (Ineligible Manufactured Housing Criteria) ▪ B5-3.2-02, HomeStyle Renovation Mortgages: Borrower Eligibility (Mortgage Terms) ▪ B5-4-02, Texas Section 50(a)(6) Mortgage Eligibility (Eligible

	<ul style="list-style-type: none"> ▪ Mortgage Products and Transaction Types) <ul style="list-style-type: none"> ▪ B5-5.2-01, DU Refi Plus and Refi Plus Eligibility (Maximum LTV, CLTV, and HCLTV Ratios and Eligible New Mortgage Loan Types) ▪ B5-6-02, MyCommunityMortgage Loan and Borrower Eligibility (Eligible Loan Types) ▪ B7-1-02, Mortgage Insurance Coverage Requirements (Mortgage Insurance Coverage Requirements) ▪ B7-2-03, General Title Insurance Coverage (Amount of Coverage) ▪ B7-2-04, Special Title Insurance Coverage Requirements (Other Mortgages) ▪ B8-3-01, Notes for Conventional Mortgages (Adjustable-Rate Mortgage Notes [First Mortgage Loans])
Representations and Warranties	<ul style="list-style-type: none"> ▪ A2-2.1-04, Limited Waiver of Contractual Warranties for Mortgages Submitted to DU ▪ A2-2.1-06, Life of Loan Representations and Warranties (Life of Loan Exclusions: Compliance with Laws and Responsible Lending Practices, and Single-Family Mortgage Product Eligibility)
Compliance with Laws	<ul style="list-style-type: none"> ▪ A2-2.1-06, Life of Loan Representations and Warranties (Life of Loan Exclusions: Compliance with Laws and Responsible Lending Practices) ▪ A3-2-01, Compliance with Laws (Compliance with Laws)
Desktop Underwriter	<ul style="list-style-type: none"> ▪ A2-2.1-04, Limited Waiver of Contractual Warranties for Mortgages Submitted to DU ▪ B3-2-01, General Information on DU (Overview) ▪ B3-6-04, Qualifying Payment Requirements (Additional Information About ARM Qualifying for DU Loan Casefiles)
Glossary Updates	<ul style="list-style-type: none"> ▪ E-1-02, Acronyms and Abbreviations ▪ E-3-01, Glossary of Fannie Mae Terms: A (“application date” added) ▪ E-3-02, Glossary of Fannie Mae Terms: B (“bona fide discount points” removed) ▪ E-3-06, Glossary of Fannie Mae Terms: F (reference to interest only feature in definition of “fixed-rate mortgage” removed) ▪ E-3-07, Glossary of Fannie Mae Terms: G (“graduated payment amount,” “graduated payment mortgage,” and “graduated payment period” removed) ▪ E-3-09, Glossary of Fannie Mae Terms: I (“interest-only feature” removed) ▪ E-3-14, Glossary of Fannie Mae Terms: N (“negative amortization” removed) ▪ E-3-16, Glossary of Fannie Mae Terms: P (“prepayment premium” deleted and “prepayment penalty” added)
Responsible Lending Practices	<ul style="list-style-type: none"> ▪ A3-2-02, Responsible Lending Practices ▪ A3-4-03, Preventing, Detecting, and Reporting Mortgage Fraud (Lender Hiring Practices moved here from A3-2-02, Responsible Lending Practices)
Multiple Appraisals	<ul style="list-style-type: none"> ▪ B4-1.1-01, General Information on Appraisal Requirements (Lender Responsibilities)

Construction-to-Permanent Transactions	<ul style="list-style-type: none"> ▪ B5-3.1-02, Conversion of Construction-to-Permanent Financing: Single-Closing Transactions (Terms of Construction Loan Period for Single-Closing Construction-to-Permanent Mortgages) ▪ B5-3.1-03, Conversion of Construction-to-Permanent Financing: Two-Closing Transactions (Two-Closing Transactions Overview)
Capacity to Repay the Mortgage Loan	<ul style="list-style-type: none"> ▪ Subpart B3, Underwriting Borrowers (Introduction) ▪ B3-1-01, Comprehensive Risk Assessment (Overview) ▪ Chapter B3-3, Income Assessment (Introduction) ▪ B3-3.1-01, General Income Information (Continuity of Income) ▪ B3-3.1-07, Verbal Verification of Employment (Verbal Verification of Employment)
Government Loans	<ul style="list-style-type: none"> • B6-1-03, Eligible VA-Guaranteed Mortgages (Eligible VA-Guaranteed Mortgages)
Subordinate Financing	<ul style="list-style-type: none"> • B2-1.1-04, Subordinate Financing (Unacceptable Subordinate Financing Terms)