Fannie Mae

Lender Letter (LL-2021-11)

May 26, 2021

To: All Fannie Mae Single-Family Sellers
Loan Eligibility Under the Preferred Stock Purchase Agreement and Revised General Qualified Mortgage Rule

In Lender Letter LL-2021-09 we introduced policies that were the result of the 2021 amendments to our senior preferred stock purchase agreement (PSPA) with Treasury and the revised General Qualified Mortgage loan definition in CFPB's rule that became effective Mar. 1, 2021. We are providing additional details about underwriting and loan eligibility policies, certain Desktop Underwriter® implementation policies, and a change to our high LTV refinance product.

Background

The Truth in Lending Act (TILA) contains provisions specifically addressing the determination that a creditor must make regarding a borrower's ability to repay a mortgage loan. These provisions are implemented in Regulation Z's Ability to Repay (ATR) section 12 C.F.R. § 1026.43. Qualified Mortgages (QM) are a subset of loans under the ATR requirements. The CFPB amended Regulation Z to replace the existing General QM loan definition with the Revised General QM loan definition (Revised QM).

The PSPA requires that we only acquire loans that meet the Revised QM loan definition or meet other requirements for loans not covered by QM. We have worked closely with Freddie Mac, in consultation with FHFA, to align on certain policies, such as those related to loans that are exempt from TILA or the ATR rule.

The information below describes the policies that are the result of these regulations and alignment. Many of these policies are in the *Selling Guide* today and remain unchanged. However, for the new policies, lenders must rely on this Lender Letter until such time as they are incorporated into the *Selling Guide*.

Definitions used in this Lender Letter

ATR Covered or QM loan: a consumer credit transaction secured by a dwelling that is subject to the Ability to Repay (ATR) QM Rule that meets the requirements in the table below. (12 C.F.R. § 1026.43) Example: a 30-year, fixed-rate loan to purchase a one-unit principal residence.

Exempt loan: there are two classifications of Exempt loans

- TILA Exempt: a loan that is exempt from TILA and as such, is exempt from the ATR requirements in Regulation Z. Example: a loan to purchase a home that the owner will rent to tenants.
- ATR Exempt: a loan that is exempt from the ATR requirements in Regulation Z. (12 C.F.R. § 1026.43(a)(3)). Example: a loan originated by a Housing Finance Agency to finance the purchase of a one-unit principal residence.

Revised General QM Rule: CFPB's QM rule in Regulation Z that became effective on Mar. 1, 2021. (12 C.F.R. § 1026.43(e)(2))

QM Patch loan: a loan originated in accordance with the temporary QM definition in Regulation Z, 12 C.F.R. § 1026.43(e)(4), that became effective Jan. 10, 2014. Example: a 30-year, fixed-rate loan to purchase a one-unit principal residence with an application date on Jan. 10, 2015 that was originated in accordance with the *Selling Guide* and purchased by us in 2015.

Effective dates

The following effective dates apply:

- Lenders can begin applying these policies immediately but must apply them to all loans with application dates on or after Jul. 1, 2021.
- As announced in LL-2021-09, GSE Patch loans that do not meet the Revised QM Rule must have application dates on or before Jun. 30, 2021 and be purchased or securitized on or before Aug. 31, 2021.
  - Exception: Single-closing construction-to-permanent loans with application dates prior to Jul. 1, 2021 that meet the QM Patch (and do not meet Revised QM) can be purchased or securitized on or before Feb. 28, 2022.
- ATR Covered loans with application dates prior to Mar. 1, 2021 (the effective date of CFPB's rule) may be purchased after Aug. 31, 2021 provided the loans otherwise meet the Revised QM Rule.

Loan eligibility

The following table describes the loan eligibility requirements for loans we will purchase.

Eligible Loan Requirements			
Regulation Z Section	**Eligibility Criteria**	**Current *Selling Guide***	**New Requirements**
1026.43(e)(2)(i)	Amortization	Fully amortizing	Same
1026.43(e)(2)(ii)	Loan term	Cannot exceed 30 years Single closing construction-to-permanent loans must have a loan term not exceeding 30 years after conversion to permanent financing (disregarding the construction period).	Same
1026.43(e)(2)(iii)	Points and fees	**ATR Covered loans**: 3% of the total loan amount or a different amount in accordance with the QM provisions of Regulation Z **Exempt loans**: 5% of the total loan amount	Same
1026.43(e)(2)(iv)	Short term ARM qualifying rate – initial fixed period 5 years or less	Greater of the note rate plus 2% or the fully indexed rate	For all loans, lenders must use the loan amount over the loan term to calculate periodic payments of principal and interest. Revised QM Rule requires the lender to use the maximum interest rate that could apply during the first five years after the first payment is due when calculating the qualifying rate. 3-year ARMs: note rate plus lifetime cap 5-year ARMs: note rate plus first rate change cap

			> **NOTE:** *For 5-year ARMs, we will continue to apply our existing policy of using the higher of the fully indexed rate or the qualifying rate to qualify the borrower.* See Qualifying interest rates for short-term ARMs below for more information about ARM qualifying rates and implementation within Desktop Underwriter (DU®).
1026.43(e)(2)(v)	Consider and verify	Requirements to analyze, verify, and document the borrower(s) income, obligations, and debt-to-income ratios **ATR Covered loans**: Must comply with the ATR/QM rule and all requirements in *Selling Guide,* Part B **Exempt loans**: Must comply with all requirements in *Selling Guide,* Part B	Same Exception: See High LTV refinance loans below
1026.43(e)(2)(vi)	Annual Percentage Rate-Average Prime Offer Rate (APR-APOR) Spread	6.50 percentage points	**ATR Covered loans**: The loan's APR cannot exceed the APOR by 2.25% or a different amount as specified in the Revised QM Rule, calculated in accordance with the provisions of that rule. **Exempt loans**: The loan's APR cannot exceed the APOR by 6.5% or more calculated in accordance with the regulatory provisions of Homeownership and Equity Protection Act (HOEPA) in TILA. **NOTE:** *For short term ARMs, lenders must calculate the APR using the maximum interest rate that could apply during the first five years after the first payment is due.*

Other requirements

Assumptions: Assumptions may or may not be subject to the Revised QM Rule depending on the circumstances. Refer to the regulation for the applicable requirements.

Representations and warranties: Lenders will be responsible for representations and warranties related to the requirements in this Lender Letter for the life of the loan. Our rights to exercise remedies related to violations of these requirements will not be waived.

Determination of regulatory compliance: We will not make the determination of whether a loan complies with or is exempt from TILA, ATR, or the Revised QM Rule, or whether a lender's designation of the status of a loan under the Revised QM Rule is correct. These determinations of compliance with the Revised QM Rule and other applicable laws are the lender's responsibility.

Qualifying interest rates for short-term ARMs

The following table describes the qualifying interest rate requirements that will be applicable for all ARMs. Changes that impact DU will be implemented for loan casefiles submitted or resubmitted to DU Version 11.0 on or after the weekend of Jul. 17, 2021. See the DU Release Notes for additional information.

ARM Type (Initial Adjustment Period)	DU ARM Plan	ARM Index	Qualifying Rate (DU and Manual)
1-Year ARMs (12 months)	FM GENERIC, 1 YR, 1% ANNUAL Cap	For CMT ARMs only See CMT ARMs below	Note rate plus 5%
	FM GENERIC, 1 YR, 2% ANNUAL Cap		Note rate plus 6%
3-year ARMs (36 months)	FM GENERIC, 3 YR	3 year SOFR (2/1/5)	Note rate plus 5%
5-year ARMs (60 months)	FM GENERIC, 5 YR	5 year SOFR (2/1/5)	Greater of fully indexed rate or note rate plus 2% (No change)
7 and 10-Year ARMs (84 and 120 months respectively)	FM GENERIC, 7 YR FM GENERIC, 10 YR	7 year SOFR (5/1/5) 10 year SOFR (5/1/5)	Greater of fully indexed rate or note rate (No change)
Lender ARM Plan	**DU ARM Plan**	**ARM Index**	**Qualifying Rate (DU)**
Any	Submission of an ARM plan number that is not recognized by DU	Any	▪ Qualifying rate entered in the ARM Qualifying Rate field in DU (No change) ▪ If the ARM Qualifying Rate field is not entered, DU will use the note rate plus 5%

"No change" indicates current *Selling Guide* and DU policies that are not changing

The fully indexed rate is calculated based on the index plus the margin and both values are required for all ARM loans submitted to DU. (No change)

> **NOTE:** *As a reminder, the Initial Adjustment Period in months must align with the initial fixed-rate period in years. For example, a "5-year ARM" must have an initial fixed period of 60 months. We updated the Standard ARM Plan Matrix to clarify the description of the column "ARM Plan Initial Fixed-Rate Interest Period/Subsequent Interest Rate Adjustment."*

Constant Maturity Treasury-Indexed ARMs

In Lender Letter LL-2021-05, we announced the retirement of all ARM plans that use an index based on constant maturity treasury securities (CMT). All CMT ARM loans must have application dates on or before Jun. 30, 2021 and be purchased as whole loans on or before Sep. 30, 2021 or delivered into MBS pools with issue dates on or before Sep. 1, 2021.

Considering this impending retirement of these ARM plans, the following policies will apply:

- CMT ARM plans will not be recognized as Fannie Mae ARM plans in DU on new loan casefiles created on or after Jul. 1, 2021 that are resubmitted after Jul. 17, 2021.
- Existing CMT ARM loan casefiles created prior to Jul. 1, 2021 will continue to be qualified per the current ARM qualifying rules (that is, the Revised QM Rule qualifying policies will not be applied). DU and manually underwritten CMT ARMs that do not meet the new qualifying rules must be purchased or securitized on or before Aug. 31, 2021.
- Existing CMT ARM loan casefiles with application dates on or before Jun. 30, 2021 that will be purchased or securitized after Aug. 31, 2021 but before Sep. 30, 2021 must meet all Revised QM Rule requirements. This includes the qualifying rate, APR-APOR spread, and all other Revised QM Rule policies. These casefiles may need to be resubmitted to DU after Jul. 17, 2021 using

- the applicable generic ARM plan, or
- a lender ARM plan and qualified using the applicable Revised QM Rule qualifying requirements.

- To accommodate the resubmission of CMT ARMs using the lender ARM plan functionality, DU will not return an "Ineligible" recommendation when a Fannie Mae ARM plan is not provided (as is currently done). The lender is responsible for ensuring the correct qualifying rate rules were used by DU.

Additional updates and information

High LTV refinance loans

Due to the extremely low volume and the impact of the Revised QM Rule, we are temporarily pausing the acquisition of high LTV refinance loans. Over the coming months we will be working with Freddie Mac, in consultation with FHFA, to determine how to modify the terms of this product. We will communicate any changes in a future *Selling Guide* update.

Effective dates

For loan casefiles created on or after Jul. 1, 2021, DU will no longer underwrite loan casefiles as high LTV refinances. Existing loan casefiles will continue to be underwritten as high LTV refinance transactions. In accordance with the deadlines announced for QM Patch loans, all DU and manually underwritten high LTV refinances must have application dates on or before Jun. 30, 2021 and must be purchased or securitized on or before Aug. 31, 2021. High LTV refinance transactions will not be eligible for purchase or securitization after Aug. 31, 2021.

The *Eligibility Matrix* and *Loan-Level Price Adjustment Matrix* have been updated to reflect this pause.

Notice regarding negotiated provisions

This paragraph serves as notice to lenders who have been granted one or more negotiated provisions (such as variances, exceptions, or special requirements) with terms that are inconsistent with the requirements of this Lender Letter. The requirements of this Lender Letter and any related future Guide updates supersede any such terms as of the effective dates described above.

Loan delivery and quality control

Lenders are reminded of the current requirement to deliver in the Uniform Closing Dataset (UCD) file (submitted to us at or before loan delivery) a number of data elements related to QM, including the method by which the creditor satisfied the ATR requirements or reason for exemption, and the APR and APOR percentages. The APR-APOR spread is also an existing data field in Loan Delivery and is required if it exceeds 1.50 percentage points. We will address delivery edits for points and fees and APR-APOR spreads, and quality control measures we may take in a future communication.

Lenders may contact their Fannie Mae Account Team if they have questions about this Lender Letter.
Have guide questions? Get answers to all your policy questions, straight from the source. Ask Poli.

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