



FHFA Duty-To-Serve Rule*

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I. Introduction

On December 29, 2016, the Federal Housing Finance Agency (FHFA) published a new final regulation requiring the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation (together “the Enterprises”) to serve the mortgage needs of very low-, low- and moderate-income families in certain prescribed markets.¹ In addition, the final rule imposes a duty to serve the housing finance needs of purchasers of manufactured housing, and purchasers of housing in rural areas. This rule implements statutory provisions found in the Housing and Economic Recovery Act of 2008 (HERA).²

Prior attempts to issue implementing regulations for these HERA provisions were unsuccessful, in large part due to Acting FHFA Director Edward DeMarco’s view that the Enterprises should not engage in new lines of business while under Government conservatorship.³ In addition to not promulgating final regulations, Acting Director DeMarco strongly supported legislative efforts to repeal the statutory mandate.⁴

II. The Final Regulation

The final rule mandates that the Enterprises serve the home mortgage needs of three income groups: (i) very-low income; (ii) low-income; and (iii) moderate-income. The families or individuals must also be purchasing homes in one of three markets: (i) manufactured housing; (ii) affordable housing; and (iii) rural housing. Thus, the rule requires the Enterprises to take actions to serve the housing finance needs for nine distinct subgroups. For example, one subgroup is very-low income families in rural areas; another is

*The information contained in this newsletter does not constitute legal advice. This newsletter is intended for educational and informational purposes only.

¹ *81 FR 96242* (Dec. 29, 2016).

² Pub. L. 110-289. 122 Stat. 2654. (July 30, 2008).

³ See, e.g., Legislative Hearing on Immediate Steps to Protect Taxpayers from the Ongoing Bailout of Fannie Mae and Freddie Mac: Hearings Before the Subcommittee On Capital Markets and Government Sponsored Enterprises, of the House Committee On Financial Services, 112th Cong. 1st Sess. (2011) at 26.

⁴ *Id.* at 110, where Mr. DeMarco states his support for eliminating the Duty-to-Serve requirement.

very-low income purchasers of manufactured housing; a third is very-low income purchasers of homes in rural areas; and so on for each income group and each market.

The final regulation goes on to explain that the Enterprises “must develop loan products and flexible underwriting guidelines to facilitate a secondary market for eligible mortgages”⁵ for each of the three markets and that they must serve “each income group in the year for which the Enterprise is evaluated and rated.”⁶

The preamble to the final rule elaborates on this mandate. It explains that “consistent with safety and soundness and consistent with the conservatorships, FHFA expects the Enterprises to show *tangible* results in each underserved market and to effectively facilitate mortgage lending to very low-, low-, and moderate-income families in each underserved market. Consistent with their charters, the Enterprises should expect mortgage purchases and activities pursuant to the Duty to Serve to earn a reasonable economic return, which may be less than the return earned on activities that do not serve these underserved markets.”⁷

III. Performance Plan

The Enterprises must prepare plans describing the specific activities and objectives each will undertake to fulfill its obligations in each underserved market over a three-year period. Proposed plans will be made public and comments will be solicited. FHFA will recommend changes after considering the public comments. The Enterprises will then submit a revised plan, which will also be subject to a review process, as well as any additional changes required by FHFA. When FHFA is satisfied with the plan, it will issue a non-objection letter for each of the three market areas in the plan, and not for the plan as a whole.

The rule does not make any specific activity mandatory. However, FHFA will determine a minimum number of activities that must be included in the Plan, and may designate certain activities as especially significant. The rule defines the activities that may be included in the plan, and permits the Enterprises to identify other activities not listed in the regulation, subject to FHFA approval.⁸

FHFA will determine whether an activity included in an Enterprise’s plan will receive duty to serve credit by considering whether the activity facilitates a secondary market for financing mortgages: On manufactured homes for very low-, low-, and moderate-income families; to preserve housing affordable to very low-, low-, and moderate-income families; and on housing for very low-, low-, and moderate-income families in rural areas.⁹

IV. Objectives

For each activity set forth in a Plan, the Plan must include one or more measurable objectives, which are the specific action items that the Enterprises will identify for each activity. All objectives must include one or more of the following assessment factors:¹⁰ (i) the extent to which the Enterprise reached out to loan sellers and other market participants in each of the market areas; (ii) the development of new loan products, more flexible underwriting guidelines, and other innovative approaches to providing financing to

⁵12 C.F.R. §§ 1282.33 — 1282.35.

⁶*Id.*

⁷81 FR 96244 (Dec. 29, 2016).

⁸12 C.F.R. §§ 1282.33 — 1282.35.

⁹12 C.F.R. § 1282.37.

¹⁰12 C.F.R. § 1282.36.

each underserved market; (iii) the volume of loans purchased in each of such underserved markets relative to the market opportunities available to the Enterprise; and (iv) the amount of investments and grants in projects which assist in meeting the needs of such underserved markets. However, since FHFA has directed the Enterprises to refrain from making grants while they are in conservatorship, during this period FHFA does not intend to provide credit to the Enterprises for making grants.

V. Evaluation

FHFA will conduct an annual evaluation of the Enterprises' activities to fulfill their obligations and will assign an annual rating for their performance for each of the three markets. The evaluation will incorporate an assessment of the Enterprise's performance in outreach, loan product development, loan purchases, and after the Enterprise is no longer in conservatorship, investments and grants.

The evaluation will include both quantitative and qualitative assessments of the Enterprises' accomplishments. FHFA may also consider "residential economic diversity" for "extra credit."

The quantitative assessment will evaluate the level of an Enterprise's accomplishment of each objective for each market. FHFA will determine if an Enterprise has achieved the "required level of accomplishment."¹¹ The qualitative assessment will evaluate such factors as "how skillfully an objective was implemented, the impact of the objective, and such other criteria as FHFA may set forth."¹² The extra credit activities, such as residential economic diversity, also will be assessed by FHFA based on the method and criteria established in FHFA guidance.

Based on the quantitative, qualitative and extra credit assessments, FHFA will assign a rating to the Enterprise's performance for each underserved market in its Plan.

VI. Ability to Pay Requirement and Private Label Securitization

A. Ability to Repay Rule

Sections 1411 of the Dodd-Frank Act provides that no creditor may make a residential mortgage loan unless he or she first makes a reasonable and good faith determination, based on documented and verified information, that the consumer has a reasonable ability to repay the loan, and all applicable taxes, insurance and assessments.¹³ This is known as the "Ability to Repay" rule.

Mortgage loans that meet the definition of a "qualified mortgage" or "QM" are presumed to meet the ability to repay requirement.¹⁴ The term "qualified mortgage" is defined by the Consumer Financial Protection Bureau (CFPB).¹⁵ Among other things, these regulations provide that any mortgage that is eligible to be purchased, guaranteed or insured by an Enterprise will be a QM. However, the mortgage must also meet three other requirements:

¹¹ *Id.*

¹² *Id.*

¹³ Codified at 15 U.S.C. §§ 1639b and 1639c.

¹⁴ 15 U.S.C. § 1639c. For so-called "higher priced mortgages," meeting the qualified mortgage definition results in a rebuttable presumption of meeting the ability to repay test. For all other mortgages, the presumption is not rebuttable.

¹⁵ 78 FR 6408 (Jan. 20, 2013).

- The loan must call for regular periodic payments that are substantially equal, except for changes due to interest rate adjustments on a variable rate loan;
- Making required payments will not result in an increase in principal balance;
- There is no balloon payment except if specified conditions are met; and
- Points and fees do not exceed 3 percent for loans of \$100,000 or more.

This special treatment for loans eligible for purchase by an Enterprise will terminate if FHFA issues its own qualified mortgage rule providing for a different treatment, the conservatorship ends, or on January 10, 2021, whichever is earlier.

Since the purpose of the duty to serve rule is to increase the secondary market for duty to serve loans, it would appear that any innovative mortgages developed by the Enterprises will be considered to be QM loans, so long as the other requirements noted above are met.

B. Private Label Securitization

Section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act¹⁶ provides that a securitizer must retain 5 percent of the credit risk of the assets collateralizing an asset-backed security. This risk cannot be hedged or transferred. However, securities backed solely by mortgages that meet the underwriting standards to be deemed a “qualified residential mortgage” (QRM) are exempt from the risk retention requirements entirely.

Under interagency developed regulations, a QRM loan is defined to mean a “qualified mortgage” (QM) loan.¹⁷ So, unless the regulation is revised, entitled securitizing mortgage loans developed by the Enterprises under their duty to serve mandate will not be subject to the credit risk requirements imposed under section 941 of the Dodd-Frank Act.

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¹⁶Codified at 15 U.S.C. §780-11.

¹⁷79 FR 77602 (Dec. 24, 2014).