Preapproval or Prequalification?

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Preapprovals are a frequent HMDA topic of conversation, whether the discussion is how to distinguish a preapproval from a prequalification, how to report for HMDA, or whether preapprovals apply only to home purchase loans.

What is a Preapproval?

An applicant with an approved preapproval request is fully credit approved and needs only to identify an acceptable property that meets all collateral conditions such as sufficient appraised value for the amount requested, no title issues, and passes all inspections. All income and credit is verified and final (subject to typical conditions such as material change in the situation, of course.)

The only conditions that may be placed on a true preapproval under both Regulation B and HMDA (Regulation C) are collateral conditions. A preapproval applicant is fully credit approved - the approval is a commitment to lend once an acceptable property is identified, whether the commitment is verbal or written. The preapproval should have a time limit after which a new approval will be required.

A prequalification request will not go through a full credit underwriting. A prequalification is not a formal commitment to lend, it is an informal estimate of the loan amount for which an applicant might qualify. A prequalification is not binding upon the financial institution and any communication with the applicant should clearly state that it is not a commitment to lend.

Preapprovals and HMDA

Preapprovals for HMDA only apply to purchases of dwellings. The information on preapprovals is in the definition of application in Regulation C/HMDA at 12 CFR 1003.2. The definition clearly states that it only applies to home purchase loans for HMDA. HMDA definitions are available here.

Application.—(1) In general. Application means an oral or written request for a home purchase loan, a home improvement loan, or a refinancing that is made in accordance with procedures used by a financial institution for the type of credit requested.

(2) Preapproval programs. A request for preapproval for a home purchase loan is an application under this section if the request is reviewed under a program in which the financial institution, after a comprehensive analysis of the creditworthiness of the applicant, issues a written commitment to the applicant valid for a designated period of time to extend a home purchase loan up to a specified amount. The written commitment may not be subject to conditions other than:

(i) Conditions that require the identification of a suitable property;
(ii) Conditions that require that no material change has occurred in the applicant's financial condition or creditworthiness prior to closing; and

(iii) Limited conditions that are not related to the financial condition or creditworthiness of the applicant that the lender ordinarily attaches to a traditional home mortgage application (such as certification of a clear termite inspection).

Appendix A of HMDA

Appendix A to Regulation C, which contains the instructions for what and how to report, also specifically says to report on requests for preapprovals of home purchase loans only and to report Code 3 for refinances and home improvement loans.

“8. Request for Preapproval of a Home Purchase Loan. Indicate whether the application or loan involved a request for preapproval of a home purchase loan by entering the applicable Code from the following:

Code 1--Preapproval requested

Code 2--Preapproval not requested

Code 3--Not applicable

Enter Code 2 if your institution has a covered preapproval program but the applicant does not request a preapproval.

Enter Code 3 if your institution does not have a preapproval program as defined in Sec. 1003.2.

Enter Code 3 for applications or loans for home improvement or refinancing, and for purchased loans.

FFIEC HMDA Q and A and Preapprovals

The FFIEC Q and A for HMDA has several informative questions and answers on Preapprovals, including what constitutes a program, treatment of ad hoc requests, commitment letters, approved not accepted requests, amount to report in various situations, etc.

A strong understanding of the Q and A is vital to accurate HMDA reporting. The Q and A for HMDA can be found here.

Preapprovals and Regulation B

Regulation B preapproval requirements apply to more situations than home purchases. You can read the requirements at the Commentary for Regulation B, 12 CFR 1002.2(f)-5. Regulation B preapprovals can apply to automobile purchases, credit cards, home purchases, any transactions at all. The Commentary can be found here.
Unlike HMDA, both preapprovals and prequalifications are treated as applications under Regulation B and trigger required notices such as adverse action. This is easy to understand when you consider that a denied inquiry triggers an adverse action notice under Regulation B.

**Summary**

Understanding the difference between prequalifications and preapprovals and the reporting requirements is important. The important factors are whether a full credit underwriting with a commitment to lend takes place or if the approval is an informal estimate of an amount for which an applicant “might” qualify. What the financial institution calls the approval is not the controlling factor.

If the financial institution calls its product a prequalification but conducts a full credit underwriting with only collateral conditions assigned, the approval is a preapproval for both HMDA and Regulation B. Similarly, if the financial institution calls its product a preapproval but does not conduct a full credit underwriting and attaches both credit and collateral conditions, the product is a prequalification product and is not reportable for HMDA.

The actions are what control HMDA reporting, not the terminology. Proper terminology is important, of course, so that applicants are not confused.

Become familiar with the rules and make sure that HMDA reporting is correct.

Applicant requests for preapprovals vs prequalifications vary regionally; preapprovals are common in some markets, especially in a fast moving home buyer markets. In other markets, prequalifications are adequate. Each financial institution must determine whether one or the other product, or both, are needed in a particular market.