Lenders Compliance Group

Thursday, April 21, 2011

Ability to Repay - Additional Analysis

In our Tuesday (4/19/11) newsletter and also in our post we notified you of the FRB's proposed amendments to Regulation Z that would set out how residential mortgage lenders would be required to determine a consumer's ability to repay a mortgage (Proposal).

The Proposal would define what are termed "qualified mortgages" and also set minimum underwriting standards for many mortgages.

The proposed amendments, which are required by the Dodd-Frank Act (DFA), also would implement limits on prepayment penalties and attempt to prevent lenders from evading the rules.

In today's review, we will provide further analysis of the Proposal.

Comment Period: Until July 22, 2011.

Because the Consumer Financial Protection Bureau (CFPB) will take over Regulation Z rulemaking authority on July 21, 2011, the FRB has said that it will not be taking final action on the proposal and that the comments it receives will be transferred to the CFPB.

Loan Products

The Proposal would apply the ability-to-repay requirement to nearly any consumer credit plan secured by a dwelling, but it would exclude open-end credit plans, reverse mortgages, construction or other temporary loans with terms of 12 months or less, and timeshare plans.

The FRB claims that the proposed requirements are similar to those it adopted for higher-priced mortgages in July 2008 under the Home Ownership and Equity Protection Act (HOEPA), but they would apply to mortgages that are not higher-priced and those that are not secured by the consumer's principal dwelling.

Ability to Repay

The DFA prohibits a lender from making a mortgage loan unless it has made "a reasonable and good faith determination, based on verified and documented information, that the consumer will have a reasonable ability to repay the loan, including any mortgage-related obligations." Examples of "mortgage-related obligations" are property taxes and homeowners' association assessments.

8 Criteria

A consumer's individual ability to repay uses 8 criteria:

1. the income or assets the lender is relying on in making its decision;
2. the consumer's current employment status;
3. the mortgage's monthly payment;
4. the monthly payment on any other mortgages on the property, such as home equity lines of credit;
5. the monthly payment for all mortgage-related obligations;
6. the consumer's other current debt obligations;
7. the consumer's monthly debt-to-income ratio or residual income; and
8. the consumer's credit history.

Special Features

If the mortgage includes an adjustable interest rate, it must be underwritten based on the fully indexed interest rate, or based on the introductory rate if that is higher than the fully indexed rate.

Features such as balloon payments, interest-only payments and negative amortization would not be prohibited. However, there would be strict underwriting standards.

Refinancing: "Nonstandard" into a "Standard" Mortgage

The lender is required to consider and verify the consumer's income and assets, if the lender is refinancing a mortgage loan and also adding certain features to the loan, such as a balloon payment, negative amortization, or interest-only payments. Notwithstanding this requirement, all the other aforementioned criteria must be considered.

The consumer must qualify for the loan based on the highest interest rate that could be imposed in the first five years after consummation, rather than over the life of the loan. There would be a requirement to satisfy limits on points and fees and the loan must materially reduce the consumer's monthly payments. Importantly, the refinancing option would be available only if the consumer is not delinquent under the existing mortgage.

Qualified Balloon Loan - Rural or Underserved Area

Some balloon loans would be considered to be qualified mortgages in rural and underserved areas. These loans would not only comply with all of the other criteria for a qualified mortgage but also would need to be underwritten based on scheduled payments other than the balloon.

Prepayment Penalties

The DFA provides limits on prepayment penalties. A prepayment penalty would be permitted only in the case of a prime, fixed-rate mortgage that meets the criteria for being a qualified mortgage.

The amount of the permitted penalty would decrease with the passage of time; for instance, a 3% penalty would be permitted in the first year of the loan, a 2% penalty in the second year, and a 1% penalty in the third year.

No penalty would be permitted more than three years after the loan was consummated. A lender that offers a consumer a loan with a prepayment penalty would also be required to offer a loan without that feature.

Safe Harbor or Rebuttable Presumption

Meeting the requirements of the "qualified mortgage" would provide the lender with some protection from liability. However, the DFA is actually not clear as to whether the consequent protection was intended to be a safe harbor from liability or only a means to provide a rebuttable presumption that the lender had complied with the ability to repay mandates.

Thus, the Proposal offers these two "alternatives" toward resolving the uncertainty vis-a-vis a "qualified mortgage:"

1. Safe Harbor Alternative: The loan would not permit negative amortization, interest-only payments, or balloon payments; the loan term would not exceed 30 years; the points and fees would not exceed 3 percent of the total loan amount; the consumer's income and assets would be documented and verified; and, the loan would be underwritten based on the maximum interest rate in the first five years, using a fully-amortizing payment schedule and considering any mortgage-related obligations.

2. Rebuttable Presumption Alternative: Includes the Safe Harbor Alternative and adds a requirement for the lender to consider and verify the monthly payment of any simultaneous mortgage and the consumer's employment, other current debt obligations, debt-to-income ratio or residual income, and credit history.

Lender Liability

The DFA provides that violations of the ability to repay requirements face tripartite penalties: (1) damages consisting of the sum of all finance charges and fees paid by the consumer, (2) the consumer's actual damages, and (3) described statutory damages.

A consumer could file a claim at any time within three years of the violation, although the consumer could assert the violation as a set-off or recoupment in a foreclosure suit at any time.

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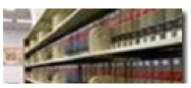

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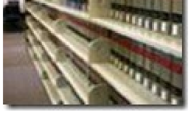

FRB: Ability-to-Repay, Proposed Rule - Notice
April 18, 2011

Labels: Ability to Repay, CFPB, Dodd-Frank Act, FRB, Non-Standard Mortgage, Prepayment Penalties, Qualified Mortgage, Qualified Residential Mortgage, Regulation Z, Safe Harbor, Standard Mortgage, TILA

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