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Client Alert

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Consumer Financial Protection Bureau Releases Final "Ability-to-Repay/Qualified Mortgage" Rules

On January 10, 2013, the Consumer Financial Protection Bureau (CFPB) released its final "Ability-to-Repay/Qualified Mortgage" rules. The rules and the concurrent proposed amendments[1] were posted on the CFPB's website following published remarks[2] by Director Richard Cordray and a two-hour "field hearing"[3] in Baltimore, MD. The bureau also promised to publish plain-language booklets and educational videos to help guide lenders through the maze of new rules.

The rules, which are over 800 pages long, are "final" in the sense that they have been revised from the proposed rules that were released for comment last summer, and they are now "official." However, the rules do not take effect for another year (January 10, 2014), and the bureau issued an additional 184-page "concurrent proposal" containing potential amendments to the new rules that address and/or clarify unresolved issues such as exemptions for certain nonprofit creditors and homeownership stabilization programs, an additional definition of a qualified mortgage for certain loans made and held in portfolio by small creditors such as community banks and credit unions, and inclusion of loan originator compensation in the points and fees calculation. Notwithstanding the pending amendments and delayed effective date, the rules issued last week will have an enormous impact on the mortgage lending business, and their complexity makes prompt commencement of implementation work essential.

The rules are a forceful attempt to create standards for "responsible lending" that encourage banks to resume issuance of residential mortgages by offering them two levels of protection from subsequent borrower claims. Director Cordray wisely anticipated the inevitable criticism from consumer advocates who object to offering banks such protections by reminding them that "you cannot have responsible lending unless you have lending in the first place, and the mortgage market as it stands today has tightened so much that many consumers cannot borrow to buy a home even with a strong credit history."

The following outline summarizes the most significant features of the new rules:

1. Minimum Underwriting (Ability-to-Repay) Standards

All mortgage lenders must verify borrowers' ability to repay by documenting and analyzing:

1. Current or reasonably expected income or assets;
2. Current employment status;
3. Credit history;

[1] http://www.consumerfinance.gov/regulations/ability-to-repay-and-qualified-mortgage-standards-under-the-truth-in-lending-act-regulation-z/.

[2] http://www.consumerfinance.gov/speeches/prepared-remarks-of-richard-cordray-at-the-ability-to-pay-rule-field-hearing/.

[3] http://www.consumerfinance.gov/blog/

4. The monthly payment for the mortgage;
5. The monthly payments on any other loans associated with the property;
6. The monthly payment for other mortgage-related obligations (such as property taxes);
7. Other debt obligations; and
8. The monthly debt-to-income ratio or residual income the borrower would be taking on with the mortgage. (Debt-to-income ratio is a consumer's total monthly debt divided by total monthly gross income).

- "Reasonably reliable third-party records" are sufficient to verify the borrower's income and debt. The rule provides a non-exhaustive list of records on which the lender may rely, including W-2s, tax returns and bank records.

- In calculating the borrower's monthly payment for mortgage-related obligations, the lender must take into consideration "the maximum interest rate that may apply during the first five years."

- Special rules apply to balloon payment, negatively amortizing, and interest-only loans.

- More relaxed rules apply where the creditor is refinancing the borrower from an adjustable-rate mortgage, interest only or negatively amortizing loan to a "standard mortgage" with a "materially" lower payment. Rather than ability to repay, the lender must consider whether the new standard mortgage is likely to prevent default once the loan is recast.

2. Definition of "Qualified Mortgage"

a. Required:

- The term of the loan is 30 years or less.

- The borrower's debt to income ratio does not exceed 43 percent, inclusive of the pending loan transaction and any simultaneous loans of which the lender is aware.

- Minimum underwriting (ability-to-repay) standards have been met.

b. Forbidden:

- Excessive points and fees, as determined based on the amount of the loan.

    - $100,000+ ─ points and fees may not exceed 3 percent of the total loan amount.
    - $60,000 to $99,999 ─ points and fees may not exceed $3,000.
    - $20,000 to $59,999 ─ points and fees may not exceed 5 percent.
    - $12,500 to $19,999 ─ points and fees may not exceed $1,000.
    - Less than $12,500 ─ points and fees may not exceed 8 percent.

- Negative amortization loans (borrower initially repays less than monthly interest).

- Interest-only loans.

- Balloon payment loans.

c. Temporary category of qualified mortgage:

- For no more than seven years, the minimum underwriting standards and 43 percent debt-to-income ratio requirements for qualified mortgages will not apply to loans that satisfy the underwriting requirements of Fannie Mae or Freddie Mac in their current federal conservatorship/receivership status, the Federal Housing Administration, the Department of Veterans Affairs, or the Rural Housing Service.

3. “Rebuttable Presumption” of Ability-to-Repay for Higher Priced Qualified Mortgages

“Higher-priced loans” (generally synonymous with “subprime loans”) are loans with an annual percentage rate that exceeds the average prime offer rate by 1.5 percent or more for a first lien, and by 3.5 percent for a subordinate lien.

For higher-priced loans that satisfy the criteria to be a “qualified mortgage,” the lender will be presumed to have complied with the ability-to-repay requirements. The borrower may rebut this presumption by showing that the lender did not in fact make a “reasonable and good faith determination of the consumer’s repayment ability at the time of consummation.” The longer a borrower is able to make payments before defaulting, the more difficult it will be to overcome the presumption.

4. “Safe Harbor” for Lower Priced Qualified Mortgages

For qualified mortgages that are not higher-priced loans (generally synonymous with “prime loans”), the lender will be granted a “safe harbor,” which is a conclusive determination that the lender has complied with the repayment ability requirements. In other words, for first mortgages with annual percentage rates no more than 1.5 percent above the average prime offer rate, or subordinate mortgages with annual percentage rates no more than 3.5 percent above the average prime offer rate, if the qualified mortgage criteria are met, the borrower cannot rebut the presumption that the lender complied with the ability-to-repay rules.

For the protections afforded by both the rebuttable presumption and the safe harbor, borrowers may still challenge whether their loans actually met the criteria to be qualified mortgages. If such challenges are successful, the loans will not be considered qualified mortgages, and therefore the lenders will lose the protections. Furthermore, the protections only apply to claims related to borrowers’ ability-to-repay and do not affect other legal rights available to consumers.

5. Omitted: Minimum Down Payments and Credit Scores

The rules did not create any requirement that borrowers make minimum down payments when purchasing their homes, or that lenders consider borrowers’ credit scores when evaluating their ability to repay their mortgages.

Ronald Rubin, a partner at Hunton & Williams LLP, was one of the earliest employees at the Consumer Financial Protection Bureau, where he was an enforcement attorney in the Supervision, Fair Lending and Enforcement Division. He played an important role in building the new agency’s enforcement capabilities, created the standard format for all of the Office of Enforcement’s policies and procedures, and drafted many critical internal rules of operation such as the Enforcement Action Process and the NORA procedures. Ron has extensive knowledge of the Dodd-Frank Act and other consumer financial laws overseen by the CFPB.

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