



Financial Institution Compliance Update



February 12, 2013

This communication is designed to provide you with quick snapshots and timely perspective on recent regulatory developments.

CFPB's Ability-to-Repay and Qualified Mortgage Standards (Final Rule)

On January 10, 2013, the Consumer Financial Protection Bureau (CFPB) issued one of its most important residential mortgage compliance rules. The main purpose of the rule is to ensure that lenders offer mortgages only to consumers that can afford them. This final rule is an amendment to Federal Reserve Regulation Z (Truth in Lending Act).

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The final rule implements sections 1411 and 1412 of the Dodd-Frank Act and the effective date is January 10, 2014. The rule requires "...creditors to make a reasonable, good faith determination of a consumer's ability to repay any consumer credit transaction secured by a dwelling (excluding an open-end credit plan, timeshare plan, reverse mortgage, or temporary loan)" [12 CFR Part 1026]. The rule also implements section 1414, which limits prepayment penalties. Moreover, the rule requires creditors to maintain evidence of compliance for three years after a covered loan is consummated.

The complete final rule can be found here: http://www.consumerfinance.gov/regulations/ability-to-repay-and-qualified-mortgage-standards-under-the-truth-in-lending-act-regulation-z/

Final Rule Key Elements

Ability-to-Repay Determinations: Creditors must consider these eight underwriting factors:

- Current or reasonably expected income or assets
- Current employment status
- The monthly payment on the covered transaction
- The monthly payment on any simultaneous loan
- The monthly payment for mortgage-related obligations
- · Current debt obligations, alimony, and child support
- The monthly debt-to-income ratio or residual income

Credit history

For instance, the guidance states that current or reasonably expected income or assets should be verified and that the assets considered excludes the property that secures the new loan. Regarding current employment status, the creditor must verify the consumer's employment status if it is going to rely on this income to determine the consumer's ability to repay loan. Regarding the monthly payment factors, the rule requires that these be included in the general ability-to-repay analysis as part of the debt-to-income ratio requirement. Similarly, the rule requires that creditors consider current debt obligations, alimony and child support as part of ability-to-repay. Regarding monthly DTI ratio or residual income, there are minimum standards (which include the aforementioned), and there is flexibility for creditors to use their own guidance to make ability-to-repay determination. For example, creditors can use monthly DTI and/or residual income. The rule also requires creditors to consider credit history; however, there is flexibility in how creditors consider it (i.e., number and age of credit lines, payment history, collections, judgments, rental payments history).

<u>Presumption for Qualified Mortgages:</u> The final rule now specifies that the presumption of compliance is conclusive in that a "qualified mortgage" loan satisfies the ability-to-repay requirements.

General Requirements for Qualified Mortgages: Based on the definition of a qualified mortgage, the final rule generally prohibits loans with negative amortization, interest-only payments, balloon payments, terms exceeding 30 years and "No-Doc" or "Low-Doc" loans. Also, the rule limits points and fees to 3 percent of loan amount and prohibits prepayment penalties on qualified mortgages. One of the most important standards is a required debt-to-income ratio no greater than 43 percent.

<u>Rural Balloon-Payment Qualified Mortgages:</u> Certain balloon-payment mortgages can be treated as qualified mortgages. The loans would qualify if originated and held by small creditors that operate predominantly in rural or underserved areas. There are, however, various eligibility criteria for the creditors and on terms of loan.

Impact on Securitization

The benefits of this final rule to improve underwriting and credit standards ties directly to the proposed Dodd-Frank Act credit risk retention requirement for mortgage securitization. Now that securitizers will be required to retain a portion of the assets being securitized, it will behoove securitizers to ensure the quality of underlying mortgages.

What Companies Should Do Now

Apart from the necessary updates to policies, procedures, training, record retention and management information systems, creditors should focus their efforts to ensure consistency among departments involved (credit, lending, loan servicing) and among employees (loan officers, underwriters). Standard manual or automated checklists that are reviewed by managers often ensure consistency among different branches, regions and markets. Also, independent or self-assessments of new controls established with enough lead time before effective date is highly recommended.









