WHITEPAPER

CFPB Final Rule on Ability-to-Repay and Qualified Mortgages

BAI LEARNING & DEVELOPMENT

Introduction

On January 10, 2013, the Consumer Financial Protection Bureau (CFPB) issued final rules amending Regulation Z (Truth in Lending) to implement §§1411 and 1412 of the Dodd-Frank Act. The rules are intended to deal with problems seen as contributing factors to the mortgage crisis; namely when lenders originated mortgage loans without properly evaluating whether the borrower would be able to repay.

The rules are **effective January 10, 2014**.

The final rule adds new §1026.43 ("Minimum standards for transactions secured by a dwelling") to Regulation Z, along with a new Appendix Q ("Standards for Determining Monthly Debt and Income"). It also makes revisions to §1026.32 ("Requirements for high-cost mortgages").

On the same day, the CFPB issued a concurrent proposal that would clarify exemptions for certain community-based lenders and small portfolio creditors, and to potentially change the treatment of indirect lending compensation under the Qualified Mortgage "points and fees" test. Comments on the proposal were due February 25, 2013.

Resource Links

- CFPB Press Release 1/10/13
- CFPB Blog Post 1/10/13
- CFPB Breakdown of Ability-to-Repay Rule
- Ability-to-Repay Rule Fact Sheet
- Ability-to-Repay Rule Summary
- Final Rules as published in the Federal Register (1/30/13; 78 Fed. Reg 6407)
- Concurrent Proposal as published in the Federal Register (1/30/13; 78 Fed. Reg 6621)

Coverage of the Ability-to-Repay Rule

The rules apply only to a **consumer-purpose, closed-end loan secured by a dwelling**. These are also called "Covered Transactions" under the rule. There are 3 parts to this definition (all 3 must be met):

1. The loan must be a **consumer-purpose** credit transaction;
2. The loan must be **secured by a dwelling**, defined as "a residential structure that contains one to four units, whether or not that structure is attached to real property" under subsection 1026.2(a)(19) of Reg Z; **and**
3. The loan must be a **closed-end** extension of credit.

The rules cover home purchase and home equity loans, as well as refinancings. Lien position is not relevant to whether a loan is covered.

Exemptions

Business-purpose mortgage loans. The ability-to-repay rule falls under Reg Z, meaning the loan must have a consumer purpose for Reg Z to apply in the first place. If the primary purpose of loan is **not** primarily personal, family or household, the rules do not apply, even if the loan is secured by a dwelling.

Modifications. A loan modification is not a new transaction under Reg Z; thus it is not covered. However, note there are exceptions to this rule under Reg Z unrelated to this new final rule that would constitute the transaction a refinancing, which may be covered.

HELOCs. Open-end extensions of credit, even if secured by dwellings, meaning Home Equity Lines of Credit or HELOCs, are excluded from coverage since they are not closed-end extensions of credit.

Timeshares. Loans secured by a consumer's interest in a **timeshare** arrangement are exempt from the rules.

Refinancing nonstandard mortgages into standard mortgages. The ability-to-repay requirements do **not** apply when loans considered "non-standard mortgages" are refinanced into "standard mortgages," **provided** the lender has considered whether the standard mortgage will likely prevent a default of the non-standard mortgage once the loan is recast. This standard substitutes for the lender's consideration of the borrower's ability to repay.

A "**nonstandard mortgage**" is a covered transaction that is:

- An adjustable-rate mortgage (ARM) with an introductory fixed rate period of one year or longer;
- An interest-only loan (meaning one or more payment may be applied solely to interest); **or**
- A negative amortization loan (meaning application of one or more payments will result in an increase in the loan's principal balance).

A "**standard mortgage**" is a covered transaction that:

- Does not have a term in excess of 40 years;
- Has a fixed interest rate for at least the first 5 years after consummation;
- Provides for regular payments that do **not**:
  - Cause the principal balance to increase (no negative amortization);
  - Allow for deferred repayment of principal (no interest-only); or
  - Result in a "balloon payment," defined as "a payment that is more than two times a regular periodic payment";
- Does not contain total "points and fees" payable in connection with the transaction in excess of amounts permitted for a Qualified Mortgage (points and fees is detailed later); **and**
- Utilizes the proceeds solely to pay:
  - The outstanding principal balance of the nonstandard mortgage; **and**
  - Closing or settlement charges required to be disclosed under RESPA.

For the exemption to apply, the following 6 conditions **must be met**:

1. The refinancing lender must be the current holder of the existing non-standard mortgage or the servicer acting on behalf of the current holder;

2. The monthly payment for the new standard mortgage must be **materially lower** than the monthly payment for the non-standard mortgage, taken into account as of the time of the refinancing;
3. The lender must receive the consumer's written application for the standard mortgage no later than 2 months after the non-standard mortgage has "recast":
    - "Recast" means the point in time when the introductory interest rate period has expired for an ARM loan, or where the period has expired allowing the borrower to make interest-only payments or those that increase the principal balance of the loan;
4. The borrower has no more than one payment on the non-standard mortgage that was more than 30 days late during the 12 months immediately preceding when the lender receives the written application for the standard mortgage;
5. The borrower has no payments on the non-standard mortgage that were more than 30 days late during the 6 months immediately preceding when the lender receives the written application for the standard mortgage; **and**
6. If the non-standard mortgage is consummated on or after January 10, 2014, it meets either the normal ability-to-repay standard or is a Qualified Mortgage.

    Partial exemptions. The following 3 types of loans have a **partial exemption** from the ability-to-repay requirements:

1. Reverse mortgages;
2. Temporary or "bridge" loans with a term of 12 months or less (such as a loan to purchase a new dwelling where the consumer plans to sell a current dwelling within 12 months, or a loan to finance the initial construction of a dwelling); and
3. The construction phase (12 months or less) of a construction-permanent loan.

These types of loans are exempt from the following requirements of the rule:

- Evaluating the consumer's ability to repay;
- Refinancing of "non-standard mortgages" into "standard mortgages";
- Eligibility for being considered "Qualified Mortgages"; and
- Provisions for balloon-payment Qualified Mortgages to be made by certain lenders.

However, these loans **are subject to** provisions regarding prepayment penalties (discussed on page 8) and prohibitions against evasion of the requirements by structuring the transaction as open-end credit.

General Ability-to-Repay Requirement

The general rule is straightforward: for all covered transactions, a creditor must making a reasonable and good faith determination at or before consummation that the consumer will have a reasonable ability to repay the loan according to its terms.

Note that the rule **applies to all consumer mortgage loans** that meet the definition of "covered transaction." It **does not matter** whether or not the loans is a Qualified Mortgage (QM). Lenders must evaluate the borrower's ability to repay the loan for all consumer-purpose, closed-end dwelling-secured loans (except as listed in the exceptions).

Verified information. Reasonably reliable **third-party records** must be used to verify the information considered by lenders to evaluate the consumer's ability to repay. This effectively puts an end to no-income/no-asset loans and stated-income loans (so-called "liar loans").

Third-party records that meet this requirement include any records **not** prepared or reviewed by the consumer, lender, or mortgage broker (or an agent of the lender or broker), credit reports, IRS or state tax returns, or records maintained by the lender pertaining to a different account at the lender institution. Employment documents from the lender or broker also qualify if the consumer is an employee. The records may be obtained directly from the consumer as long as the lender determines they are reasonably reliable.

Records may be in writing or electronic, but must be specific to the individual consumer.

Evaluating Ability-to-Repay

It is important to note the rule allows lenders to remain flexible; they do **not** impose any sort of minimum underwriting standards on covered mortgage loans (DTI or otherwise), nor are there any limitations on points and fees. Even though certain minimum criteria must be **considered** by the lender (such as income or assets), there is **no minimum amount** of income or assets that a consumer must meet to qualify for a loan, or maximum amount of debt that would disqualify a consumer. The lender merely must consider information listed in reliable third-party records in its underwriting of an application.

At a minimum, a lender **must** consider the following factors regarding the consumer's:

1. *Current or reasonably expected income **or** assets* (other than the value of the collateral). Either or both may be considered.
2. *Current employment status*, if employment income is relied upon.
3. *Monthly payment on the covered transaction*. This is calculated by assuming the loan will be repaid in substantially equal monthly payments during its term. If the loan is an ARM loan, the monthly payment must be calculated using the **fully-indexed rate** (meaning the rate when the loan is "recast," or reset to the non-promotional rate; this is determined at the time of closing) or the introductory rate, whichever is higher. Special rules apply for balloon, interest-only or negative amortization loans.
4. *Monthly payment on any simultaneous loan*. If the lender, at the time of closing, knows (or has reason to know), that **multiple covered loans or HELOCs** secured by the same dwelling will be made to the same borrower, it must consider whether the consumer has the reasonable ability to make the **combined payments** of all such loans, including all applicable taxes, insurance and assessments.
5. *Monthly payment for mortgage-related obligations*, such as taxes, insurance premiums, assessments, and similar recurring charges.
6. *Current debt obligations, alimony, and child support.* Flexibility is permitted here if the lender knows an obligation will be paid off soon after consummation.
7. *Monthly total monthly debt-to-total monthly income (DTI) ratio **or** "residual income"* (defined as the amount of monthly income remaining after subtracting monthly debt obligations). Compensating factors may be considered here and flexibility is expressly permitted. The commentary states: "the creditor may reasonably and in good faith determine that a consumer has the ability to repay despite a higher ratio or lower residual income in light of the consumer's assets."

8. *Credit history*. This could be the consumer's credit score (but need not be), or "nontraditional credit references" such as rental or utility bill payments for consumers with little credit histories. The rule doesn't mandate *what* must be considered; only *that* information regarding credit history must be considered.

To provide guidance on how income and debt may be calculated, new Appendix Q has been added to Reg Z. The new Appendix is detailed and addresses issues such as non-traditional, self-employed, part-time, seasonal, non-employment related, rental, retirement, military, government assistance, or social security income, documentation requirements, establishing the consumer's "income trend," homeownership subsidies; as well as types of obligations and specific items to be considered when calculating the DTI ratio. But again to satisfy the requirements of the ability-to-repay rule, Appendix Q need not be followed to the letter; **lenders may use their own definitions and criteria**.

Qualified Mortgage

The concept of the Qualified Mortgage (QM) is to provide a degree of certainty and protection to lenders against legal claims, provided the lender makes the mortgage loan in conformance with the standards in new §1026.43.

Coverage. The types of mortgage loans eligible for the QM designation are the same as those listed under the ability-to-repay coverage section. In other words, if a loan does not fall under the ability-to-repay rules, it cannot be eligible to be a Qualified Mortgage.

Two Types of Qualified Mortgages. Qualified Mortgages fit into two distinct categories of legal protection: (1) those that fall within a **safe harbor** of conclusively presumptive compliance with the ability-to-repay rule; and (2) "higher-priced covered transactions," which are those that fall under a **rebuttable presumption** of compliance.

The difference between a safe harbor versus rebuttable presumption QM is the loan's APR.

- To qualify for the **safe harbor**, the loan's APR can be no more than 1.5% over the APOR for a loan secured by a first lien loan, or no more than 3.5% over the APOR for a loan secured by a junior lien as of the date the rate was set.
- If the loan otherwise meets the requirements of a QM, but the APR is higher than the APOR threshold as of the date the rate was set, the loan qualifies for the **rebuttable presumption**.

These thresholds are the same as those used to determine whether a loan is a Higher-Priced Mortgage Loan, or HPML, under §1026.35 of Reg Z. Thus a HPML can still be a QM as a "higher-priced covered transaction"; however it will qualify for the rebuttable presumption rather than the safe harbor.

The **safe harbor** means the loan is deemed to comply with the requirement without any more information necessary. If this is the case, whether or not the lender made a reasonable or good faith determination of the borrower's ability to repay does not matter.

The **rebuttable presumption** means the loan is "presumed to comply." This can be rebutted, however, by proving "that, despite having made a QM the creditor did not make a reasonable and good faith determination of the consumer's repayment ability."

Characteristics of a Qualified Mortgage

A QM **cannot** have **any** of the following characteristics:

- A payment schedule that could result in negative amortization;
- Interest-only payments (deferral of principal repayment);
- A term that exceeds 30 years (note that for purposes of this requirement the loan term begins not at closing, but the future point in time when the first periodic payment is due);
- "Points and fees" paid by the consumer exceeding certain threshold percentages or amounts;
- A DTI ratio above 43%, unless the loan meets certain guidelines under an alternative test; **and**
- A balloon payment, unless the loan meets certain requirements and is made by a lender in a rural or underserved area.

The first three restrictions are self-explanatory; details on the latter three follow.

Points and fees. Depending upon the loan amount, the points and fees threshold is calculated as either a percentage of the loan amount or a static amount, as follows:

Loan amount equal to or greater than:	Loan amount less than:	Total Points and Fees Threshold
$100,000		3% of total loan amount
$60,000	$100,000	$3,000
$20,000	$60,000	5% of total loan amount
$12,500	$20,000	$1,000
$0	$12,500	8% of total loan amount

Each dollar amount in the chart above (loan amounts and points and fees amounts) will be indexed annually to inflation.

What constitutes points and fees? This is defined in §1026.32 of Reg Z (the HOEPA loan provisions) rather than within the ability-to-repay section (§1026.43), and what is included for QM consideration purposes has only minor differences from HOEPA. The points and fees to be included are those that are **known** by the lender at or before loan consummation (even if the charge will be assessed or paid post-closing).

Here is what is **included in "points and fees"** for purposes of determining whether the thresholds are exceeded:

- **All finance charge** items (under Reg Z rules); **except** the following items can be **excluded**:
  - Interest;
  - Federal or State government guarantees or insurance premiums or charges that protect the lender against default or similar loss (whether paid pre- or post-closing);
  - Private mortgage insurance (PMI) premiums paid post-closing;
  - PMI premiums paid at or before closing, known as up-front premiums (whether paid in cash at that time or financed), provided the premium is

refundable and paid automatically on a pro-rata basis when the loan is paid in full. The amount can be excluded **only if** the portion of the up-front premium does not exceed the amount that the borrower would pay for comparable FHA insurance for the loan;

    - Any bona fide third-party charge **not** retained by the lender, loan originator, or an affiliate of either. There are exceptions to the exclusion, however, meaning the following must be **included** in points and fees:

- Up-front PMI premiums under the provisions detailed above;
- Real estate charges that are not considered "reasonable"; and
- Credit insurance, or debt cancellation or suspension coverage premiums payable at or before closing.
    - Up to 2 "bona fide discount points" paid by the consumer, paid to reduce the interest rate. The amount can be excluded if the non-reduced interest rate does not exceed the average prime offer rate (or APOR, the comparison rate used to determine whether a loan is a Higher-Priced Mortgage Loan, or HTML; a similar comparison rate is used for loans secured by personal property) by more than 1 percentage point;
    - Up to 1 "bona fide discount point" paid by the consumer to reduce the interest rate if the non-reduced interest rate does not exceed the APOR by more than 2 percentage points.
- Points charged to offset (due to being passed on to the borrower) what are called "**loan-level price adjustments**," or LLPAs. Imposed by Fannie Mae and Freddie Mac, those charges must be included in points and fees. LLPAs are essentially discounts on what Fannie or Freddie pay on a loan to compensate for additional risk they take on, and many lenders recoup those discounts by passing them on to the borrower.
- Fees and charges that are **normally excluded** from the finance charge (application, title, survey, document preparation, notary, credit report, appraisal, flood determination, pest inspection fees, etc.) must be **included** in points and fees **if** any of the following are true:
    - The charge is unreasonable;
    - The creditor receives some sort of compensation (direct or indirect) in connection with the charge; **or**
    - The charge is paid to an affiliate of the creditor.

If the charge is reasonable, the creditor does not receive any compensation in connection with the charge, or it is not paid to an affiliate, the fees and charges can be **excluded** from points and fees.

- All **loan originator compensation** paid directly or indirectly by the borrower or lender that can be attributed to the loan at the time the interest rate is set (later events, such as bonuses to loan originators who meet volume goals, are irrelevant). "Compensation" includes the dollar value of monetary and non-monetary rewards, no matter what it's called or when paid, and must be included if the originator receives the compensation if the particular loan closes.

The CFPB's concurrent proposal sought comment on whether clarification is needed regarding the inclusion of both "direct" and "indirect" loan originator compensation into the points and fees total. For example, a fee paid directly by the borrower to a mortgage broker (considered a "loan originator" would be counted; then if the broker pays a portion of the direct fee to an employee of the broker (also considered a "loan originator") that amount must also be included again as an "indirect" fee. This creates a "double counting" situation. The Bureau is seeking comment on whether to exclude the double-counted "indirect" fee from the total. Similar issues are in play if a fee

is paid to the lender, who then passes on a portion of the fee to an employee or broker (who are also loan originators);

- Credit life, disability, unemployment, or property insurance premiums or other charges payable at or before consummation must be included (no matter whether paid in cash or financed, or whether the coverage is mandatory or optional);
- Premiums or charges for other life, accident, health or loss-of-income insurance for which the creditor is a beneficiary must be included (no matter whether paid in cash or financed, or whether the coverage is mandatory or optional);
- Any payments directly or indirectly for any debt cancellation or suspension agreement or contract must be included (no matter whether paid in cash or financed, or whether the coverage is mandatory or optional); and
- The maximum **prepayment penalty** that may be charged or collected under the terms of the loan must be included;
- The total prepayment penalty incurred by the borrower if the consumer refinances the loan with the current holder of the existing loan, a servicer acting on behalf of the current holder, or an affiliate of either must be included.

DTI standard. To be considered a QM, the borrower's DTI, meaning the ratio of the consumer's monthly debt to total monthly income, calculated at the time of loan closing, **cannot exceed 43%**. Unlike the looser standard for calculating DTI under the ability-to-repay rule, for QM purposes DTI must be calculated by utilizing the precise standards for debt and income detailed in Appendix Q. Flexibility is not permitted.

The standards in Appendix Q **require**:

- Items to be considered and verified for the 2 prior years; and
- Sufficient information must be gathered to make projections for the following 3 years.

The language in Appendix Q is drawn extensively from the FHA Single Family Handbook 4155.1, *Mortgage Credit Analysis for Mortgage Insurance*, dated March 24, 2011 (later updates are not included). One important difference is that while the FHA Handbook allows income not meeting the criteria to be considered as a compensating factor, Appendix Q does **not** allow consideration of such income. This means any income items not specifically included in Appendix Q cannot be considered for determining DTI for QM purposes.

Other **differences** between calculating DTI under the ability-to-repay requirement and QM purposes:

- Like income items, debt items listed in Appendix Q **must** be considered, but other items that may be considered under the ability-to-repay rule **cannot** be included when determining the DTI for the QM standard. These income and debt restrictions for QM purposes serve to standardize the DTI calculation across the industry.
- The payment calculation is also slightly different than that under the ability-to-repay rule. For QM purposes, the "maximum interest rate" that may apply in the first 5 years after the first payment due date must be used for ARMs rather than the "fully-indexed rate."
- The consumer's credit history **must** be considered under the ability-to-repay rule, but it need not be considered when calculating the DTI for QM purposes.

The mortgage monthly payment must include taxes, insurance, assessments, and similar items, of the covered transaction, plus the payment on any simultaneous loan secured by the same dwelling the lender knows (or has reason to know) will be made.

GSE/federal agency alternative to DTI limit. Even if the borrower's DTI ratio exceeds 43%, the loan may still be a QM if it meets certain federal government eligibility criteria. Assuming other requirements are met, the loan would be a QM if it can be:

- Insured by the U.S. Department of Housing and Urban Development (HUD) or Rural Housing Service;
- Guaranteed by the U.S. Department of Veterans Affairs (VA) or the U.S. Department of Agriculture (under the Single Family Housing Guaranteed Loan Program); or
- Purchased or guaranteed by **Fannie Mae or Freddie Mac**, as long as they operate under Federal Housing Finance Agency (FHFA) conservatorship or receivership (or its limited-life successors, if any).
    - This option will become unavailable if Fannie Mae or Freddie Mac is removed from federal government conservatorship.
    - The loan need not actually be purchased by Fannie Mae or Freddie Mac to meet the test; it merely must meet eligibility guidelines for purchase, including written guidance or an underwriting recommendation provided by the agencies' Automated Underwriting Systems (AUS): Fannie Mae's Desktop Underwriter (DU) or Freddie Mac's Loan Prospector (LP).
    - Note that this test will exclude any jumbo mortgage loans where the DTI exceeds 43%, since a jumbo loan cannot qualify for purchase or guaranty under Fannie Mae or Freddie Mac guidelines.

Note that this alternative test will cease to be available in 7 years (meaning January 10, 2021) or earlier if those agencies issues rules to define a Qualified Mortgage.

Balloon payments. A Qualified Mortgage generally **cannot** have a balloon payment, defined as a payment that is more than twice the amount of a regular payment. However, there is an exception for certain balloon loans made by certain lenders.

The balloon loan **must** be made by a lender who qualifies for the **rural or underserved exception**. That means during the preceding calendar year the lender:

- Had total assets of less than $2 billion at the end of the year (the asset threshold will be adjusted each year).
- Including its affiliates, originated in the aggregate 500 or fewer first lien-secured covered transactions; and
- Extended more than 50% of its total **first lien-secured** covered transactions on properties located in counties designated either “rural” or “underserved” by the CFPB (The Bureau will publish a list of rural and underserved counties annually).

In addition to being made by an eligible lender, the loan must:

- Have a term of at least 5 years;
- Have a fixed interest rate;
- Have payments that are substantially equal and based on an amortization schedule not longer than 30 years;

- Meet certain basic underwriting standards: the lender must determine at or before closing that the borrower can make the payments (excluding the balloon payment) from the consumer's current or reasonably expected income or assets. Lenders must consider and verify the borrower's DTI ratio, but there is no specific DTI limit for balloon-payment QMs (43% or otherwise); **and**
- Be held in the lender's portfolio for at least 3 years (some transfers are permitted, but there are specific rules for these).

Safe harbor vs. rebuttable presumption. Like any other QM, the loan's APR (and whether it exceeds the applicable APOR threshold) determines whether it falls under the safe harbor or rebuttable presumption.

Prepayment Penalties

Generally speaking, prepayment penalties are severely restricted or prohibited on consumer loan transactions secured by a dwelling. However, there are exceptions where certain types of prepayment penalties are permitted.

Coverage. Coverage of the prepayment penalty restrictions is **different** than coverage of the ability-to-repay rules. In addition to loan types covered by the ability-to-repay rules, the following transactions are **also covered** by the prepayment penalties rules (although they are exempt from the ability-to-repay rules):

- Reverse mortgages;
- Temporary or "bridge" loans with a term of 12 months or less (such as a loan to finance the purchase of a new dwelling where the borrower plans to sell a current dwelling within 12 months, or a loan to finance the initial construction of a dwelling); and
- The construction phase (12 months or less) of construction-to-permanent loans.

Timeshare-secured loans and HELOCs are **exempt** from both the ability-to-repay and prepayment penalties rules.

General restrictions. The basic rule is that a covered transaction may **not** include a prepayment penalty **unless** (1) the particulars of the penalty are permitted by law; and (2) the loan meets the following 3 criteria:

- The loan is a Qualified Mortgage;
- The loan has a fixed rate (the APR cannot increase after consummation); and
- The loan is **not** a higher-rate covered transaction, meaning the APR does not exceed the Average Prime Offer Rate, or APOR, by more than 1.5% if secured by a first lien or more than 3.5% if secured by a junior lien.

In other words, only fixed-rate QMs that qualify for the safe harbor (non-HPML QMs) may include prepayment penalties. But even for these loans, the allowable prepayment penalty is limited as follows:

- It cannot be charged more than 3 years after consummation; and
- It cannot exceed the following percentages of the outstanding loan amount that is prepaid:
    - 2% if prepaid during the first 2 years after closing; and
    - 1% if prepaid during the 3rd year after closing.

A consumer cannot be offered a covered transaction that includes an allowable prepayment penalty **unless** the lender **also offers** an alternative covered transaction option that does **not** contain a prepayment penalty. This alternative loan **must**:

- Have the same type of interest rate (fixed-rate or step-rate) as the covered transaction with the prepayment penalty;
- **Not** have a variable APR (that can increase after consummation);
- Have the same term as covered transaction with a prepayment penalty;
- Have regular periodic payments that do not include a balloon payment, or for a step-rate loan, **not** have the possibility of increasing the loan balance through negative amortization; or interest-only payments;
- Satisfy the QM points and fees restriction; and
- Be a loan for which the creditor has a good faith belief that the consumer likely qualifies, based on information known at the time the loan without a prepayment penalty is offered.

There are additional provisions for what happens if the loan with a prepayment penalty is offered through a broker.

Consequences of Violations

The amendments made to the Truth in Lending Act by Dodd-Frank subject the lender to serious consequences if it does not make a reasonable and good faith determination at or before consummation that the borrower will have a reasonable ability to repay the loan.

Evidence of compliance. Whether or not the creditor's ability-to-repay decision was reasonable and made in good faith will be specific to each individual transaction. Each decision will be "viewed in the context of all facts and circumstances relevant to a particular extension of credit," including how the lender's underwriting standards were applied.

Utilizing underwriting standards that traditionally result in lower delinquency and default rates, or using those "based on empirically derived, demonstrably and statistically sound models" will be viewed favorably when considering compliance with the rule, while the converse is also true.

It should be obvious, but a consumer's statement that he or she has the ability to repay the loan is not a reasonable or good faith indicator of the lender's determination. Other factors that may contribute to a finding of noncompliance include the lender ignoring:

- Evidence that its underwriting standards are not effective at determining consumers' repayment ability;
- The fact the consumer may have had insufficient residual income to cover other recurring obligations and expenses once the new mortgage payment is added; or
- The borrower would have the ability to repay **only if** he or she was subsequently able to refinance the loan or sold the collateral.

Lenders cannot require or force consumers into arbitration to resolve such challenges, and consumers cannot waive their rights.

Statute of limitations and damages. The borrower will have a right to sue the lender for damages for a violation of the ability-to-repay rule for 3 years after the violation occurred (which would be the closing of the loan). In such a suit the borrower could **potentially recover**:

- Actual damages;
- Special statutory damages equal to the sum of **all finance charges and fees paid** by the consumer (although the lender can defend against this by showing that its failure to comply was not material);
- Statutory damages in an individual or class action (with increased civil liability limits); and
- Court costs and attorney fees available under other TILA provisions.

Remedies in foreclosure. In addition, if the lender (or other party acting on its behalf) initiates either a judicial or non-judicial **foreclosure** or other action to collect on the loan, a consumer may assert a violation of the ability-to-repay rules as a defense by setoff or recoupment. More importantly, under this section (meaning there is a foreclosure involved) a consumer may assert this even after the 3-year period in which he or she could bring suit for damages.

Recoupment means the borrower would be allowed to deduct from the plaintiff's (the foreclosing bank's) recovery the amounts this new provision would allow to be deducted (meaning the amounts listed above). This amount is limited to what the borrower could have received if he or she had filed a private suit within the 3-year timeframe. Damages, including costs and attorney's fees, are computed up to the day before the expiration of the time limit.

Record Retention

Lenders must retain evidence of compliance with the ability-to-repay rules by keeping records (paper or electronic) related to minimum standards for transactions secured by a dwelling for **3 years** after the consummation of a covered transaction. This time period matches the statute of limitations for suits brought by borrowers for alleged violations. Wise lenders will likely choose to retain documentation well beyond this time frame, however.

BAI Learning & Development Customer Resources

BAI Learning & Development provides industry-leading regulatory compliance training solutions to more than 1,500 banks, credit unions, and regulatory agency clients, including the FDIC and NCUA.

In addition to the BAI Learning Manager's state-of-the-art technology and compliance training courseware, customers have complimentary access to a robust collection of resources to supplement their knowledge of the regulatory environment and enhance financial training initiatives. The BAI Learning & Development online community, L&D Connect, links compliance and training professionals to one another, to industry experts, and to a host of complimentary BAI webinars and whitepapers.

To join L&D Connect, please click the L&D Connect icon in the Learning Manager or contact Customer Support Services at 800-264-7600. All compliance and training personnel from customer organizations are welcome to join.