Regulation Z –
Ability to Repay Proposal

Outlook Live Webinar – May 26, 2011

Board of Governors of the Federal Reserve System
Division of Consumer and Community Affairs

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Introduction

- The Dodd-Frank Act amends the Truth in Lending Act (TILA) to require creditors to determine a consumer's ability to repay a mortgage loan and to establish minimum mortgage underwriting standards.
- The Board issued a proposal under Reg. Z on April 19, 2011 which was published in the Federal Register on May 11, 2011.
- Comments are due July 22, 2011.
- Rulemaking authority transfers to the Consumer Financial Protection Bureau on July 21, 2011.

Overview

- 2008 HOEPA Final Rule for "higher-priced mortgage loans"
- 2011 Ability to Repay Proposal
  - Coverage – consumer-purpose closed-end mortgages
    - Does not apply to HELOCs, loan modifications, timeshare plans, reverse mortgages, temporary loans
  - Requirement – good faith and reasonable determination that the consumer will have a reasonable ability to repay the mortgage
  - Four options for compliance
    - General ability-to-repay standard
    - Qualified mortgage (QM)
    - Balloon payment qualified mortgage
    - Refinancing of a "non-standard mortgage" into a "standard mortgage"
  - Penalties

Ability-to-Repay Standard v. Qualified Mortgage

	General Ability-to-Repay Standard	Qualified Mortgage
Risky Features	No requirement	No negative amortization, interest only payments, balloon payments
Term	No requirement	May not exceed 30 years
Points & Fees	No requirement	May not exceed 3% of the total loan amount for loans of $75,000 or more, exceptions for smaller loans
Mortgage Underwriting	Fully indexed rate or introductory rate, whichever is greater	Maximum interest rate in the first 5 years after consummation
Mortgage-Related Obligations	Consider and verify	Consider
Income or Assets	Consider and verify	Consider and verify
Employment Status	Consider and verify	(No specific requirement)
Simultaneous Liens	Consider and verify	(No specific requirement)
Current Debt Obligations	Consider and verify	(No specific requirement)
DTI or RI	Consider and verify	(No specific requirement)
Credit History	Consider and verify	(No specific requirement)

General Ability-to-Repay Standard

Compliance Option #1: General Ability-to-Repay Standard

- No limits on risky features, loan term, and points and fees
- Underwriting of the mortgage payment
  - Fully indexed rate or introductory rate, whichever is greater
  - Monthly, substantially equal payments that amortize the loan amount over the loan term
  - Special calculations for loans with negative amortization, interest only payments, or balloon payments
    - Higher-priced balloon loan – use balloon payment
    - Balloon loan that is not higher-priced – use the maximum payment scheduled during the first 5 years after consummation

General Ability-to-Repay Standard
(continued)

- Other underwriting requirements: consider and verify the following –
  - Income or assets (other than the home)
  - Employment status
  - Mortgage payment
  - Simultaneous loan
  - Mortgage-related obligations
  - Current debt obligations
  - Monthly debt-to-income ratio (DTI) or residual income
  - Credit history

Qualified Mortgage *(continued)*

<u>Compliance Option #2: Qualified Mortgage</u>

- Background: 2008 HOEPA Final Rule and the presumption of compliance
- Dodd-Frank Act's definition of a "qualified mortgage"
- Safe harbor v. rebuttable presumption
  - Statutory interpretation
  - Policy reasons

Qualified Mortgage *(continued)*

Alternative 1: Safe harbor

- Limits on risky features: no negative amortization, interest only payments, or balloon payments
- Loan term: may not exceed 30 years
- Points and fees: generally may not exceed 3% of the total loan amount
- Mortgage underwriting
  - Maximum rate in the first 5 years after consummation
  - Payment schedule fully amortizes the loan
- Underwriting generally
  - Consider and verify income or assets
  - Consider mortgage-related obligations

Qualified Mortgage *(continued)*

Alternative 2: Rebuttable presumption

- Same as Alternative 1, plus creditor must consider and verify—
  - Employment status
  - Simultaneous loans
  - Current debt obligations
  - DTI or residual income
  - Credit history

Qualified Mortgage *(continued)*

- Points and fees
- Definition now includes—
  - Fees paid directly or indirectly to a loan officer or mortgage broker by the consumer or the creditor
  - Upfront private mortgage insurance that exceeds FHA limits
  - Any prepayment penalty on any existing loan
  - The maximum prepayment penalty on the new loan
- Exclusion for certain bona fide discount points, and bona fide third party charges not retained by the creditor, loan originator, or an affiliate of either
- Threshold for smaller loans of less than $75,000

Qualified Residential Mortgage

Qualified Residential Mortgage (QRM)

- The Dodd-Frank Act provides an exemption from risk retention for a QRM
- The Act states that the QRM can be “no broader than” the QM and regulators must consider default risk
- March 31 – proposal jointly issued by the Board, OCC, SEC, FDIC, SEC, HUD, and FHFA
- QRM appears to be stricter than QM, esp. DTI, credit history, LTV, servicing

QRM v. QM

	Qualified Residential Mortgage	Qualified Mortgage
Risky Features	No negative amortization, interest only payments, balloon payments, subordinate liens for purchases, prepayment penalties	No negative amortization, interest only payments, balloon payments
Term	May not exceed 30 years	May not exceed 30 years
Points & Fees	May not exceed 3% of the total loan amount	May not exceed 3% of the total loan amount for loans of $75,000 or more, exceptions for smaller loans
Mortgage Underwriting	Maximum interest rate in the first 5 years after the first periodic payment is due	Maximum interest rate in the first 5 years after consummation
Mortgage-Related Obligations	Consider and verify	Consider
Income or Assets	Consider and verify	Consider and verify
Employment Status	Consider and verify	(No specific requirement)
Simultaneous Liens	Consider and verify	(No specific requirement)
Current Debt Obligations	Consider and verify	(No specific requirement)
DTI or RI	DTI: Front end ratio of 28, back end ratio of 36	(No specific requirement)
Credit History	Current on all debts; no 60-day delinquencies in the past 2 years; no bankruptcies or foreclosures in the past 3 years	(No specific requirement)
LTV	Purchase: 80%; Refinancing: 70-75%	No specific requirement
Servicing	Commitment in mortgage transaction documents	No specific requirement

Balloon-Payment Qualified Mortgage

<u>Compliance Option #3: Balloon-Payment Qualified Mortgage</u>

- Same as requirements for QM, except—
  - Limited to certain creditors
  - Risky features: loan may have interest only payments and balloon payments
  - Minimum loan term: loan must have a term of 5 years or greater
  - Mortgage underwriting
    - All of the scheduled payments, except the balloon payment
    - Amortization period does not exceed 30 years

Balloon-Payment Qualified Mortgage
(continued)

- Definition of a “creditor” (4 components)—
  - Operates predominantly in rural or underserved areas
    - Made more than 50% of its balloon loans in rural or underserved counties
  - Limit on number/amount of consumer-purpose closed-end mortgages
    - Proposal solicits comment on the appropriate number or amount
  - Balloon loans held in portfolio
    - Alternative 1: Has never sold a balloon-payment loan since the effective date
    - Alternative 2: Has not sold a balloon-payment loan in the preceding calendar year or current year
  - Limit on asset size ($2 billion or less for 2011)

Refinancing into a Standard Loan

<u>Compliance Option #4: Refinancing into a Standard Loan</u>

- Exception from income or asset verification to preserve streamlined refinancings
- Definition of a “non-standard mortgage”
  - Adjustable-rate mortgage with an introductory fixed interest rate for a period of years
  - Interest only loan
  - Negative amortization loan

Refinancing into a Standard Loan
(continued)

- Definition of a "standard mortgage"
  - No negative amortization, interest only payments, balloon payments
  - Loan term may not exceed 40 years
  - Limits on points and fees
  - Interest rate is fixed for the first 5 years after consummation
  - Limits on use of loan proceeds
  - Mortgage underwriting based on maximum interest rate in the first 5 years

Other Protections

- Limits on prepayment penalties
  - Prepayment penalties only available for prime, fixed-rate QMs
  - Prepayment penalties may not exceed:
    - In the 1st year, 3% of the outstanding loan balance prepaid
    - In the 2nd year, 2% of the outstanding loan balance prepaid
    - In the 3rd year, 1% of the outstanding loan balance prepaid
  - No prepayment penalty after the third year
  - Creditor must offer the consumer a loan without a prepayment penalty
- Expansion of record retention rules
- Prohibition on evasion through open-end credit

Questions

- Questions from webinar participants

- >>Thank you!

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