CFBP's Final Mortgage Regulations:

Ability-to-Repay and Qualified Mortgage Rules

October 24, 2013

E. Andrew Keeney, Esq.

Kaufman & Canoles, P.C.

Ability-to-Repay and Qualified Mortgage Rules

E. Andrew Keeney, Esq.

Kaufman & Canoles, P.C.

150 West Main Street, Suite 2100

Norfolk, VA 23510

(757) 624-3153

eakeeney@kaufcan.com

History

Proposed Regulation: 474 pages

Comments Received: 1800

Final Regulation: 804 pages

Effective Date: January 10, 2014

Number of Days Remaining: 78

Let’s Roll!

Will the Ability to Repay Rule be Workable for Credit Unions?

Overview

- Applies to **ALL** credit unions offering mortgage loans
- Must determine a consumer's ability to repay a mortgage before making the loan
- Regulation covers all consumer mortgages except home equity (HELOCs), timeshare plans, reverse mortgages or temporary loans
- Ability-to-Repay determination and underwriting considerations
- Underwriting considerations
- Qualified mortgages and a "Safe Harbor"
- Exemptions

Ability to Repay and Qualified Mortgage Rule

January 2013

- CFPB amended Regulation Z (Truth in Lending Act) by issuing new regulations governing mortgage lending requirements, known as the "Ability-to-Repay and Qualified Mortgage Rule"

Effective date: January 10, 2014

Ability to Repay and Qualified Mortgage Rule

- Regulation Z currently prohibits lenders from making a higher-priced or higher-cost mortgage loan without regard for the consumer's ability to repay the loan
- New Rule establishes minimum requirements for all lenders to make an ability-to-repay determination prior to extending a residential mortgage loan
- New Rule offers Safe Harbors from liability

Ability to Repay and Qualified Mortgage Rule

- New Ability-to-Repay Rule applies to all closed-end mortgage loans (home purchases, refinancing, home equity loans, vacation home loans, etc.)
- Does not apply to open-end credit plans, time share plans, reverse mortgages or temporary loans (i.e., 12 months or less)
- New Rule goes into effect **January 10, 2014**
- *BUT*, some rule changes may be in the works

Ability to Repay Determinations

(at a minimum credit unions must consider
8 underwriting factors in determining
a borrower's ability to pay)

Minimum Underwriting Factors

1. Current or reasonably expected income or assets

Current or Reasonably Expected Income or Assets Determination

- Section 1026.43(b)(4) prescribes the manner in which the creditor verifies the borrower's assets or income
- May review specified records to satisfy this requirement
  - Tax returns
  - IRS Form W-2 (or similar forms)
  - Employer records
  - Government agency records (e.g., Social Security Administration "proof of income" letter)

Current or Reasonably Expected Income or Assets Determination

- May review specified records to satisfy this requirement
  - Financial institution records
  - Check cashing receipts
- Credit union needs to verify **only** the income/assets actually relied upon in making its determination of whether to extend credit

Minimum Underwriting Factors

1. Current or reasonably expected income or assets
2. Current Employment Status

Minimum Underwriting Factors

1. Current or reasonably expected income or assets
2. Current Employment Status
3. The monthly payment on the covered transaction

Minimum Underwriting Factors

1. Current or reasonably expected income or assets
2. Current Employment Status
3. The monthly payment on the covered transaction
4. The monthly payment on any simultaneous loans

Minimum Underwriting Factors

1. Current or reasonably expected income or assets
2. Current Employment Status
3. The monthly payment on the covered transaction
4. The monthly payment on any simultaneous loans
5. The monthly payment for mortgage-related obligations
6. Current debt obligations, alimony and child support

Minimum Underwriting Factors

1. Current or reasonably expected income or assets
2. Current Employment Status
3. The monthly payment on the covered transaction
4. The monthly payment on any simultaneous loans
5. The monthly payment for mortgage-related obligations
6. Current debt obligations, alimony and child support
7. The monthly debt-to-income ratio or residual income
8. Credit history

"I'd like a no-interest loan, since I have no interest in paying it back."

Qualified Mortgages
a.k.a. Safe Harbor

Qualified Mortgages - General

Qualified mortgage: a residential mortgage that provides for regular, substantially equal payments and does **not** include any of the following:

- Negative amortization loans
- Interest-only loans
- Balloon payment loans (with some exceptions)
- Loan with a term exceeding **30** years
- "No-doc" loans
- Points and fees in excess of or exceeding **3%** of total loan amount (for loans over $100,000)

Qualified Mortgages – Safe Harbor

- Presumption of Compliance for Qualified Mortgages
- Higher-Priced Covered Transaction (Rebuttable Presumption)
- "Avoid the lawyers"

Qualified Mortgages

"Financial Institutions are not required to issue only Qualified Mortgages." CFPB Director Richard Cordray has indicated that it would be a mistake for prudential regulators (NCUA?) to examine institutions in a way that steers them toward providing only mortgages defined as "qualified" under the Ability-to-Repay rule.

"I think there has been more hubbub around these requirements than is perhaps justified"

BUT…

Qualified Mortgages – Special Rules

Qualified Mortgage Presumption

- Rule provides a presumption that "qualified mortgages" satisfy the Ability-to-Repay requirements:
  - Conclusive presumption (a safe harbor) for qualified mortgages that **are not** higher-priced or subprime
  - Rebuttable presumption for qualified mortgages that **are** higher-priced or subprime
- Benefits?

Some Qualified Mortgage Presumptions

- Rule establishes underwriting criteria for qualified mortgages:
  - Monthly payments must be calculated based on the highest payment that will apply in the first 5 years of the loan
  - Consumer has a total debt-to-income ratio that is less than or equal to 43%
- Possible changes pending – stay tuned

Qualified Mortgage & Fannie/Freddie Underwriting Standards

- Compliance with Fannie Mae / Freddie Mac underwriting guidelines alone does not necessarily mean a loan is a Qualified Mortgage
- A temporary special rule (sunset date no later than 1/10/2021) if a loan that meets Fannie/Freddie underwriting standards PLUS additional criteria will be considered a Qualified Mortgage
- **BUT…?!**

Qualified Mortgage & Fannie/Freddie Underwriting Standards

- A loan that satisfies Fannie/Freddie underwriting standards is considered a Qualified Mortgage, if it <u>also</u> meets the following requirements:
  - Regular, substantially equal periodic payments
  - Term is 30 years or less, and
  - Total points and fees do not exceed 3%
- **BUT…?!**


Excedrin
MIGRAINE
Acetaminophen, Aspirin & Caffeine
Pain Reliever/Pain Reliever Aid
50 COATED CAPLETS*
*CAPSULE-SHAPED TABLETS
PACKAGE FOR HOUSEHOLDS WITHOUT YOUNG CHILDREN

Higher Priced Covered Transaction/Qualified Mortgage

Defined as a covered transaction with an APR that exceeds the average prime offer rate for a comparable transaction by 1.5% or more for a first-lien covered transaction, or by 3.5% or more for a subordinate-lien transaction

REBUTTABLE PRESUMPTION

Balloon – Payment Qualified Mortgages

A qualified mortgage may provide for a balloon-payment, provided:

- No increase in principal balance (negative amortization)
- Term does not exceed 30 years
- Total points and fees do not exceed 3% (for loans greater than $100,000)

Balloon – Payment Qualified Mortgages

Credit union should first consider:

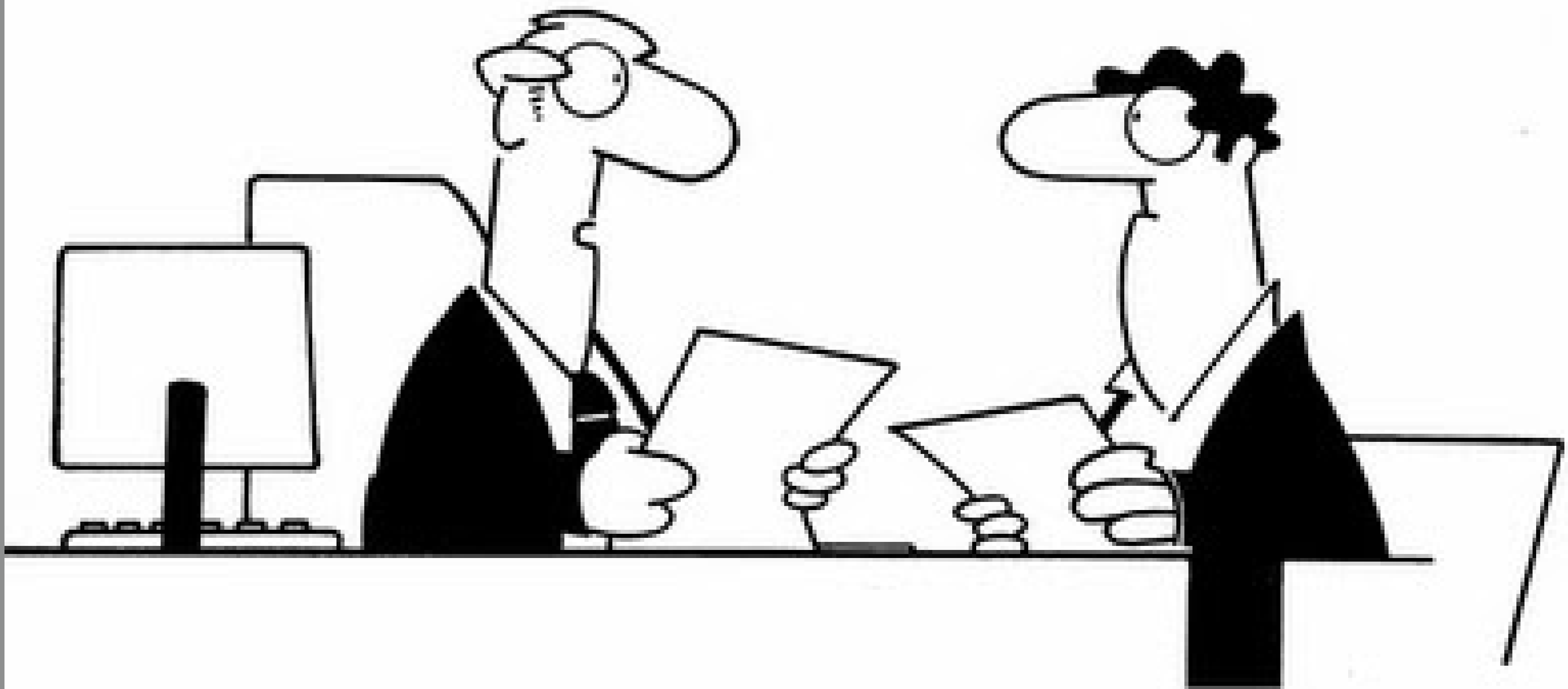
- Borrower's current or reasonably expected income or assets (other than the dwelling that secured the loan)
- Borrower's current debt obligations, alimony and child support
- 43%

Balloon – Payment Qualified Mortgages

- Credit union determines borrower can make all of the scheduled payments together with the monthly payments for mortgage-related obligations but excluding the balloon payment
- Credit union considers debt-to-income ratio and verifies debt obligations and income (43%)
- Regular, scheduled payments are substantially equal
- Term must be at least 5 years

Balloon Payment Qualified Mortgage

- For loans that are not higher-priced covered transaction for a balloon payment, must use the maximum payment scheduled the first 5 years of the loan
- For higher-priced covered transactions must consider the consumer's ability to repay the loan based on the payment schedule, including any required balloon payment



"It's an adjustable mortgage. If interest rates go up, your payment increases. If interest rates go down, your payment increases."

Balloon – Payment Qualified Mortgages *(continued)*

Credit unions meet specific requirements:

- At least 50% of first-lien covered transactions in rural or underserved counties in previous year
  - Predominantly rural or underserved areas
    - Rural: a county that is neither:
      - Metropolitan area, nor
      - Micropolitan area adjacent to a metropolitan area
    - Underserved: a county in which no more than 2 creditors have extended five or more first-lien mortgages.

Balloon – Payment Qualified Mortgages *(continued)*

- Predominantly rural or underserved areas *(continued)*
  - A list of "rural" and "underserved" counties will be designated each year
- NCUA definition: The Federal Credit Union Act defines an underserved area as a local community, neighborhood, or rural district that is an "investment area" as defined in Section 103(16) of the Community Development Banking and Financial Institutions Act of 1994. Examples of underserved areas: An area where the percentage of population living in poverty is at least 20%, unemployment rate is at least 1.5 times the national average, etc.

Balloon – Payment Qualified Mortgages *(Continued)*

- Credit unions meet specific requirements *(continued)*:
  - No more than 500 first lien covered transactions in previous year, and
  - Had less than $2 billion in the previous calendar year

Balloon – Payment Qualified Mortgages *(continued)*

Generally, balloon payment qualified mortgages **cannot** be transferred or assigned without losing their exempt status.

This restriction does not apply where:

1. Sales/assignments occurring at least 3 years after consummation of the loan
2. Buyer/assignee operates predominantly in rural or underserved area
3. Buyer/assignee originated 500 or fewer first-lien mortgages
4. Buyer/assignee had less than $2 billion in assets at end of preceding year

Points and Fees

Qualified Mortgages – Limits on Points and Fees

Points and fees on qualified mortgages cannot exceed 3% on loans of $100,000 or more (varies for loans less than $100,000)

Points and Fees

Points and fees include the following that are known at or before consummation:

- All finance charges, except:
  - Interest;
  - premium/charge imposed in connection with any guaranty or insurance on borrower default;
  - Bona fide third party charge not retained by lender, loan originator, or affiliate or either.

Points and Fees

Points and fees include the following that are known at or before consummation *(continued)*:

- Compensation paid by consumer or creditor to loan originator
- Real-estate related fees (e.g., title insurance, title examination, survey, loan-related document preparation, notary, appraisals, etc.), unless:
  - Reasonable charge
  - Not paid to lender
  - Not paid to an affiliate of lender

Points and Fees

- All finance charges, except *(continued)*:
  - – 2 discount points where interest rate with discount does not exceed:
    - APR by more than 1%; or
    - For transactions secured by personal property, the average rate under National Housing Act by more than 1%.
  - – 1 discount point where interest rate with discount does not exceed:
    - APR by more than 2%; or
    - For transactions secured by personal property, the average rate under the National Housing Act by more than 2%.

Points and Fees

Points and fees include the following that are known at or before consummation (cont.):

- Compensation paid by consumer or creditor to loan originator
- Real-estate related fees (e.g. title insurance, title examination, survey, loan-related document preparation, notary, appraisals, etc.), unless:
  - Reasonable charge
  - Not paid to lender
  - Not paid to an affiliate of lender
- Possible double counting

Points and Fees

Points and fees include the following that are known at or before consummation *(continued)*:

- Premiums/other charges for any life, credit disability, unemployment, property, etc. insurance for which lender is the beneficiary
- Max prepayment penalty
- Total prepayment penalty for refinancing
- Loan level pricing adjustments

Qualified Mortgages – Limits on Points and Fees

Points and fees on qualified mortgages cannot exceed 3% on loans of $100,000 or more

Possible changes pending – stay tuned

A Glossary of Payment Calculations

- Balloon Payment Loans
- Interest Only Loans
- Negative Amortization Loans
- Simultaneous Loans

A Glossary of Other Key Terms or Definitions

- Total Loan Amount
- Fully Indexed Rate
- Higher Priced Covered Transaction
- Maximum Loan Amount
- Mortgage Related Obligations
- Simultaneous Loan
- Third Party Record
- Repayment Ability

Monthly Debt-to-Income Ratio or Residual Income

Determination of Debt-to-Income Ratio

- Credit union is required to consider the borrower's monthly debt-to-income ratio prior to extending a mortgage loan
- Credit union must consider the borrower's total monthly debt obligations, including mortgage loan payments, payment of any other mortgage-related obligations and any other debt obligations
- **The regulation does not prescribe a maximum debt-to-income threshold.** Credit union must use its discretion to make a good faith reasonable determination of whether a potential borrower's debt-to-income ratio is too high and would adversely affect their ability to pay
- **43%!!!!**

Some of The Numbers

1. 43%
2. 8
3. 30
4. 3%
5. 78

Best Practices

Remember

1. Form an in-house credit union team that meets regularly
2. Involve credit union management
3. Hold the third party vendors accountable
4. Involve NAFCU Compliance Team
5. Review all policies and procedures - Now
6. Develop a new set of documentation for Ability-to-Repay
7. Establish a timetable with achievable deadlines – stick to it
8. Evaluate the benefits of Qualified Mortgages
9. Establish goals for % of Non-Qualified Mortgages
10. <u>Prepare</u> but anticipate last minute changes

E. Andrew Keeney, Esq.

Kaufman & Canoles, P.C.

150 West Main Street, Suite 2100

Norfolk, VA 23510

(757) 624-3153

eakeeney@kaufcan.com

CFPB's Final Mortgage Regulations:

Ability-to-Repay and Qualified Mortgage Rules

October 24, 2013

E. Andrew Keeney, Esq.

Kaufman & Canoles, P.C.