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## Regulation Z – Ability to Repay and Qualified Mortgage Rules

The Consumer Financial Protection Bureau (CFPB) has amended Regulation Z by requiring creditors to make a determination of a consumer's "Ability to Repay" for any consumer credit transaction secured by a dwelling, with certain exceptions. The rule also establishes certain protections from liability under these rules for "Qualified Mortgages." The rule limits prepayment penalties and contains record retention requirements.

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Links: [Final Rule - 01/10/13](#)  
[Final Rule - 05/29/13](#)  
[Final Rule - 07/10/13](#)  
[Final Rule - 09/13/13](#)

Pursuant to the Dodd-Frank Act, the CFPB has issued a final rule amending Regulation Z, which implements Truth in Lending. This rule amends the regulation by addressing ability to repay requirements for most dwelling-secured transactions and establishing standards for qualified mortgages. These rules are contained within a section of the regulation entitled "Minimum Standards for Transactions Secured by a Dwelling" (12 CFR 1026.43). The new final rule was initially published in January 2013 with additional rules issued thereafter with further amendments and clarifications.

### **What Transactions Do These Rules Cover?**

These rules apply to any consumer credit transaction that is secured by a dwelling, including any attached real property. A dwelling means any 1-to-4 residential structure, whether or not it is attached to real property. Exceptions include:

- Home equity lines of credit and
- Transactions secured by an interest in a timeshare plan

### **What is "Ability to Repay"?**

Generally, for covered transactions, a loan must not be made unless a reasonable and good faith determination is done that the consumer has a reasonable ability to repay the loan. The ability to repay provisions do not limit loan features and terms; however, they do affect the evaluation and underwriting of a covered transaction.

To make a repayment determination, a creditor will follow a two-prong approach consisting of consideration and verification.

**Consideration** - The provisions outline 8 criteria that must be considered, which include:

- Income or Assets
- Employment Status
- Payment on Covered Transaction
- Simultaneous Loans
- Mortgage-Related Obligations
- Current Debt Obligations
- Monthly Debt-To-Income or Residual Income
- Credit History

**Verification** – Generally, creditors must verify the information relied upon using reasonably reliable third party records. Examples of verification records include, but are not limited to, the following: tax returns, payroll statements, financial institution records and credit reports. The rules allow for oral verification of employment status, provided that a record of that information is created.

Keep in mind that verification is required for *information relied upon*. For example, if a creditor has verified income and assets that support the obligation, it need not verify additional income and assets that the consumer has available from other sources.

While the ability to repay provisions are required for covered transactions, other provisions apply to:

- Refinancing of Non-Standard Mortgages – Generally, this provides greater flexibility to help refinance certain non-standard mortgages into standard mortgages without having to meet the rule's ability to repay requirements.
- Qualified Mortgages (QMs) – QM standards, if met, provide some protection from liability.

## What Are Qualified Mortgages?

Regulation Z has been amended with specific mortgage loan standards that, if met, provide a creditor with some protection. In exchange for meeting these standards, QMs receive either a conclusive or a rebuttable presumption that the creditor has complied with the ability to repay requirements. At a high level, QMs are mortgages that:

- Meet specific qualifications
- Do not contain risky features
- Have certain limitations, for example on points and fees
- Meet certain underwriting qualifications

The regulation contains standards for different types of QMs. To highlight one type, the General QM definition contains the following features:

- Loan Feature Limitations – *no negative amortization, interest-only or balloon payments*
- Term Limit – *30 years*
- Points & Fees Limit – *generally, 3%*
- Payment Underwriting – *consider maximum rate in first 5 years*
- Include in Underwriting and Debt-to-Income – *mortgage-related obligations, employment status, simultaneous loans, credit history*
- Consider & Verify – *income, assets and debt*
- Debt-to-Income – *at or less than 43%*

The Regulation has also been amended with an **Appendix Q**. This appendix outlines the standards for determining monthly debt and income in satisfying QM requirements. At a high level, Appendix Q outlines:

- Consumer Employment-Related Income – *stability of income; salary, wages & other forms of income; income analysis based on types of tax return*
- Non-Employment-Related Consumer Income – *alimony, child support & maintenance income; investment & trust income; military & government agency and assistance program income; rental income*
- Consumer Liabilities and Recurring Obligations – *installment loans; revolving credit, alimony, child support*
- Consumer Liabilities and Contingent Liability – *liability that exists when an individual is held responsible for a debt if another party defaults*

## What Are The Prepayment Penalty Limitations?

For covered transactions, prepayment penalties are greatly restricted. They are only permitted for fixed-rate or stepped rate QMs that are not considered "higher priced" and only when applicable law otherwise permits them to be charged. The determination of whether a QM is "higher priced" is based on a comparison of the loan's APR as compared to the Average Prime Offer Rate (APOR); which is further impacted by the type of QM. When such a penalty is allowed, it is restricted in a variety of ways, such as being charged after the first 3 years of the loan and limits on the amount based on loan balance and when it is charged.

## What Are The Record Retention Requirements?

While you may wish to keep these records longer, the regulation requires that you retain evidence of compliance with the Ability to Repay and Qualified Mortgage rules for 3 years after consummation of the loan.

## Recommendations for Next Steps

By January 10, 2014:

1. Discuss with the Board and Senior Management lending strategies regarding QM standards to determine extent of policy and procedural changes.
2. Policy Updates –
  - a. Review Truth in Lending, other mortgage lending and underwriting-related policies as they relate to consumer credit secured by a dwelling. Update policies as needed to reflect new Ability to Repay requirements and as warranted, prepayment penalty limitations. As needed, update same policies to address Qualified Mortgages.
  - b. Review Record Retention policy and update to ensure coverage of evidence of compliance with these rules.
3. Procedural Updates -
  - a. Review mortgage lending & underwriting-related procedures to address new Ability to Repay requirements. Ensure procedures properly identify covered applications and consideration and verification of required criteria.
  - b. As needed, review procedures and update to address QM standards. Ensure procedures properly identify covered transactions, limitations on loan features and terms and application of Appendix Q.
  - c. Ensure procedures are updated as needed to reflect new prepayment penalty restrictions and record retention requirements.
4. Implement new or revised controls where feasible. Consider secondary reviews and the implementation of checklists. Enhance underwriting documentation. Research automated solutions.
5. Train applicable staff on the requirements of the final rule and internal policies and procedures.

**Additional Resource from the CFPB – Comparison Chart**

A snapshot of the referenced chart is provided below; however, it may be accessed at the following address:  
[http://files.consumerfinance.gov/f/201308\\_cfpb\\_atr-and-qm-comparison-chart\\_V2\\_final.pdf](http://files.consumerfinance.gov/f/201308_cfpb_atr-and-qm-comparison-chart_V2_final.pdf)

**General Comparison of Ability-to-Repay Requirements with Qualified Mortgages<sup>1</sup>**

	ATR Standard	General QM Definition	Agency/GSE QM (Temporary)	Balloon-Payment QM	Small Creditor QM	Small Creditor Balloon-Payment QM (Temporary)
Loan feature limitations	No limitations	No negative amortization, interest-only, or balloon payments	No negative amortization, interest-only, or balloon payments	No negative amortization or interest-only payments	No negative amortization, interest-only, or balloon payments	No negative amortization or interest-only payments
Loan term limit	No limitations	30 years	30 years	No more than 30 years, no less than 5 years	30 years	No more than 30 years, no less than 5 years
Points & fees limit	No limitations	3%	3%	3%	3%	3%
Payment Underwriting	Greater of fully indexed or introductory rate	Max rate in first 5 years	As applicable, per GSE or agency requirements	Amortization schedule no more than 30 years	Max rate in first 5 years	Amortization schedule no more than 30 years
Mortgage-related obligations	Consider and verify	Included in underwriting monthly payment <sup>2</sup> and DTI <sup>3</sup>	As applicable, per GSE or agency requirements	Included in underwriting monthly payment <sup>2</sup> and DTI <sup>3</sup>	Included in underwriting monthly payment <sup>2</sup> and DTI <sup>3</sup>	Included in underwriting monthly payment <sup>2</sup> and DTI <sup>3</sup>
Income or assets	Consider and verify	Consider and verify	As applicable, per GSE or agency requirements	Consider and verify	Consider and verify	Consider and verify
Employment status	Consider and verify	Included in underwriting DTI	As applicable, per GSE or agency requirements	No specific requirement	No specific requirement	No specific requirement
Simultaneous loans	Consider and verify	Included in underwriting DTI	As applicable, per GSE or agency requirements	Included in underwriting DTI	Included in underwriting DTI	Included in underwriting DTI
Debt, alimony, child support	Consider and verify	Consider and verify	As applicable, per GSE or agency requirements	Consider and verify	Consider and verify	Consider and verify
DTI or Residual Income	Consider and verify	DTI ≤ 43 percent	As applicable, per GSE or agency requirements	Consider and verify	Consider and verify	Consider and verify
Credit History	Consider and verify	Included in underwriting DTI	As applicable, per GSE or agency requirements	No specific requirement	No specific requirement	No specific requirement



**General Comparison of Ability-to-Repay Requirements with Qualified Mortgages<sup>1</sup>**

<sup>1</sup> This chart compares the general ATR requirements with the requirements for originating QM loans. Additional requirements may apply, particularly for small creditor and balloon-payment QM loans. This chart is not a substitute for the rule. Only the rule and its Official Interpretations can provide complete and definitive information regarding its requirements. The complete rule, including the Official Interpretations and small entity compliance guide, is available at <http://www.consumerfinance.gov/regulations/ability-to-repay-and-qualified-mortgage-standards-under-the-truth-in-lending-act-regulation-z/>.

<sup>2</sup> "Included in underwriting monthly payment" means that the rule does not require the creditor to separately consider and verify this factor. However, a creditor must consider this factor when underwriting the consumer's monthly payment under the rule.

<sup>3</sup> "Included in underwriting DTI" means that the rule does not require the creditor to separately consider and verify these factors. However, a creditor considers and verifies these factors when calculating the consumer's debt-to-income ratio.