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MICHIGAN CREDIT UNION LEAGUE & AFFILIATES

Comment Call (13-02)

To: All Affiliated Credit Union CEOs

From: Kieran Marion – Vice President Governmental Affairs
Shawn Wolbert – Legislative & Regulatory Specialist

Date: January 25, 2013

RE: CFPB – Ability to Repay Standards under the Truth in Lending Act (Regulation Z)

Summary

The Consumer Financial Protection Bureau (CFPB) proposes to amend Regulation Z. which implements the Truth in Lending Act (TILA, and the final rule the CFPB published implementing sections 1411, 1412, and 1414 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), which creates new TILA section 129C. The proposal would provide exemptions and modifications to the ability-to-repay requirement; clarify the calculation of points and fees in transactions involving loan originator compensation.

Among other things, the Dodd-Frank Act 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) and establishes certain protections from liability under this requirement for "qualified mortgages." The CFPB is proposing certain amendments to the final rule implementing these requirements, including exemptions for certain nonprofit creditors and certain homeownership stabilization programs and an additional definition of a qualified mortgage for certain loans made and held in portfolio by small creditors.

Proposal Focus

The proposal addresses several exemption issues in order to preserve access to credit for low to moderate income consumers; which include:

- Extension of credit for programs administered by a housing finance agency (HFA) or Emergency Economic Stabilization Act (EESA) program, and certain types of nonprofit creditors;
- Refinances that are eligible to be insured, guaranteed, or made pursuant to a program administered by the Federal Housing Administration, U.S. Department of Veterans Affairs, or the U.S. Department of Agriculture;
- Extensions of credit that are refinancings eligible to be purchased or guaranteed by the Federal National Mortgage Association (Fannie Mae) or the Federal Home Loan Mortgage Corporation (Freddie Mac) from the ability-to-repay requirements;

There are several proposed amendments that would apply to small creditors including: a fourth category of qualified mortgages for certain transactions originated by small creditors; small creditors would not have to use the instructions in appendix Q to calculate debt-to-income ratio, and a loan with a consumer debt-to-income ratio higher than 43 percent could be a qualified mortgage if all other criteria are met; and the proposed changes will allow small creditors to charge a higher annual percentage rate for first-lien qualified mortgages in the proposed new category and still benefit from the presumption of "safe harbor."

Finally, the CFPB is proposing to allow small creditors operating predominantly in rural or underserved areas to offer first-lien balloon loans with a higher annual percentage rate and still benefit from "safe harbor."

A copy of the proposed rule can be found here: http://files.consumerfinance.gov/f/201301_cfpb_concurrent-proposal_ability-to-repay.pdf.

Comments on the proposal must be received by ***February 25, 2013***.

Background

Beginning in about 2006, mortgage delinquencies and foreclosure rates increased dramatically, caused in part by the gradual deterioration in underwriting standards in mortgage lending. In 2010 Congress significantly amended the statutory requirements governing mortgage practices with the intent to restrict the practices that contributed to the crisis through Title XIV of the Dodd-Frank Act, titled the Mortgage Reform and Anti-Predatory Lending Act. On January 10, 2013 the CFPB published a final rule to implement sections 1411, 1412, and 1414 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), which creates new TILA section 129C. The Final Rule has an effective date of **January 10, 2014**.

The Proposed Rule

Section 1026.32 Requirements for High-Cost Mortgages

Mortgage Originator Compensation – Points and Fees

Section 1431 of the Dodd-Frank Act requires that "all compensation paid *directly or indirectly* by a consumer *or creditor* to a mortgage originator from any source, including a mortgage originator be included in points and fees for qualified and high-cost mortgages. Prior to the amendment, HOEPA had provided that only compensation paid by a consumer to a mortgage broker at or before closing should count toward the points and fees threshold. Under amended TILA section 103(bb)(4)(B), however, compensation paid to anyone that qualifies as a "mortgage originator" is to be included in points and fees. Therefore, in addition to compensation paid to mortgage brokerage firms, points and fees also includes compensation paid to other mortgage originators, including employees of a creditor.

In addition, the Dodd-Frank Act removed the phrase "payable at or before closing" from the high-cost mortgage points and fees test and did not apply the "payable at or before closing" limitation to the points and fees cap for qualified mortgages.

The literal language of TILA section 103(bb)(4), as amended by the Dodd-Frank Act, defines points and fees to include all items included in the finance charge (except interest rate), all compensation paid directly or indirectly by a consumer or creditor to a loan originator, "and" various other enumerated items. The CFPB believes the statute would be read to require that loan originator compensation be treated as additive to the other elements of points and fees, and that this would not be in the best interest of either consumers or industry in all circumstances. Due to the literal definition points and fees could be required to be counted twice when the credit union pays loan originator compensation to its own employees (counting once for the credit union compensations, and as required additionally to compensation the MLO will earn in the transaction).

The CFPB has proposed three issues for comment to specify calculation methods where loan originator compensation could be counted twice under the statutory scheme:

1) ***Should the statutory language (§1026.32(b)) preclude offsetting and require a creditor to include compensation paid by a consumer or creditor to a loan originator in the calculation of points and fees in addition to any fees or charges paid by the consumer to the creditor?***

Example: A member pays the credit union a $3,000 origination fee and that the credit union pays to its loan officer employee $1,500 in compensation attributed to the transaction. For purposes of *calculating points and fees, the $3,000 origination fee will be included in points and fees (§1026.32(b)(1)(i)) and the $1,500 in loan officer compensation is also included in points and fees, equaling $4,500 in total points and fees, provided that no other points and fees are paid or compensation received.*

2) ***The second alternative would allow all member payments of up-front fees and points to offset creditor payments to the loan originator.***

Example: *A consumer pays to the creditor a $3,000 origination fee and that the creditor pays to the loan originator $1,500 in compensation attributed to the transaction. The $3,000 origination fee is included in points and fees as required by §1026.32(b)(1)(i), but the $1,500 in loan originator compensation need not be included in points and fees. If, however, the consumer pays to the creditor a $1,000 origination fee and the creditor pays to the loan originator $1,500 in compensation, then the $1,000 origination fee and $500 of the loan originator compensation is included in points and fees under equaling $1,500 in total points and fees.*

3) ***The Bureau also seeks feedback as to whether, if it were to adopt the first alternative in some or all instances, the creditor should be permitted to reduce the loan originator compensation by the full amount of points and fees included in finance charges or whether the reduction should be limited to that portion of points and fees denominated as general origination charges, rather than specific fees that are passed through to affiliates?***

The CFPB would also like input on the following issues:

Are there differences in various types of loans, consumers, loan origination channels, or market segments which would justify applying different interpretations regarding offsetting to such categories?

What are the likely market reactions and impacts on the pricing of and access to credit from this proposed amendment, particularly as to how such reactions might affect interest rate levels and safe harbor afforded to particular qualified mortgages and for high-cost mortgages?

<u>Section 1026.43 Applicability of the Ability-to-Repay</u>

Ability to Repay Exemptions for Certain Types of Creditors

In accordance with the Dodd-Frank Act, Section 129C(a)(1) of TILA, no creditor may make a residential mortgage loan unless the creditor makes a reasonable and good faith determination based on verified and documented information that, at the time the loan is consummated, the consumer has a reasonable ability to repay the loan, according to its terms, and all applicable taxes, insurance, and assessments.

The CFPB is concerned that applying the ability-to-repay standards will negatively impact community focused lending programs and homeownership stabilization and foreclosure prevention programs. Because these programs already have carefully calibrated underwriting standards and are generally subject to significant government monitoring the CFPB is concerned that overlaying an additional set of underwriting requirements and private liabilities could divert resources and reduce the effectiveness and availability of such programs. Additionally, the CFPB is concerned that the costs of implementing and complying with the ability-to-repay requirements would endanger the viability and effectiveness of the programs. The CFPB has also proposed exempting Community Development Financial Institutions, Community Housing Development Organizations, and Downpayment Assistance Providers.

The CFPB has also proposed an exemption for small creditors who:

- Close fewer than 100 loan transactions secured by a dwelling a year;

- Extend credit secured by a dwelling only to consumers with income that did not exceed the qualifying limit for moderate income families, as established pursuant to section 8 of the United States Housing Act of 1937; **and**
- The extension of credit is to a consumer with income that does not exceed this qualifying limit.

The proposed exemptions are narrowly targeted to apply only to certain types of creditors and extensions of credit. Under the proposed exemption consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay.

The CFPB would like input on the following issues:

How do the costs of implementing and complying with the ability-to-repay requirements endanger the viability and effectiveness of lending programs offered to members?

Are the exemptions proposed for: community focused lending programs, homeowner stabilization and foreclosure prevention programs, Community Development Financial Institutions, Community Housing Development Organizations, Downpayment Assistance Providers, and small creditors appropriate?

Should the proposed exemption on the ability-to-repay requirements be extended to creditors designated as nonprofits under section 501(c)(4) of the Internal Revenue Code of 1986?

The Bureau also specifically requests comment regarding the costs that nonprofit creditors will incur in connection with the ability-to-repay requirements, the extent to which these additional costs will affect the ability of nonprofit creditors to extend credit to low- to moderate-income consumers, and whether consumers could be harmed by providing an exemption to the ability-to-repay requirements to the nonprofit creditors.

Ability-to-Repay and Refinancing

Two provisions of the Dodd-Frank Act address refinancing of existing mortgage loans under the ability-to-repay requirements. As amended by the Dodd-Frank Act, TILA (Section 129C(a)(5)) provides that Federal agencies may create an exemption from the income and verification requirements for certain streamlined refinancing's of loans made, guaranteed, or insured by various federal agencies.

In addition, TILA (Section 129C(a)(6)(E) provides special ability-to-repay requirements to encourage applications to refinance existing "hybrid loans" into "standard loans" with the same creditor, where the consumer has not been delinquent on any payments on the existing loan and the monthly payments would be reduced under the refinanced loan. However, the amendment to TILA has a very narrow focus and only applies if:

- The refinancing is conducted in response to an application to refinance a non-standard mortgage into a standard mortgage;
- The creditor for the standard mortgage is the current holder of the existing nonstandard mortgage or the servicer acting on behalf of the current holder;
- The creditor receives the consumer's written application for the standard mortgage before the non-standard mortgage is recast;
- The creditor considers whether the standard mortgage likely will prevent a default by the consumer on the non-standard mortgage once the loan is recast;
- The creditor determines that the monthly payment for the standard mortgage is materially lower than the monthly payment for the non-standard mortgage, as calculated under § 1026.43(d)(5);
- The consumer has made no more than one payment more than 30 days late on the nonstandard mortgage during the 12 months immediately preceding the application for refinancing;
- The consumer has made no payments more than 30 days late during the six months immediately preceding the creditor's receipt of the consumer's written application for the standard mortgage; **and**
- If the non-standard mortgage was consummated on or after January 10, 2014, the non-standard mortgage was made in accordance with § 1026.43(c) or (e), as applicable.

The CFPB is concerned that the ability-to-repay requirements for refinancing may deter creditors from participating in Emergency Economic Stabilization Act programs like Making Homes Affordable. The CFPB is also concerned that requiring credit extended pursuant to these programs to comply with the ability-to-repay provisions may make it more difficult for many consumers to qualify for assistance and increase the cost of credit for those who do, thereby impacting the availability of credit for these at-risk consumers. Based on these concerns that CFPB would like input on:

Should extensions of credit made pursuant to a program authorized by the Emergency Economic Stabilization Act be exempt from § 1026.43(c) through (f)?

Should Federal agency loans, like U.S. Department of Housing and Urban Development be exempt from the ability-to-repay requirements for refinancing through TILA?

Should an extension of credit that is a refinancing and is eligible to be insured, guaranteed, or made pursuant to a program administered by the Federal Housing Administration, U.S. Department of Veterans Affairs, or the U.S. Department of Agriculture be exempt?

The CFPB would also like input on exempting transactions eligible for purchase or guarantee by Fannie Mae or Freddie Mac provided that the refinancing is made pursuant to an eligible targeted refinancing program, which such entities are operating under the conservatorship or receivership of the Federal Housing Finance Agency on the date the refinancing is consummated, that the existing obligation satisfied and replaced by the refinancing is owned by Fannie Mae or Freddie Mac.

Ability-to-Repay and Qualified Mortgages

Based on the new guidance generally a loan with a balloon payment cannot be a qualified mortgage; however TILA (Section 129C(b)(2)(E)) provides that certain balloon loans originated and held in portfolio by small creditors operating predominantly in rural or underserved areas can be qualified mortgages.

Credit unions must place importance on the qualified mortgage status because TILA provides that, if a creditor fails to comply with the ability-to-repay requirements, a consumer may be able to recover special statutory damages equal to the sum of all finance charges and fees paid within the first three years after consummation and may be able to assert the creditor's failure to comply to obtain recoupment or setoff in a foreclosure action even after the statute of limitations for affirmative claims has passed. Small creditors have repeatedly asserted to the CFPB and to other regulators that they are unable or unwilling to assume the risk of litigation associated with the ability-to-repay requirements and therefore are unwilling to make loans outside the scope of the qualified mortgage safe harbor.

The amendments to TILA provide that certain balloon loans are qualified mortgages if they are made by a small creditor that:

- Had total assets less than $2 billion (adjusted for inflation) as of the end of the preceding calendar year;
- Together with all affiliates, extended 500 or fewer first-lien covered transactions during the preceding calendar year; **and**
- Extended more than 50 percent of its total covered transactions secured by properties that are in rural or underserved areas during the preceding calendar year.

This exemption only applies to loans held in portfolio by these small creditors for at least three years. In contrast, a qualified mortgage that is a higher-priced covered transaction is subject to a rebuttable presumption of compliance. The CFPB is proposing to create an additional category of qualified mortgages that would include certain loans originated and held in portfolio by small creditors which would include: a first-lien loan that is a qualified mortgage would be a higher-priced covered transaction if the annual percentage rate exceeds the average prime offer rate for a comparable transaction by 3.5 or more percentage points. This would have the effect of extending the qualified mortgage safe harbor to first-lien qualified mortgages made and held in portfolio by certain small.

The CFPB would like input on:

Should an amendment be made permitting certain small creditors to make first-lien portfolio loans at a higher annual percentage rate and still benefit from the qualified mortgage safe harbor?
If no amendment is made what adverse impact will this have on consumers?

Do small credit unions need additional time, beyond the January 10, 2014 effective date of the CFPB's 2013 ATR Final Rule, to comply with the ability-to-repay requirements, or do those creditors require any additional accommodations, modifications, or exemptions?

The CFPB also solicits comment on the proposed 3.5 percentage point threshold and whether another threshold would be more appropriate?

Finally, the CFPB solicits comment on whether the CFPB also should raise the threshold for subordinate-lien covered transactions that are qualified mortgages, and what threshold would be appropriate for those loans?

Qualified Mortgages and Balloon Loans

The CFPB is also proposing to amend the definition of higher-priced covered transaction (§1026.43(b)(4)) with respect to qualified mortgages that are balloon loans originated and held in portfolio by small creditors operating predominantly in rural or underserved areas. The amendment would provide that a first-lien loan that is a qualified mortgage is a higher-priced covered transaction if the annual percentage rate exceeds the average prime offer rate for a comparable transaction by 3.5 or more percentage points. This would have the effect of extending the qualified mortgage safe harbor to first-lien balloon loans made and held in portfolio by small creditors operating predominantly in rural or underserved areas that have an annual percentage rate between 1.5 and 3.5 percentage points above the average prime offer rate.

The CFPB solicits comments for:

Is an amendment to the definition of higher-priced covered transactions for small creditors needed to preserve access to responsible, affordable mortgage credit in rural and underserved areas and regarding any adverse effects the proposed amendment would have on consumers in these or other areas?

The CFPB would also like to know if it should raise the threshold for subordinate-lien covered transactions that are qualified mortgages and, if so, what threshold would be appropriate?

Qualified Mortgages

TILA, Section §1026.43(c), provides that a creditor or assignee of a qualified mortgage that is a higher-priced covered transaction is presumed to comply with the repayment ability requirements, but that presumption can be rebutted by a consumer under certain circumstances. Specifically, TILA if a creditor fails to comply with the ability-to-repay requirements, a consumer may be able to recover special statutory damages equal to the sum of all finance charges and fees paid within the first three years after consummation and may be able to assert the creditor's failure to comply to obtain recoupment or setoff in a foreclosure action even after the statute of limitations on affirmative claims has expired.

The CFPB would like to propose an additional category of qualified mortgage which provides that certain balloon loans made by small creditors operating predominantly in rural or underserved areas are qualified mortgages. The additional category would include loans originated by small creditors that:

- Have total assets that do not exceed $2 billion as of the end of the preceding calendar year (adjusted annually for inflation); and
- Together with all affiliates, extended 500 or fewer first-lien covered transactions during the preceding calendar year.

The proposed additional category would include only loans held in portfolio by small creditors. When underwriting the loan the creditor would have to take into account the monthly payment for any mortgage-related obligations, and:

- Use the maximum interest rate that may apply during the first five years and periodic payments of principal and interest that will repay the full principal; and
- Consider and verify the consumer's current and reasonably expected income or assets other than the value of the property securing the loan.
- The creditor also would be required to consider the consumer's debt-to-income ratio or residual income and to verify the underlying information. In contrast, the general definition of a qualified mortgage requires a creditor to calculate the consumer's debt-to-income ratio according to instructions in appendix Q and specifies that the consumer's debt-to-income ratio must be 43 percent or less.

The proposed change would:

- Provide additional guidance regarding the requirement to comply with the general definition of a qualified mortgage.
- Restate the regulatory requirement that a covered transaction must satisfy the requirements of general definition of qualified mortgage, except with regard to debt-to-income ratio, to be a qualified mortgage.
- Explain that a qualified mortgage may not result in a balloon payment.
- Clarify that a covered transaction may be a qualified mortgage even though the consumer's monthly debt-to-income ratio exceeds 43 percent.
- Clarify that the qualified mortgage does not prescribe a specific monthly debt-to-income ratio with which creditors must comply.
- Provide instructions on calculating the payment on the covered transaction.
- Clarify that creditors are not required to calculate the consumer's monthly debt-to-income ratio in accordance with appendix Q, as required under the general definition of qualified mortgages.
- Explain that a qualified mortgage that is sold due to a capital restoration plan caused by bankruptcy or receivership would retain its status as a qualified mortgage following the sale. However, if the creditor simply chose to sell the same qualified mortgage as one way to comply with general regulatory capital requirements in the absence of supervisory action or agreement, the mortgage would lose its status as a qualified mortgage following the sale unless it qualifies under another definition of qualified mortgage.
- Clarify that a qualified mortgage retains its qualified mortgage status if a creditor merges with, is acquired by, or acquires another person regardless of whether the creditor or its successor is eligible to originate new qualified mortgages.

The CFPB would like input regarding:

Is non-conforming mortgage credit likely to be unavailable under the current rule and whether amending the rule as proposed would ensure that such credit is made available in a responsible, affordable way?

Is the proposed $2 billion asset threshold for small creditors appropriate, and whether the threshold should be higher or lower?

Is the proposed 500 transaction limit appropriate for small creditors?

Are the requirements that loans be held in portfolio too restrictive, and should other criteria, guidance or exemptions be considered?

The CFPB solicits comment on whether qualified mortgages originated by small creditors be exempt from the requirement to consider debt-to-income ratio calculated according to appendix Q and the prohibition on debt-to-income ratios in excess of 43 percent, and whether other requirements related to debt-to-income ratio or residual income should be provided, either in lieu of or in addition to those proposed?

Finally, the proposal would provide different legal status to loans with identical terms because the creditor is small and intends to hold the loan in portfolio. The CFPB would like to understand the significance of this risk considering that consumers who obtain small creditor portfolio loans likely could have obtained credit from other sources and on the extent to which a consumer who obtains a portfolio loan from a small creditor would be disadvantaged by the inability to make an affirmative claim of noncompliance with the ability-to-repay rules or to assert noncompliance in a foreclosure action.

Conclusion

The proposal presented by the CFPB should results in an economic burden reduction for small entities. The proposed exemptions for nonprofit creditors would lessen any economic impact resulting from the ability-to-repay requirements. The proposed exemptions for homeownership stabilization, foreclosure prevention, and refinancing programs would also soften any economic impact on small entities extending credit pursuant to those programs. The CFPB estimates that 6,296 credit unions will qualify as small entities. The proposed new category of qualified mortgage would make it easier for small entities to originate qualified mortgages. While all of these proposed exemptions may entail additional recordkeeping costs, the Bureau believes that these costs are minimal and outweighed by the cost reductions resulting from the proposal. Small entities for which such cost reductions are outweighed by additional record keeping costs may choose not to utilize the proposed exemptions.

Comment Letters

Please submit a Comment Letter to:

Monica Jackson
Office of the Executive Secretary
Bureau of Consumer Financial Protection
1700 G Street, NW
Washington, DC 20552

Electronically: http://www.regulations.gov Identify your comments with Docket No. CFPB-2012-0050 or RIN 3170-AA33 and follow the instructions for submitting comments.

Please submit to MCUL a copy of your response to the attention of:

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We Appreciate Your Response.