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A BRIEF ON:

ABILITY-TO-REPAY AND QUALIFIED MORTGAGE RULE

Congress adopted Ability-to-Repay (ATR) requirements for residential mortgage loans through the Dodd-Frank Act. Dodd-Frank also established terms for Qualified Mortgages (QMs), which provide creditors a presumption of compliance with ATR requirements. In July 2013, the Consumer Financial Protection Bureau finalized the rule implementing the ATR/QM provisions of the Dodd-Frank Act, and will start enforcing it on January 10, 2014.

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OVERVIEW

The Ability-to-Repay (ATR) and Qualified Mortgage (QM) Rule implements certain provisions of the Dodd-Frank Act which requires credit unions to "make a reasonable, good-faith determination of a borrower's reasonable ability to repay the loan." While the rule is intended to ensure consumers don't receive loans with deceptive terms or onerous debt burdens, it increases the potential liability of credit unions that make mortgage loans since it provides borrowers with an opportunity to assert a violation of the ATR requirement. To help limit this liability, the Consumer Financial Protection Bureau (CFPB) created standards for a Qualified Mortgage, which substantially limits a borrower's ability to claim in court that a loan was not affordable and therefore ran afoul of the rule. This protection adds more legal certainty for a credit union and is therefore more desirable. Conversely, non-QM loans add more legal uncertainty for a credit union and will likely be less desirable.

WHAT IS THE ATR/QM RULE ABOUT

The Ability-to-Repay (ATR) and Qualified Mortgage (QM) rule requires a credit union to make a reasonable, good-faith determination of a borrower's reasonable ability to repay the loan before the mortgage is consummated.

ATR creates a liability for credit unions that make mortgage loans. If a borrower has trouble repaying a loan, the borrower can claim the credit union failed to make a reasonable, good-faith determination of ATR before the loan was made. If the borrower proves this claim in court, then the credit union could be liable for up to three years of finance charges and fees the borrower paid, plus the borrower's legal fees. Additionally, a borrower can challenge any foreclosure action by claiming the credit union did not make a reasonable, good-faith determination of ATR before consummation of the loan. This foreclosure defense is carried with the mortgage, so that if a mortgage is assigned to another credit union there is still assignee liability.

ATR STANDARD AND UNDERWRITING FACTORS

Under ATR, credit unions must make a reasonable, good-faith determination the borrower has the reasonable ability to repay the loan, and the credit union should document how it considers each determination. The determination must include eight underwriting factors:

1. Current or reasonably expected income the borrower will rely on to repay
2. Current employment status
3. Monthly mortgage payment for the loan
4. Monthly payment on any simultaneous loan secured by same property
5. Monthly payments for property taxes, insurance, and HOA fees associated with property
6. Debts, alimony, and child-support obligations
7. Monthly debt-to-income ratio or residual income
8. Credit history

A "reasonableness and good faith determination" of a borrower's ATR depends on the facts and circumstances relevant to the particular loan. As the "reasonableness" standard may be subjective, and therefore not consistent, compliance with ATR standards may not be certain, ***unless*** a credit union makes a QM loan.

QUALIFIED MORTGAGES

To limit their liability and provide credit unions with more certainty of compliance with ATR standards, the rule provides standards for QMs, which grant credit unions a presumption of compliance with the ATR rule. There are four types of QMs: General QMs, Temporary QMs, Small Creditor QMs and Balloon-Payment QMs. However, for the purposes of this brief, only General QMs will be discussed in detail.

General QMs may not have negative-amortization, interest-only, or balloon payment features that exceed 30 years. They also may not have points and fees exceeding the specified limits (*discussed in more detail below*).

Additionally, for a loan to be QM, a credit union must:

- Underwrite based on a fully amortizing schedule using the maximum rate permitted during the first 5-years after the date of first periodic payment
- Consider and verify the borrower's income, assets and debt obligations
- Determine the borrower's monthly debt-to-income ratio is no more than 43%

In exchange for meeting these requirements, QMs receive either a conclusive or a rebuttable presumption the credit union complied with ATR requirements, thereby reducing liability uncertainty. The type of presumption – conclusive or rebuttable – depends on the pricing of the loan (*discussed below in "Safe-harbor vs Rebuttable presumption"*).

If a credit union's loan to a member meets the standards of a Qualified Mortgage, and a borrower subsequently makes a claim the credit union violated the ATR rule, there is a presumption the credit union complied with the rule's standards. Therefore, the burden of a credit union's ***non***-compliance falls to the borrower. However, if a credit union makes a non-QM loan to a borrower, and that borrower subsequently makes a claim the credit union violated ATR standards, then the burden of compliance falls to the credit union. Failure to prove compliance opens a credit union to a host of liabilities. As a bottom line, QM loans give a credit union more certainty about potential liability.

QM POINTS-AND-FEES CAPS

For a loan to be considered QM the points and fees may not exceed certain caps, which are based on the loan size. Unless otherwise specified, the closing costs a credit union pays then recoups from the borrower over time through the interest rate are not counted in points and fees. The standard points-and-fees caps are:

- 3% of the total loan amount for a loan greater than or equal to $100,000
- $3,000 for a loan greater than or equal to $60,000 but less than $100,000
- 5% of the total loan amount for a loan greater than or equal to $20,000 but less than $60,000
- $1,000 for a loan greater than or equal to $12,500 but less than $20,000

- 8% of the total loan amount for a loan less than $12,500

THE TWO KINDS OF QMS AND THEIR LIMITED LIABILITES

The type of presumption of compliance for QMs varies based on its price. If the QM is a fist-lien mortgage with an APR that exceeds the Average Prime Offer Rate (APOR) by 1.5% or more (3.5% or more for junior liens), then the loan is classified as a higher-priced QM. Loans that do not exceed these thresholds are classified as non-higher-priced QMs.

A higher-priced QM provides a credit union with a rebuttable presumption of compliance with ATR requirements. However, a borrower can rebut the presumption by proving that the credit union failed to make a reasonable determination that the borrower could reasonably repay the QM because income, debt, and other obligations left insufficient residual income to reasonably meet living expenses.

A non-higher-priced QM provides a credit union with a conclusive presumption of compliance with ATR requirements (*ie*, a safe harbor). This conclusive presumption is a stronger shield against liability, offering a “safe harbor” for credit unions. This safe harbor provides credit unions with more legal certainty and protects against frivolous lawsuits. For example, a borrower could claim that a credit union did not make a reasonable and good-faith determination of repayment ability, and therefore, claim that the credit union violated ATR. If a court finds that the QM requirements were met, and it’s a non-higher-priced QM, then the court would dismiss the claim.