

Farm Credit Administration

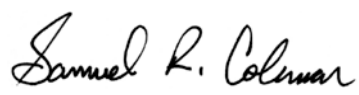
1501 Farm Credit Drive
McLean, Virginia 22102-5090
(703) 883-4000

INFORMATIONAL MEMORANDUM



March 8, 2013

To: Chief Executive Officer
All Farm Credit System Institutions

From: Samuel R. Coleman, Director and Chief Examiner
Office of Examination 

Subject: Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act (Regulation Z)

The purpose of this Informational Memorandum is to provide information regarding a final rule recently adopted by the Consumer Financial Protection Bureau (CFPB) that revises Regulation Z (Truth in Lending), at 12 CFR Part 1026. The rule, which was published in the Federal Register at 78 FR 6408 on January 30, 2013, adopts Ability-to-Repay and Qualified Mortgage Standards. The rule applies only to loans that are subject to the Truth in Lending Act (TILA) and takes effect on January 10, 2014. All institutions should adopt appropriate procedures to ensure compliance with the rule.

The new Ability-to-Repay requirements contain the following provisions:

1. A lender must collect and verify a consumer's financial records and must consider, at a minimum, eight specified underwriting factors.
2. A lender must determine that a borrower has sufficient assets or income to repay the loan.
3. A lender may not base its evaluation of a consumer's ability to repay on a teaser rate.
4. A lender refinancing a borrower from a risky mortgage loan to a more stable, standard mortgage loan can do so without undertaking the full underwriting process required by the new rules.

Lenders will be presumed to have complied with the Ability-to-Repay requirements if they issue Qualified Mortgages. Qualified Mortgages must have the following features:

1. No excess upfront points and fees, as defined by the rule.

2. Caps on how much income can go towards debt. For a temporary, transitional period, loans that exceed the specified 43 percent debt-to-income ratio, but meet specified standards, will be considered Qualified Mortgages. Loans that meet these specified standards include those loans eligible to be purchased or guaranteed by Fannie Mae or Freddie Mac, those loans eligible to be insured by the U.S. Department of Housing and Urban Development or the Rural Housing Service, and those loans eligible to be guaranteed by the U.S. Department of Veterans Affairs or the U.S. Department of Agriculture.
3. No toxic loan features. Examples of toxic loan features include interest-only, negative amortization, terms longer than 30 years, and balloon payments.

The prohibition on balloon payments does not apply to loans made by smaller creditors in rural or underserved areas. Specifically, creditors may originate Qualified Mortgages with balloon payments if they:

- a. Have less than \$2 billion in total assets;
- b. Originate at least 50 percent of their dwelling-secured, first-lien consumer mortgage loans in counties that are rural or underserved (as will be designated by the CFPB), and
- c. Originate no more than 500 dwelling-secured, first-lien consumer mortgage loans per year.

Balloon-payment loans, when originated by such creditors, are considered Qualified Mortgages only if they:

- a. Have a term of at least 5 years;
- b. Have a fixed interest rate;
- c. Meet certain basic underwriting standards, and
- d. Are held in the originator's portfolio for at least three years (with some exceptions).

The rule establishes two types of Qualified Mortgages that have different presumptions regarding compliance with the Ability-to-Repay requirements. The two types are:

1. **Qualified Mortgages with rebuttable presumption** are higher-priced loans typically for consumers with insufficient or weak credit history (i.e., subprime loans). In a dispute, consumers can rebut the presumption that the creditor properly took into account their ability to repay the loan by proving the creditor did not consider their living expenses after their mortgage or other debts. This does not affect the rights of a consumer to challenge a lender for violating any other federal consumer protection laws.
2. **Qualified Mortgages with safe harbor** are lower-priced loans that are typically made to borrowers who pose fewer risks (i.e., prime loans). In a dispute, the lender will be considered to have legally satisfied the Ability-to-Repay rules, but consumers can still

legally challenge whether the loan meets the definition of a “Qualified Mortgage.” This does not affect the rights of a consumer to challenge a lender for violating any other federal consumer protection laws.

The language of the final rule, together with a detailed summary of the rule, a summary of the rule for consumers, and other information about the rule, can be found on the CFPB’s website, at www.consumerfinance.gov. From the home page, go to the *Law and Regulation* section and click on *Regulations*. There you will find a list of all CFPB rules issued. When you click on the link to any rule, you will find a page that links to the text of that rule, along with a summary and other information about the rule.

The Farm Credit Administration is providing this information as a courtesy to keep you informed of issues that may affect your institution. This information should not be seen as a replacement for management's due diligence in monitoring issues that may affect your institution.

If you have any questions about this Informational Memorandum, please contact Jennifer A. Cohn, Senior Counsel, Office of General Counsel, at (703) 883-4028, or by email at cohnj@fca.gov; and/or Dan Fennewald, Director, Examination Policy Division, Office of Examination, at 952-259-0432, or by email at fennewaldd@fca.gov.