Wednesday, October 23, 2013

Fair Lending Compliance, Ability-to-Repay and Qualified Mortgages

On October 22, 2013, the Consumer Financial Protection Bureau (Bureau), Office of the Comptroller of the Currency (OCC), Board of Governors of the Federal Reserve System (Board), Federal Deposit Insurance Corporation (FDIC), and the National Credit Union Administration (NCUA) (collectively, the Agencies) issued a statement in response to inquiries from creditors about whether they would be liable under the disparate impact doctrine of the Equal Credit Opportunity Act (ECOA) [15 U.S.C. 1691 *et seq.*, and its implementing regulation, Regulation B, 12 C.F.R. Part 1002] by originating only Qualified Mortgages as defined under the Bureau's recent Ability-to-Repay and Qualified Mortgage Standards Rule (ATR Rule). The ATR Rule implements provisions of the Truth in Lending Act (TILA).[1]

The Agencies' general approach and expectations regarding fair lending, including the disparate impact doctrine, are summarized in prior issuances.[2]

The Agencies state that they are issuing this statement to describe some general principles that will guide supervisory and enforcement activities with respect to entities within their jurisdiction as the Ability-to-Repay Rule takes effect in January 2014. Per the Agencies, **the requirements of the Ability-to-Repay Rule and ECOA are compatible.** ECOA and Regulation B promote creditors acting on the basis of their legitimate business needs.[3]

Therefore, the Agencies do not anticipate that a creditor's decision to offer only Qualified Mortgages would, absent other factors, elevate a supervised institution's fair lending risk.

The Bureau's Ability-to-Repay Rule implements provisions of the Dodd-Frank Act that require creditors to make a reasonable, good faith determination that a consumer has the ability to repay a mortgage loan before extending the consumer credit.[4] TILA and the Ability-to-Repay Rule create a presumption of compliance with the ability-to-repay requirements for certain "Qualified Mortgages," which are subject to certain restrictions as to risky features, limitations on upfront points and fees, and specialized underwriting requirements.

Consistent with the statutory framework, there are several ways to satisfy the Ability-to-Repay Rule, including, according to the Agencies, making responsibly underwritten loans that are not Qualified Mortgages.

The Bureau does not believe that it is possible to define by rule every instance in which a mortgage is affordable for the borrower. Nonetheless, the Agencies are recognizing that some creditors might be inclined to originate all or predominantly Qualified Mortgages, particularly when the Ability-to-Repay Rule first takes effect. The Rule includes transition mechanisms that encourage preservation of access to credit during this transition period.

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Furthermore, according to the issuance, the Agencies expect that creditors, in selecting their business models and product offerings, would consider "demonstrable factors" that may include credit risk, secondary market opportunities, capital requirements, and liability risk. The Ability-to-Repay Rule does not dictate precisely how creditors should balance such factors, nor do either TILA or ECOA. Consequently, as creditors assess their business models, the Agencies are clearly stating they understand that implementation of the Ability-to-Repay Rule, other Dodd-Frank Act regulations, and other changes in economic and mortgage market conditions have real world impacts and that creditors may have a legitimate business need to fine tune their product offerings over the next few years in response.

Importantly, the Agencies seem to be recognizing that some creditors' existing business models are such that all of the loans they originate will already satisfy the requirements for Qualified Mortgages. An example given is where a creditor has decided to restrict its mortgage lending only to loans that are purchasable on the secondary market might find that - in the current market - are Qualified Mortgages under the transition provision. Thereby giving Qualified Mortgage status to most loans that are eligible for purchase, guarantee, or insurance by Fannie Mae, Freddie Mac, or certain federal agency programs.

With respect to any fair lending risk, the Agencies claim that situation here is not substantially different from what creditors have historically faced in developing product offerings or responding to regulatory or market changes. The decisions creditors will make about their product offerings in response to the Ability-to-Repay Rule are similar to the decisions that creditors have made in the past with regard to other significant regulatory changes affecting particular types of loans.

An example provided is where some creditors may have decided not to offer "higher-priced mortgage loans" after July 2008 (viz., following the adoption of various rules regulating these loans or previously decided not to offer loans subject to the Home Ownership and Equity Protection Act after regulations to implement that statute were first adopted in 1995). There were no ECOA or Regulation B challenges to those decisions.

Inevitably, creditors should continue to evaluate fair lending risk as they would for other types of product selections, including by carefully monitoring their policies and practices and implementing effective compliance management systems. As with any other compliance matter, individual cases will be evaluated on their own merits.

The OCC, the Board, the FDIC, and the NCUA believe that the same principles described above apply in supervising institutions for compliance with the Fair Housing Act (FHA), 42 U.S.C. § 3601 *et seq.*, and its implementing regulation, 24 C.F.R. Part 100.[5]

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[1] See http://www.consumerfinance.gov/regulations/ability-to-repay-and-qualified-mortgage-standards-under-the-truth-in-lending-act-regulation-z/. Disparate impact is one of the methods of proving lending discrimination under ECOA. See 12 C.F.R. pt. 1002 & Supp. I.
[2] For instance, in 1994, eight federal agencies published the Policy Statement on Discrimination in Lending, 59 Fed. Reg. 18,266 (Apr. 15, 1994), and last year the Bureau issued a bulletin on lending discrimination, CFPB Bulletin 2012-04 (Fair Lending) (Apr. 18, 2012). In addition, the OCC, Board, FDIC, NCUA, and Bureau each have fair lending examination procedures.
[3] Even where a facially neutral practice results in a disproportionately negative impact on a protected class, a creditor is not liable provided the practice meets a legitimate business need that cannot reasonably be achieved as well by means that are less disparate in their impact. See 12 C.F.R. §1002.6; 12 C.F.R. pt. 1002, Supp. I, § 1002.6, ¶ 6(a)-2.
[4] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 1411, 124 Stat. 1376, 2142 (2010) (codified at 15 U.S.C. § 1639c).
[5] The OCC, Board, FDIC, and the NCUA have supervisory authority as to the FHA.

Labels: Ability-to-Repay, ECOA, Fair Lending, Qualified Mortgage, Qualified Mortgage Standards Rule, Regulation B, TILA, Truth in Lending Act

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