

Affordable Mortgage Lending Opportunities: Exemptions Under the Ability-to-Repay Rule

The Dodd–Frank Wall Street Reform and Consumer Protection Act¹ (Dodd–Frank) included a number of provisions amending the Truth in Lending Act (TILA) that are designed to shield consumers from predatory mortgage features and practices. The ability-to-repay (ATR) requirement is one of those key consumer protections and applies to virtually all closed-end mortgages. The ATR requirement directs lenders to make a reasonable and good faith determination at or before the time of consummation that the customer will have a reasonable ability to repay the mortgage.²

Dodd-Frank also shifted rulemaking authority under TILA to the Consumer Financial Protection Bureau (CFPB), which issued regulations detailing the specific underwriting requirements to meet the ATR standard. The general requirement for verifying and documenting ability to repay is quite detailed and requires a creditor to consider eight underwriting criteria.³

¹ Public Law 111-203, 124 Stat. 1376 (2010).

² 12 CFR 1026.43(c).

³ 12 CFR 1026.43(c)(2). The eight ATR underwriting factors include: 1) current or reasonably expected income or assets; 2) employment status; 3) monthly mortgage payment for the loan; 4) monthly payment on simultaneous loans secured by the same property; 5) monthly mortgage-related debt obligations (such as tax and insurance payments); 6) debts, alimony, and child support obligations; 7) monthly debt-to-

Alternatively, a presumption of compliance with the general ATR requirement arises if a creditor originates loans that meet the standards for any type of qualified mortgage (QM) defined in the rule.⁴

If a lender does not comply with the ATR requirement, a consumer may bring an action seeking to recover damages within three years of the violation. The consumer may be able to seek recoupment or setoff in any subsequent foreclosure action, regardless of when the violation occurred, based on the creditor's alleged failure to comply with the ATR rule.

Exemptions Under the ATR Rule for Affordable Mortgage Lending

An often-voiced concern about the ATR and QM requirements has been that these provisions may restrict mortgage credit availability, particularly for low- or moderate-income (LMI) consumers. To address this concern, the CFPB issued regulations outlining exemptions from the ATR requirement for credit extensions by

income or residual income of all mortgage and non-mortgage obligations, as a ratio of gross monthly income; and 8) credit history.

⁴ 12 CFR 1026.43(e), (f).

certain types of community-focused creditors and under specified programs.⁵

Loans that fall within any of the following categories of creditors or programs are exempt from the ATR rule's underwriting requirements. A creditor, therefore, may originate ATR-exempt loans without meeting each of the eight underwriting factors under the general ATR requirement or all of the requirements for making a QM. Of course, at a high level, ATR and QM underwriting criteria are simply fundamental factors typically taken into account as part of safe and sound underwriting, so ATR-exempt creditors and programs will generally incorporate some of these considerations.

ATR-Exempt Creditors

The ATR requirement does not apply to specified types of community-focused lenders.⁶ An exemption from the ATR requirement applies to an extension of credit made by a

- creditor designated by the U.S. Department of the Treasury as a Community Development Financial Institution (CDFI).⁷
- creditor designated by the U.S. Department of Housing and Urban

⁵ 12 CFR 1026.43(a)(3)(iv–vi). *See also* [78 Fed. Reg. 35430, 35440](#) (June 12, 2013), wherein the CFPB noted that it “...was concerned that the ability-to-repay requirements were substantially different from the underwriting requirements employed by these [community-focused] creditors or required under these programs, which would discourage participation in and frustrate the purposes of these programs and significantly impair access to responsible, affordable credit for certain consumers.”

⁶ *See* [78 Fed. Reg. at 35464](#).

⁷ 12 CFR 1026.43(a)(3)(v)(A).

Development (HUD) as either a Downpayment Assistance through Secondary Financing Provider, or a Community Housing Development Organization (CHDO) that meets certain criteria.⁸

- nonprofit lender,⁹ if several conditions are met—the loan must be to an LMI consumer, and in the calendar year prior to when a consumer files an application, the nonprofit lender must have made no more than 200 loans and extended credit only to LMI consumers.¹⁰ Some types of consumer credit transactions are not counted towards the 200-loan limit.¹¹

⁸ 12 CFR 1026.43(a)(3)(v)(B) and (C). The CFPB decided to narrow application of the exemption only to a creditor that: 1) is designated as a CHDO for purposes of residential mortgage lending; 2) has entered into a commitment with a participating jurisdiction; and 3) is undertaking a project under the HOME Program, pursuant to the provisions of 24 CFR 92.300(a). The terms CHDO, commitment, participating jurisdiction, and project are defined under 24 CFR 92.2. *See also* 78 Fed. Reg. at 35464.

⁹ 12 CFR 1026.43(a)(3)(v)(D). This provision is restricted to a creditor with a tax exemption ruling or determination letter from the Internal Revenue Service under section 501(c)(3) of the Internal Revenue Code of 1986 (26 USC 501(c)(3); 26 CFR 1.501(c)(3)-1).

¹⁰ The applicable LMI limits are determined by HUD under section 102 of the Housing and Community Development Act of 1974.

¹¹ 12 CFR 1026.43(a)(3)(vii). Certain consumer credit transactions that meet all of the following six criteria are not considered in determining the 200-loan limit:

1. A transaction secured by a subordinate lien.
2. A transaction for the purpose of
 - down payment, closing costs, or other similar home buyer assistance, such as principal or interest subsidies;
 - property rehabilitation assistance;
 - energy efficiency assistance; or
 - foreclosure avoidance or prevention.
3. The credit contract provides that the repayment of credit is

The nonprofit lender must establish written procedures in order to determine that consumers have a reasonable ability to repay their loans.

ATR-Exempt Programs

In addition to exemptions for certain creditors, specific loan programs are exempt from the ATR requirement. This exemption applies to an extension of credit under a program

- administered by a housing finance agency,¹² whether the loans (including a
 - forgiven either incrementally or in whole, at a date certain, and subject only to specified ownership and occupancy conditions (e.g., maintain the property as consumer’s principal dwelling for five years);
 - deferred for a minimum of 20 years after consummation of the transaction;
 - deferred until sale of the property securing the transaction; or
 - deferred until the property securing the transaction is no longer the principal dwelling of the consumer.
- 4. No-interest credit contracts;
- 5. A transaction where the total costs payable by the consumer in connection with the transaction at consummation are less than 1 percent of the amount of credit extended and include no charges other than recordation fees and application fees and fees for housing counseling services that are bona fide and reasonable; and
- 6. A transaction where the creditor complies with all other applicable requirements of 12 CFR 1026 in connection with the transaction.

¹² 12 CFR 1026.43(a)(3)(iv). The exemption applies regardless of whether the program administered by a housing finance agency receives funding from federal, state, or other sources. *See* 78 Fed. Reg. at 35463 for further commentary. At 24 CFR 266.5, a housing finance agency is defined as “any public body, agency, or instrumentality created by a specific act of a State legislature or local municipality empowered to finance activities designed to provide housing and related facilities, through land acquisition, construction or rehabilitation. The term State includes the several States, Puerto Rico, the District of Columbia, Guam, the Trust Territory of

subordinate loan) are made directly to consumers or made by other creditors pursuant to a program administered by a housing finance agency;¹³ or

- authorized by sections 101 or 109 of the Emergency Economic Stabilization Act (EESA).¹⁴ For example, this provision would cover loans made under a state Hardest Hit Fund (HHF) program.¹⁵

Loan Types Eligible for ATR Exemption

The ATR exemptions allow community-based lenders and programs to continue to offer flexible underwriting for their affordable mortgage products such as grant programs that cover closing costs, soft second down payment assistance, or loans with higher debt-to-income ratios.

All of the exemptions from the ATR rule discussed above are available for first or second lien closed-end consumer credit transactions secured by a dwelling, including one-to-four unit residential properties, condominiums, and cooperatives.¹⁶ The ATR exemption applies regardless of the amount of the loan and whether the loan is secured by the principal residence of the consumer.¹⁷ ATR-exempt

the Pacific Islands, American Samoa and the Virgin Islands.”

¹³ 12 CFR 1026, supp. I, comment 43(a)(3)(iv)-1. *See* 78 Fed. Reg. at 35504, 35463.

¹⁴ 12 CFR 1026.43(a)(3)(vi). *See* Division A of Public Law No. 110–343, 122 Stat. 3765 (2008).

¹⁵ 12 CFR 1026.43(a)(3)(vi). 78 Fed. Reg. at 35431. Although some states have fully used their HHF allocation, HHF funds can be used until December 31, 2017.

¹⁶ 12 CFR 1026.43(a). The ATR rule does not apply to open-end credit plans, such as home equity lines of credit, time share plans, or reverse mortgages.

¹⁷ 78 Fed. Reg. at 35469.

loans, however, are subject to restrictions on prepayment penalties.¹⁸

Effect of ATR Exemptions

Loans originated by ATR-exempt creditors or under ATR-exempt programs, as described above, are not required to comply with the specified underwriting requirements of the ATR rule. Whenever one of these exemptions applies, a loan is not subject to the civil liability provisions of the ATR rule, and the consumer has no rights to bring an action seeking to recover damages or to pursue a claim for recoupment or setoff in any subsequent foreclosure action under the ATR rule.

The ATR exemption remains in place even if the loan is sold, assigned, or otherwise transferred to a creditor that does not qualify for the exemption.¹⁹ ATR-exempt lenders and loans originated under a program that is ATR-exempt are free from any loan transfer restrictions that the rule imposes on certain types of qualified mortgages. Thus, originators of such loans can choose to either hold loans in portfolio or sell the loans. Purchasers of loans originated by exempt lenders or pursuant to exempt programs do not need to qualify for the exemption.

¹⁸ ATR-exempt loans, as described above and defined by 12 CFR 1026.43(a)(3), are only exempt from the requirements of 12 CFR 1026.43(c)-(f). The restrictions on prepayment penalties are in 12 CFR 1026.43(g).

¹⁹ “[Ability-to-Repay and Qualified Mortgage Rule: Small Entity Compliance Guide](#),” CFPB, page 31.

Credit Risk Retention

The Credit Risk Retention rule²⁰ implements a provision in Dodd-Frank that requires a securitizer to retain not less than 5 percent of the credit risk of any asset that the securitizer, through the issuance of an asset-backed security (ABS), transfers, sells, or conveys to a third party.²¹ Loans that meet qualified residential mortgage (QRM) requirements, however, are exempt from these risk-retention requirements.²²

Affordable mortgage programs with expansive underwriting or loan terms may not meet the explicit ATR and QRM requirements. Recognizing that this could prevent ATR-exempt creditors or programs from taking advantage of the QRM exemption from credit risk retention, the Credit Risk Retention regulation included an exemption from the risk-retention requirement for community-focused residential mortgage loans, which includes all categories of ATR-exempt loans *except* for such loan programs as a state-administered HHF program or Making Home Affordable program authorized by sections 101 and 109 of EESA.²³ Also, the community-focused residential mortgage exemption will be periodically evaluated over time and as the market evolves.²⁴

The rationale for exempting community-focused residential loans originated by

²⁰ [79 Fed. Reg. 77602](#) (December 24, 2014).

²¹ See section 941(b) of Dodd-Frank, which amends the Securities Exchange Act of 1934 and adds a new section 15G 15 USC 78o-11.

²² 15 USC 78o-11(c)(1)(C)(iii).

²³ 12 CFR 43.19(a). See also [79 Fed. Reg. at 77693-77697](#).

²⁴ 79 Fed. Reg. at 77696-77697.

ATR-exempt lenders and housing finance agency ATR-exempt loans is that providing affordable housing is integral to their mission and, therefore, these entities have an incentive to maintain high underwriting standards and ensure that borrowers are given appropriate and affordable loans.²⁵

There is no risk retention required for any securitization transaction collateralized solely by community-focused residential mortgages and servicing assets. For securitization transactions when both community-focused residential mortgages and other residential mortgages are commingled, the percentage of risk retention required is reduced by the ratio of the unpaid principal balance of the community-focused mortgages to the total unpaid principal balance of residential mortgages that are collateralizing the ABS. If the community-focused residential mortgage asset ratio exceeds 50 percent, the community-focused residential mortgage asset ratio will be deemed to be 50 percent.²⁶

Community Reinvestment Act

The Community Reinvestment Act (CRA) regulation provides the basis for assessing a bank's record of helping to meet the credit needs of its entire community, including LMI neighborhoods, consistent with the safe and sound operation of the bank.

CRA consideration of retail lending and community development activities would not be impaired or precluded by the fact that the activity does or does not involve an ATR exemption. The ATR exemption itself is not a factor in determining whether an activity qualifies for CRA consideration.

²⁵ *Ibid.*, at 77694.

²⁶ 12 CFR 43.19(f)(2).

For banks interested in partnering with ATR-exempt creditors or participating in programs that are ATR-exempt, there are various activities that are eligible for CRA consideration.

Banks that originate ATR-exempt mortgage loans pursuant to a partnership with a state or local housing finance agency or a state HHF program may receive CRA consideration under the retail lending test.²⁷ A bank that purchases an ATR-exempt loan from a qualifying community-focused lender would also receive CRA consideration under the retail lending test.²⁸ Investment test consideration is available when a bank purchases a mortgage-backed security backed by loans to LMI individuals. Note, however, that retail or investment test consideration would be the same whether a loan is ATR-exempt or ATR-compliant.

Certain CRA-eligible activities can help to bolster a community-focused lending institution's capital and promote affordable mortgage lending. Bank deposits in, grants to, or shares in financial intermediaries—such as CDFIs and community loan funds that primarily lend or facilitate lending in LMI areas or to LMI individuals in order to promote community development—can be considered as qualified investments.²⁹ For example, a grant to a CDFI that will use the funds to make ATR-exempt loans to LMI individuals could be considered under CRA as a qualified investment.

Alternatively, if a bank purchases stock or makes an equity-type investment in an

²⁷ 12 CFR 25.22 and 195.22.

²⁸ *Ibid.*

²⁹ “Community Reinvestment Act: Interagency Questions and Answers Regarding Community Reinvestment” (2010 Q&As), 75 Fed. Reg. 11642, 69678, March 11, 2010, Q&A § __.12(t) – 4.

entity, such as a CDFI, that primarily lends in LMI areas or to LMI individuals, the bank may claim a pro rata share of the partnership's loans as community development loans. The bank's pro rata share is based on its percentage of equity ownership in the partnership.³⁰

Community development loans and qualified investments made under the CRA must benefit the bank's assessment area(s) or the bank's broader statewide or regional area that includes its assessment area(s).

A bank may also provide community development services to a community-focused lender offering an ATR-exempt loan program by, for example, serving on a loan review committee, developing loan application and underwriting standards or secondary market vehicles or programs, or assisting in marketing financial services.³¹

Many community-based loan programs include a counseling component to prepare a potential borrower to handle the responsibilities of homeownership. Community development services include providing credit counseling, home buyer and home-maintenance counseling, financial planning or other financial services education to promote community

³⁰ 2010 Q&As, Q&A § __.22(d) – 1. See also Q&A § __.23(b) – 1 that provides information concerning consideration of an equity or equity-type investment under the investment test and both the lending and investment tests. (Note that in connection with an intermediate small institution's CRA performance evaluation, community development loans, including pro-rata shares of community development loans, are considered in the community development test applicable to intermediate small banks.)

³¹ "Community Reinvestment Act: Interagency Questions and Answers Regarding Community Reinvestment" (2013 Q&As), 78 Fed. Reg. 69671, 69678, November 20, 2013, Q&A § __.12(i) – 3.

development, and affordable housing.³² CRA consideration is also available for grants or loans to enable not-for-profit organizations to offer counseling for homeownership and home maintenance.³³

Summary

The ATR exemptions provided by the CFPB acknowledge the special role of community-focused lenders and programs and, in many cases, the substantial experience these lenders and programs have in providing responsible, affordable loan products to LMI consumers. By finding ways to partner with ATR-exempt lenders and programs, banks can enhance the availability of affordable mortgage lending.

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³² *Ibid.*

³³ 2010 Q&As, § __.12(t) – 4.