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What the new Ability-to-Repay rule means for consumers

Consumer Financial Protection Bureau

Background

When you apply for a mortgage, you may struggle to understand how big a monthly payment you can afford. You may assume that lenders and mortgage brokers will not make you a loan that you cannot afford. But, in the years leading up to the financial crisis, lenders too often made mortgages to consumers who could not pay them back. As a result, many consumers ended up in delinquency and foreclosure.

The Dodd-Frank Wall Street Reform and Consumer Protection Act requires lenders to take more into consideration when making mortgage loans. The Bureau's Ability-to-Repay rule does that. It requires lenders, before making a mortgage loan, to look at a consumer's financial information and be sure that the consumer can afford to repay the loan.

This rule applies to most mortgage loans. However, it excludes certain types of loans, like home equity lines of credit, timeshare plans, reverse mortgages, and temporary loans.

This rule also creates a category of loans that have certain, more stable features. This category of loans is called Qualified Mortgages (QM). Lenders that make QMs are presumed to have met the Ability-to-Repay requirements.

The Ability-to-Repay/QM rule will help make sure that you get a mortgage loan you can afford. The rule will also help make sure that responsible lenders aren't forced to compete with reckless lenders engaged in risky practices.

Ability to repay

Under the Ability-to-Repay rule, before you get a mortgage loan, the lender will have to determine you will have the ability to repay the loan.

The lender must collect and verify your financial information.

When you apply for a mortgage loan, you will have to give the lender certain financial information. The lender will have to check the information using reliable documents, such as a W-2 or pay stub. The lender generally must consider eight types of information:

1. Your current income or assets.
2. Your current employment status.

3. Your credit history.
4. The monthly payment for the mortgage.
5. Your monthly payments on other mortgage loans you get at the same time.
6. Your monthly payments for other mortgage-related expenses (such as property taxes)
7. Your other debts.
8. Your monthly debt payments, including the mortgage, compared to your monthly income ("debt-to-income ratio") or how much money you have left over each month after paying your debts ("residual income").

You must have enough assets or income to pay back the mortgage.

The lender must determine that you can repay the loan. The lender may look at your current income and assets (except the value of the mortgaged property itself). The lender must also look at your debt-to-income ratio or the amount of money you'll have left over each month to pay for things like food and heat.

A lender can't determine your ability to repay using "teaser" rates.

The lender can't use temporary low payment rates to determine whether you are able to repay the mortgage. For example, if the loan is an adjustable-rate mortgage, the lender will generally have to consider the highest interest rate that you may have to pay.

The rule includes exceptions for refinancing a consumer out of a risky loan.

In defined circumstances, the Ability-to-Repay rule may not apply to a creditor refinancing a borrower from a riskier mortgage to a more stable mortgage. An example of a risky loan could be an interest-only loan. An example of a more stable mortgage could be a fixed-rate mortgage.

Qualified mortgages

The rule presumes a lender has met the Ability-to-Repay requirements if the lender makes a Qualified Mortgage, or QM. A QM must meet certain requirements. For example, the loan cannot have certain risky features that harmed consumers during the mortgage crisis. Temporarily, QMs can also be loans that can be bought or guaranteed by Fannie Mae or Freddie Mac or insured by certain government agencies, such as the Federal Housing Administration.

Here are the features of Qualified Mortgages:

No risky loan features

QMs cannot have the following loan features:

- An “interest-only” period, when a consumer pays only the interest without paying down the principal.
- “Negative amortization,” when the loan principal increases over time, even though the borrower is making payments.
- Loan terms that are longer than 30 years.
- “Balloon payments,” which are larger-than-usual payments at the end of the loan term.

However, loans with balloon payments are allowed by small creditors in certain circumstances.

Cap on how much income can go towards debt

QMs will generally require that the borrower’s monthly debt, including the mortgage, isn’t more than 43 percent of the borrower’s monthly pre-tax income. (This limit does not apply to the temporarily authorized QMs, eligible for Fannie Mae, Freddie Mac, or certain government agencies, described above. It also does not apply to QMs made by certain small lenders that hold on to the loans.)

No excess upfront points and fees

QMs have limits on the amount of upfront points and fees that the consumer can be charged. The limits will depend upon the size of the loan. Many third-party charges, such as the cost of a credit report, are not included in the limit. QMs also have limits on discount points, which a consumer pays in return for a reduced interest rate.

Certain legal protections for lenders

Lenders that make QMs get certain legal protections even if the loans default. For QMs that are not "higher-priced," lenders get a "safe harbor." This means that the lender complies with the Ability-to-Repay rule if the loan meets the QM definition. Consumers can still legally challenge their lender under this rule if they believe that the loan does not meet the definition of a QM. For QMs that are "higher-priced," with higher than average interest rates, the rule works differently. For those loans, lenders get a "rebuttable presumption" that they met the Ability-to-Repay rule. However, consumers can challenge that presumption by proving that they, in fact, did not have enough income to pay the mortgage and their other living expenses. The Ability-to-Repay rule does not affect the rights of a consumer to challenge a lender for violating any other federal consumer protection laws.

When a Qualified Mortgage can have a balloon payment

While a loan with a balloon payment generally cannot be a Qualified Mortgage, a small lender can make a loan with a balloon payment that is a Qualified Mortgage in certain circumstances.

What to do if your lender doesn't follow the rules

If you think your lender is not following the Ability-to-Replay/Qualified Mortgage rule, the Consumer Financial Protection Bureau wants to know. You can get in touch with us these ways:

Online: www.consumerfinance.gov/complaint
By telephone (in 187 languages)**:**

(855) 411-CFPB (2372)

Español (855) 411-CFPB (2372)

TTY/TDD (855) 729-CFPB

(2372)

8 a.m. to 8 p.m. Eastern, Monday–Friday:

By mail: Consumer Financial Protection Bureau

P.O. Box 4503

Iowa City, Iowa 52244
By fax: (855) 237-2392

The Ability-to-Repay/Qualified Mortgage rule is one of many rules that protect you when you get a mortgage.

You can find more information about these home mortgage rules at http://consumerfinance.gov/regulations.

You can see answers to frequently asked questions about home mortgages at http://consumerfinance.gov/askcfpb/.