POLICY STATEMENT

Ability-to-Repay Rules - Regulation Z

(12 CFR 1026.43)

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Qualified Mortgage Requirements - Regulation Z

(12 CFR 1026.43)

Management Approval: ______________________________

Title: _________________________________

Signature: _________________________

Date: _________________________

Ability-to-Repay and Qualified Mortgage Rules – Policy Statement. Update 10/22/14

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Introduction – Ability-to-Repay

In January of 2013, the Consumer Financial Protection Bureau ("CFPB") issued its 800 page Ability-to-Repay and Qualified Mortgage final rule amending Regulation Z. The regulation then in effect prohibited a creditor from making a higher-priced mortgage loan without considering the borrower's ability to repay the loan. As required by the Dodd-Frank Act, the final rule expands the ability-to-repay requirements to include most closed-end mortgage loans, with a few exceptions as indicated below.

In late May 2013, the CFPB issued a second final rule totaling nearly 300 pages that amends certain limited areas of the Ability-to-Repay and QM rule issued in January. This second rule exempts certain nonprofit creditors, facilitates lending by certain small creditors including community banks and credit unions, and establishes exceptions for the calculation of loan origination compensation.

In July 2013, the CFPB issued a 160 page final rule amending the ATR/QM rule. Although, these amendments did not affect the Ability-to-Repay requirements of the previous ATR/QM rules, the July amendments provided clarifications regarding QM status for certain loans that are eligible for purchase, guarantee, or insurance by the GSEs or federal agencies such as the U.S. Department of Housing and Urban Development.

In September 2013, the CFPB issued additional amendments to the ATR/QM rule clarifying QM status for certain loans that are eligible for guarantee by the U.S. Department of Veterans Affairs.

The foregoing ATR/QM rules, amendments, and clarifications shall be herein referred to as the "Rule."

Effective Date

This Rule became effective on January 10, 2014.

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Types of mortgage loans covered by these provisions

The Rule applies to all consumer-purpose, closed-end loans secured by a dwelling, including home- purchase loans, refinances and home equity loans---whether first-lien or subordinate-lien loans.

Dwelling means a residential structure that contains one to four units, whether or not the structure is attached to real property. Regulation Z Section 1026.2(a)(19) defines "dwelling" to include an individual condominium unit, cooperative unit, mobile home, and trailer, if it is used as a residence. A dwelling need not be the consumer's principal residence to fit the definition, so a vacation or second home could be a dwelling.

Mobile homes, boats, and trailers are dwellings if they are in fact used as residences, just as are condominium and cooperative units. Recreational vehicles, campers, and the like not used as residences are not dwellings.

For purposes of the Rule, the term "dwelling" includes any real property to which the residential structure is attached that also secures the loan.

This all-inclusive definition of dwelling means that credit unions should have procedures in place for items such as boats, trailers, and recreational vehicles to determine at the time of application whether the borrower intends to utilize that item as a residence. If the item will be used as a residence, the loan will be considered a mortgage loan subject to the Ability-to-Repay requirements.

The Rule does not cover:

- Home equity Lines of Credit (HELOCs) or other open-end credit;
- Temporary or "bridge" loans with a term of 12 months or less, such as loans to finance

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the purchase of a new dwelling when the borrower intends to sell his current dwelling within 12 months, or a loan to finance the initial construction of a dwelling;

- The construction phase of 12 months or less of a construction-to-permanent loan;
- Reverse Mortgages;
- Mortgages secured by an interest in a timeshare plan;
- Business purpose loans secured by a dwelling; or
- A loan modification (except one that is considered a refinancing).

A "Covered Transaction" is defined as a consumer loan secured by a dwelling, including any real property attached to a dwelling other than the exceptions mentioned above.

The Rule requires creditors to make a reasonable and good faith determination at or before consummation of the loan that the consumer will have a reasonable ability to repay the loan based on its terms. That requirement may be satisfied by any of the following four ways:

- By following the Rule's general ability to repay standards;
- By making a Qualified Mortgage;
- By refinancing a non-standard mortgage into a standard mortgage; and
- For small creditors that serve primarily rural or underserved areas, by making a qualifying mortgage in a rural or underserved area.

Ability-to-Repay Determination

The Rule describes minimum requirements for creditors making ability-to-repay determinations,

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but does not dictate that they follow particular underwriting methods. At a minimum, creditors generally must consider the following eight underwriting factors:

1. The borrower's current or reasonably expected income or assets, other than the value of the dwelling that secures the loan;

2. The borrower's current employment status (a creditor may verify the employment status orally if the creditor prepares a record of the information obtained);

3. The new monthly mortgage payment;

4. The monthly payment on any simultaneous mortgage;

5. The borrower's monthly payment for mortgage-related obligations;

6. The borrower's current debt obligations (if a creditor reviews a borrower's credit report to verify current debt obligations and the application states a debt not shown on the credit report, the creditor is not required to independently verify that debt);

7. The borrower's monthly debt-to-income ratio, or residual income; and

8. The borrower's credit history.

Consideration of Repayment Ability

Income or assets generally: The creditor may consider any type of current or reasonably expected income,
including salary, wages, self-employment income, military or reserve duty income, bonus pay, tips, commissions, interest payments, dividends, retirement benefits or entitlements, rental income, royalty payments, trust income, public assistance payments, and alimony, child support, and separate maintenance payments.

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The creditor may consider any of the borrower's assets, other than the value of the dwelling securing the loan, including; funds in a savings or checking account, amounts vested in a retirement account, stocks, bonds, certificates of deposit, and amounts available to the borrower from a trust fund.

Income or assets relied on: A creditor only needs to consider the income or assets necessary to support a determination that the consumer can repay the covered transaction. For example, if a borrower's loan application states that the borrower earns an annual salary from both a full-time job and a part-time job and the creditor determines that the borrower's income from the full-time job is sufficient to repay the loan, the creditor is not required to consider or verify the borrower's income from the part-time job.

Seasonal or irregular income: A creditor may determine that a borrower can make periodic loan payments even if the borrower's income is seasonal or irregular. If the creditor determines that the borrower's annual income divided equally across 12 months is sufficient for the borrower to make monthly loan payments, the creditor may determine that the borrower can repay the loan, even though the borrower may not receive income during certain months.

Employment status and income: Employment status need not be full-time, and employment need not occur at regular intervals. Employment may be full-time, part-time, seasonal, irregular, military, or self- employment, so long as the creditor considers those characteristics of the employment. A creditor must verify a borrower's current employment status only if the creditor relies on the borrower's employment income in determining the borrower's repayment ability.

Mortgage-related obligations: These include expected property taxes and insurance premiums or similar charges that are required by the creditor.

Consideration of current debt obligations: Examples of current debt obligations include

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student loans, automobile loans, revolving debt, and existing mortgages that will not be paid off at or before consummation. However, a creditor may take into account that an existing mortgage or any other debt is likely to be paid off soon after consummation. For example, an existing mortgage is likely to be paid off soon after consummation because there is an existing contract for sale of the property that secures that mortgage.

Consideration of credit history: “Credit history” may include factors such as the number and age of credit lines, payment history, and any judgments, collections, or bankruptcies. A creditor is not required to obtain or consider a consolidated credit score or prescribe a minimum credit score that must be applied. The Rule does not specify which aspects of credit history a creditor must consider or how various aspects of credit history should be weighed against each other or against other underwriting factors. A creditor may give various aspects of a borrower’s credit history as much or as little weight as is appropriate to reach a good faith determination of the ability to repay. Where a borrower has obtained few or no extensions of traditional “credit”, a creditor may look to nontraditional credit references, such as rental payment history or utility payments.

Commentary at 43(c)(3): Verification using third-party records.

The September 2013 amendments generally do not require creditors to obtain additional records to verify the existence or amount of obligations shown on a borrower’s credit report or listed on the borrower’s application. If a creditor relies on a borrower’s credit report to verify the borrower’s current debt obligations and the borrower’s application lists a debt obligation not shown on the credit report, the creditor may consider the existence and amount of the obligation as it is stated on the consumer’s application. The creditor is generally not required to further verify the existence or amount of the obligation.

Multiple applicants: When two or more borrowers apply for an extension of credit as joint obligors with primary liability on a loan, a creditor must consider the credit history of all joint applicants. A creditor is not required to consider the credit history of a surety or guarantor.

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Verification

Verification using third-party records: A creditor must verify the information that it relies on in determining a consumer's repayment ability using reasonably reliable third-party records, except as stated below for the verification of income or assets.

Verification of Income or Assets: A creditor may verify the borrower's income using a tax-return transcript issued by the Internal Revenue Service ("IRS"). Examples of other records the creditor may use to verify the borrower's income or assets include:

- Copies of tax returns the borrower filed with the IRS or a state taxing authority;
- IRS Form W-2s or similar IRS forms used for reporting wages or tax withholding;
- Payroll statements, including military Leave and Earnings Statements;
- Financial institution records;
- Records from the borrower's employer or a third party that obtained information from the employer; records from a Federal, State, or local government agency stating the borrower's income from benefits or entitlements;
- Receipts from the borrower's use of check cashing services, and
- Receipts from the borrower's use of a funds transfer service.

Records specific to the individual: A creditor must verify records that are specific to the individual. Records regarding average incomes in the consumer's geographic location or average wages paid by the borrower's employer are not specific to the individual borrower and are not sufficient for verification.

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Obtaining records: A creditor may obtain records from a third-party service provider or directly from the borrower as long as the records are reasonably reliable and specific to the individual borrower.

Credit Report as a reasonably reliable third-party record: A credit report is generally considered a reasonably reliable third-party record for purposes of verifying items such as the borrower's current debt obligations, monthly debts, and credit history.

Verification of simultaneous loans: While a credit report may be used to verify current obligations, it will not reflect a simultaneous loan that has not yet been consummated and may not reflect a loan that has just recently been consummated. The creditor may verify the simultaneous loan by obtaining third-party verification from the third-party creditor of the simultaneous loan by obtaining a copy of the promissory note or other written verification from the third-party creditor.

Verification of mortgage-related obligations: With respect to the verification of property taxes, a record is reasonably reliable if the information was provided by a governmental organization, such as a taxing authority or local government, or referenced in the title report if the source of the property tax information was a local taxing authority.

Verification of current debt obligations: If a creditor relies on a borrower's credit report to verify current debt obligations and the borrower's application lists a debt not shown on the credit report, the creditor may consider the existence and amount of the debt as stated on the borrower's application.

Verification of credit history: To verify credit history, a creditor may look to credit reports from credit bureaus or to reasonably reliable third-party records such as evidence of rental payments or public utility payments.

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Verification of military employment: A creditor may verify the employment status of military personnel by using a military Leave and Earnings Statement or by using the electronic database maintained by the Department of Defense.

Payment Calculation

A creditor must calculate the borrower's monthly payment on the mortgage loan (covered transaction) using:

- The fully indexed rate or any introductory interest rate, whichever is greater, and
- Substantially equal fully amortizing monthly payments

A creditor must consider the following special rules for calculation of the borrower's monthly payment for loans with a balloon payment, interest-only loans, and negative amortization loans:

- For a loan with a balloon payment that is not considered a higher-priced mortgage loan, a creditor must use the maximum payment scheduled during the first five years after the date on which the first regular periodic payment is due.
- For a loan with a balloon payment that is considered a higher-priced mortgage loan, a creditor must use the maximum payment in the payment schedule, including any balloon payment.
- For an interest-only loan, a creditor must use the fully indexed rate or any introductory interest rate, whichever is greater, and substantially equal, monthly payments of principal and interest that will repay the loan amount over the loan term that remains as of the date the loan is recast.
- For a negative amortization loan, a creditor must use the fully indexed rate or any

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introductory interest rate, whichever is greater, and substantially equal, monthly payments of principal and interest that will repay the maximum loan amount over the loan term that remains as of the date the loan is recast.

Financing of Non-Standard Mortgages

A non-standard mortgage loan is defined as a covered transaction that is:

- An adjustable-rate mortgage with an introductory fixed interest rate for a period of one year or longer;
- An interest-only loan; or
- A negative amortization loan.

Financing of Standard Mortgages

A standard mortgage loan is defined as a covered transaction:

- That provides for regular periodic payments that do not: Cause the principal balance to increase;
- Allow the consumer to defer repayment of principal; or Result in a balloon payment;
- For which the total points and fees payable in connection with the loan do not exceed the limits permitted for Qualified Mortgages (generally limited to three percent for loan amounts greater than or equal to $100,000);
- For which the term does not exceed 40 years;
- For which the interest rate is fixed for at least five years after consummation; and
- For which the proceeds of the loan are used solely for the following purposes:

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- To pay off the outstanding principal balance on the non-standard mortgage loan; and
- To pay closing costs or settlement charges required to be disclosed under RESPA.

Refinancing

A non-standard mortgage loan may be refinanced into a standard mortgage loan when the following conditions are met:

- The creditor for the standard mortgage loan is the current holder of the existing non-standard mortgage loan or the servicer acting on behalf of the current holder;
- The monthly payment for the standard mortgage loan is materially lower than the monthly payment for the non-standard mortgage loan;
- The creditor receives the borrower's written application for the standard mortgage loan no later than two months after the non-standard mortgage loan has recast;
- The borrower has made no more than one payment more than 30 days late on the non-standard mortgage loan during the 12 months immediately preceding receipt of the borrower's written application;
- The borrower has made no payments more than 30 days late during the six months immediately preceding the creditor's receipt of the written application; and
- If the non-standard mortgage loan was consummated on or after January 10, 2014, the non- standard mortgage was made according to the Ability-to-Repay requirements or

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the Qualified Mortgage requirements.

Exemption from the Ability-to-Repay Requirements

A creditor is not required to comply with the Ability-to-Repay requirements if:

- All of the above conditions are met (under the heading "Refinancing") for the refinancing of a non- standard mortgage loan into a standard mortgage loan; and

- The creditor has considered whether the change to a standard mortgage loan likely will prevent a default by the borrower on the non-standard mortgage loan once the loan is recast.

Offer of Rate Discounts and Other Favorable Terms

When refinancing a non-standard mortgage, a creditor may offer to the borrower rate discounts and terms that are the same as, or better than, the rate discounts and terms offered by the creditor to new borrowers as long as such discounts are not prohibited by State or Federal law.

Payment Calculations

When determining whether the borrower's monthly payment for a standard mortgage will be materially lower than the monthly payment for the non-standard mortgage, the following guidelines must be used:

- **Non-standard mortgage loan:** For comparing monthly payments, the creditor must calculate the monthly payment for a non-standard mortgage loan based on substantially equal, monthly, fully amortizing payments of principal and interest using:

    The fully indexed rate within a reasonable time period before or after the date the creditor receives the borrower's written application for the standard

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mortgage loan;

The term of the loan remaining on the date the recast occurs, assuming all scheduled payments have been made up to the recast date and the payment due on the recast date is made and credited on that date; and

A remaining loan amount:

* For an ARM, that is the outstanding principal balance on the date of the recast, assuming all payments have been made up to the recast date and the payment due on the recast date is made and credited on that date;

* For an interest-only loan, that is the outstanding principal balance on the date of the recast, assuming all payments have been made up to the recast date and the payment due on the recast date is made and credited on that date; or

* For a negative amortization loan, that is the maximum loan amount, determined after adjusting for the outstanding principal balance.

- **Standard mortgage loan:** For comparing monthly payments, the creditor must calculate the monthly payment for a standard mortgage loan based on substantially equal, monthly, fully amortizing payments based on the maximum interest rate that could apply during the first five years after consummation.

Record Retention

A creditor must retain evidence of compliance with Section 1026.43 for three years after consummation. Although a creditor is not required to retain actual paper copies of the

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documentation used in underwriting a loan, the creditor must be able to reproduce such records accurately. For example, if a creditor uses a consumer's IRS Form W-2 to verify the borrower's income, the creditor must be able to reproduce the IRS Form W-2 itself, and not merely the income information that was contained on the form.

CFPB Examination Procedures

The CFPB supervises depository institutions and credit unions with total assets of more than $10 billion, and their affiliates. The CFPB also has authority to supervise certain nonbanks, such as payday lenders, private education lenders, and mortgage companies including originators, brokers, and servicers. While the CFPB doesn't directly supervise financial institutions with assets below $10 billion, the regulations still apply to those institutions and it is likely that the prudential regulators and various state examiners will follow these same or very similar examination procedures.

Minimum standards for transactions secured by a dwelling – Section 1026.43

a. Determine whether the financial institution is a creditor that originates covered transactions. Covered transactions are transactions secured by a dwelling, including any real property attached to a dwelling. They do not do not include: home equity lines of credit; timeshare loans (except for the prepayment penalty provisions in section 1026.43(g)); reverse mortgages; temporary, "bridge," or construction loans of 12 months or less; renewable or non-renewable construction loans of 12 months or less that are a part of a construction- to-permanent transaction; or an extension of credit under a program administered by a Housing Finance Agency (defined in 24 CFR 266.5), by community development or non-profit lenders specified in section 1026.43(a)(3)(v), or in connection with certain federal emergency economic stabilization programs). (§1026.43(a))

b. Determine if a loan is a streamline refinance under section 1026.20(a) and Commentary 1026.20(a) and whether it qualifies under section 1026.43(d), below.

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Refinancing Non-Standard Mortgages – Section 1026.43(d)

a. Determine whether the creditor has refinanced a non-standard mortgage defined in 1026.43(d)(i) (an ARM with an introductory rate fixed for a year or more, an interest-only loan, or a negative amortization loan) into a standard mortgage as defined in 1026.43(d)(ii) and considered whether the standard mortgage likely will prevent a default by the consumer once the loan is recast. In addition, determine that the following conditions are met (§1026.43(d)(3)):

1. At the time of the refinance, the creditor for the standard mortgage is the current holder of the existing non- standard mortgage or the servicer acting on behalf of the current holder (§1026.43(d)(2)(i));

2. The monthly payment for the standard mortgage is materially lower (a payment reduction of 10 percent or more is sufficient) than the monthly payment for the non-standard mortgage using the payment calculation rules in section 1026.43(d)(5) (§1026.43(d)(2)(ii));

3. The creditor received the consumer's written application for the standard mortgage no later than two months after the non-standard mortgage had recast (§1026.43(d)(2)(iii));

4. The consumer had made no more than one payment more than 30 days late on the non-standard mortgage during the 12 months immediately before the creditor receives the consumer's written application for the standard mortgage (§1026.43(d)(2)(iv));

5. The consumer made no payments more than 30 days late during the six months immediately before the creditor received the consumer's written application for the standard mortgage (§1026.43(d)(2)(v)); and

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6. If the non-standard mortgage was consummated on or after January 10, 2014, the non-standard mortgage was made in accordance with the ability to repay or the qualified mortgage requirements (§1026.43(c) or (e)). (Also: §1026.43(d)(vi))

Ability to Repay – Section 1026.43(c)

For all covered transactions, except streamline refinances, creditors must make a good faith determination that the consumer will have a reasonable ability to repay the loan, and must verify the information upon which it relied. A creditor can meet this obligation by complying with the ability-to- repay requirement in section 1026.43(c) or by making qualified mortgages under section 1026.43(e) and (f) (which limit certain risky loan features and practices), which are presumed to satisfy the ability-to- repay requirements.

a. Determine whether the creditor makes a reasonable and good faith determination at or before consummation that the consumer will have a reasonable ability to repay the loan according to its terms, based (except as otherwise provided for loans under section 1026.43 (d), (e), and (f) for refinancing non- standard to standard mortgages, qualified mortgages, and certain balloon qualified mortgages respectively), at a minimum, on the criteria set forth below. (§1026.43(c)(1))

b. Determine whether the creditor considered the following, at a minimum, in determining the consumer's ability to repay: (§1026.43(c)(2)):

1. The consumer's current or reasonably expected income or assets (other than the value of the dwelling, including any real property attached to the dwelling, that secures the loan); (§1026.43(c)(2)(i))

2. If the creditor relies on employment income, the consumer's current employment status; (§1026.43(c)(2)(ii))

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3. The consumer’s monthly payment on the covered transaction, calculated in accordance with section 1026.43(c)(5); (§1026.43(c)(2)(iii)) (see g. below)

4. The consumer’s monthly payment on any simultaneous loan that the creditor knows or has reason to know will be made, calculated in accordance with section 1026.43(c)(6); (§1026.43(c)(2)(iv))

5. The consumer’s monthly payment for mortgage-related obligations; (§1026.43(c)(2)(v))

6. The consumer’s current debt obligations, alimony, and child support; (§1026.43(c)(2)(vi))

7. The consumer’s monthly debt-to-income ratio or residual income in accordance with section 1026.43(c)(7) and section 1026.43(c)(2)(vii) and (viii)); and

8. The consumer’s credit history (§1026.43(c)(2)(viii)).

c. Determine whether the creditor verified the information it relied upon when considering the eight factors listed above using reasonably reliable third-party records, except that special rules apply for verification of income or assets, employment, and current debt obligations that are not shown on the consumer’s credit report.

Income and Assets, Employment and Debt Obligations

d. For purposes of calculating “c” above, determine that the creditor verified the information that it relied on using reliable third-party records except that:

1. A creditor may verify a consumer’s employment status orally if the creditor prepares a written record of the information obtained orally; and (§1026.43(c)(3)(ii))

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2. A creditor that relies on a credit report to verify a consumer's current obligations need not independently verify obligations that the consumer lists on the application that are not in the consumer's credit report. (§1026.43(c)(3)(iii))

e. For the purposes of calculating "c" above, determine whether the creditor verified the income or assets it relied upon, by using third-party records that provide reasonably reliable evidence, (§1026.43(c)(4)) such as:

1. A tax-return transcript issued by the Internal Revenue Service (IRS); (§1026.43(c)(4))

2. Copies of tax returns the consumer filed with the IRS or a state taxing authority; (§1026.43(c)(4)(i))

3. IRS Form W-2s or similar IRS forms used for reporting wages or tax withholding; (§1026.43(c)(4)(ii))

4. Payroll statements, including military Leave and Earnings Statements; (§1026.43(c)(4)(iii))

5. Financial institution records; (§1026.43(c)(4)(iv))

6. Records from the consumer's employer or a third party that obtained information from the employer; (§1026.43(c)(4)(v))

7. Records from a federal, state, or local government agency stating the consumer's income from benefits or entitlements; (§1026.43(c)(4)(vi))

8. Receipts from the consumer's use of check cashing services; and (§1026.43(c)(4)(vii))

9. Receipts from the consumer's use of a funds transfer service. (§1026.43(c)(4)(viii))

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f. For employment status, if the creditor orally verified employment status, determine whether the creditor prepared a written record of the information obtained orally. (§1026.43(c)(3)(ii))

Monthly payment calculation

g. For purposes of calculating "b.3" above, determine whether the creditor calculated the monthly payment (except for balloon payment, interest-only and negative amortization loans) by using:

1. The fully indexed rate or any introductory interest rate, whichever is greater; and monthly, fully amortizing payments that are substantially equal. (§1026.43(c)(5))

2. For a loan with a balloon payment:

    i. The maximum payment scheduled during the first five years after the date on which the first regular periodic payment will be due for a loan that is not a higher-priced covered transaction as defined under section 1026.43(b)(4); (§1026.43(c)(5)(ii)(A)(1)) or

    ii. The maximum payment in the payment schedule, including any balloon payment, for a higher-priced covered transaction. (§1026.43(c)(5)(ii)(A)(2))

3. For an interest-only loan:

    i. The fully indexed rate or any introductory interest rate, whichever is greater; and

    ii. Substantially equal, monthly payments of principal and interest that will repay the loan amount over the term of the loan remaining as of the date the loan is recast. (§1026.43(c)(5)(ii)(B))

4. For a negative amortization loan:

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i. The fully indexed rate or any introductory interest rate, whichever is greater; and

ii. Substantially equal, monthly payments of principal and interest that will repay the maximum loan amount as defined in section 1026.43(b)(7) over the term of the loan remaining as of the date the loan is recast. (§1026.43(c)(5)(ii)(C))

Monthly payment calculation for simultaneous loans

h. For the purposes of calculating "b. 4" above, determine whether the creditor calculated the monthly payment on any simultaneous loan that was used to determine the consumer's repayment ability, including any mortgage-related obligations, as follows:

1. For a simultaneous loan that is a covered transaction, using the payment calculation rules for covered transactions, described above (§1026.43(c)(6)(i)); or

2. For a home equity line of credit, by using the periodic payment required under the terms of the plan and the amount of credit drawn at or before consummation of the covered transaction. (§1026.43(c)(6)(ii)).

Monthly debt-to-income ratio or residual income

i. When a creditor considers the consumer's monthly debt-to-income ratio, determine whether the creditor considered the ratio of the consumer's total monthly debt obligations to the consumer's total monthly income. (§1026.43(c)(7)(ii)(A))

1. "Total monthly debt obligations" means the total of: the monthly payment on the covered transaction (as required by §1026.43(c)(2)(iii) and (c)(5)), simultaneous loans (as required by

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§1026.43(c)(2)(iv) and (c)(6)), mortgage-related obligations (as required by §1026.43(c)(2)(v)), and current debt obligations, alimony, and child support (as required by §1026.43(c)(2)(vi)).

2. "Total monthly income" means the total of the consumer's current or reasonably expected income, including any income from assets (as required by §1026.43(c)(2)(i) and (4)).

j. If a creditor considers the consumer's monthly residual income, determine whether the creditor considered the consumer's remaining income after subtracting the consumer's total monthly debt obligations from the consumer's total monthly income. (§1026.43(c)(7)(ii)(B)) Total monthly debt obligations and total monthly income are defined in section 1026.43(c)(7)(i)(A) and (B).

Appendix: Definitions

Covered Transaction: A consumer credit transaction ("loan") that is secured by a dwelling, including any real property attached to a dwelling, other than an exempt transaction.

Fully amortizing payment: A periodic payment of principal and interest that will fully repay the loan amount over the loan term.

Fully indexed rate: The interest rate calculated using the index or formula that will apply after recast, as determined at the time of consummation, and the maximum margin that can apply at any time during the loan term.

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Higher-priced covered transaction: A covered transaction with an annual percentage rate that exceeds the average prime offer rate for a comparable transaction as of the date the interest rate is set by 1.5 or more percentage points for a first-lien loan, or by 3.5 or more percentage points for a subordinate-lien loan.

Loan term: The period of time to repay the obligation in full.

Mortgage-related obligations: Property taxes, premiums and similar charges identified in 1026.4(b)(5), (7), and
(10) that are required by the creditor, fees and special assessments imposed by a condominium, cooperative, or homeowners association, ground rent and leasehold payments.

Simultaneous loan: Another covered transaction or home equity line of credit that will be secured by the same dwelling and made to the same borrower at or before consummation of the covered transaction or, if made after consummation, will cover closing costs of the first covered transaction.

Commentary 43(b)(11)---defining "Recast": For an adjustable-rate mortgage, the expiration of the period during which payments based on the introductory fixed rate are permitted; for an interest-only loan, the expiration of the period during which the interest-only payments are permitted; and, for a negative amortization loan, the expiration of the period during which negatively amortizing payments are permitted.

For adjustable-rate mortgages, interest-only loans, and negative amortization loans, the date on which the recast is considered to occur is the due date of the last monthly payment based on the introductory fixed rate, the interest-only payment, or the negatively amortizing payment, respectively. For example, a loan in an amount of $200,000 has a 30-year loan term. The loan agreement provides for a fixed interest rate and permits interest-only payments for the first five years of the loan (60 months). The loan is recast on the due date of the 60th monthly payment. The term of the loan remaining as of the date the loan is recast is 25 years or 300 months.

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Introduction – Qualified Mortgages

In January of 2013, the Consumer Financial Protection Bureau ("CFPB") issued its 800 page Ability-to-Repay and Qualified Mortgage ("ATR/QM") final rule amending Regulation Z. At that time, Regulation Z prohibited a creditor from making a higher-priced mortgage loan without considering the borrower's ability to repay the loan. As required by the Dodd-Frank Act, this final rule expands the ability-to-repay requirements to include most closed-end mortgage loans, with a few exceptions as indicated below.

In late May of 2013, the CFPB issued a second final rule totaling nearly 300 pages that amended certain limited areas of the ATR/QM rule issued in January. This second rule exempts certain nonprofit creditors, facilitates lending by certain small creditors including community banks and credit unions and establishes exceptions for the calculation of loan origination compensation.

In July of 2013, the CFPB issued a 160 page final rule amending the ATR/QM rule. Although, these amendments did not affect the Ability-to-Repay requirements of the previous ATR/QM rule, the July amendments provided clarifications regarding QM status for certain loans that are eligible for purchase, guarantee, or insurance by the GSEs or federal agencies such as the U.S. Department of Housing and Urban Development ("HUD").

In September of 2013, the CFPB issued additional amendments to the ATR/QM rule clarifying QM status for certain loans that are eligible for guarantee by the U.S. Department of Veterans Affairs.

Collectively, the foregoing ATR/QM rules, amendments, and clarifications pertaining to non-government loans shall be herein referred to as the "Rule," and HUD's ATR/QM rule shall be referred to as the "HUD Rule."

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Effective Date

The Rule and the HUD Rule are effective for applications taken on January 10, 2014.

Types of mortgage loans covered by these provisions

The Rule applies to all consumer-purpose, closed-end loans secured by a dwelling, including home- purchase loans, refinances and home equity loans---whether first-lien or subordinate-lien loans.

The Rule impacts more than just disclosures and timing. It creates three categories of loans with different risks and legal treatments:

- QM Safe Harbor Loans;
- QM Rebuttable Presumption Loans; and
- Non-QM Loans.

Nothing in the Rule requires a supervised entity to make a QM loan, although these loans will offer some protection from liability in the event of borrower-initiated lawsuits and defenses to foreclosure proceedings. All three categories of loans must comply with the ATR requirements.

Earlier in 2013, the Federal Housing Finance Agency directed Fannie Mae and Freddie Mac to limit their future acquisitions of mortgages originated on or after January 10, 2014, to QM loans under the Rule.

Supervised entities will have to determine which of the three categories (or combination of categories) of mortgage loans they will originate as of the effective date of the Rule.

How safe is the "Safe Harbor"?

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The CFPB's Rule offers a degree of legal protection from consumer lawsuits for creditors that make QM loans and adhere to the QM standards including the 43% Debt-to-Income (DTI) ratio that supposedly ensures the borrower's ability to repay. However, these requirements are currently untested in any court and no one really knows how courts will interpret them. Additionally, it may take a considerable amount of time after the effective date of January 10, 2014 before any lawsuits are filed and the issues are decided. Until courts actually begin to hear safe harbor cases, there remains a degree of uncertainty regarding the degree of protection afforded by the Rule. In the meantime, supervised entities should take steps to protect themselves from any lawsuits. Supervised entities should improve documentation concerning all aspects of their loan underwriting and loan approval process for each individual loan subject to these requirements.

Scope

The Rule applies to all consumer-purpose, closed-end loans secured by a dwelling, including home- purchase loans, refinances and home equity loans---whether first-lien or subordinate-lien loans.

Dwelling means a residential structure that contains one to four units, whether or not the structure is attached to real property. Regulation Z Section 1026.2(a)(19) defines "dwelling" to include an individual condominium unit, cooperative unit, mobile home, and trailer, if it is used as a residence. A dwelling need not be the consumer's principal residence to fit the definition, so a vacation or second home are considered a dwelling under the Rule.

Mobile homes, boats, and trailers are dwellings if they are in fact used as residences, just as are condominium and cooperative units. Recreational vehicles, campers, and the like not used as residences are not dwellings.

For purposes of the Ability-to-Repay Rules, the term "dwelling" includes any real property to which the residential structure is attached that also secures the loan.

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This all-inclusive definition of dwelling means that supervised entities should have procedures in place for items such as boats, trailers, and recreational vehicles to determine at the time of application whether the borrower intends to utilize that item as a residence. If the item will be used as a residence, the loan will be considered a mortgage loan subject to the Ability-to-Repay requirements.

Qualified Mortgages – In General

Liability Protection: For QMs that are not higher-priced, the Rule provides a "safe harbor". This means that if the loan is challenged by a defaulting borrower, the QM will be deemed to comply with the Ability-to-Repay requirements of the Rule. For QMs that are higher-priced, the Rule provides a "presumption of compliance" which is a lesser degree of protection from liability than a "safe harbor." These loans will not be deemed to comply with the ATR requirements of the Rule.

A "higher-priced" mortgage loan is a covered transaction with an APR that exceeds the "average prime offer rate" (APOR) for a comparable transaction as of the date the interest rate is set by 1.5 percent or more for a first-lien loan, or by 3.5 percent or more for a subordinate-lien loan (Section 1026.35).

Rebutting the Presumption of Compliance: In order for the borrower to rebut the presumption of compliance for a QM that is a higher-priced mortgage loan, the borrower must be prove that, despite meeting the prerequisites for a QM, the creditor did not make a reasonable and good faith determination of the borrower's repayment ability at the time of consummation, by showing that the borrower's income, debt obligations, alimony, child support, and the borrower's monthly payment (including mortgage-related obligations such as taxes and property insurance) on the covered transaction and on any simultaneous loans would leave the borrower with insufficient residual income or assets other than the value of the dwelling that secures the loan with which to meet living expenses, including any recurring and material non-debt obligations.

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The longer the period of time that the borrower has demonstrated an actual ability to repay the loan by making timely payments, without modification or accommodation, after consummation or, for an adjustable-rate mortgage, after recast, the less likely the borrower will be able to rebut the presumption based on insufficient residual income and prove that, at the time the loan was made, the creditor failed to make a reasonable and good faith determination that the borrower had the reasonable ability to repay the loan.

General Characteristics of a QM Loan

- Regular periodic payments that are substantially equal, subject to interest rate adjustments, that do not result in an increase of the principal balance (negative amortization), deferral of principal payment, or a balloon payment. The terms of the legal obligation must require the borrower to make payments of principal and interest on a monthly (or other) basis that will fully repay the loan amount over the loan term.

- No negative amortization.

- No deferral of principal. That is, a loan allows the deferral of principal repayment if one or more of the periodic payments may be applied only to accrued interest and not to loan principal.

- No balloon payments.

- Points and fees may not be excessive (limits vary depending on the loan amount):
  - 3%, of the loan amount on a loan exceeding $100,000;
  - $3,000, for a loan greater than or equal to $60,000, but less than $100,000;

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- 5 percent of the 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 percent of the loan amount, for a loan

  amount less than $12,500;
- All fee and loan amounts are indexed for inflation.

- Term cannot exceed 30 years.
- Underwritten based on the maximum interest rate that could apply during the first five years after the date on which the first regular payment is due. For a fixed rate mortgage loan, creditors should use the interest rate in effect at consummation.
- Based on verified current or reasonably expected income or assets and current debt obligations, alimony and child support.
- Monthly debt to income ("DTI") ratio may not exceed 43 percent.

Temporary QM Treatment for Government and GSE – Eligible Loans

The Rule provides for a second, temporary category of QMs that have somewhat more flexible underwriting requirements. Mortgage loans eligible to be purchased, guaranteed, or insured by certain government entities-
--the Department of Housing and Urban Development, the Department of Veterans Affairs, the Department of Agriculture and the Rural Housing Service, or by Fannie Mae or Freddie Mac as long as they remain in conservatorship—will be treated as a QM as long as it meets the following requirements:

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- Regular periodic payments that are substantially equal, subject to interest rate adjustments
- No Negative amortization
- No deferral of payments
- No balloon payments
- No excessive points and fees (see above)
- Term does not exceed 30 years

This temporary provision will phase out over time as the various Federal agencies issue their own QM Rules and if GSE conservatorship ends, and in any event after seven years.

These Government Related Loans do not have to meet the 43 percent maximum DTI ratio that applies to ordinary QMs.

Small Creditor QM Loans

The May 2013 amendment to the original Rule created a special category of QM Loans that may be made by creditors that qualify as "Small Creditors." A Small Creditor is a creditor that had total assets of $2 billion or less at the end of the prior calendar year, and together with all affiliates originated 500 or fewer covered transactions. In order to receive QM status, a Small Creditor loan must meet all QM requirements other than the 43 percent DTI ratio and without regard to the standards in Appendix Q.

Rural Balloon-Payment QM Loans

The Rule also treats certain balloon-payment loans as QM's if they are originated and held in portfolio by small creditors operating predominantly in rural or underserved areas. Loans are only eligible if they have a term of at least five years, a fixed-interest rate, and meet certain basic underwriting standards; debt-to-income ratios must be considered but are not subject to the 43 percent general requirement.

Creditors are only eligible to make rural balloon-payment QMs if they originate at least 50 percent

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of their first- lien mortgages in counties that are rural or underserved, have less than $2 billion in assets, and (along with any affiliates) originate no more than 500 first-lien mortgages per year. Creditors must generally hold the loans in their portfolios for three years in order to maintain their QM status.

HUD Qualified Mortgage

In December of 2013, HUD defined a QM that is insured, guaranteed or administered by HUD. The compliance effective date is January 10, 2014 and applies to mortgages with a case number assignment on or after that date.

In order to meet HUD's QM definition, mortgage loans must:

- Require periodic payments without risky features;
- Have terms not to exceed 30 years;
- Limit upfront points and fees to no more than three percent with adjustments to facilitate smaller loans (except for Title I, Title II, Manufactured Housing, Section 184,Section 184A loans and others as detailed below); and
- Be insured or guaranteed by FHA or HUD.

The HUD Rule establishes two types of Qualified Mortgages that have different protective features for consumers and different legal consequences for lenders. HUD's Qualified Mortgage classifies a loan as either Rebuttable Presumption Qualified Mortgages or Safe Harbor Qualified Mortgages depending on the relation of the loan's Annual Percentage Rate (APR) to the Average Prime Offer Rate (APOR), the rate for the average borrower receiving a conventional mortgage.

The two categories of HUD's Qualified Mortgages are:

Rebuttable Presumption Qualified Mortgage: Loans with APRs greater than APOR + 115 basis points (bps) plus the on-going Mortgage Insurance Premium (MIP) rate. Legally, lenders that

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offer these loans are presumed to have determined that the borrower met the Ability-to-Repay standard. Consumers can challenge that presumption, however, by proving that they did not, in fact, have sufficient income to pay the mortgage and their other living expenses.

Safe Harbor Qualified Mortgage: Loans with APRs equal to or less than APOR + 115 bps plus the on-going MIP. These mortgages offer lenders the greatest legal certainty that they are in compliance with the Ability-to-Repay standard. Consumers can still legally challenge the lender if they believe the loan does not meet the definitions of a Safe Harbor Qualified Mortgage.

NOTE: The HUD Rule covers Title II manufactured housing, Title I manufactured housing and property improvement loans, Section 184 Indian Home Loan Guarantee Program mortgages and Section 184A Native Hawaiian Housing Loan Guarantee Program mortgages. The HUD Rule designates loans insured under these programs as Safe Harbor Qualified Mortgages regardless of upfront points/fees and APR to APOR ratio so as not to interfere with current lending practices until appropriate parameters can be determined.

HUD Qualified Mortgage – Exemptions

HUD adopted the CFPB's list of transactions that are exempt from the Ability-to-Repay requirements, which include reverse mortgages; bridge loans with a term of 12 months or less; Construction-to-permanent loans for 12 months or less for the construction phase; extension of credit by a Housing Finance Agency; extension of credit by Community Development Financial Institutions; extension of credit made pursuant to a program authorized by Sections 101 and 109 of the Emergency Economic Stabilization Act of 2008; Down Payment Assistance through a Secondary Financing Provider made pursuant HUD's regulations; Community Housing Development Organization (CHDO), provided that the creditor has entered into a commitment with a participating jurisdiction and is undertaking a project under the HOME program; and a 501(c)(3) organization that secured no more than 200 dwellings in the prior calendar year to consumers with income that did not exceed the low- and moderate-income household limit as established pursuant to Section 102 of the Housing and Community Development Act of 1974 (42 U.S.C. 5302(a)(20)) and the creditor determines, in accordance with written procedures,

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that the consumer has a reasonable ability to repay the extension of credit.

Record Retention

A creditor must retain evidence of compliance with Section 1026.43 for three years after consummation of the transaction. Although a creditor is not required to retain actual paper copies of the documentation used in underwriting a loan, the creditor must be able to reproduce such records accurately. For example, if a creditor uses a consumer's IRS Form W-2 to verify the borrower's income, the creditor must be able to reproduce the IRS Form W-2 itself, and not merely the income information that was contained on the form.

CFPB Examination Procedures

The CFPB supervises depository institutions and credit unions with total assets of more than $10 billion, and their affiliates. The CFPB also has authority to supervise certain nonbanks, such as payday lenders, private education lenders, and mortgage companies including originators, brokers, and servicers. While the CFPB doesn't directly supervise financial institutions with assets below $10 billion, the regulations still apply to those institutions and it is likely that the supervised entities and various state examiners will follow these same or very similar examination procedures.

Minimum standards for transactions secured by a dwelling – Section 1026.43

c. Determine whether the financial institution is a creditor that originates covered transactions. Covered transactions are transactions secured by a dwelling, including any real property attached to a dwelling. They do not include the following: home equity lines of credit; timeshare loans [except for the prepayment penalty provisions set forth in section 1026.43(g)]; reverse mortgages; temporary "bridge," or construction loans of 12 months or less; renewable or non-renewable construction loans of 12 months or less that are a part of a construction-to-permanent transaction; or an extension of credit under a program administered by a Housing Finance Agency (defined in 24 CFR 266.5), by community development or non-profit lenders

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specified in section 1026.43(a)(3)(v), or in connection with certain federal emergency economic stabilization programs). (§1026.43(a))

d. Determine if a loan is a streamline refinance under section 1026.20(a) and Commentary 1026.20(a) and whether it qualifies under section 1026.43(d), below.

Refinancing Non-Standard Mortgages – Section 1026.43(d)

b. Determine whether the creditor has refinanced a non-standard mortgage defined in 1026.43(d)(i) (an ARM with an introductory rate fixed for a year or more, an interest-only loan, or a negative amortization loan) into a standard mortgage as defined in 1026.43(d)(ii) and considered whether the standard mortgage likely will prevent a default by the consumer once the loan is recast. In addition, determine that the following conditions are met (§1026.43(d)(3)):

1. At the time of the refinance, the creditor for the standard mortgage is the current holder of the existing non-standard mortgage or the servicer acting on behalf of the current holder (§1026.43(d)(2)(i));

2. The monthly payment for the standard mortgage is materially lower (a payment reduction of 10 percent or more is sufficient) than the monthly payment for the non-standard mortgage using the payment calculation rules in section 1026.43(d)(5) (§1026.43(d)(2)(ii));

3. The creditor received the consumer's written application for the standard mortgage no later than two months after the non-standard mortgage had recast [§1026.43(d)(2)(iii)];

4. The consumer had made no more than one payment more than 30 days late on the non-standard mortgage during the 12 months immediately before the creditor

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receives the consumer’s written application for the standard mortgage [§1026.43(d)(2)(iv)];

5. The consumer made no payments more than 30 days late during the six months immediately before the creditor received the consumer’s written application for the standard mortgage [§1026.43(d)(2)(v)]; and

6. If the non-standard mortgage was consummated on or after January 10, 2014, the non-standard mortgage was made in accordance with the ability to repay or the qualified mortgage requirements [§1026.43(c) or (e)). (§1026.43(d)(vi)].

Ability to Repay – Section 1026.43(c)

For all covered transactions, except streamline refinances, creditors must make a good faith determination that the consumer will have a reasonable ability to repay the loan, and must verify the information upon which it relied. A creditor can meet this obligation by complying with the ability-to- repay requirement in section 1026.43(c) or by making qualified mortgages under section 1026.43(e) and (f) (which limit certain risky loan features and practices), which are presumed to satisfy the ability-to- repay requirements.

i. Determine whether the creditor makes a reasonable and good faith determination at or before consummation that the consumer will have a reasonable ability to repay the loan according to its terms, based (except as otherwise provided for loans under section 1026.43 (d), (e), and (f) for refinancing non- standard to standard mortgages, qualified mortgages, and certain balloon qualified mortgages respectively), at a minimum, on the criteria set forth below. (§1026.43(c)(1))

j. Determine whether the creditor considered the following, at a minimum, in determining the consumer’s ability to repay: (§1026.43(c)(2))

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1. The consumer's current or reasonably expected income or assets (other than the value of the dwelling, including any real property attached to the dwelling, that secures the loan); [§1026.43(c)(2)(i)]

2. If the creditor relies on employment income, the consumer's current employment status; [§1026.43(c)(2)(ii)]

3. The consumer's monthly payment on the covered transaction, calculated in accordance with section 1026.43(c)(5); [§1026.43(c)(2)(iii)] (see g. below)

4. The consumer's monthly payment on any simultaneous loan that the creditor knows or has reason to know will be made, calculated in accordance with section 1026.43(c)(6); [§1026.43(c)(2)(iv)]

5. The consumer's monthly payment for mortgage-related obligations; [§1026.43(c)(2)(v)]

6. The consumer's current debt obligations, alimony, and child support; [§1026.43(c)(2)(vi)]

7. The consumer's monthly debt-to-income ratio or residual income in accordance with section 1026.43(c)(7) and section 1026.43(c)(2)(vii) and (viii); and

8. The consumer's credit history [§1026.43(c)(2)(viii)].

k. Determine whether the creditor verified the information it relied upon when considering the eight factors listed above using reasonably reliable third-party records, except that special rules apply for verification of income or assets, employment, and current debt obligations that are not shown on the consumer's credit report.

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Income and Assets, Employment and Debt Obligations

l. For purposes of calculating "c" above, determine that the creditor verified the information that it relied on using reliable third-party records except that:

1. A creditor may verify a consumer's employment status orally if the creditor prepares a written record of the information obtained orally; and [§1026.43(c)(3)(ii)]

2. A creditor that relies on a credit report to verify a consumer's current obligations need not independently verify obligations that the consumer lists on the application that are not in the consumer's credit report. [§1026.43(c)(3)(iii)]

m. For the purposes of calculating "c" above, determine whether the creditor verified the income or assets it relied upon, by using third-party records that provide reasonably reliable evidence, [§1026.43(c)(4)] such as:

1. A tax-return transcript issued by the Internal Revenue Service (IRS); [(§1026.43(c)(4)]

2. Copies of tax returns the consumer filed with the IRS or a state taxing authority; (§1026.43(c)(4)(i))

3. IRS Form W-2s or similar IRS forms used for reporting wages or tax withholding; (§1026.43(c)(4)(ii))

4. Payroll statements, including military Leave and Earnings Statements; (§1026.43(c)(4)(iii))

5. Financial institution records; (§1026.43(c)(4)(iv))

6. Records from the consumer's employer or a third party that obtained information from the employer; (§1026.43(c)(4)(v))

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7. Records from a federal, state, or local government agency stating the consumer's income from benefits or entitlements; (§1026.43(c)(4)(vi))

8. Receipts from the consumer's use of check cashing services; and (§1026.43(c)(4)(vii))

9. Receipts from the consumer's use of a funds transfer service. (§1026.43(c)(4)(viii))

n. For employment status, if the creditor orally verified employment status, determine whether the creditor prepared a written record of the information obtained orally. (§1026.43(c)(3)(ii))

Monthly payment calculation

o. For purposes of determining "b" "3" above, ascertain whether the creditor calculated the monthly payment (except for balloon payment, interest-only and negative amortization loans) by using:

1. The fully indexed rate or any introductory interest rate, whichever is greater; and monthly, fully amortizing payments that are substantially equal. (§1026.43(c)(5))

2. For a loan with a balloon payment:

i. The maximum payment scheduled during the first five years after the date on which the first regular periodic payment will be due for a loan that is not a higher-priced covered transaction as defined under section 1026.43(b)(4); (§1026.43(c)(5)(ii)(A)(1)) or

ii. The maximum payment in the payment schedule, including any balloon payment, for a higher-priced covered transaction. (§1026.43(c)(5)(ii)(A)(2))

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3. For an interest-only loan:

i. The fully indexed rate or any introductory interest rate, whichever is greater; and

ii. Substantially equal, monthly payments of principal and interest that will repay the loan amount over the term of the loan remaining as of the date the loan is recast. (§1026.43(c)(5)(ii)(B))

4. For a negative amortization loan:

i. The fully indexed rate or any introductory interest rate, whichever is greater; and

ii. Substantially equal, monthly payments of principal and interest that will repay the maximum loan amount as defined in section 1026.43(b)(7) over the term of the loan remaining as of the date the loan is recast. [§1026.43(c)(5)(ii)(C)]

Monthly payment calculation for simultaneous loans

p. For the purposes of determining "b" "4" above, ascertain whether the creditor calculated the monthly payment on any simultaneous loan that was used to determine the consumer's repayment ability, including any mortgage-related obligations, as follows:

1. For a simultaneous loan that is a covered transaction, using the payment calculation rules for covered transactions, described above [§1026.43(c)(6)(i)]; or

2. For a home equity line of credit, by using the periodic payment required under the terms of the plan and the amount of credit drawn at or before consummation of the covered transaction. [§1026.43(c)(6)(ii)].

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Monthly debt-to-income ratio or residual income

i. When a creditor considers the consumer's monthly debt-to-income ratio, determine whether the creditor considered the ratio of the consumer's total monthly debt obligations to the consumer's total monthly income. [§1026.43(c)(7)(ii)(A)]

1."Total monthly debt obligations" means the total of the following : the monthly payment on (a) the covered transaction (as required by §1026.43(c)(2)(iii) and (c)(5)), (b) simultaneous loans (as required by §1026.43(c)(2)(iv) and (c)(6)), (c) mortgage-related obligations (as required by §1026.43(c)(2)(v)), and (d) current debt obligations, alimony, and child support (as required by §1026.43(c)(2)(vi)).

2. "Total monthly income" means the total of the consumer's current or reasonably expected income, including any income from assets (as required by §1026.43(c)(2)(i) and (4)).

j. If a creditor considers the consumer's monthly residual income, determine whether the creditor considered the consumer's remaining income after subtracting the consumer's total monthly debt obligations from the consumer's total monthly income. (§1026.43(c)(7)(ii)(B)) Total monthly debt obligations and total monthly income are defined in section 1026.43(c)(7)(i)(A) and (B).

Appendix: Definitions

Covered Transaction: A consumer credit transaction (loan) that is secured by a dwelling, including any real property attached to a dwelling, other than an exempt transaction.

Fully amortizing payment: A periodic payment of principal and interest that will fully repay the loan amount over the existing term of the loan.

Fully indexed rate: The interest rate calculated using the index or formula that will apply after recast, as determined at the time of consummation, and the maximum margin that can

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apply at any time during the loan term.

Higher-priced covered transaction: A covered transaction with an annual percentage rate that exceeds the average prime offer rate for a comparable transaction as of the date the interest rate is set by 1.5 or more percentage points for a first-lien loan, or by 3.5 or more percentage points for a subordinate-lien loan.

Loan term: The period of time to repay the obligation in full.

Mortgage-related obligations: Property taxes, premiums and similar charges identified in 1026.4(b)(5), (7), and
(10) that are required by the creditor, fees and special assessments imposed by a condominium, cooperative, or homeowners association, ground rent and leasehold payments.

Simultaneous loan: Another covered transaction or home equity line of credit that will be secured by the same dwelling and made to the same borrower at or before consummation of the covered transaction or, if made after consummation, will cover closing costs of the first covered transaction.

Commentary 43(b)(11)---defining "Recast": For an adjustable-rate mortgage, the expiration of the period during which payments based on the introductory fixed rate are permitted; for an interest-only loan, the expiration of the period during which the interest-only payments are permitted for a negative amortization loan, the expiration of the period during which negatively amortizing payments are permitted.

For adjustable-rate mortgages, interest-only loans, and negative amortization loans, the date on which the recast is considered to occur is the due date of the last monthly payment based on the introductory fixed rate, the interest-only payment, or the negatively amortizing payment, respectively. For example, when a loan in an amount of $200,000; (1) has a 30-year loan term; (2) has a loan agreement that provides for a fixed interest rate and permits interest-only

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payments for the first five years of the loan (60 months); or (3) recasts on the due date of the 60th monthly payment; the term of the loan remaining as of the date the loan is recast is 25 years or 300 months.

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