Federal Reserve Bank of San Francisco
101 Market Street, San Francisco, California 94105

April 21, 2011

To State Member Banks, Bank
Holding Companies, Financial Holding
Companies, and Foreign Bank Offices
in the Twelfth Federal Reserve District

Federal Reserve Proposes Rule Under Regulation Z Pertaining to a Consumer's Ability to Repay a Mortgage and Minimum Mortgage Underwriting Standards

The Federal Reserve Board on April 19, 2011 requested public comment on a proposed rule under Regulation Z that would require creditors to determine a consumer's ability to repay a mortgage before making the loan and would establish minimum mortgage underwriting standards.

The revisions to the regulation, which implements the Truth in Lending Act (TILA), are being made pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act. The proposal would apply to all consumer mortgages (except home equity lines of credit, timeshare plans, reverse mortgages, or temporary loans).

Consistent with the act, the proposal would provide four options for complying with the ability-to-repay requirement.

- First, a creditor can meet the general ability-to-repay standard by considering and verifying specified underwriting factors, such as the consumer's income or assets.
- Second, a creditor can make a "qualified mortgage," which provides the creditor with special protection from liability provided the loan does not have certain features, such as negative amortization; the fees are within specified limits; and the creditor underwrites the mortgage payment using the maximum interest rate in the first five years. The Board is soliciting comment on two alternative approaches for defining a "qualified mortgage."
- Third, a creditor operating predominantly in rural or underserved areas can make a balloon-payment qualified mortgage. This option is meant to preserve access to credit for consumers located in rural or underserved areas where banks originate balloon loans to hedge against interest rate risk for loans held in portfolio.
- Finally, a creditor can refinance a "non-standard mortgage" with risky features into a more stable "standard mortgage" with a lower monthly payment. This option is meant to preserve access to streamlined refinancings.

The proposal would also implement the Dodd-Frank Act's limits on prepayment penalties.

The Board is soliciting comment on the proposed rule until July 22, 2011. General rulemaking authority for TILA is scheduled to transfer to the Consumer Financial Protection Bureau on July 21, 2011. Accordingly, this rulemaking will not be finalized by the Board.

The Board's notice for the proposed rule is attached.

Additional Information

All circulars and documents are available on the Internet through the Federal Reserve Bank of San Francisco's website, at http://www.frbsf.org/banking/letters.

For additional information, please contact:

Federal Reserve Bank of San Francisco
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Attachment: Highlights of Proposed Ability-to-Repay Rules (26 KB PDF)

Notice (1.15 MB PDF)