

UDAAP May Interfere With 'Ability-To-Repay' Under TILA

Law360, New York (May 09, 2012, 1:09 PM ET) -- A lender's obligation to consider and verify a borrower's ability to repay a home mortgage loan is once again at the center of attention, currently resulting from the Consumer Financial Protection Bureau's open comment period for a proposed regulation that will define which loan products are considered "qualified mortgage(s)" under the Dodd-Frank Act's "ability-to-repay" amendment to the Truth In Lending Act ("TILA").

The "ability-to-repay" amendment states that "no creditor may make a residential mortgage loan unless the creditor makes a reasonable and good faith determination based on verified and documented information that, at the time the loan is consummated, the consumer has a reasonable ability-to-repay the loan, according to its terms, and all applicable taxes, insurance (including mortgage guarantee insurance), and assessments." 15 USCA § 1639c(a)(1).

The amendment also provides certain protections from claims that the lender failed to assess a borrower's ability to repay the loan if the loan fits the definition of a "qualified mortgage." The definition for a qualified mortgage encompasses products without specified features, such as balloon payments and hidden charges, which some believe result in a greater likelihood of a borrower's inability to meet their repayment obligations.

The CFPB has indicated that any final rule will necessarily include a determination as to the legal impact of a "qualified mortgage." This legal impact will inform whether selling loans that meet that definition will entitle the lender to a complete "safe harbor" from a claim that the lender failed to consider a borrower's ability to repay or, in the alternative, whether that definition would afford the lesser protection of a rebuttable presumption that the lender made appropriate assessment of the lender's repayment ability.

In a recent letter to CFPB Director Richard Cordray, a consortium of mortgage lending trade groups, housing rights advocates and other interested parties requested that the CFPB issue a rule giving a broad interpretation to the definition of a "qualified mortgage" so as to afford lenders the maximum amount of litigation and enforcement protections associated with selling such loans. According to the letter, construing such protections narrowly would force lenders to limit the availability of loan products in order to manage risk and, as a result, "would undermine prospects for a housing recovery and threaten the redevelopment of a sound mortgage market."

One of the purposes of the ability-to-repay amendment is "to assure that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability-to-repay the loans and that are understandable and not unfair, deceptive or abusive." 15 USCA § 1639b(a)(2). Thus, the provision binds itself to one of the central (and, as yet, largely unexplored) themes of Title X of the Dodd-Frank Act's consumer protection provisions: the general mandate that the CFPB implement regulations that "prevent a covered person or service provider from committing or engaging in an unfair, deceptive, or abusive act or practice," also referred to by its acronym "UDAAP." 12 USC § 5531.

UDAAP Muddies The Water

Regardless of the scope of the CFPB's final interpretation of a "qualified mortgage" and the protections that such an outcome may afford a loan product under the "ability-to-repay" amendment, so long as Title X's general UDAAP provision remains largely undefined and unexplored, a daunting lack of clarity will surround the extent to which a lender is generally obligated to assess a borrower's financial ability to repay a loan.

Unlike the modified TILA ability-to-repay statute and proposed regulation, which features relatively finite contour and clearly defined categories of required conduct, the scope of the general UDAAP mandate remains largely undefined by regulation and untested through litigation. As such, UDAAP could undermine any clarity provided by a final rule regarding the scope of the ability-to-repay provision under TILA.

This is the case because the general prohibition against UDAAP arguably includes a de facto requirement that a borrower's ability-to-repay be considered, even when the loan product is a "qualified loan," or even when the lender has otherwise complied with the ability-to-pay amendment.

Looking Back at UDAP to Look Forward to UDAAP

One of the "crystal balls" that is available to provide insight into how courts or the CFPB might interpret the UDAAP standards of unfairness, deception and abuse is a retrospective review of the decisions by courts that have applied state consumer protection statutes, the so-called "Little FTC Acts." Many of these statutes contain prohibitions against "unfair" or "deceptive" conduct, and are referred to as "UDAP," missing only a single "A" corresponding to the new "abusive" standard in the Dodd-Frank Act.

A review of this case law reveals that a number of courts have found that a plaintiff had stated a viable UDAP claim by alleging that the lender had, in some manner, failed to consider or account for the borrower's inability-to-repay the loan at issue. Although the courts in a majority of jurisdictions, including California, Nevada and Hawaii, have held that a lender does not have an obligation to account for a borrower's repayment ability, the jurisdictions that have found otherwise could serve as a predictor that UDAAP may continue to impose a broader obligation on a lender than those specifically set forth in the "ability-to-repay" amendment with its exemptions and potentially more narrow scope.

There are five general categories of state UDAP decisions that, at a minimum, may suggest how UDAAP could be interpreted as imposing additional obligations on a lender to assess the borrower's ability to repay. First, some courts, such as the federal district court in Illinois, have found that concealment of the borrower's inability to repay the loan from the borrower himself was sufficient for the borrower to state a claim under state UDAP laws. Second, some courts, like the state courts in New York, have held that a lender's lack of inquiry into the borrower's ability to repay the mortgage was sufficient to provide the borrower with grounds to challenge the mortgage.

Third, there are a number of cases in jurisdictions such as the District of Columbia, where allegations of the lender's affirmative knowledge that the borrower would not likely be able to repay the loan was sufficient to state a claim for conduct that would be considered "unconscionable" under the applicable consumer protection statute. While UDAAP does not make reference to "unconscionable" conduct, one could argue that unconscionability fits within one or more of the UDAAP standards.

Fourth, some courts, e.g., the federal courts in New York, have found potential liability in allegations that a lender failed to consider a borrower's ability to repay, in addition to the lender engaging in some other unfair or deceptive conduct. Thus, the "unfair" or "deceptive" conduct could potentially reside in the totality of the defendant lender's conduct, one such factor being the lender's failure to consider the borrower's ability to repay.

Finally, a majority of jurisdictions have rejected claims brought under a state's UDAP and other consumer protection laws, based on the allegation that the lender failed to consider the borrower's ability to pay. Courts arrived at the conclusion that a lender has no obligation to assess a borrower's repayment ability in a variety of ways including, among others, that the lender is not a fiduciary of the borrower and, absent extraordinary circumstances, owes no duty to assess the borrower's ability to repay.

Conclusion

The variety of approaches that different jurisdictions have taken to a lender's obligation to consider repayment ability merely highlights the lack of clarity surrounding the Dodd-Frank Act's UDAAP provisions. As illustrated in the "qualified mortgage" context, the confusion caused by UDAAP continues to overshadow the other progress that the CFPB has sought to achieve in other areas. So long as UDAAP remains without firm definition, clarity as to other provisions in Dodd-Frank will bring little comfort to lenders and other consumer financial service providers because the frontier of permissible loan products, and associated expense and litigation exposure, will remain impossible to predict with any certainty.

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