



## Litigation Anticipated as Lenders Seek to Define When a Consumer has the Ability to Repay under the Dodd-Frank Wall Street Reform and Consumer Protection Act

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In addition to overhauling the nation's financial system, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act") also raised multiple issues that, at this point, seem bound for frequent litigation. Section 1411 of the Act, which imposes minimum standards for mortgages, contains at least one such pitfall.

Section 1411 of the Act states that "[i]n accordance with regulations prescribed by the [Federal Reserve Board], 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 . . . ." Despite being one of the Act's most salient issues for lenders, the Act does not define what constitutes a "reasonable ability." Understanding this definition will be crucial to future lending, however, as lenders may otherwise find themselves subject to significant liability.

The Act does contain a checklist of items that a lender must examine when making the "reasonable ability" determination. Specifically, lenders must analyze a consumer's (i) credit history, (ii) current income, (iii) expected income that the consumer is reasonably assured of receiving, (iv) current obligations, (v) debt-to-income ratio, or the residual income the consumer will have after paying non-mortgage debt and mortgage-related obligations, (vi) employment status, and (vii) other financial resources other than the consumer's equity in the dwelling or real property that secures repayment of the loan. Although the Act instructs lenders regarding what must be examined, it does not instruct how it is to be examined or measured, leaving lenders with questions such as: (i) must a standard be universally applied to all consumers, or can it vary?; (ii) can the standard vary among loan products?; and (iii) can one factor outweigh another? Unfortunately for lenders, the answers to these questions and the definition of this standard are

likely to evolve over time through rule making, regulations and case law.

Until that time, however, being aware of litigation involving certain state consumer protection statutes that contain similar language may provide insight into future treatment by the federal courts. In addition, lenders should take caution and properly maintain their loan files, as such files will undoubtedly be targeted and analyzed by plaintiffs' lawyers when asserting claims against lenders. Such files will be a lender's first line of defense when seeking safe harbor under the Act or otherwise defending a consumer claim.

If you have questions about the information in this alert, please contact Tom McKee at .

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