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**Advisory | Financial Services Litigation**

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# Sixth Circuit Rules Lenders Cannot Rely on Borrowers to Satisfy 'Ability to Repay' Rule Under TILA

From late 2007 through much of 2009, the United States endured the "Great Recession" as stocks plummeted, markets froze, and companies crumbled. The cause of the Great Recession has generally been attributed to deficient oversight and regulation of lenders and financial institutions, including mortgage loan providers. In response, Congress passed the Dodd-Frank Act Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). In part, the Dodd-Frank Act amended several sections of the Truth in Lending Act (TILA) and added a new "reasonable ability to repay" provision, which requires creditors to take certain measures before making a residential mortgage (Ability to Repay Provision). 15 U.S.C. § 1639c.

The Ability to Repay Provision provides 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…" 15 U.S.C. § 1639c(a)(1). This provision is designed to prevent creditors from lending to borrowers who cannot afford to repay the loan by requiring creditors to verify upfront the income stated on a borrower's loan application.

Ten years after its enactment, the Ability to Repay Provision was the focus of a July 2020 decision by the Sixth Circuit. In *Elliott v. First Federal Community Bank of Bucyrus*, Elliott claimed that the First Federal Community Bank of Bucyrus violated TILA by failing to properly verify his income and negligently approving his mortgage loan. After the trial court granted summary judgment in favor of the bank, Elliott appealed to the Sixth Circuit, which reversed.

In late 2014, Elliott and his wife contemplated separating and began the process of dividing assets, including their rental properties. Elliott applied with the bank to refinance the existing mortgage on one of the couple's rental properties to remove his wife as an obligor on the existing loan. Elliott listed his income as: base employment income of $528.95 per month, spousal support of $2,300 per month, Social Security of $1,975 per month, and rental income of $1,400 per month. In reviewing Elliott's refinance application, the bank considered, and relied upon, verbal statements of Elliott and his soon-to-be ex-wife, Golan, to verify Elliott's representation that he would be receiving $2,300 per month. However, the separation agreement itself, which provided that Elliott would receive $2,200 per month, was not executed until early February 2015 — nearly two months after the loan was consummated.

The bank also sought to verify Elliott's representation that he received $1,400 in rental income through a review of Elliott's tax returns, which showed rental income in the past, but not from the correct property. The bank did not review the lease in question under which Elliott received only $1,000 per month.

Nevertheless, on Dec. 11, 2014, Elliott executed a promissory note and a mortgage securing the loan based on the income that he stated. However, Elliott's finances then began to deteriorate. He stopped performance under the separation agreement and sought additional spousal support. This proved to be a misstep, as the divorce court entered a judgment far less favorable to Elliott. Under the new judgment, Elliott received just $250 per month in spousal support, as opposed to the $2,200 per month under the separation agreement. Elliott eventually defaulted on the note.

In January 2017, Elliott sued the bank for (1) a violation of TILA by making the loan without a reasonable and good-faith determination that he had a reasonable ability to repay the loan and for failing to verify his stated income with documentation; and (2) negligence in making the loan. After cross motions for summary judgment, the trial court ruled in favor of the bank. Elliott appealed. The Sixth Circuit reversed, holding that the bank had violated TILA by failing to verify Elliot's claimed income with third-party records.

The Sixth Circuit found that the bank violated TILA's Ability to Repay Provision "by considering spousal support and rental income that were not properly verified and documented in making its reasonable-ability-to-repay-determination." According to the Sixth Circuit, the bank ran afoul of TILA because it relied solely on verbal statements regarding the amount and duration of pending spousal support payments, and did not "verify" the spousal support "using reasonably reliable third-party records." 12 C.F.R. § 1026.43(b)(13).

Indeed, the bank had no evidence of any spousal-support payments because Golan had not begun making them. Thus, the bank did not verify, using third-party records, the spousal support payments claimed on Elliott's application as required by TILA.

The court also found the bank failed to properly document and verify the rental income claimed on Elliott's application. The bank admitted it did not review the lease, but instead reviewed a tax return demonstrating only past rental income. By failing to verify the listed rental income with any documents to establish that income, the bank did not comply with TILA regulations found at 12 C.F.R. § 1026.43(c)(3)&(4).

So, what does this all mean with respect to TILA? The Ability to Repay Provision requires that creditors, including lenders of residential mortgages, verify through third-party records the income listed on the borrower's application. If a creditor fails to do so, TILA permits rescission and imposes liability for all actual damages on any creditor who fails to comply with any requirement imposed thereunder, which includes a potential award of attorneys' fees.

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