6. In Supplement I to Part 1026—Official Interpretations:

A. Under *Section 1026.25—Record Retention:*

i. Under *25(a) General rule*, paragraph 2 is revised.

ii. *25(c) Records related to certain requirements for mortgage loans*, *25(c)(3) Records related to minimum standards for transactions secured by a dwelling*, and paragraphs 1 and 2 are added.

B. Under *Section 1026.32—Requirements for Certain Closed-End Home Mortgages*, the heading is revised.

C. Under revised *Section 1026.32—Requirements for High-Cost Mortgages:*

i. Under *32(b) Definitions*:

a. *Paragraph 32(b)(1)* and paragraph 1are added.

b. Under *Paragraph 32(b)(1)(i)*, paragraph 1 is revised.

c. *Paragraph 32(b)(1)(i)(B)* and paragraph 1 are added.

d. *Paragraph 32(b)(1)(i)(C)* and paragraphs 1 and 2 are added.

e. *Paragraph 32(b)(1)(i)(D)* and paragraphs 1, 2, 3, and 4 are added.

f. *Paragraph 32(b)(1)(i)(E)* and paragraphs 1, 2, and 3 are added.

g. *Paragraph 32(b)(1)(i)(F)* and paragraphs 1 and 2 are added.

h. Under *Paragraph 32(b)(1)(ii)*, paragraphs 1 and 2 are revised and paragraphs 3 and 4 are added.

i. *Paragraph 32(b)(1)(iii)* and paragraph 1 are added.

j. Under *Paragraph 32(b)(1)(iv)*, paragraph 1 is revised and paragraphs 2 and 3 are added.

k. *32(b)(3) Bona fide discount point*, *32(b)(3)(i) Closed-end credit*, and paragraph 1 are added.

l. *32(b)(4) Total loan amount*, *32(b)(4)(i) Closed-end credit*, and paragraph 1 are added.

m. *32(b)(6) Prepayment penalty* and paragraphs 1 and 2 are added.

D. *Section 1026.43—Minimum Standards for Transactions Secured by a Dwelling* is added.

The revisions, removals, and additions read as follows:

Supplement I to Part 1026—Official Interpretations

*** * * * ***

Subpart D—Miscellaneous

*** * * * ***

Section 1026.25—Record Retention

25(a) General rule.

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2. *Methods of retaining evidence.* Adequate evidence of compliance does not necessarily mean actual paper copies of disclosure statements or other business records. The evidence may be retained by any method that reproduces records accurately (including computer programs). Unless otherwise required, the creditor need retain only enough information to reconstruct the required disclosures or other records. Thus, for example, the creditor need not retain each open-end periodic statement, so long as the specific information on each statement can be retrieved.

* * * * *

25(c) Records related to certain requirements for mortgage loans.

25(c)(3) Records related to minimum standards for transactions secured by a dwelling.

1. *Evidence of compliance with repayment ability provisions*. A creditor must retain evidence of compliance with § 1026.43 for three years after the date of consummation of a consumer credit transaction covered by that section. (See comment 25(c)-2 for guidance on the retention of evidence of compliance with the requirement to offer a consumer a loan without a prepayment penalty under § 1026.43(g)(3).) If a creditor must verify and document information used in underwriting a transaction subject to § 1026.43, the creditor shall retain evidence sufficient to demonstrate compliance with the documentation requirements of the rule. Although a creditor need not retain actual paper copies of the documentation used in underwriting a transaction subject to § 1026.43, to comply with § 1026.25(c)(3), the creditor must be able to reproduce such records accurately. For example, if the creditor uses a consumer's Internal Revenue Service (IRS) Form W-2 to verify the consumer's income, the creditor must be able to reproduce the IRS Form W-2 itself, and not merely the income information that was contained in the form.

2. *Dwelling-secured transactions and prepayment penalties*. If a transaction covered by § 1026.43 has a prepayment penalty, the creditor must maintain records that document that the creditor complied with requirements for offering the consumer an alternative transaction that does not include a prepayment penalty under § 1026.43(g)(3), (4), or (5). However, the creditor need not maintain records that document compliance with those provisions if a transaction is consummated without a prepayment penalty or if the creditor and consumer do not consummate a covered transaction. If a creditor offers a transaction with a prepayment penalty to a consumer through a mortgage broker, to evidence compliance with § 1026.43(g)(4) the creditor should retain evidence of the alternative covered transaction presented to the mortgage broker, such as a rate sheet, and the agreement with the mortgage broker required by § 1026.43(g)(4)(ii).

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Subpart E—Special Rules for Certain Home Mortgage Transactions

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Section 1026.32—Requirements for High-Cost Mortgages

*   *   *   *   *

32(b) Definitions.

Paragraph 32(b)(1).

1. *Known at or before consummation*. Section 1026.32(b)(1) includes in points and fees for closed-end credit transactions those items listed in § 1026.32(b)(1)(i) through (vi) that are known at or before consummation. The following examples clarify how to determine whether a charge or fee is known at or before consummation.

i. *General*. In general, a charge or fee is "known at or before consummation" if the creditor knows at or before consummation that the charge or fee will be imposed in connection with the transaction, even if the charge or fee is scheduled to be paid after consummation. Thus, for example, if the creditor charges the consumer $400 for an appraisal conducted by an affiliate of the creditor, the $400 is included in points and fees, even if the consumer finances it and repays it over the loan term, because the creditor knows at or before consummation that the charge or fee is imposed in connection with the transaction. By contrast, if a creditor does not know whether a charge or fee will be imposed, it is not included in points and fees. For example, charges or fees that the creditor may impose if the consumer seeks to modify a loan after consummation are not included in points and fees, because the creditor does not know at or before consummation whether the consumer will seek to modify the loan and therefore incur the fees or charges.

ii. *Prepayment penalties*. Notwithstanding the guidance in comment 32(b)(1)-1.i, under § 1026.32(b)(1)(v) the maximum prepayment penalty that may be charged or collected under the terms of the mortgage loan is included in points and fees because the amount of the maximum prepayment penalty that may be charged or collected is known at or before consummation.

iii. *Certain mortgage and credit insurance premiums*. Notwithstanding the guidance in comment 32(b)(1)-1.i, under § 1026.32(b)(1)(i)(C)(*1*) and (iii) premiums and charges for private mortgage insurance and credit insurance that are payable after consummation are not included in points and fees, even if the amounts of such premiums and charges are known at or before consummation.

Paragraph 32(b)(1)(i).

1. *General*. Section 1026.32(b)(1)(i) includes in the total "points and fees" items included in the finance charge under § 1026.4(a) and (b). However, certain items that may be included in the finance charge are excluded from points and fees under § 1026.32(b)(1)(i)(A) through (F). Items excluded from the finance charge under other provisions of § 1026.4 are not included in the total points and fees under § 1026.32(b)(1)(i), but may be included in points and fees under § 1026.32(b)(1)(ii) through (vi). To illustrate: A fee imposed by the creditor for an appraisal performed by an employee of the creditor meets the definition of "finance charge" under § 1026.4(a) as "any charge payable directly or indirectly by the consumer and imposed directly or indirectly by the creditor as an incident to or a condition of the extension of credit." However, § 1026.4(c)(7) specifies that appraisal fees are not included in the finance charge. A fee imposed by the creditor for an appraisal performed by an employee of the creditor therefore would not be included in the finance charge and would not be counted in points and fees under § 1026.32(b)(1)(i). Section 1026.32(b)(1)(iii), however, expressly includes in points and fees

items listed in § 1026.4(c)(7) (including appraisal fees) if the creditor receives compensation in connection with the charge. A creditor would receive compensation for an appraisal performed by its own employee. Thus, the appraisal fee in this example must be included in the calculation of points and fees.

Paragraph 32(b)(1)(i)(B).

1. *Federal and State mortgage insurance premiums and guaranty fees.* Under § 1026.32(b)(1)(i)(B), mortgage insurance premiums or guaranty fees in connection with a Federal or State agency program are excluded from points and fees, even though they are included in the finance charge under § 1026.4(a) and (b). For example, if a consumer is required to pay a $2,000 mortgage insurance premium for a loan insured by the Federal Housing Administration, the $2,000 must be included in the finance charge but is not counted in points and fees. Similarly, if a consumer pays a 2 percent funding fee for a loan guaranteed by the U.S. Department of Veterans Affairs or through the U.S Department of Agriculture's Rural Development Single Family Housing Guaranteed Loan Program, the fee is included in the finance charge but is not included in points and fees.

Paragraph 32(b)(1)(i)(C).

1. *Private mortgage insurance premiums.* i. *Payable after consummation*. Under § 1026.32(b)(1)(i)(C)(*1*), private mortgage insurance premiums payable after consummation are excluded from points and fees.

ii. *Payable at or before consummation*. A. *General.* Under § 1026.32(b)(1)(i)(C)(*2*), private mortgage insurance premiums payable at or before consummation (*i.e.*, single or up-front premiums) may be excluded from points and fees, even though they are included in the finance charge under § 1026.4(a) and (b). However, the portion of the premium that exceeds the amount payable under policies in effect at the time of origination under section 203(c)(2)(A) of the National Housing Act (12 U.S.C. 1709(c)(2)(A)) is included in points and fees. To determine whether any portion of the premium exceeds the amount payable under policies in effect at the time of origination under section 203(c)(2)(A) of the National Housing Act, a creditor references the premium amount that would be payable for the transaction under that Act, as implemented by applicable regulations and other written authorities issued by the Federal Housing Administration (such as Mortgagee Letters), even if the transaction would not qualify to be insured under that Act (including, for example, because the principal amount exceeds the maximum insurable under that Act).

B. *Non-refundable premiums.* To qualify for the exclusion from points and fees, private mortgage insurance premiums payable at or before consummation must be required to be refunded on a pro rata basis and the refund must be automatically issued upon notification of the satisfaction of the underlying mortgage loan.

C. *Example.* Assume that a $3,000 private mortgage insurance premium charged on a closed-end mortgage loan is payable at or before closing and is required to be refunded on a pro rata basis and that the refund is automatically issued upon notification of the satisfaction of the underlying mortgage loan. Assume also that the maximum premium allowable under the National Housing Act is $2,000. In this case, the creditor could exclude $2,000 from points and fees but would have to include the $1,000 that exceeds the allowable premium under the National Housing Act. However, if the $3,000 private mortgage insurance premium were not required to be refunded on a pro rata basis or if the refund were not automatically issued upon notification of the satisfaction of the underlying mortgage loan, the entire $3,000 premium would be included in points and fees.

2. *Method of paying private mortgage insurance premiums.* The portion of any private mortgage insurance premiums payable at or before consummation that does not qualify for an exclusion from points and fees under § 1026.32(b)(1)(i)(C)(*2*) must be included in points and fees for purposes of § 1026.32(b)(1)(i) whether paid in cash or financed and whether the insurance is optional or required.

Paragraph 32(b)(1)(i)(D).

1. *Charges not retained by the creditor, loan originator, or an affiliate of either.* In general, a creditor is not required to count in points and fees any bona fide third-party charge not retained by the creditor, loan originator, or an affiliate of either. For example, if bona fide charges are imposed by a third-party settlement agent and are not retained by the creditor, loan originator, or an affiliate of either, those charges are not included in points and fees, even if those charges are included in the finance charge under § 1026.4(a)(2). The term *loan originator* has the same meaning as in § 1026.36(a)(1).

2. *Private mortgage insurance.* The exclusion for bona fide third-party charges not retained by the creditor, loan originator, or an affiliate of either is limited by § 1026.32(b)(1)(i)(C) in the general definition of "points and fees." Section 1026.32(b)(1)(i)(C) requires inclusion in points and fees of premiums or other charges payable at or before consummation for any private guaranty or insurance protecting the creditor against the consumer's default or other credit loss to the extent that the premium or charge exceeds the amount payable under policies in effect at the time of origination under section 203(c)(2)(A) of the National Housing Act (12 U.S.C. 1709(c)(2)(A)). These premiums or charges must also be included if the premiums or charges are not required to be refundable on a pro-rated basis, or the refund is not required to be automatically issued upon notification of the satisfaction of the

underlying mortgage loan. Under these circumstances, even if the premiums or other charges are not retained by the creditor, loan originator, or an affiliate of either, they must be included in the points and fees calculation for qualified mortgages. See comments 32(b)(1)(i)(c)-1 and -2 for further discussion of including private mortgage insurance premiums payable at or before consummation in the points and fees calculation.

3. *Real estate-related fees.* The exclusion for bona fide third-party charges not retained by the creditor, loan originator, or an affiliate of either is limited by § 1026.32(b)(1)(iii) in the general definition of points and fees. Section 1026.32(b)(1)(iii) requires inclusion in points and fees of items listed in § 1026.4(c)(7) unless the charge is reasonable, the creditor receives no direct or indirect compensation in connection with the charge, and the charge is not paid to an affiliate of the creditor. If a charge is required to be included in points and fees under § 1026.32(b)(1)(iii), it may not be excluded under § 1026.32(b)(1)(i)(D), even if the criteria for exclusion in § 1026.32(b)(1)(i)(D) are satisfied.

4. *Credit insurance.* The exclusion for bona fide third-party charges not retained by the creditor, loan originator, or an affiliate of either is limited by § 1026.32(b)(1)(iv) in the general definition of points and fees. Section 1026.32(b)(1)(iv) requires inclusion in points and fees of premiums and other charges for credit insurance and certain other types of insurance. If a charge is required to be included in points and fees under § 1026.32(b)(1)(iv), it may not be excluded under § 1026.32(b)(1)(i)(D), even if the criteria for exclusion in § 1026.32(b)(1)(i)(D) are satisfied.

Paragraph 32(b)(1)(i)(E).

1. *Bona fide discount point.* The term *bona fide discount point* is defined in § 1026.32(b)(3).

2. *Average prime offer rate.* The average prime offer rate for purposes of paragraph (b)(1)(i)(E) of this section is the average prime offer rate that applies to a comparable transaction as of the date the discounted interest rate for the transaction is set. For the meaning of "comparable transaction," refer to comment 35(a)(2)-2. The table of average prime offer rates published by the Bureau indicates how to identify the comparable transaction. *See* comment 35(a)(2)-2.

3. *Example.* Assume a transaction that is a first-lien, purchase-money home mortgage with a fixed interest rate and a 30-year term. Assume also that the consumer locks in an interest rate of 6 percent on May 1, 2014 that was discounted from a rate of 6.5 percent because the consumer paid two discount points. Finally, assume that the average prime offer rate as of May 1, 2014 for home mortgages with a fixed interest rate and a 30-year term is 5.5 percent. The creditor may exclude two bona fide discount points from the points and fees calculation because the rate from which the discounted rate was derived (6.5 percent) exceeded the average prime offer rate for a comparable transaction as of the date the rate on the transaction was set (5.5 percent) by only 1 percentage point.

Paragraph 32(b)(1)(i)(F).

1. *Bona fide discount point and average prime offer rate.* Comments 32(b)(1)(i)(E)-1 and -2 provide guidance concerning the definition of *bona fide discount point* and *average prime offer rate*, respectively.

2. *Example.* Assume a transaction that is a first-lien, purchase-money home mortgage with a fixed interest rate and a 30-year term. Assume also that the consumer locks in an interest rate of 6 percent on May 1, 2014, that was discounted from a rate of 7 percent because the consumer paid four discount points. Finally, assume that the average prime offer rate as of May

1, 2014, for home mortgages with a fixed interest rate and a 30-year term is 5 percent. The creditor may exclude one discount point from the points and fees calculation because the rate from which the discounted rate was derived (7 percent) exceeded the average prime offer rate for a comparable transaction as of the date the rate on the transaction was set (5 percent) by only 2 percentage points.

Paragraph 32(b)(1)(ii).

1. *Loan originator compensation—general*. Compensation paid by a consumer or creditor to a loan originator is included in the calculation of points and fees for a transaction, provided that such compensation can be attributed to that particular transaction at the time the interest rate is set. Loan originator compensation includes amounts the loan originator retains and is not dependent on the label or name of any fee imposed in connection with the transaction.

2. *Loan originator compensation—attributable to a particular transaction.* i. Loan originator compensation includes the dollar value of compensation, such as a bonus, commission, or award of merchandise, services, trips, or similar prizes, that is paid by a consumer or creditor to a loan originator and can be attributed to that particular transaction. The amount of compensation that can be attributed to a particular transaction is the dollar value of compensation that the loan originator will receive if the transaction is consummated. As explained in comment 32(b)(1)(ii)-3, the amount of compensation that a loan originator will receive is calculated as of the date the interest rate is set and includes compensation that is paid before, at, or after consummation.

ii. Loan originator compensation excludes compensation that cannot be attributed to that transaction, including, for example:

A. Compensation based on the long term performance of the loan originator’s loans.

B. Compensation based on the overall quality of a loan originator's loan files.

C. The base salary of a loan originator. However, any compensation in addition to the base salary that can be attributed to the transaction at the time the interest rate is set must be included in loan originator compensation for the purpose of calculating points and fees.

3. *Loan originator compensation—timing*. Compensation paid to a loan originator that can be attributed to a transaction must be included in the points and fees calculation for that loan regardless of whether the compensation is paid before, at, or after consummation. The amount of loan originator compensation that can be attributed to a transaction is determined as of the date the interest rate is set. Thus, loan originator compensation for a transaction includes the portion of a bonus, commission, or award of merchandise, services, trips, or similar prizes that can be attributed to that transaction at the time the creditor sets the interest rate for the transaction, even if that bonus, commission, or award of merchandise, services, trips, or similar prizes is not paid until after consummation. For example, assume a $100,000 transaction and that, as of the date the interest rate is set, the loan originator is entitled to receive a commission equal to 1 percent of the loan amount at consummation, *i.e.*, $1,000, payable at the end of the month. In addition, assume that after the date the interest rate is set but before consummation of the transaction, the loan originator originates other transactions that enable the loan originator to meet a loan volume threshold, which increases the loan originator's commission to 1.25 percent of the loan amount, *i.e.*, $1,250. In this case, the creditor need include only $1,000 as loan originator compensation in points and fees because, as of the date the interest rate was set, the loan originator would have been entitled to receive $1,000 upon consummation of the transaction.

4. *Loan originator compensation—examples.* The following examples illustrate the rule:

i. Assume that, according to a creditor's compensation policies, the creditor awards its loan officers a bonus every year based on the number of loan applications taken by the loan officer that result in consummated transactions during that year, and that each consummated transaction increases the year-end bonus by $100. In this case, $100 of the bonus is loan originator compensation that must be included in points and fees for the transaction.

ii. Assume that, according to a creditor's compensation policies, the creditor awards its loan officers a year-end bonus equal to a flat dollar amount for each of the consummated transactions originated by the loan officer during that year. Assume also that the per-transaction dollar amount is finalized at the end of the year, according to a predetermined schedule that provides for a specific per-transaction dollar amount based on the total dollar value of consummated transactions originated by the loan officer. If on the date the interest rate for a transaction is set, the loan officer has originated total volume that qualifies the loan officer to receive a $300 bonus per transaction under the predetermined schedule, then $300 of the year-end bonus can be attributed to that particular transaction and therefore is loan originator compensation that must be included in points and fees for that transaction.

iii. Assume that, according to a creditor's compensation policies, the creditor awards its loan officers a bonus at the end of the year based on the number of consummated transactions originated by the loan officer during that year. Assume also that, for the first 10 transactions originated by the loan officer in a given year, no bonus is awarded; for the next 10 transactions originated by the loan officer up to 20, a bonus of $100 per transaction is awarded; and for each transaction originated after the first 20, a bonus of $200 per transaction is awarded. In this case, if, on the date the interest rate for the transaction is set, the loan officer has originated 10 or fewer transactions that year, then none of the year-end bonus is attributable to the transaction and therefore none of the bonus is included in points and fees for that transaction. If, on the date the interest rate for the transaction is set, the loan officer has originated at more than 10 but no more than 20 transactions, $100 of the bonus is attributable to the transaction and is included in points and fees for that transaction. If, on the date the interest rate for the transaction is set, the loan officer has originated more than 20 transactions, $200 of the bonus is attributable to the transaction and is included in points and fees for the transaction.

iv. Assume that, according to a creditor's compensation policies, the creditor pays its loan officers a base salary of $500 per week and awards its loan officers a bonus of $250 for each consummated transaction. For each transaction, none of the $500 base salary is counted in points and fees as loan originator compensation under § 1026.32(b)(1)(ii) because no precise portion of the base salary can be attributed to a particular transaction, but the $250 bonus is counted as loan originator compensation that is included in points and fees.

Paragraph 32(b)(1)(iii).

1. *Other charges.* Section 1026.32(b)(1)(iii) defines points and fees to include all items listed in § 1026.4(c)(7), other than amounts held for the future payment of taxes, unless certain exclusions apply. An item listed in § 1026.4(c)(7) may be excluded from the points and fees calculation if the charge is reasonable; the creditor receives no direct or indirect compensation from the charge; and the charge is not paid to an affiliate of the creditor. For example, a reasonable fee paid by the consumer to an independent, third-party appraiser may be excluded from the points and fees calculation (assuming no compensation is paid to the creditor or its affiliate and no charge is paid to an affiliate). By contrast, a fee paid by the consumer for an appraisal performed by the creditor must be included in the calculation, even though the fee may be excluded from the finance charge if it is bona fide and reasonable in amount.

Paragraph 32(b)(1)(iv).

1. *Credit insurance and debt cancellation or suspension coverage*. In determining points and fees for purposes of § 1026.32(b)(1), premiums paid at or before consummation for credit insurance or any debt cancellation or suspension agreement or contract are included in points and fees whether they are paid in cash or, if permitted by applicable law, financed and whether the insurance or coverage is optional or required. Such charges are also included whether the amount represents the entire premium or payment for the coverage or an initial payment.

2. *Credit property insurance*. Credit property insurance includes insurance against loss of or damage to personal property, such as a houseboat or manufactured home. Credit property insurance covers the creditor's security interest in the property. Credit property insurance does not include homeowners' insurance, which, unlike credit property insurance, typically covers not only the dwelling but its contents and protects the consumer's interest in the property.

3. *Life, accident, health, or loss-of-income insurance.* Premiums or other charges for these types of insurance are included in points and fees only if the creditor is a beneficiary. If the consumer or another person designated by the consumer is the sole beneficiary, then the premiums or other charges are not included in points and fees.

32(b)(3) Bona fide discount point.

32(b)(3)(i) Closed-end credit.

1. *Definition of bona fide discount point.* Section 1026.32(b)(3) provides that, to be bona fide, a discount point must reduce the interest rate based on a calculation that is consistent with established industry practices for determining the amount of reduction in the interest rate or time-price differential appropriate for the amount of discount points paid by the consumer. To satisfy this standard, a creditor may show that the reduction is reasonably consistent with established

industry norms and practices for secondary mortgage market transactions. For example, a creditor may rely on pricing in the to-be-announced (TBA) market for mortgage-backed securities (MBS) to establish that the interest rate reduction is consistent with the compensation that the creditor could reasonably expect to receive in the secondary market. The creditor may also establish that its interest rate reduction is consistent with established industry practices by showing that its calculation complies with requirements prescribed in Fannie Mae or Freddie Mac guidelines for interest rate reductions from bona fide discount points. For example, assume that the Fannie Mae Single-Family Selling Guide or the Freddie Mac Single Family Seller/Servicer Guide imposes a cap on points and fees but excludes from the cap discount points that result in a bona fide reduction in the interest rate. Assume the guidelines require that, for a discount point to be bona fide so that it would not count against the cap, a discount point must result in at least a 25 basis point reduction in the interest rate. Accordingly, if the creditor offers a 25 basis point interest rate reduction for a discount point and the requirements of § 1026.32(b)(1)(i)(E) or (F) are satisfied, the discount point is bona fide and is excluded from the calculation of points and fees.

32(b)(4) Total loan amount.

32(b)(4)(i) Closed-end credit.

1. *Total loan amount; examples.* Below are several examples showing how to calculate the total loan amount for closed-end mortgage loans, each using a $10,000 amount borrowed, a $300 appraisal fee, and $400 in prepaid finance charges. A $500 single premium for optional credit unemployment insurance is used in one example.

i. If the consumer finances a $300 fee for a creditor-conducted appraisal and pays $400 in prepaid finance charges at closing, the amount financed under § 1026.18(b) is $9,900 ($10,000 plus the $300 appraisal fee that is paid to and financed by the creditor, less $400 in prepaid finance charges). The $300 appraisal fee paid to the creditor is added to other points and fees under § 1026.32(b)(1)(iii). It is deducted from the amount financed ($9,900) to derive a total loan amount of $9,600.

ii. If the consumer pays the $300 fee for the creditor-conducted appraisal in cash at closing, the $300 is included in the points and fees calculation because it is paid to the creditor. However, because the $300 is not financed by the creditor, the fee is not part of the amount financed under § 1026.18(b). In this case, the amount financed is the same as the total loan amount: $9,600 ($10,000, less $400 in prepaid finance charges).

iii. If the consumer finances a $300 fee for an appraisal conducted by someone other than the creditor or an affiliate, the $300 fee is not included with other points and fees under § 1026.32(b)(1)(iii). In this case, the amount financed is the same as the total loan amount: $9,900 ($10,000 plus the $300 fee for an independently-conducted appraisal that is financed by the creditor, less the $400 paid in cash and deducted as prepaid finance charges).

iv. If the consumer finances a $300 fee for a creditor-conducted appraisal and a $500 single premium for optional credit unemployment insurance, and pays $400 in prepaid finance charges at closing, the amount financed under § 1026.18(b) is $10,400 ($10,000, plus the $300 appraisal fee that is paid to and financed by the creditor, plus the $500 insurance premium that is financed by the creditor, less $400 in prepaid finance charges). The $300 appraisal fee paid to the creditor is added to other points and fees under § 1026.32(b)(1)(ii), and the $500 insurance premium is added under 1026.32(b)(1)(iv). The $300 and $500 costs are deducted from the amount financed ($10,400) to derive a total loan amount of $9,600.

32(b)(6) Prepayment penalty.

1. *Examples of prepayment penalties; closed-end credit transactions.* For purposes of § 1026.32(b)(6)(i), the following are examples of prepayment penalties:

i. A charge determined by treating the loan balance as outstanding for a period of time after prepayment in full and applying the interest rate to such "balance," even if the charge results from interest accrual amortization used for other payments in the transaction under the terms of the loan contract. "Interest accrual amortization" refers to the method by which the amount of interest due for each period (*e.g.*, month) in a transaction's term is determined. For example, "monthly interest accrual amortization" treats each payment as made on the scheduled, monthly due date even if it is actually paid early or late (until the expiration of any grace period). Thus, under the terms of a loan contract providing for monthly interest accrual amortization, if the amount of interest due on May 1 for the preceding month of April is $3,000, the loan contract will require payment of $3,000 in interest for the month of April whether the payment is made on April 20, on May 1, or on May 10. In this example, if the consumer prepays the loan in full on April 20 and if the accrued interest as of that date is $2,000, then assessment of a charge of $3,000 constitutes a prepayment penalty of $1,000 because the amount of interest actually earned through April 20 is only $2,000.

ii. A fee, such as an origination or other loan closing cost, that is waived by the creditor on the condition that the consumer does not prepay the loan. However, the term prepayment penalty does not include a waived bona fide third-party charge imposed by the creditor if the consumer pays all of a covered transaction's principal before the date on which the principal is due sooner than 36 months after consummation. For example, assume that at consummation, the creditor waives $3,000 in closing costs to cover bona fide third-party charges but the terms of the loan agreement provide that the creditor may recoup the $3,000 in waived charges if the consumer repays the entire loan balance sooner than 36 months after consummation. The $3,000 charge is not a prepayment penalty. In contrast, for example, assume that at consummation, the creditor waives $3,000 in closing costs to cover bona fide third-party charges but the terms of the loan agreement provide that the creditor may recoup $4,500, in part to recoup waived charges, if the consumer repays the entire loan balance sooner than 36 months after consummation. The $3,000 that the creditor may impose to cover the waived bona fide third-party charges is not a prepayment penalty, but the additional $1,500 charge is a prepayment penalty and subject to the restrictions under § 1026.43(g).

iii. A minimum finance charge in a simple interest transaction.

iv. Computing a refund of unearned interest by a method that is less favorable to the consumer than the actuarial method, as defined by section 933(d) of the Housing and Community Development Act of 1992, 15 U.S.C. 1615(d). For purposes of computing a refund of unearned interest, if using the actuarial method defined by applicable State law results in a refund that is greater than the refund calculated by using the method described in section 933(d) of the Housing and Community Development Act of 1992, creditors should use the State law definition in determining if a refund is a prepayment penalty.

2. *Fees that are not prepayment penalties; closed-end credit transactions*. For purposes of § 1026.32(b)(6)(i), fees that are not prepayment penalties include, for example:

i. Fees imposed for preparing and providing documents when a loan is paid in full if such fees are imposed whether or not the loan is prepaid. Examples include a loan payoff statement, a reconveyance document, or another document releasing the creditor's security interest in the dwelling that secures the loan.

ii. Loan guarantee fees.

*	*	*	*	*

Section 1026.43—Minimum Standards for Transactions Secured by a Dwelling

1. *Record retention*. See § 1026.25(c)(3) and comments 25(c)(3)-1 and -2 for guidance on the required retention of records as evidence of compliance with § 1026.43.

43(a) Scope.

1. *Consumer credit*. In general, § 1026.43 applies to consumer credit transactions secured by a dwelling, but certain dwelling-secured consumer credit transactions are exempt or partially exempt from coverage under § 1026.43(a)(1) through (3). (See § 1026.2(a)(12) for the definition of "consumer credit.") Section 1026.43 does not apply to an extension of credit primarily for a business, commercial, or agricultural purpose, even if it is secured by a dwelling. See § 1026.3 and associated commentary for guidance in determining the primary purpose of an extension of credit. In addition, § 1026.43 does not apply to any change to an existing loan that is not treated as a refinancing under § 1026.20(a).

2. *Real property*. "Dwelling" means a residential structure that contains one to four units, whether or not the structure is attached to real property. *See* § 1026.2(a)(19). For purposes of § 1026.43, the term "dwelling" includes any real property to which the residential structure is attached that also secures the covered transaction. For example, for purposes of § 1026.43(c)(2)(i), the value of the dwelling that secures the covered transaction includes the value of any real property to which the residential structure is attached that also secures the covered transaction.

Paragraph 43(a)(3).

1. *Renewable temporary or "bridge" loan*. Under § 1026.43(a)(3)(ii), a temporary or "bridge" loan with a term of 12 months or less is exempt from § 1026.43(c) through (f).

Examples of such a loan are a loan to finance the purchase of a new dwelling where the consumer plans to sell a current dwelling within 12 months and a loan to finance the initial construction of a dwelling. Where a temporary or "bridge loan" is renewable, the loan term does not include any additional period of time that could result from a renewal provision provided that any renewal possible under the loan contract is for one year or less. For example, if a construction loan has an initial loan term of 12 months but is renewable for another 12-month loan term, the loan is exempt from § 1026.43(c) through (f) because the initial loan term is 12 months.

2. *Construction phase of a construction-to-permanent loan.* Under § 1026.43(a)(3)(iii), a construction phase of 12 months or less of a construction-to-permanent loan is exempt from § 1026.43(c) through (f). A construction-to-permanent loan is a potentially multiple-advance loan to finance the construction, rehabilitation, or improvement of a dwelling that may be permanently financed by the same creditor. For such a loan, the construction phase and the permanent phase may be treated as separate transactions for the purpose of compliance with § 1026.43(c) through (f), and the construction phase of the loan is exempt from § 1026.43(c) through (f), provided the initial term is 12 months or less. See § 1026.17(c)(6)(ii), allowing similar treatment for disclosures. Where the construction phase of a construction-to-permanent loan is renewable for a period of one year or less, the term of that construction phase does not include any additional period of time that could result from a renewal provision. For example, if the construction phase of a construction-to-permanent loan has an initial term of 12 months but is renewable for another 12-month term before permanent financing begins, the construction phase is exempt from § 1026.43(c) through (f) because the initial term is 12 months. Any renewal of one year or less also qualifies for the exemption. The permanent phase of the loan is treated as a

separate transaction and is not exempt under § 1026.43(a)(3)(iii). It may be a qualified mortgage if it satisfies the appropriate requirements.

43(b) Definitions.

43(b)(1) Covered transaction.

1. The definition of covered transaction restates the scope of the rule as described at § 1026.43(a).

43(b)(3) Fully indexed rate.

1. *Discounted and premium adjustable-rate transactions*. In some adjustable-rate transactions, creditors may set an initial interest rate that is not determined by the index or formula used to make later interest rate adjustments. In some cases, the initial rate charged to consumers is lower than the rate would be if it were calculated using the index or formula that will apply after recast, as determined at consummation (*i.e.,* a "discounted rate"). In other cases, the initial rate may be higher (*i.e.,* a "premium rate"). For purposes of determining the fully indexed rate where the initial interest rate is not determined using the index or formula for subsequent interest rate adjustments, the creditor must use the interest rate that would have applied had the creditor used such index or formula plus margin at the time of consummation. That is, in determining the fully indexed rate, the creditor must *not* take into account any discounted or premium rate. To illustrate, assume an adjustable-rate transaction where the initial interest rate is not based on an index or formula, or is based on an index or formula that will not apply after recast, and is set at 5 percent for the first five years. The loan agreement provides that future interest rate adjustments will be calculated based on a specific index plus a 3 percent margin. If the value of the index at consummation is 5 percent, the interest rate that would have been applied at consummation had the creditor based the initial rate on this index is 8 percent (5

percent plus 3 percent margin). For purposes of § 1026.43(b)(3), the fully indexed rate is 8 percent. For discussion of payment calculations based on the greater of the fully indexed rate or premium rate for purposes of the repayment ability determination under § 1026.43(c), see § 1026.43(c)(5)(i) and comment 43(c)(5)(i)-2.

2. *Index or formula value at consummation.* The value at consummation of the index or formula need not be used if the contract provides for a delay in the implementation of changes in an index value or formula. For example, if the contract specifies that rate changes are based on the index value in effect 45 days before the change date, the creditor may use any index value in effect during the 45 days before consummation in calculating the fully indexed rate.

3. *Interest rate adjustment caps*. If the terms of the legal obligation contain a periodic interest rate adjustment cap that would prevent the initial rate, at the time of the first adjustment, from changing to the rate determined using the index or formula value at consummation (*i.e.*, the fully indexed rate), the creditor must not give any effect to that rate cap when determining the fully indexed rate. That is, a creditor must determine the fully indexed rate without taking into account any periodic interest rate adjustment cap that may limit how quickly the fully indexed rate may be reached at any time during the loan term under the terms of the legal obligation. To illustrate, assume an adjustable-rate mortgage has an initial fixed rate of 5 percent for the first three years of the loan, after which the rate will adjust annually to a specified index plus a margin of 3 percent. The loan agreement provides for a 2 percent annual interest rate adjustment cap, and a lifetime maximum interest rate of 10 percent. The index value in effect at consummation is 4.5 percent; the fully indexed rate is 7.5 percent (4.5 percent plus 3 percent), regardless of the 2 percent annual interest rate adjustment cap that would limit when the fully indexed rate would take effect under the terms of the legal obligation.

4. *Lifetime maximum interest rate*. A creditor may choose, in its sole discretion, to take into account the lifetime maximum interest rate provided under the terms of the legal obligation when determining the fully indexed rate. To illustrate, assume an adjustable-rate mortgage has an initial fixed rate of 5 percent for the first three years of the loan, after which the rate will adjust annually to a specified index plus a margin of 3 percent. The loan agreement provides for a 2 percent annual interest rate adjustment cap and a lifetime maximum interest rate of 7 percent. The index value in effect at consummation is 4.5 percent; under the generally applicable rule, the fully indexed rate is 7.5 percent (4.5 percent plus 3 percent). Nevertheless, the creditor may choose to use the lifetime maximum interest rate of 7 percent as the fully indexed rate, rather than 7.5 percent, for purposes of § 1026.43(b)(3). Furthermore, if the creditor chooses to use the lifetime maximum interest rate and the loan agreement provides a range for the maximum interest rate, then the creditor complies by using the highest rate in that range as the maximum interest rate for purposes of § 1026.43(b)(3).

5. *Step-rate and fixed-rate mortgages*. Where the interest rate offered under the terms of the legal obligation is not based on, and does not vary with, an index or formula (*i.e.*, there is no fully indexed rate), the creditor must use the maximum interest rate that may apply at any time during the loan term. To illustrate:

i. Assume a step-rate mortgage with an interest rate fixed at 6.5 percent for the first two years of the loan, 7 percent for the next three years, and 7.5 percent thereafter for the remainder of loan term. For purposes of this section, the creditor must use 7.5 percent, which is the maximum rate that may apply during the loan term. “Step-rate mortgage” is defined in § 1026.18(s)(7)(ii).

ii. Assume a fixed-rate mortgage with an interest rate at consummation of 7 percent that is fixed for the 30-year loan term. For purposes of this section, the maximum interest rate that may apply during the loan term is 7 percent, which is the interest rate that is fixed at consummation. "Fixed-rate mortgage" is defined in § 1026.18(s)(7)(iii).

43(b)(4) Higher-priced covered transaction.

1. *Average prime offer rate*. The average prime offer rate is defined in § 1026.35(a)(2). For further explanation of the meaning of "average prime offer rate," and additional guidance on determining the average prime offer rate, see comments 35(a)(2)-1 through -4.

2. *Comparable transaction*. A higher-priced covered transaction is a consumer credit transaction that is secured by the consumer's dwelling with an annual percentage rate that exceeds by the specified amount the average prime offer rate for a comparable transaction as of the date the interest rate is set. The published tables of average prime offer rates indicate how to identify a comparable transaction. *See* comment 35(a)(2)-2.

3. *Rate set*. A transaction's annual percentage rate is compared to the average prime offer rate as of the date the transaction's interest rate is set (or "locked") before consummation. Sometimes a creditor sets the interest rate initially and then re-sets it at a different level before consummation. The creditor should use the last date the interest rate is set before consummation.

43(b)(5) Loan amount.

1. *Disbursement of the loan amount*. The definition of "loan amount" requires the creditor to use the entire loan amount as reflected in the loan contract or promissory note, even though the loan amount may not be fully disbursed at consummation. For example, assume the consumer enters into a loan agreement where the consumer is obligated to repay the creditor $200,000 over 15 years, but only $100,000 is disbursed at consummation and the remaining $100,000 will be disbursed during the year following consummation in a series of advances

($25,000 each quarter). For purposes of this section, the creditor must use the loan amount of $200,000, even though the loan agreement provides that only $100,000 will be disbursed to the consumer at consummation. Generally, creditors should rely on § 1026.17(c)(6) and associated commentary regarding treatment of multiple-advance and construction-to-permanent loans as single or multiple transactions. *See also* comment 43(a)(3)-2.

43(b)(6) Loan term.

1. *General*. The loan term is the period of time it takes to repay the loan amount in full. For example, a loan with an initial discounted rate that is fixed for the first two years, and that adjusts periodically for the next 28 years has a loan term of 30 years, which is the amortization period on which the periodic amortizing payments are based.

43(b)(7) Maximum loan amount.

1. *Calculation of maximum loan amount*. For purposes of § 1026.43(c)(2)(iii) and (c)(5)(ii)(C), a creditor must determine the maximum loan amount for a negative amortization loan by using the loan amount plus any increase in principal balance that can result from negative amortization based on the terms of the legal obligation. In determining the maximum loan amount, a creditor must assume that the consumer makes the minimum periodic payment permitted under the loan agreement for as long as possible, until the consumer must begin making fully amortizing payments; and that the interest rate rises as quickly as possible after consummation under the terms of the legal obligation. Thus, creditors must assume that the consumer makes the minimum periodic payment until any negative amortization cap is reached or until the period permitting minimum periodic payments expires, whichever occurs first. "Loan amount" is defined in § 1026.43(b)(5); "negative amortization loan" is defined in § 1026.18(s)(7)(v).

2. *Assumed interest rate*. In calculating the maximum loan amount for an adjustable-rate mortgage that is a negative amortization loan, the creditor must assume that the interest rate will increase as rapidly as possible after consummation, taking into account any periodic interest rate adjustment caps provided in the loan agreement. For an adjustable-rate mortgage with a lifetime maximum interest rate but no periodic interest rate adjustment cap, the creditor must assume that the interest rate increases to the maximum lifetime interest rate at the first adjustment.

3. *Examples*. The following are examples of how to determine the maximum loan amount for a negative amortization loan (all amounts shown are rounded, and all amounts are calculated using non-rounded values):

i. *Adjustable-rate mortgage with negative amortization.* A. Assume an adjustable-rate mortgage in the amount of $200,000 with a 30-year loan term. The loan agreement provides that the consumer can make minimum monthly payments that cover only part of the interest accrued each month until the principal balance reaches 115 percent of its original balance (*i.e.,* a negative amortization cap of 115 percent) or for the first five years of the loan (60 monthly payments), whichever occurs first. The introductory interest rate at consummation is 1.5 percent. One month after the first day of the first full calendar month following consummation, the interest rate adjusts and will adjust monthly thereafter based on the specified index plus a margin of 3.5 percent. The maximum lifetime interest rate is 10.5 percent; there are no other periodic interest rate adjustment caps that limit how quickly the maximum lifetime rate may be reached. The minimum monthly payment for the first year is based on the initial interest rate of 1.5 percent. After that, the minimum monthly payment adjusts annually, but may increase by no more than 7.5 percent over the previous year's payment. The minimum monthly payment is $690 in the first year, $742 in the second year, and $797 in the first part of the third year.

B. To determine the maximum loan amount, assume that the initial interest rate increases to the maximum lifetime interest rate of 10.5 percent at the first adjustment (*i.e.*, the due date of the first periodic monthly payment) and accrues at that rate until the loan is recast. Assume the consumer makes the minimum monthly payments as scheduled, which are capped at 7.5 percent from year-to-year. As a result, the consumer's minimum monthly payments are less than the interest accrued each month, resulting in negative amortization (*i.e.*, the accrued but unpaid interest is added to the principal balance). Thus, assuming that the consumer makes the minimum monthly payments for as long as possible and that the maximum interest rate of 10.5 percent is reached at the first rate adjustment (*i.e.*, the due date of the first periodic monthly payment), the negative amortization cap of 115 percent is reached on the due date of the 27th monthly payment and the loan is recast. The maximum loan amount as of the due date of the 27th monthly payment is $229,251.

ii. *Fixed-rate, graduated payment mortgage with negative amortization*. A loan in the amount of $200,000 has a 30-year loan term. The loan agreement provides for a fixed interest rate of 7.5 percent, and requires the consumer to make minimum monthly payments during the first year, with payments increasing 12.5 percent over the previous year every year for four years. The payment schedule provides for payments of $943 in the first year, $1,061 in the second year, $1,193 in the third year, $1,343 in the fourth year, and $1,511 for the remaining term of the loan. During the first three years of the loan, the payments are less than the interest accrued each month, resulting in negative amortization. Assuming that the consumer makes the minimum periodic payments for as long as possible, the maximum loan amount is $207,662, which is reached at the end of the third year of the loan (on the due date of the 36th monthly payment). See comment 43(c)(5)(ii)(C)-3 providing examples of how to determine the consumer’s repayment ability for a negative amortization loan.

43(b)(8) Mortgage-related obligations.

1. *General.* Section 1026.43(b)(8) defines mortgage-related obligations, which must be considered in determining a consumer’s ability to repay pursuant to § 1026.43(c). Section 1026.43(b)(8) includes, in the evaluation of mortgage-related obligations, fees and special assessments owed to a condominium, cooperative, or homeowners association. Section 1026.43(b)(8) includes ground rent and leasehold payments in the definition of mortgage-related obligations. See commentary to § 1026.43(c)(2)(v) regarding the requirement to take into account any mortgage-related obligations for purposes of determining a consumer’s ability to repay.

2. *Property taxes.* Section 1026.43(b)(8) includes property taxes in the evaluation of mortgage-related obligations. Obligations that are related to the ownership or use of real property and paid to a taxing authority, whether on a monthly, quarterly, annual, or other basis, are property taxes for purposes of § 1026.43(b)(8). Section 1026.43(b)(8) includes obligations that are equivalent to property taxes, even if such obligations are not denominated as “taxes.” For example, governments may establish or allow independent districts with the authority to impose levies on properties within the district to fund a special purpose, such as a local development bond district, water district, or other public purpose. These levies may be referred to as taxes, assessments, surcharges, or by some other name. For purposes of § 1026.43(b)(8), these are property taxes and are included in the determination of mortgage-related obligations.

3. *Insurance premiums and similar charges*. Section 1026.43(b)(8) includes in the evaluation of mortgage-related obligations premiums and similar charges identified in § 1026.4(b)(5), (7), (8), or (10) that are required by the creditor. This includes all premiums or

charges related to coverage protecting the creditor against a consumer's default, credit loss, collateral loss, or similar loss, if the consumer is required to pay the premium or charge. For example, if Federal law requires flood insurance to be obtained in connection with the mortgage loan, the flood insurance premium is a mortgage-related obligation for purposes of § 1026.43(b)(8). Section 1026.43(b)(8) does not include premiums or similar charges identified in § 1026.4(b)(5), (7), (8), or (10) that are not required by the creditor and that the consumer purchases voluntarily. For example:

i. If a creditor does not require earthquake insurance to be obtained in connection with the mortgage loan, but the consumer voluntarily chooses to purchase such insurance, the earthquake insurance premium is not a mortgage-related obligation for purposes of § 1026.43(b)(8).

ii. If a creditor requires a minimum amount of coverage for homeowners' insurance and the consumer voluntarily chooses to purchase a more comprehensive amount of coverage, the portion of the premium allocated to the required minimum coverage is a mortgage-related obligation for purposes of § 1026.43(b)(8), while the portion of the premium allocated to the more comprehensive coverage voluntarily purchased by the consumer is not a mortgage-related obligation for purposes of § 1026.43(b)(8).

iii. If the consumer purchases insurance or similar coverage not required by the creditor at consummation without having requested the specific non-required insurance or similar coverage and without having agreed to the premium or charge for the specific non-required insurance or similar coverage prior to consummation, the premium or charge is not voluntary for purposes of § 1026.43(b)(8) and is a mortgage-related obligation.

4. *Mortgage insurance, guarantee, or similar charges*. Section 1026.43(b)(8) includes in the evaluation of mortgage-related obligations premiums or charges protecting the creditor

against the consumer's default or other credit loss. This includes all premiums or similar charges, whether denominated as mortgage insurance, guarantee insurance, or otherwise, as determined according to applicable State or Federal law. For example, monthly "private mortgage insurance" payments paid to a non-governmental entity, annual "guarantee fee" payments required by a Federal housing program, and a quarterly "mortgage insurance" payment paid to a State agency administering a housing program are all mortgage-related obligations for purposes of § 1026.43(b)(8). Section 1026.43(b)(8) includes these charges in the definition of mortgage-related obligations if the creditor requires the consumer to pay them, even if the consumer is not legally obligated to pay the charges under the terms of the insurance program. For example, if a mortgage insurance program obligates the creditor to make recurring mortgage insurance payments, and the creditor requires the consumer to reimburse the creditor for such recurring payments, the consumer's payments are mortgage-related obligations for purposes of § 1026.43(b)(8). However, if a mortgage insurance program obligates the creditor to make recurring mortgage insurance payments, and the creditor does not require the consumer to reimburse the creditor for the cost of the mortgage insurance payments, the recurring mortgage insurance payments are not mortgage-related obligations for purposes of § 1026.43(b)(8).

5. *Relation to the finance charge.* Section 1026.43(b)(8) includes in the evaluation of mortgage-related obligations premiums and similar charges identified in § 1026.4(b)(5), (7), (8), or (10) that are required by the creditor. These premiums and similar charges are mortgage-related obligations regardless of whether the premium or similar charge is excluded from the finance charge pursuant to § 1026.4(d). For example, a premium for insurance against loss or damage to the property written in connection with the credit transaction is a premium identified in § 1026.4(b)(8). If this premium is required by the creditor, the premium is a mortgage-related

obligation pursuant to § 1026.43(b)(8), regardless of whether the premium is excluded from the finance charge pursuant to § 1026.4(d)(2).

43(b)(11) Recast.

1. *Date of the recast*. The term "recast" means, 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. To illustrate: 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. Thus, the term of the loan remaining as of the date the loan is recast is 25 years (300 months).

43(b)(12) Simultaneous loan.

1. *General*. Section 1026.43(b)(12) defines a simultaneous loan as another covered transaction or a home equity line of credit (HELOC) subject to § 1026.40 that will be secured by the same dwelling and made to the same consumer at or before consummation of the covered transaction, whether it is made by the same creditor or a third-party creditor. (As with all of § 1026.43, the term "dwelling" includes any real property attached to a dwelling.) For example, assume a consumer will enter into a legal obligation that is a covered transaction with Creditor A. Immediately prior to consummation of the covered transaction with Creditor A, the consumer

opens a HELOC that is secured by the same dwelling with Creditor B. For purposes of this section, the loan extended by Creditor B is a simultaneous loan. See commentary to § 1026.43(c)(2)(iv) and (c)(6), discussing the requirement to consider the consumer's payment obligation on any simultaneous loan for purposes of determining the consumer's ability to repay the covered transaction subject to this section.

2. *Same consumer*. For purposes of the definition of "simultaneous loan," the term "same consumer" includes any consumer, as that term is defined in § 1026.2(a)(11), that enters into a loan that is a covered transaction and also enters into another loan (*e.g.,* second-lien covered transaction or HELOC) secured by the same dwelling. Where two or more consumers enter into a legal obligation that is a covered transaction, but only one of them enters into another loan secured by the same dwelling, the "same consumer" includes the person that has entered into both legal obligations. For example, assume Consumer A and Consumer B will both enter into a legal obligation that is a covered transaction with a creditor. Immediately prior to consummation of the covered transaction, Consumer B opens a HELOC that is secured by the same dwelling with the same creditor; Consumer A is not a signatory to the HELOC. For purposes of this definition, Consumer B is the same consumer and the creditor must include the HELOC as a simultaneous loan.

43(b)(13) Third-party record.

1. *Electronic records*. Third-party records include records transmitted electronically. For example, to verify a consumer's credit history using third-party records as required by § 1026.43(c)(2)(viii) and 1026.43(c)(3), a creditor may use a credit report prepared by a consumer reporting agency that is transmitted electronically.

2. *Forms*. A record prepared by a third party includes a form a creditor gives to a third

party to provide information, even if the creditor completes parts of the form unrelated to the information sought. For example, if a creditor gives a consumer's employer a form for verifying the consumer's employment status and income, the creditor may fill in the creditor's name and other portions of the form unrelated to the consumer's employment status or income.

Paragraph 43(b)(13)(i).

1. *Reviewed record*. Under § 1026.43(b)(13)(i), a third-party record includes a document or other record prepared by the consumer, the creditor, the mortgage broker, or the creditor's or mortgage broker's agent, if the record is reviewed by an appropriate third party. For example, a profit-and-loss statement prepared by a self-employed consumer and reviewed by a third-party accountant is a third-party record under § 1026.43(b)(13)(i). In contrast, a profit-and-loss statement prepared by a self-employed consumer and reviewed by the consumer's non-accountant spouse is not a third-party record under § 1026.43(b)(13)(i).

Paragraph 43(b)(13)(iii).

1. *Creditor's records*. Section 1026.43(b)(13)(iii) provides that a third-party record includes a record the creditor maintains for an account of the consumer held by the creditor. Examples of such accounts include checking accounts, savings accounts, and retirement accounts. Examples of such accounts also include accounts related to a consumer's outstanding obligations to a creditor. For example, a third-party record includes the creditor's records for a first-lien mortgage to a consumer who applies for a subordinate-lien home equity loan.

43(c) Repayment ability.

43(c)(1) General requirement.

1. *Reasonable and good faith determination. i. General.* Creditors generally are required by § 1026.43(c)(1) to make reasonable and good faith determinations of consumers' ability to

repay. Section 1026.43(c) and the accompanying commentary describe certain requirements for making this ability-to-repay determination, but do not provide comprehensive underwriting standards to which creditors must adhere. For example, the rule and commentary do not specify how much income is needed to support a particular level of debt or how credit history should be weighed against other factors. So long as creditors consider the factors set forth in § 1026.43(c)(2) according to the requirements of § 1026.43(c), creditors are permitted to develop their own underwriting standards and make changes to those standards over time in response to empirical information and changing economic and other conditions. Whether a particular ability-to-repay determination is reasonable and in good faith will depend not only on the underwriting standards adopted by the creditor, but on the facts and circumstances of an individual extension of credit and how a creditor's underwriting standards were applied to those facts and circumstances. A consumer's statement or attestation that the consumer has the ability to repay the loan is not indicative of whether the creditor's determination was reasonable and in good faith.

ii. *Considerations.* A. The following may be evidence that a creditor's ability-to-repay determination was reasonable and in good faith:

1. The consumer demonstrated actual ability to repay the loan by making timely payments, without modification or accommodation, for a significant period of time after consummation or, for an adjustable-rate, interest-only, or negative-amortization mortgage, for a significant period of time after recast;

2. The creditor used underwriting standards that have historically resulted in comparatively low rates of delinquency and default during adverse economic conditions; or

3. The creditor used underwriting standards based on empirically derived, demonstrably and statistically sound models.

B. In contrast, the following may be evidence that a creditor's ability-to-repay determination was not reasonable or in good faith:

1. The consumer defaulted on the loan a short time after consummation or, for an adjustable-rate, interest-only, or negative-amortization mortgage, a short time after recast;

2. The creditor used underwriting standards that have historically resulted in comparatively high levels of delinquency and default during adverse economic conditions;

3. The creditor applied underwriting standards inconsistently or used underwriting standards different from those used for similar loans without reasonable justification;

4. The creditor disregarded evidence that the underwriting standards it used are not effective at determining consumers' repayment ability;

5. The creditor disregarded evidence that the consumer may have insufficient residual income to cover other recurring obligations and expenses, taking into account the consumer's assets other than the property securing the loan, after paying his or her monthly payments for the covered transaction, any simultaneous loans, mortgage-related obligations, and any current debt obligations; or

6. The creditor disregarded evidence that the consumer would have the ability to repay only if the consumer subsequently refinanced the loan or sold the property securing the loan.

C. All of the considerations listed in paragraphs (A) and (B) above may be relevant to whether a creditor's ability-to-repay determination was reasonable and in good faith. However, these considerations are not requirements or prohibitions with which creditors must comply, nor are they elements of a claim that a consumer must prove to establish a violation of the ability-to-repay requirements. For example, creditors are not required to validate their underwriting criteria using mathematical models. These considerations also are not absolute in their application; instead they exist on a continuum and may apply to varying degrees. For example, the longer a consumer successfully makes timely payments after consummation or recast the less likely it is that the creditor's determination of ability to repay was unreasonable or not in good faith. Finally, each of these considerations must be viewed in the context of all facts and circumstances relevant to a particular extension of credit. For example, in some cases inconsistent application of underwriting standards may indicate that a creditor is manipulating those standards to approve a loan despite a consumer's inability to repay. The creditor's ability-to-repay determination therefore may be unreasonable or in bad faith. However, in other cases inconsistently applied underwriting standards may be the result of, for example, inadequate training and may nonetheless yield a reasonable and good faith ability-to-repay determination in a particular case. Similarly, although an early payment default on a mortgage will often be persuasive evidence that the creditor did not have a reasonable and good faith belief in the consumer's ability to repay (and such evidence may even be sufficient to establish a prima facie case of an ability-to-repay violation), a particular ability-to-repay determination may be reasonable and in good faith even though the consumer defaulted shortly after consummation if, for example, the consumer experienced a sudden and unexpected loss of income. In contrast, an ability-to-repay determination may be unreasonable or not in good faith even though the consumer made timely payments for a significant period of time if, for example, the consumer was able to make those payments only by foregoing necessities such as food and heat.

2. *Repayment ability at consummation*. Section 1026.43(c)(1) requires the creditor to determine, at or before the time the loan is consummated, that a consumer will have a reasonable ability to repay the loan. A change in the consumer's circumstances after consummation (for

example, a significant reduction in income due to a job loss or a significant obligation arising from a major medical expense) that cannot be reasonably anticipated from the consumer's application or the records used to determine repayment ability is not relevant to determining a creditor's compliance with the rule. However, if the application or records considered at or before consummation indicate there will be a change in a consumer's repayment ability after consummation (for example, if a consumer's application states that the consumer plans to retire within 12 months without obtaining new employment or that the consumer will transition from full-time to part-time employment), the creditor must consider that information under the rule.

3. *Interaction with Regulation B.* Section 1026.43(c)(1) does not require or permit the creditor to make inquiries or verifications prohibited by Regulation B, 12 CFR part 1002.

43(c)(2) Basis for determination.

1. *General.* Section 1026.43(c)(2) sets forth factors creditors must consider when making the ability-to-repay determination required under § 1026.43(c)(1) and the accompanying commentary provides guidance regarding these factors. Creditors must conform to these requirements and may rely on guidance provided in the commentary. However, § 1026.43(c) and the accompanying commentary do not provide comprehensive guidance on definitions and other technical underwriting criteria necessary for evaluating these factors in practice. So long as a creditor complies with the provisions of § 1026.43(c), the creditor is permitted to use its own definitions and other technical underwriting criteria. A creditor may, but is not required to, look to guidance issued by entities such as the Federal Housing Administration, the U.S. Department of Veterans Affairs, the U.S. Department of Agriculture, or Fannie Mae or Freddie Mac while operating under the conservatorship of the Federal Housing Finance Agency. For example, a creditor may refer to such guidance to classify particular inflows, obligations, or property as

"income," "debt," or "assets." Similarly, a creditor may refer to such guidance to determine what information to use when evaluating the income of a self-employed or seasonally employed consumer or what information to use when evaluating the credit history of a consumer who has obtained few or no extensions of traditional "credit" as defined in § 1026.2(a)(14). These examples are illustrative, and creditors are not required to conform to guidance issued by these or other such entities. However, as required by § 1026.43(c)(1), a creditor must ensure that its underwriting criteria, as applied to the facts and circumstances of a particular extension of credit, result in a reasonable, good faith determination of a consumer's ability to repay. For example, a definition used in underwriting that is reasonable in isolation may lead to ability-to-repay determinations that are unreasonable or not in good faith when considered in the context of a creditor's underwriting standards or when adopted or applied in bad faith. Similarly, an ability-to-repay determination is not unreasonable or in bad faith merely because the underwriting criteria used included a definition that was by itself unreasonable.

Paragraph 43(c)(2)(i).

1. *Income or assets generally*. A creditor may base its determination of repayment ability on current or reasonably expected income from employment or other sources, assets other than the dwelling that secures the covered transaction, or both. The creditor may consider any type of current or reasonably expected income, including, for example, the following: 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. The creditor may consider any of the consumer's assets, other than the value of the dwelling that secures the covered transaction, including, for example, the following: funds in a

savings or checking account, amounts vested in a retirement account, stocks, bonds, certificates of deposit, and amounts available to the consumer from a trust fund. (As stated in § 1026.43(a), the value of the dwelling includes the value of the real property to which the residential structure is attached, if the real property also secures the covered transaction.)

2. *Income or assets relied on*. A creditor need consider only the income or assets necessary to support a determination that the consumer can repay the covered transaction. For example, if a consumer's loan application states that the consumer earns an annual salary from both a full-time job and a part-time job and the creditor reasonably determines that the consumer's income from the full-time job is sufficient to repay the loan, the creditor need not consider the consumer's income from the part-time job. Further, a creditor need verify only the income (or assets) relied on to determine the consumer's repayment ability. *See* comment 43(c)(4)-1.

3. *Reasonably expected income*. If a creditor relies on expected income in excess of the consumer's income, either in addition to or instead of current income, the expectation that the income will be available for repayment must be reasonable and verified with third-party records that provide reasonably reliable evidence of the consumer's expected income. For example, if the creditor relies on an expectation that a consumer will receive an annual bonus, the creditor may verify the basis for that expectation with records that show the consumer's past annual bonuses, and the expected bonus must bear a reasonable relationship to the past bonuses. Similarly, if the creditor relies on a consumer's expected salary from a job the consumer has accepted and will begin after receiving an educational degree, the creditor may verify that expectation with a written statement from an employer indicating that the consumer will be employed upon graduation at a specified salary.

4. *Seasonal or irregular income*. A creditor reasonably may determine that a consumer can make periodic loan payments even if the consumer's income, such as self-employment income, is seasonal or irregular. For example, assume a consumer receives seasonal income from the sale of crops or from agricultural employment. Each year, the consumer's income arrives during only a few months. If the creditor determines that the consumer's annual income divided equally across 12 months is sufficient for the consumer to make monthly loan payments, the creditor reasonably may determine that the consumer can repay the loan, even though the consumer may not receive income during certain months.

5. *Multiple applicants*. When two or more consumers apply for an extension of credit as joint obligors with primary liability on an obligation, § 1026.43(c)(2)(i) does not require the creditor to consider income or assets that are not needed to support the creditor's repayment ability determination. If the income or assets of one applicant are sufficient to support the creditor's repayment ability determination, the creditor is not required to consider the income or assets of the other applicant. For example, if a husband and wife jointly apply for a loan and the creditor reasonably determines that the wife's income is sufficient to repay the loan, the creditor is not required to consider the husband's income.

Paragraph 43(c)(2)(ii).

1. *Employment status and income*. Employment status need not be full-time, and employment need not occur at regular intervals. If, in determining the consumer's repayment ability, the creditor relies on income from the consumer's employment, then that employment may be, for example, full-time, part-time, seasonal, irregular, military, or self-employment, so long as the creditor considers those characteristics of the employment. Under § 1026.43(c)(2)(ii), a creditor must verify a consumer's current employment status only if the

creditor relies on the consumer's employment income in determining the consumer's repayment ability. For example, if a creditor relies wholly on a consumer's investment income to determine repayment ability, the creditor need not verify or document employment status. See comments 43(c)(2)(i)-5 and 43(c)(4)-2 for guidance on which income to consider when multiple consumers apply jointly for a loan.

Paragraph 43(c)(2)(iii).

1. *General*. For purposes of the repayment ability determination required under § 1026.43(c)(2), a creditor must consider the consumer's monthly payment on a covered transaction that is calculated as required under § 1026.43(c)(5).

Paragraph 43(c)(2)(iv).

1. *Home equity lines of credit*. For purposes of § 1026.43(c)(2)(iv), a simultaneous loan includes any covered transaction or home equity line of credit (HELOC) subject to § 1026.40 that will be made to the same consumer at or before consummation of the covered transaction and secured by the same dwelling that secures the covered transaction. A HELOC that is a simultaneous loan that the creditor knows or has reason to know about must be considered as a mortgage obligation in determining a consumer's ability to repay the covered transaction even though the HELOC is not a covered transaction subject to § 1026.43. See § 1026.43(a) discussing the scope of this section. "Simultaneous loan" is defined in § 1026.43(b)(12). For further explanation of "same consumer," see comment 43(b)(12)-2.

2. *Knows or has reason to know*. In determining a consumer's repayment ability for a covered transaction under § 1026.43(c)(2), a creditor must consider the consumer's payment obligation on any simultaneous loan that the creditor knows or has reason to know will be or has been made at or before consummation of the covered transaction. For example, where a covered

transaction is a home purchase loan, the creditor must consider the consumer's periodic payment obligation for any "piggyback" second-lien loan that the creditor knows or has reason to know will be used to finance part of the consumer's down payment. The creditor complies with this requirement where, for example, the creditor follows policies and procedures that are designed to determine whether at or before consummation the same consumer has applied for another credit transaction secured by the same dwelling. To illustrate, assume a creditor receives an application for a home purchase loan where the requested loan amount is less than the home purchase price. The creditor's policies and procedures must require the consumer to state the source of the down payment and provide verification. If the creditor determines the source of the down payment is another extension of credit that will be made to the same consumer at or before consummation and secured by the same dwelling, the creditor knows or has reason to know of the simultaneous loan and must consider the simultaneous loan. Alternatively, if the creditor has information that suggests the down payment source is the consumer's existing assets, the creditor would be under no further obligation to determine whether a simultaneous loan will be extended at or before consummation of the covered transaction. The creditor is not obligated to investigate beyond reasonable underwriting policies and procedures to determine whether a simultaneous loan will be extended at or before consummation of the covered transaction.

3. *Scope of timing*. For purposes of § 1026.43(c)(2)(iv), a simultaneous loan includes a loan that comes into existence concurrently with the covered transaction subject to § 1026.43(c). A simultaneous loan does not include a credit transaction that occurs after consummation of the covered transaction that is subject to this section. However, any simultaneous loan that specifically covers closing costs of the covered transaction, but is scheduled to be extended after consummation must be considered for the purposes of § 1026.43(c)(2)(iv).

Paragraph 43(c)(2)(v).

1. *General.* A creditor must include in its repayment ability assessment the consumer's monthly payment for mortgage-related obligations, such as the expected property taxes and premiums or similar charges identified in § 1026.4(b)(5), (7), (8), or (10) that are required by the creditor. See § 1026.43(b)(8) defining the term "mortgage-related obligations." Mortgage-related obligations must be included in the creditor's determination of repayment ability regardless of whether the amounts are included in the monthly payment or whether there is an escrow account established. Section 1026.43(c)(2)(v) includes only payments that occur on an ongoing or recurring basis in the evaluation of the consumer's monthly payment for mortgage-related obligations. One-time charges, or obligations satisfied at or before consummation, are not ongoing or recurring, and are therefore not part of the consumer's monthly payment for purposes of § 1026.43(c)(2)(v). For example:

i. Assume that a consumer will be required to pay property taxes, as described in comment 43(b)(8)-2, on a quarterly, annual, or other basis after consummation. Section 1026.43(c)(2)(v) includes these recurring property taxes in the evaluation of the consumer's monthly payment for mortgage-related obligations. However, if the consumer will incur a one-time charge to satisfy property taxes that are past due, § 1026.43(c)(2)(v) does not include this one-time charge in the evaluation of the consumer's monthly payment for mortgage-related obligations.

ii. Assume that a consumer will be required to pay mortgage insurance premiums, as described in comment 43(b)(8)-2, on a monthly, annual, or other basis after consummation. Section 1026.43(c)(2)(v) includes these recurring mortgage insurance payments in the evaluation of the consumer's monthly payment for mortgage-related obligations. However, if the consumer will incur a one-time fee or charge for mortgage insurance or similar purposes, such as an up-front mortgage insurance premium imposed at consummation, § 1026.43(c)(2)(v) does not include this up-front mortgage insurance premium in the evaluation of the consumer's monthly payment for mortgage-related obligations.

2. *Obligations to an association, other than special assessments*. Section 1026.43(b)(8) defines mortgage-related obligations to include obligations owed to a condominium, cooperative, or homeowners association. However, § 1026.43(c)(2)(v) does not require a creditor to include in the evaluation of the consumer's monthly payment for mortgage-related obligations payments to such associations imposed in connection with the extension of credit, or imposed as an incident to the transfer of ownership, if such obligations are fully satisfied at or before consummation. For example, if a homeowners association imposes a one-time transfer fee on the transaction, and the consumer will pay the fee at or before consummation, § 1026.43(c)(2)(v) does not require the creditor to include this one-time transfer fee in the evaluation of the consumer's monthly payment for mortgage-related obligations. Section 1026.43(c)(2)(v) also does not require the creditor to include this fee in the evaluation of the consumer's monthly payment for mortgage-related obligations if the consumer finances the fee in the loan amount. However, if the consumer incurs the obligation and will satisfy the obligation with recurring payments after consummation, regardless of whether the obligation is escrowed, § 1026.43(c)(2)(v) requires the creditor to include the transfer fee in the evaluation of the consumer's monthly payment for mortgage-related obligations.

3. *Special assessments imposed by an association*. Section 1026.43(b)(8) defines mortgage-related obligations to include special assessments imposed by a condominium, cooperative, or homeowners association. Section 1026.43(c)(2)(v) does not require a creditor to

include special assessments in the evaluation of the consumer’s monthly payment for mortgage-related obligations if the special assessments are fully satisfied at or before consummation. For example, if a homeowners association imposes a special assessment that the consumer will have to pay in full at or before consummation, § 1026.43(c)(2)(v) does not include the special assessment in the evaluation of the consumer’s monthly payment for mortgage-related obligations. Section 1026.43(c)(2)(v) does not require a creditor to include special assessments in the evaluation of the consumer’s monthly payment for mortgage-related obligations if the special assessments are imposed as a one-time charge. For example, if a homeowners association imposes a special assessment that the consumer will have to satisfy in one payment, § 1026.43(c)(2)(v) does not include this one-time special assessment in the evaluation of the consumer’s monthly payment for mortgage-related obligations. However, if the consumer will pay the special assessment on a recurring basis after consummation, regardless of whether the consumer’s payments for the special assessment are escrowed, § 1026.43(c)(2)(v) requires the creditor to include this recurring special assessment in the evaluation of the consumer’s monthly payment for mortgage-related obligations.

4. *Pro rata amount.* For purposes of § 1026.43(c)(2)(v), the creditor may divide the recurring payments for mortgage-related obligations into monthly, pro rata amounts. In considering a mortgage-related obligation that is not paid monthly, if the mortgage loan is originated pursuant to a government program the creditor may determine the pro rata monthly amount of the mortgage-related obligation in accordance with the specific requirements of that program. If the mortgage loan is originated pursuant to a government program that does not contain specific standards for determining the pro rata monthly amount of the mortgage-related obligation, or if the mortgage loan is not originated pursuant to a government program, the

creditor complies with § 1026.43(c)(2)(v) by dividing the total amount of a particular non-monthly mortgage-related obligation by no more than the number of months from the month that the non-monthly mortgage-related obligation was due prior to consummation until the month that the non-monthly mortgage-related obligation will be due after consummation. When determining the pro rata monthly payment amount, the creditor may also consider comment 43(c)(2)(v)-5, which explains that the creditor need not project potential changes. The following examples further illustrate how a creditor may determine the pro rata monthly amount of mortgage-related obligations, pursuant to § 1026.43(c)(2)(v):

i. Assume that a consumer applies for a mortgage loan on February 1st. Assume further that the subject property is located in a jurisdiction where property taxes are paid in arrears on the first day of October. The creditor complies with § 1026.43(c)(2)(v) by determining the annual property tax amount owed in the prior October, dividing the amount by 12, and using the resulting amount as the pro rata monthly property tax payment amount for the determination of the consumer's monthly payment for mortgage-related obligations. The creditor complies even if the consumer will likely owe more in the next year than the amount owed the prior October because the jurisdiction normally increases the property tax rate annually, provided that the creditor does not have knowledge of an increase in the property tax rate at the time of underwriting. See also comment 43(c)(2)(v)-5 regarding estimates of mortgage-related obligations.

ii. Assume that a subject property is located in a special water district, the assessments for which are billed separately from local property taxes. The creditor complies with § 1026.43(c)(2)(v) by dividing the full amount that will be owed by the number of months in the assessment period, and including the resulting amount in the calculation of monthly mortgage-related obligations. However, § 1026.43(c)(2)(v) does not require a creditor to adjust the monthly amount to account for potential deviations from the average monthly amount. For example, assume in this example that the special water assessment is billed every eight months, that the consumer will have to pay the first water district bill four months after consummation, and that the seller will not provide the consumer with any funds to pay for the seller's obligation (*i.e.*, the four months prior to consummation). Although the consumer will be required to budget twice the average monthly amount to pay the first water district bill, § 1026.43(c)(2)(v) does not require the creditor to use the increased amount; the creditor complies with § 1026.43(c)(2)(v) by using the average monthly amount.

iii. Assume that the subject property is located in an area where flood insurance is required by Federal law, and assume further that the flood insurance policy premium is paid every three years following consummation. The creditor complies with § 1026.43(c)(2)(v) by dividing the three-year premium by 36 months and including the resulting amount in the determination of the consumer's monthly payment for mortgage-related obligations. The creditor complies even if the consumer will not establish a monthly escrow for flood insurance.

iv. Assume that the subject property is part of a homeowners association that has imposed upon the seller a special assessment of $1,200. Assume further that this special assessment will become the consumer's obligation upon consummation of the transaction, that the consumer is permitted to pay the special assessment in twelve $100 installments after consummation, and that the mortgage loan will not be originated pursuant to a government program that contains specific requirements for prorating special assessments. The creditor complies with § 1026.43(c)(2)(v) by dividing the $1,200 special assessment by 12 months and including the resulting $100 monthly amount in the determination of the consumer's monthly payment for mortgage-related obligations. The creditor complies by using this calculation even if the consumer intends to pay the special assessment in a manner other than that used by the creditor in determining the monthly pro rata amount, such as where the consumer intends to pay six $200 installments.

5. *Estimates*. Estimates of mortgage-related obligations should be based upon information that is known to the creditor at the time the creditor underwrites the mortgage obligation. Information is known if it is reasonably available to the creditor at the time of underwriting the loan. Creditors may rely on guidance provided under comment 17(c)(2)(i)-1 in determining if information is reasonably available. For purposes of this section, the creditor need not project potential changes, such as by estimating possible increases in taxes and insurance. See comment 43(c)(2)(v)-4 for additional examples discussing the projection of potential changes. The following examples further illustrate the requirements of § 1026.43(c)(2)(v):

i. Assume that the property is subject to a community governance association, such as a homeowners association. The creditor complies with § 1026.43(c)(2)(v) by relying on an estimate of mortgage-related obligations prepared by the homeowners association. In accordance with the guidance provided under comment 17(c)(2)(i)-1, the creditor need only exercise due diligence in determining mortgage-related obligations, and complies with § 1026.43(c)(2)(v) by relying on the representations of other reliable parties in preparing estimates.

ii. Assume that the homeowners association has imposed a special assessment on the seller, but the seller does not inform the creditor of the special assessment, the homeowners association does not include the special assessment in the estimate of expenses prepared for the creditor, and the creditor is unaware of the special assessment. The creditor complies with

§ 1026.43(c)(2)(v) if it does not include the special assessment in the determination of mortgage-related obligations. The creditor may rely on the representations of other reliable parties, in accordance with the guidance provided under comment 17(c)(2)(i)-1.

iii. Assume that the homeowners association imposes a special assessment after the creditor has completed underwriting, but prior to consummation. The creditor does not violate § 1026.43(c)(2)(v) if the creditor does not include the special assessment in the determination of the consumer's monthly payment for mortgage-related obligations, provided the homeowners association does not inform the creditor about the special assessment during underwriting. Section 1026.43(c)(2)(v) does not require the creditor to re-underwrite the loan. The creditor has complied with § 1026.43(c)(2)(v) by including the obligations known to the creditor at the time the loan is underwritten, even if the creditor learns of new mortgage-related obligations before the transaction is consummated.

Paragraph 43(c)(2)(vi).

1. *Consideration of current debt obligations.* Section 1026.43(c)(2)(vi) requires creditors to consider a consumer's current debt obligations and any alimony or child support the consumer is required to pay. Examples of current debt obligations include student loans, automobile loans, revolving debt, and existing mortgages that will not be paid off at or before consummation. Creditors have significant flexibility to consider current debt obligations in light of attendant facts and circumstances, including that an obligation is likely to be paid off soon after consummation. For example, a creditor may take into account that 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. Similarly, creditors should consider whether debt obligations in forbearance or deferral at the time of underwriting are likely to affect the

consumer’s ability to repay based on the payment for which the consumer will be liable upon expiration of the forbearance or deferral period and other relevant facts and circumstances, such as when the forbearance or deferral period will expire.

2. *Multiple applicants.* When two or more consumers apply for an extension of credit as joint obligors with primary liability on an obligation, § 1026.43(c)(2)(vi) requires a creditor to consider the debt obligations of all such joint applicants. For example, if a co-applicant is repaying a student loan at the time of underwriting, the creditor complies with § 1026.43(c)(2)(vi) by considering the co-applicant’s student loan obligation. If one consumer is merely a surety or guarantor, § 1026.43(c)(2)(vi) does not require a creditor to consider the debt obligations of such surety or guarantor. The requirements of § 1026.43(c)(2)(vi) do not affect the disclosure requirements of this part, such as, for example, §§ 1026.17(d), 1026.23(b), 1026.31(e), 1026.39(b)(3), and 1026.46(f).

Paragraph 43(c)(2)(vii).

1. *Monthly debt-to-income ratio and residual income*. See § 1026.43(c)(7) and its associated commentary regarding the definitions and calculations for the monthly debt-to-income ratio and residual income.

Paragraph 43(c)(2)(viii).

1. *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. Section 1026.43(c)(2)(viii) does not require creditors to obtain or consider a consolidated credit score or prescribe a minimum credit score that creditors must apply. The rule also 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. Some

aspects of a consumer's credit history, whether positive or negative, may not be directly indicative of the consumer's ability to repay. A creditor therefore may give various aspects of a consumer's credit history as much or as little weight as is appropriate to reach a reasonable, good faith determination of ability to repay. Where a consumer has obtained few or no extensions of traditional "credit," as defined in § 1026.2(a)(14), a creditor may, but is not required to, look to nontraditional credit references, such as rental payment history or utility payments.

2. *Multiple applicants.* When two or more consumers apply for an extension of credit as joint obligors with primary liability on an obligation, § 1026.43(c)(2)(viii) requires a creditor to consider the credit history of all such joint applicants. If a consumer is merely a surety or guarantor, § 1026.43(c)(2)(viii) does not require a creditor to consider the credit history of such surety or guarantor. The requirements of § 1026.43(c)(2)(viii) do not affect the disclosure requirements of this part, such as, for example, §§ 1026.17(d), 1026.23(b), 1026.31(e), 1026.39(b)(3), and 1026.46(f).

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

1. *Records specific to the individual consumer*. Records a creditor uses for verification under § 1026.43(c)(3) and (4) must be specific to the individual consumer. Records regarding average incomes in the consumer's geographic location or average wages paid by the consumer's employer, for example, are not specific to the individual consumer and are not sufficient for verification.

2. *Obtaining records*. To conduct verification under § 1026.43(c)(3) and (4), a creditor may obtain records from a third-party service provider, such as a party the consumer's employer uses to respond to income verification requests, as long as the records are reasonably reliable and specific to the individual consumer. A creditor also may obtain third-party records directly from

the consumer, likewise as long as the records are reasonably reliable and specific to the individual consumer. For example, a creditor using payroll statements to verify the consumer's income, as allowed under § 1026.43(c)(4)(iii), may obtain the payroll statements from the consumer.

3. *Credit report as a reasonably reliable third-party record*. A credit report generally is considered a reasonably reliable third-party record under § 1026.43(c)(3) for purposes of verifying items customarily found on a credit report, such as the consumer's current debt obligations, monthly debts, and credit history. Section 1026.43(c)(3) generally does not require creditors to obtain additional reasonably reliable third-party records to verify information contained in a credit report. For example, if a credit report states the existence and amount of a consumer's debt obligation, the creditor is not required to obtain additional verification of the existence or amount of that obligation. In contrast, a credit report does not serve as a reasonably reliably third-party record for purposes of verifying items that do not appear on the credit report. For example, certain monthly debt obligations, such as legal obligations like alimony or child support, may not be reflected on a credit report. Thus, a credit report that does not list a consumer's monthly alimony obligation does not serve as a reasonably reliable third-party record for purposes of verifying that obligation. If a credit report reflects a current debt obligation that a consumer has not listed on the application, the creditor complies with § 1026.43(c)(3) if the creditor considers the existence and amount of the debt obligation as it is reflected in the credit report. However, in some cases a creditor may know or have reason to know that a credit report may be inaccurate in whole or in part. For example, a creditor may have information indicating that a credit report is subject to a fraud alert, extended alert, active duty alert, or similar alert identified in 15 U.S.C. 1681c-1 or that a debt obligation listed on a credit report is subject to a

statement of dispute pursuant to 15 U.S.C. 1681i(b). A creditor may also have other reasonably reliable third-party records or other information or evidence that the creditor reasonably finds to be reliable that contradict the credit report or otherwise indicate that the credit report is inaccurate. If a creditor knows or has reason to know that a credit report may be inaccurate in whole or in part, the creditor complies with § 1026.43(c)(3) by disregarding an inaccurate or disputed item, items, or credit report, but does not have to obtain additional third-party records. The creditor may also, but is not required, to obtain other reasonably reliable third-party records to verify information with respect to which the credit report, or item therein, may be inaccurate. For example, the creditor might obtain statements or bank records regarding a particular debt obligation subject to a statement of dispute. See also comment 43(c)(3)-6, which describes a situation in which a consumer reports a debt obligation that is not listed on a credit report.

4. *Verification of simultaneous loans*. Although 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. If the creditor knows or has reason to know that there will be a simultaneous loan extended at or before consummation, the creditor may verify the simultaneous loan by obtaining third-party verification from the third-party creditor of the simultaneous loan. For example, the creditor may obtain a copy of the promissory note or other written verification from the third-party creditor. For further guidance, see comments 43(c)(3)-1 and -2 discussing verification using third-party records.

5. *Verification of mortgage-related obligations*. Creditors must make the repayment ability determination required under § 1026.43(c)(2) based on information verified from reasonably reliable records. For general guidance regarding verification see comments 43(c)(3)-1 and -2, which discuss verification using third-party records. With respect to the verification of

mortgage-related obligations that are property taxes required to be considered under § 1026.43(c)(2)(v), a record is reasonably reliable if the information in the record was provided by a governmental organization, such as a taxing authority or local government. The creditor complies with § 1026.43(c)(2)(v) by relying on property taxes referenced in the title report if the source of the property tax information was a local taxing authority. With respect to other information in a record provided by an entity assessing charges, such as a homeowners association, the creditor complies with § 1026.43(c)(2)(v) if it relies on homeowners association billing statements provided by the seller. Records are also reasonably reliable if the information in the record was obtained from a valid and legally executed contract. For example, the creditor complies with § 1026.43(c)(2)(v) by relying on the amount of monthly ground rent referenced in the ground rent agreement currently in effect and applicable to the subject property. Records, other than those discussed above, may be reasonably reliable for purposes of § 1026.43(c)(2)(v) if the source provided the information objectively.

6. *Verification of current debt obligations*. Section 1026.43(c)(3) does not require creditors to obtain additional records to verify the existence or amount of obligations shown on a consumer's credit report or listed on the consumer's application, absent circumstances described in comment 43(c)(3)-3. Under § 1026.43(c)(3)(iii), if a creditor relies on a consumer's credit report to verify a consumer's current debt obligations and the consumer'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 not required to further verify of the existence or amount of the obligation, absent circumstances described in comment 43(c)(3)-3.

7. *Verification of credit history*. To verify credit history, a creditor may, for example,

look to credit reports from credit bureaus or to reasonably reliable third-party records that evidence nontraditional credit references, such as evidence of rental payment history or public utility payments.

8. *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 to facilitate identification of consumers covered by credit protections provided pursuant to 10 U.S.C. 987.

43(c)(4) Verification of income or assets.

1. *Income or assets relied on*. A creditor need consider, and therefore need verify, only the income or assets the creditor relies on to evaluate the consumer's repayment ability. *See* comment 43(c)(2)(i)-2. For example, if a consumer's application states that the consumer earns a salary and is paid an annual bonus and the creditor relies on only the consumer's salary to evaluate the consumer's repayment ability, the creditor need verify only the salary. *See also* comments 43(c)(3)-1 and -2.

2. *Multiple applicants*. If multiple consumers jointly apply for a loan and each lists income or assets on the application, the creditor need verify only the income or assets the creditor relies on in determining repayment ability. *See* comment 43(c)(2)(i)-5.

3. *Tax-return transcript*. Under § 1026.43(c)(4), a creditor may verify a consumer's income using an Internal Revenue Service (IRS) tax-return transcript, which summarizes the information in a consumer's filed tax return, another record that provides reasonably reliable evidence of the consumer's income, or both. A creditor may obtain a copy of a tax-return transcript or a filed tax return directly from the consumer or from a service provider. A creditor need not obtain the copy directly from the IRS or other taxing authority. *See* comment 43(c)(3)-

2.

Paragraph 43(c)(4)(vi).

1. *Government benefits*. In verifying a consumer's income, a creditor may use a written or electronic record from a government agency of the amount of any benefit payments or awards, such as a "proof of income letter" issued by the Social Security Administration (also known as a "budget letter," "benefits letter," or "proof of award letter").

43(c)(5) Payment calculation.

43(c)(5)(i) General rule.

1. *General*. For purposes of § 1026.43(c)(2)(iii), a creditor must determine the consumer's ability to repay the covered transaction using the payment calculation methods set forth in § 1026.43(c)(5). The payment calculation methods differ depending on the type of credit extended. The payment calculation method set forth in § 1026.43(c)(5)(i) applies to any covered transaction that does not have a balloon payment, or that is not an interest-only or negative amortization loan, whether such covered transaction is a fixed-rate, adjustable-rate or step-rate mortgage. The terms "fixed-rate mortgage," "adjustable-rate mortgage," "step-rate mortgage," "interest-only loan" and "negative amortization loan" are defined in § 1026.18(s)(7)(iii), (i), (ii), (iv) and (v), respectively. For the meaning of the term "balloon payment," see § 1026.18(s)(5)(i). The payment calculation methods set forth in § 1026.43(c)(5)(ii) apply to any covered transaction that is a loan with a balloon payment, interest-only loan, or negative amortization loan. See comment 43(c)(5)(i)-5 and the commentary to § 1026.43(c)(5)(ii), which provide examples for calculating the monthly payment for purposes of the repayment ability determination required under § 1026.43(c)(2)(iii).

2. *Greater of the fully indexed rate or introductory rate; premium adjustable-rate*

transactions. A creditor must determine a consumer's repayment ability for the covered transaction using substantially equal, monthly, fully amortizing payments that are based on the greater of the fully indexed rate or any introductory interest rate. In some adjustable-rate transactions, creditors may set an initial interest rate that is not determined by the index or formula used to make later interest rate adjustments. Sometimes, this initial rate charged to consumers is lower than the rate would be if it were determined by using the index plus margin, or formula (*i.e.,* fully indexed rate). However, an initial rate that is a premium rate is higher than the rate based on the index or formula. In such cases, creditors must calculate the fully amortizing payment based on the initial "premium" rate. "Fully indexed rate" is defined in § 1026.43(b)(3).

3. *Monthly, fully amortizing payments.* Section 1026.43(c)(5)(i) does not prescribe the terms or loan features that a creditor may choose to offer or extend to a consumer, but establishes the calculation method a creditor must use to determine the consumer's repayment ability for a covered transaction. For example, the terms of the loan agreement may require that the consumer repay the loan in quarterly or bi-weekly scheduled payments, but for purposes of the repayment ability determination, the creditor must convert these scheduled payments to monthly payments in accordance with § 1026.43(c)(5)(i)(B). Similarly, the loan agreement may not require the consumer to make fully amortizing payments, but for purposes of the repayment ability determination under § 1026.43(c)(5)(i), the creditor must convert any non-amortizing payments to fully amortizing payments.

4. *Substantially equal*. In determining whether monthly, fully amortizing payments are substantially equal, creditors should disregard minor variations due to payment-schedule irregularities and odd periods, such as a long or short first or last payment period. That is,

monthly payments of principal and interest that repay the loan amount over the loan term need not be equal, but the monthly payments should be substantially the same without significant variation in the monthly combined payments of both principal and interest. For example, where no two monthly payments vary from each other by more than 1 percent (excluding odd periods, such as a long or short first or last payment period), such monthly payments would be considered substantially equal for purposes of this section. In general, creditors should determine whether the monthly, fully amortizing payments are substantially equal based on guidance provided in § 1026.17(c)(3) (discussing minor variations), and § 1026.17(c)(4)(i) through (iii) (discussing payment-schedule irregularities and measuring odd periods due to a long or short first period) and associated commentary.

5. *Examples*. The following are examples of how to determine the consumer's repayment ability based on substantially equal, monthly, fully amortizing payments as required under § 1026.43(c)(5)(i) (all amounts shown are rounded, and all amounts are calculated using non-rounded values):

i. *Fixed-rate mortgage*. A loan in an amount of $200,000 has a 30-year loan term and a fixed interest rate of 7 percent. For purposes of § 1026.43(c)(2)(iii), the creditor must determine the consumer's ability to repay the loan based on a payment of $1,331, which is the substantially equal, monthly, fully amortizing payment that will repay $200,000 over 30 years using the fixed interest rate of 7 percent.

ii. *Adjustable-rate mortgage with discount for five years*. A loan in an amount of $200,000 has a 30-year loan term. The loan agreement provides for a discounted interest rate of 6 percent that is fixed for an initial period of five years, after which the interest rate will adjust annually based on a specified index plus a margin of 3 percent, subject to a 2 percent annual periodic interest rate adjustment cap. The index value in effect at consummation is 4.5 percent; the fully indexed rate is 7.5 percent (4.5 percent plus 3 percent). Even though the scheduled monthly payment required for the first five years is $1199, for purposes of § 1026.43(c)(2)(iii) the creditor must determine the consumer's ability to repay the loan based on a payment of $1,398, which is the substantially equal, monthly, fully amortizing payment that will repay $200,000 over 30 years using the fully indexed rate of 7.5 percent.

iii. *Step-rate mortgage*. A loan in an amount of $200,000 has a 30-year loan term. The loan agreement provides that the interest rate will be 6.5 percent for the first two years of the loan, 7 percent for the next three years of the loan, and 7.5 percent thereafter. Accordingly, the scheduled payment amounts are $1,264 for the first two years, $1,328 for the next three years, and $1,388 thereafter for the remainder of the term. For purposes of § 1026.43(c)(2)(iii), the creditor must determine the consumer's ability to repay the loan based on a payment of $1,398, which is the substantially equal, monthly, fully amortizing payment that would repay $200,000 over 30 years using the fully indexed rate of 7.5 percent.

43(c)(5)(ii) Special rules for loans with a balloon payment, interest-only loans, and negative amortization loans.

Paragraph 43(c)(5)(ii)(A).

1. *General*. For loans with a balloon payment, the rules differ depending on whether the loan is a higher-priced covered transaction, as defined under § 1026.43(b)(4), or is not a higher-priced covered transaction because the annual percentage rate does not exceed the applicable threshold calculated using the applicable average prime offer rate (APOR) for a comparable transaction. "Average prime offer rate" is defined in § 1026.35(a)(2); "higher-priced covered transaction" is defined in § 1026.43(b)(4). For higher-priced covered transactions with a balloon

payment, the creditor must consider the consumer's ability to repay the loan based on the payment schedule under the terms of the legal obligation, including any required balloon payment. For loans with a balloon payment that are not higher-priced covered transactions, the creditor should use the maximum payment scheduled during the first five years of the loan following the date on which the first regular periodic payment will be due. "Balloon payment" is defined in § 1026.18(s)(5)(i).

2. *First five years after the date on which the first regular periodic payment will be due*. Under § 1026.43(c)(5)(ii)(A)(*1*), the creditor must determine a consumer's ability to repay a loan with a balloon payment that is not a higher-priced covered transaction using the maximum payment scheduled during the first five years (60 months) after the date on which the first regular periodic payment will be due. To illustrate:

i. Assume a loan that provides for regular monthly payments and a balloon payment due at the end of a six-year loan term. The loan is consummated on August 15, 2014, and the first monthly payment is due on October 1, 2014. The first five years after the first monthly payment end on October 1, 2019. The balloon payment must be made on the due date of the 72nd monthly payment, which is September 1, 2020. For purposes of determining the consumer's ability to repay the loan under § 1026.43(c)(2)(iii), the creditor need not consider the balloon payment that is due on September 1, 2020.

ii. Assume a loan that provides for regular monthly payments and a balloon payment due at the end of a five-year loan term. The loan is consummated on August 15, 2014, and the first monthly payment is due on October 1, 2014. The first five years after the first monthly payment end on October 1, 2019. The balloon payment must be made on the due date of the 60th monthly payment, which is September 1, 2019. For purposes of determining the consumer's ability to repay the loan under § 1026.43(c)(2)(iii), the creditor must consider the balloon payment that is due on September 1, 2019.

3. *Renewable balloon-payment mortgage; loan term*. A balloon-payment mortgage that is not a higher-priced covered transaction could provide that a creditor is unconditionally obligated to renew a balloon-payment mortgage at the consumer's option (or is obligated to renew subject to conditions within the consumer's control). See comment 17(c)(1)-11 discussing renewable balloon-payment mortgages. For purposes of this section, the loan term does not include any period of time that could result from a renewal provision. To illustrate, assume a three-year balloon-payment mortgage that is not a higher-priced covered transaction contains an unconditional obligation to renew for another three years at the consumer's option. In this example, the loan term for the balloon-payment mortgage is three years, and not the potential six years that could result if the consumer chooses to renew the loan. Accordingly, the creditor must underwrite the loan using the maximum payment scheduled in the first five years after consummation, which includes the balloon payment due at the end of the three-year loan term. See comment 43(c)(5)(ii)(A)-4.ii, which provides an example of how to determine the consumer's repayment ability for a three-year renewable balloon-payment mortgage that is not a higher-priced covered transaction.

4. *Examples of loans with a balloon payment that are not higher-priced covered transactions*. The following are examples of how to determine the maximum payment scheduled during the first five years after the date on which the first regular periodic payment will be due (all amounts shown are rounded, and all amounts are calculated using non-rounded values):

i. *Balloon-payment mortgage with a three-year loan term; fixed interest rate*. A loan agreement provides for a fixed interest rate of 6 percent, which is below the APOR-calculated threshold for a comparable transaction; thus the loan is not a higher-priced covered transaction. The loan amount is $200,000, and the loan has a three-year loan term but is amortized over 30 years. The monthly payment scheduled for the first three years following consummation is $1,199, with a balloon payment of $193,367 due at the end of the third year. For purposes of § 1026.43(c)(2)(iii), the creditor must determine the consumer's ability to repay the loan based on the balloon payment of $193,367.

ii. *Renewable balloon-payment mortgage with a three-year loan term*. Assume the same facts above in comment 43(c)(5)(ii)(A)-4.i, except that the loan agreement also provides that the creditor is unconditionally obligated to renew the balloon-payment mortgage at the consumer's option at the end of the three-year term for another three years. In determining the maximum payment scheduled during the first five years after the date on which the first regular periodic payment will be due, the creditor must use a loan term of three years. Accordingly, for purposes of § 1026.43(c)(2)(iii), the creditor must determine the consumer's ability to repay the loan based on the balloon payment of $193,367.

iii. *Balloon-payment mortgage with a six-year loan term; fixed interest rate*. A loan provides for a fixed interest rate of 6 percent, which is below the APOR threshold for a comparable transaction, and thus, the loan is not a higher-priced covered transaction. The loan amount is $200,000, and the loan has a six-year loan term but is amortized over 30 years. The loan is consummated on March 15, 2014, and the monthly payment scheduled for the first six years following consummation is $1,199, with the first monthly payment due on May 1, 2014. The first five years after the date on which the first regular periodic payment will be due end on May 1, 2019. The balloon payment of $183,995 is required on the due date of the 72nd monthly payment, which is April 1, 2020 (more than five years after the date on which the first regular periodic payment will be due). For purposes of § 1026.43(c)(2)(iii), the creditor may determine the consumer's ability to repay the loan based on the monthly payment of $1,199, and need not consider the balloon payment of $183,995 due on April 1, 2020.

5. *Higher-priced covered transaction with a balloon payment*. Where a loan with a balloon payment is a higher-priced covered transaction, the creditor must determine the consumer's repayment ability based on the loan's payment schedule, including any balloon payment. For example (all amounts are rounded): Assume a higher-priced covered transaction with a fixed interest rate of 7 percent. The loan amount is $200,000 and the loan has a ten year loan term, but is amortized over 30 years. The monthly payment scheduled for the first ten years is $1,331, with a balloon payment of $172,955. For purposes of § 1026.43(c)(2)(iii), the creditor must consider the consumer's ability to repay the loan based on the payment schedule that fully repays the loan amount, including the balloon payment of $172,955.

Paragraph 43(c)(5)(ii)(B).

1. *General*. For loans that permit interest-only payments, the creditor must use the fully indexed rate or introductory rate, whichever is greater, to calculate the substantially equal, monthly payment 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. For discussion regarding the fully indexed rate, and the meaning of "substantially equal," see comments 43(b)(3)-1 through -5 and 43(c)(5)(i)-4, respectively. Under § 1026.43(c)(5)(ii)(B), the relevant term of the loan is the period of time that remains as of the date the loan is recast to require fully amortizing payments. For a loan on which only interest and no principal has been paid, the loan amount will be the outstanding principal balance at the time of the recast. "Loan amount" and "recast" are defined in § 1026.43(b)(5) and (b)(11), respectively. "Interest-only" and "Interest-only loan" are defined in

§ 1026.18(s)(7)(iv).

2. *Examples.* The following are examples of how to determine the consumer's repayment ability based on substantially equal, monthly payments of principal and interest under § 1026.43(c)(5)(ii)(B) (all amounts shown are rounded, and all amounts are calculated using non-rounded values):

i. *Fixed-rate mortgage with interest-only payments for five years*. A loan in an amount of $200,000 has a 30-year loan term. The loan agreement provides for a fixed interest rate of 7 percent, and permits interest-only payments for the first five years. The monthly payment of $1,167 scheduled for the first five years would cover only the interest due. The loan is recast on the due date of the 60th monthly payment, after which the scheduled monthly payments increase to $1,414, a monthly payment that repays the loan amount of $200,000 over the 25 years remaining as of the date the loan is recast (300 months). For purposes of § 1026.43(c)(2)(iii), the creditor must determine the consumer's ability to repay the loan based on a payment of $1,414, which is the substantially equal, monthly, fully amortizing payment that would repay $200,000 over the 25 years remaining as of the date the loan is recast using the fixed interest rate of 7 percent.

ii. *Adjustable-rate mortgage with discount for three years and interest-only payments for five years*. A loan in an amount of $200,000 has a 30-year loan term, but provides for interest-only payments for the first five years. The loan agreement provides for a discounted interest rate of 5 percent that is fixed for an initial period of three years, after which the interest rate will adjust each year based on a specified index plus a margin of 3 percent, subject to an annual interest rate adjustment cap of 2 percent. The index value in effect at consummation is 4.5 percent; the fully indexed rate is 7.5 percent (4.5 percent plus 3 percent). The monthly payments for the first three years are $833. For the fourth year, the payments are $1,167, based on an interest rate of 7 percent, calculated by adding the 2 percent annual adjustment cap to the initial rate of 5 percent. For the fifth year, the payments are $1,250, applying the fully indexed rate of 7.5 percent. These first five years of payments will cover only the interest due. The loan is recast on the due date of the 60th monthly payment, after which the scheduled monthly payments increase to $1,478, a monthly payment that will repay the loan amount of $200,000 over the remaining 25 years of the loan (300 months). For purposes of § 1026.43(c)(2)(iii), the creditor must determine the consumer's ability to repay the loan based on a monthly payment of $1,478, which is the substantially equal, monthly payment of principal and interest that would repay $200,000 over the 25 years remaining as of the date the loan is recast using the fully indexed rate of 7.5 percent.

Paragraph 43(c)(5)(ii)(C).

1. *General*. For purposes of determining the consumer's ability to repay a negative amortization loan, the creditor must use substantially equal, monthly payments of principal and interest based on the fully indexed rate or the introductory rate, whichever is greater, that will repay the maximum loan amount over the term of the loan that remains as of the date the loan is recast. Accordingly, before determining the substantially equal, monthly payments the creditor must first determine the maximum loan amount and the period of time that remains in the loan term after the loan is recast. "Recast" is defined in § 1026.43(b)(11). Second, the creditor must use the fully indexed rate or introductory rate, whichever is greater, to calculate the substantially equal, monthly payment amount that will repay the maximum loan amount over the term of the loan remaining as of the date the loan is recast. For discussion regarding the fully indexed rate and the meaning of "substantially equal," see comments 43(b)(3)-1 through -5 and 43(c)(5)(i)-4,

respectively. For the meaning of the term “maximum loan amount” and a discussion of how to determine the maximum loan amount for purposes of § 1026.43(c)(5)(ii)(C), see § 1026.43(b)(7) and associated commentary. “Negative amortization loan” is defined in § 1026.18(s)(7)(v).

2. *Term of loan*. Under § 1026.43(c)(5)(ii)(C), the relevant term of the loan is the period of time that remains as of the date the terms of the legal obligation recast. That is, the creditor must determine substantially equal, monthly payments of principal and interest that will repay the maximum loan amount based on the period of time that remains after any negative amortization cap is triggered or any period permitting minimum periodic payments expires, whichever occurs first.

3. *Examples*. The following are examples of how to determine the consumer’s repayment ability based on substantially equal, monthly payments of principal and interest as required under § 1026.43(c)(5)(ii)(C) (all amounts shown are rounded, and all amounts are calculated using non-rounded values):

i. *Adjustable-rate mortgage with negative amortization*. A. Assume an adjustable-rate mortgage in the amount of $200,000 with a 30-year loan term. The loan agreement provides that the consumer can make minimum monthly payments that cover only part of the interest accrued each month until the date on which the principal balance reaches 115 percent of its original balance (*i.e.*, a negative amortization cap of 115 percent) or for the first five years of the loan (60 monthly payments), whichever occurs first. The introductory interest rate at consummation is 1.5 percent. One month after consummation, the interest rate adjusts and will adjust monthly thereafter based on the specified index plus a margin of 3.5 percent. The index value in effect at consummation is 4.5 percent; the fully indexed rate is 8 percent (4.5 percent plus 3.5 percent). The maximum lifetime interest rate is 10.5 percent; there are no other periodic interest rate adjustment caps that limit how quickly the maximum lifetime rate may be reached. The minimum monthly payment for the first year is based on the initial interest rate of 1.5 percent. After that, the minimum monthly payment adjusts annually, but may increase by no more than 7.5 percent over the previous year's payment. The minimum monthly payment is $690 in the first year, $742 in the second year, and $797 in the first part of the third year.

B. To determine the maximum loan amount, assume that the interest rate increases to the maximum lifetime interest rate of 10.5 percent at the first adjustment (*i.e.*, the due date of the first periodic monthly payment), and interest accrues at that rate until the loan is recast. Assume that the consumer makes the minimum monthly payments scheduled, which are capped at 7.5 percent from year-to-year, for the maximum possible time. Because the consumer's minimum monthly payments are less than the interest accrued each month, negative amortization occurs (*i.e.*, the accrued but unpaid interest is added to the principal balance). Thus, assuming that the consumer makes the minimum monthly payments for as long as possible and that the maximum interest rate of 10.5 percent is reached at the first rate adjustment (*i.e.*, the due date of the first periodic monthly payment), the negative amortization cap of 115 percent is reached on the due date of the 27th monthly payment and the loan is recast as of that date. The maximum loan amount as of the due date of the 27th monthly payment is $229,251, and the remaining term of the loan is 27 years and nine months (333 months).

C. For purposes of § 1026.43(c)(2)(iii), the creditor must determine the consumer's ability to repay the loan based on a monthly payment of $1,716, which is the substantially equal, monthly payment of principal and interest that will repay the maximum loan amount of $229,251 over the remaining loan term of 333 months using the fully indexed rate of 8 percent. See comments 43(b)(7)-1 and -2 discussing the calculation of the maximum loan amount, and

§ 1026.43(b)(11) for the meaning of the term "recast."

ii. *Fixed-rate, graduated payment mortgage*. A loan in the amount of $200,000 has a 30-year loan term. The loan agreement provides for a fixed interest rate of 7.5 percent, and requires the consumer to make minimum monthly payments during the first year, with payments increasing 12.5 percent over the previous year every year for four years (the annual payment cap). The payment schedule provides for payments of $943 in the first year, $1,061 in the second year, $1,193 in the third year, $1,343 in the fourth year, and then requires $1,511 for the remaining term of the loan. During the first three years of the loan, the payments are less than the interest accrued each month, resulting in negative amortization. Assuming the minimum payments increase year-to-year up to the 12.5 percent payment cap, the consumer will begin making payments that cover at least all of the interest accrued at the end of the third year. Thus, the loan is recast on the due date of the 36th monthly payment. The maximum loan amount on that date is $207,662, and the remaining loan term is 27 years (324 months). For purposes of § 1026.43(c)(2)(iii), the creditor must determine the consumer's ability to repay the loan based on a monthly payment of $1,497, which is the substantially equal, monthly payment of principal and interest that will repay the maximum loan amount of $207,662 over the remaining loan term of 27 years using the fixed interest rate of 7.5 percent.

43(c)(6) Payment calculation for simultaneous loans.

1. *Scope*. In determining the consumer's repayment ability for a covered transaction under § 1026.43(c)(2)(iii), a creditor must include consideration of any simultaneous loan which it knows, or has reason to know, will be made at or before consummation of the covered transaction. For a discussion of the standard "knows or has reason to know," see comment 43(c)(2)(iv)-2. For the meaning of the term "simultaneous loan," see § 1026.43(b)(12).

2. *Payment calculation—covered transaction*. For a simultaneous loan that is a covered transaction, as that term is defined under § 1026.43(b)(1), a creditor must determine a consumer's ability to repay the monthly payment obligation for a simultaneous loan as set forth in § 1026.43(c)(5), taking into account any mortgage-related obligations required to be considered under § 1026.43(c)(2)(v). For the meaning of the term "mortgage-related obligations," see § 1026.43(b)(8).

3. *Payment calculation—home equity line of credit*. For a simultaneous loan that is a home equity line of credit subject to § 1026.40, the creditor must consider the periodic payment required under the terms of the plan when assessing the consumer's ability to repay the covered transaction secured by the same dwelling as the simultaneous loan. Under § 1026.43(c)(6)(ii), a creditor must determine the periodic payment required under the terms of the plan by considering the actual amount of credit to be drawn by the consumer at consummation of the covered transaction. The amount to be drawn is the amount requested by the consumer; when the amount requested will be disbursed, or actual receipt of funds, is not determinative. Any additional draw against the line of credit that the creditor of the covered transaction does not know or have reason to know about before or during underwriting need not be considered in relation to ability to repay. For example, where the creditor's policies and procedures require the source of down payment to be verified, and the creditor verifies that a simultaneous loan that is a HELOC will provide the source of down payment for the first-lien covered transaction, the creditor must consider the periodic payment on the HELOC by assuming the amount drawn is at least the down payment amount. In general, a creditor should determine the periodic payment based on guidance in the commentary to § 1026.40(d)(5) (discussing payment terms).

43(c)(7) Monthly debt-to-income ratio or residual income.

1. *Monthly debt-to-income ratio or monthly residual income*. Under § 1026.43(c)(2)(vii), the creditor must consider the consumer's monthly debt-to-income ratio, or the consumer's monthly residual income, in accordance with the requirements in § 1026.43(c)(7). In contrast to the qualified mortgage provisions in § 1026.43(e), § 1026.43(c) does not prescribe a specific monthly debt-to-income ratio with which creditors must comply. Instead, an appropriate threshold for a consumer's monthly debt-to-income ratio or monthly residual income is for the creditor to determine in making a reasonable and good faith determination of a consumer's ability to repay.

2. *Use of both monthly debt-to-income ratio and monthly residual income.* If a creditor considers the consumer's monthly debt-to-income ratio, the creditor may also consider the consumer's residual income as further validation of the assessment made using the consumer's monthly debt-to-income ratio.

3. *Compensating factors*. The creditor may consider factors in addition to the monthly debt-to-income ratio or residual income in assessing a consumer's repayment ability. For example, the creditor may reasonably and in good faith determine that a consumer has the ability to repay despite a higher debt-to-income ratio or lower residual income in light of the consumer's assets other than the dwelling, including any real property attached to the dwelling, securing the covered transaction, such as a savings account. The creditor may also reasonably and in good faith determine that a consumer has the ability to repay despite a higher debt-to-income ratio in light of the consumer's residual income.

43(d) Refinancing of non-standard mortgages.

43(d)(1) Definitions.

43(d)(1)(i) Non-standard mortgage.

Paragraph 43(d)(1)(i)(A).

1. *Adjustable-rate mortgage with an introductory fixed rate.* Under § 1026.43(d)(1)(i)(A), an adjustable-rate mortgage with an introductory fixed interest rate for one year or longer is considered a "non-standard mortgage." For example, a covered transaction that has a fixed introductory rate for the first two, three, or five years and then converts to a variable rate for the remaining 28, 27, or 25 years, respectively, is a "non-standard mortgage." A covered transaction with an introductory rate for six months that then converts to a variable rate for the remaining 29 and one-half years is not a "non-standard mortgage."

43(d)(1)(ii) Standard mortgage.

Paragraph 43(d)(1)(ii)(A).

1. *Regular periodic payments.* Under § 1026.43(d)(1)(ii)(A), a "standard mortgage" must provide for regular periodic payments that do not result in an increase of the principal balance (negative amortization), allow the consumer to defer repayment of principal (*see* comment 43(e)(2)(i)-2), or result in a balloon payment. Thus, the terms of the legal obligation must require the consumer to make payments of principal and interest on a monthly or other periodic basis that will repay the loan amount over the loan term. Except for payments resulting from any interest rate changes after consummation in an adjustable-rate or step-rate mortgage, the periodic payments must be substantially equal. For an explanation of the term "substantially equal," see comment 43(c)(5)(i)-4. In addition, a single-payment transaction is not a "standard mortgage" because it does not require "regular periodic payments." *See also* comment 43(e)(2)(i)-1.

Paragraph 43(d)(1)(ii)(D).

1. *First five years after consummation*. A "standard mortgage" must have an interest rate that is fixed for at least the first five years (60 months) after consummation. For example,

assume an adjustable-rate mortgage that applies the same fixed interest rate to determine the first 60 payments of principal and interest due. The loan is consummated on August 15, 2013, and the first monthly payment is due on October 1, 2013. The date that is five years after consummation is August 15, 2018. The first interest rate adjustment occurs on September 1, 2018. This loan meets the criterion for a "standard mortgage" under § 1026.43(d)(1)(ii)(D) because the interest rate is fixed until September 1, 2018, which is more than five years after consummation. For guidance regarding step-rate mortgages, see comment 43(e)(2)(iv)-3.iii.

Paragraph 43(d)(1)(ii)(E).

1. *Permissible use of proceeds.* To qualify as a "standard mortgage," the loan's proceeds may be used for only two purposes: paying off the non-standard mortgage and paying for closing costs, including paying escrow amounts required at or before closing. If the proceeds of a covered transaction are used for other purposes, such as to pay off other liens or to provide additional cash to the consumer for discretionary spending, the transaction does not meet the definition of a "standard mortgage."

43(d)(2) Scope.

1. *Written application.* For an explanation of the requirements for a "written application" in § 1026.43(d)(2)(iii), (d)(2)(iv), and (d)(2)(v), see comment 19(a)(1)(i)-3.

Paragraph 43(d)(2)(ii).

1. *Materially lower*. The exemptions afforded under § 1026.43(d)(3) apply to a refinancing only if the monthly payment for the new loan is "materially lower" than the monthly payment for an existing non-standard mortgage. The payments to be compared must be calculated based on the requirements under § 1026.43(d)(5). Whether the new loan payment is "materially lower" than the non-standard mortgage payment depends on the facts and

circumstances. In all cases, a payment reduction of 10 percent or more meets the "materially lower" standard.

Paragraph 43(d)(2)(iv).

1. *Late payment—12 months prior to application*. Under § 1026.43(d)(2)(iv), the exemptions in § 1026.43(d)(3) apply to a covered transaction only if, during the 12 months immediately preceding the creditor's receipt of the consumer's written application for a refinancing, the consumer has made no more than one payment on the non-standard mortgage more than 30 days late. (For an explanation of "written application," see comment 43(d)(2)-1.) For example, assume a consumer applies for a refinancing on May 1, 2014. Assume also that the consumer made a non-standard mortgage payment on August 15, 2013, that was 45 days late. The consumer made no other late payments on the non-standard mortgage between May 1, 2013, and May 1, 2014. In this example, the requirement under § 1026.43(d)(2)(iv) is met because the consumer made only one payment that was over 30 days late within the 12 months prior to applying for the refinancing (*i.e.*, eight and one-half months prior to application).

2. *Payment due date.* Whether a payment is more than 30 days late is measured in relation to the contractual due date not accounting for any grace period. For example, if the contractual due date for a non-standard mortgage payment is the first day of every month, but no late fee will be charged as long as the payment is received by the 16th of the month, the payment due date for purposes of § 1026.43(d)(2)(iv) and (v) is the first day of the month, not the 16th day of the month. Thus, a payment due under the contract on October 1st that is paid on November 1st is made more than 30 days after the payment due date.

Paragraph 43(d)(2)(v).

1. *Late payment—six months prior to application.* Under § 1026.43(d)(2)(v), the

exemptions in § 1026.43(d)(3) apply to a covered transaction only if, during the six months immediately preceding the creditor's receipt of the consumer's written application for a refinancing, the consumer has made no payments on the non-standard mortgage more than 30 days late. (For an explanation of "written application" and how to determine the payment due date, see comments 43(d)(2)-1 and 43(d)(2)(iv)-2.) For example, assume a consumer with a non-standard mortgage applies for a refinancing on May 1, 2014. If the consumer made a payment on March 15, 2014, that was 45 days late, the requirement under § 1026.43(d)(2)(v) is not met because the consumer made a payment more than 30 days late one and one-half months prior to application. If the number of months between consummation of the non-standard mortgage and the consumer's application for the standard mortgage is six or fewer, the consumer may not have made any payment more than 30 days late on the non-standard mortgage.

Paragraph 43(d)(2)(vi).

1. *Non-standard mortgage loan made in accordance with ability-to-repay or qualified mortgage requirements.* For non-standard mortgages that are consummated on or after January 10, 2014, § 1026.43(d)(2)(vi) provides that the refinancing provisions set forth in § 1026.43(d) apply only if the non-standard mortgage was made in accordance with the requirements of § 1026.43(c) or (e), as applicable. For example, if a creditor originated a non-standard mortgage on or after January 10, 2014 that did not comply with the requirements of § 1026.43(c) and was not a qualified mortgage pursuant to § 1026.43(e), § 1026.43(d) would not apply to the refinancing of the non-standard mortgage loan into a standard mortgage loan. However, § 1026.43(d) applies to the refinancing of a non-standard mortgage loan into a standard mortgage loan, regardless of whether the non-standard mortgage loan was made in compliance with § 1026.43(c) or (e), if the non-standard mortgage loan was consummated prior to January 10,

2014.

43(d)(3) Exemption from repayment ability requirements.

1. *Two-part determination*. To qualify for the exemptions in § 1026.43(d)(3), a creditor must have considered, first, whether the consumer is likely to default on the existing mortgage once that loan is recast and, second, whether the new mortgage likely would prevent the consumer's default.

43(d)(4) Offer of rate discounts and other favorable terms.

1. *Documented underwriting practices*. In connection with a refinancing made pursuant to § 1026.43(d), § 1026.43(d)(4) requires a creditor offering a consumer rate discounts and terms that are the same as, or better than, the rate discounts and terms offered to new consumers to make such an offer consistent with the creditor's documented underwriting practices. Section 1026.43(d)(4) does not require a creditor making a refinancing pursuant to § 1026.43(d) to comply with the underwriting requirements of § 1026.43(c). Rather, § 1026.43(d)(4) requires creditors providing such discounts to do so consistent with documented policies related to loan pricing, loan term qualifications, or other similar underwriting practices. For example, assume that a creditor is providing a consumer with a refinancing made pursuant to § 1026.43(d) and that this creditor has a documented practice of offering rate discounts to consumers with credit scores above a certain threshold. Assume further that the consumer receiving the refinancing has a credit score below this threshold, and therefore would not normally qualify for the rate discount available to consumers with high credit scores. This creditor complies with § 1026.43(d)(4) by offering the consumer the discounted rate in connection with the refinancing made pursuant to § 1026.43(d), even if the consumer would not normally qualify for that discounted rate, provided that the offer of the discounted rate is not prohibited by applicable State or Federal law.

However, § 1026.43(d)(4) does not require a creditor to offer a consumer such a discounted rate.

43(d)(5) Payment calculations.

43(d)(5)(i) Non-Standard mortgage.

1. *Payment calculation for a non-standard mortgage.* In determining whether the monthly periodic payment for a standard mortgage is materially lower than the monthly periodic payment for the non-standard mortgage under § 1026.43(d)(2)(ii), the creditor must consider the monthly payment for the non-standard mortgage that will result after the loan is "recast," assuming substantially equal payments of principal and interest that amortize the remaining loan amount over the remaining term as of the date the mortgage is recast. For guidance regarding the meaning of "substantially equal," see comment 43(c)(5)(i)-4. For the meaning of "recast," see § 1026.43(b)(11) and associated commentary.

2. *Fully indexed rate.* The term "fully indexed rate" in § 1026.43(d)(5)(i)(A) for calculating the payment for a non-standard mortgage is generally defined in § 1026.43(b)(3) and associated commentary. Under § 1026.43(b)(3) the fully indexed rate is calculated at the time of consummation. For purposes of § 1026.43(d)(5)(i), however, the fully indexed rate is calculated within a reasonable period of time before or after the date the creditor receives the consumer's written application for the standard mortgage. Thirty days is generally considered "a reasonable period of time."

3. *Written application.* For an explanation of the requirements for a "written application" in § 1026.43(d)(5)(i), see comment 19(a)(1)(i)-3.

4. *Payment calculation for an adjustable-rate mortgage with an introductory fixed rate*. Under § 1026.43(d)(5)(i), the monthly periodic payment for an adjustable-rate mortgage with an introductory fixed interest rate for a period of one or more years must be calculated based on

several assumptions.

i. First, the payment must be based on the outstanding principal balance as of the date on which the mortgage is recast, assuming all scheduled payments have been made up to that date and the last payment due under those terms is made and credited on that date. For example, assume an adjustable-rate mortgage with a 30-year loan term. The loan agreement provides that the payments for the first 24 months are based on a fixed rate, after which the interest rate will adjust annually based on a specified index and margin. The loan is recast on the due date of the 24th payment. If the 24th payment is due on September 1, 2014, the creditor must calculate the outstanding principal balance as of September 1, 2014, assuming that all 24 payments under the fixed rate terms have been made and credited timely.

ii. Second, the payment calculation must be based on substantially equal monthly payments of principal and interest that will fully repay the outstanding principal balance over the term of the loan remaining as of the date the loan is recast. Thus, in the example above, the creditor must assume a loan term of 28 years (336 monthly payments).

iii. Third, the payment must be based on the fully indexed rate, as described in § 1026.43(d)(5)(i)(A).

5. *Example of payment calculation for an adjustable-rate mortgage with an introductory fixed rate*. The following example illustrates the rule described in comment 43(d)(5)(i)-4:

i. A loan in an amount of $200,000 has a 30-year loan term. The loan agreement provides for a discounted introductory interest rate of 5 percent that is fixed for an initial period of two years, after which the interest rate will adjust annually based on a specified index plus a margin of 3 percentage points.

ii. The non-standard mortgage is consummated on February 15, 2014, and the first monthly payment is due on April 1, 2014. The loan is recast on the due date of the 24th monthly payment, which is March 1, 2016.

iii. On March 15, 2015, the creditor receives the consumer's written application for a refinancing after the consumer has made 12 monthly on-time payments. On this date, the index value is 4.5 percent.

iv. To calculate the non-standard mortgage payment that must be compared to the standard mortgage payment under § 1026.43(d)(2)(ii), the creditor must use:

A. The outstanding principal balance as of March 1, 2016, assuming all scheduled payments have been made up to March 1, 2016, and the last payment due under the fixed rate terms is made and credited on March 1, 2016. In this example, the outstanding principal balance is $193,948.

B. The fully indexed rate of 7.5 percent, which is the index value of 4.5 percent as of March 15, 2015 (the date on which the application for a refinancing is received) plus the margin of 3 percent.

C. The remaining loan term as of March 1, 2016, the date of the recast, which is 28 years (336 monthly payments).

v. Based on these assumptions, the monthly payment for the non-standard mortgage for purposes of determining whether the standard mortgage monthly payment is lower than the non-standard mortgage monthly payment (*see* § 1026.43(d)(2)(ii)) is $1,383. This is the substantially equal, monthly payment of principal and interest required to repay the outstanding principal balance at the fully indexed rate over the remaining term.

6. *Payment calculation for an interest-only loan*. Under § 1026.43(d)(5)(i), the monthly periodic payment for an interest-only loan must be calculated based on several assumptions:

i. First, the payment must be based on the outstanding principal balance as of the date of the recast, assuming all scheduled payments are made under the terms of the legal obligation in effect before the mortgage is recast. For a loan on which only interest and no principal has been paid, the outstanding principal balance at the time of recast will be the loan amount, as defined in § 1026.43(b)(5), assuming all scheduled payments are made under the terms of the legal obligation in effect before the mortgage is recast. For example, assume that a mortgage has a 30-year loan term, and provides that the first 24 months of payments are interest-only. If the 24th payment is due on September 1, 2015, the creditor must calculate the outstanding principal balance as of September 1, 2015, assuming that all 24 payments under the interest-only payment terms have been made and credited timely and that no payments of principal have been made.

ii. Second, the payment calculation must be based on substantially equal monthly payments of principal and interest that will fully repay the loan amount over the term of the loan remaining as of the date the loan is recast. Thus, in the example above, the creditor must assume a loan term of 28 years (336 monthly payments).

iii. Third, the payment must be based on the fully indexed rate, as described in § 1026.43(d)(5)(i)(A).

7. *Example of payment calculation for an interest-only loan*. The following example illustrates the rule described in comment 43(d)(5)(i)-6:

i. A loan in an amount of $200,000 has a 30-year loan term. The loan agreement provides for a fixed interest rate of 7 percent, and permits interest-only payments for the first two years (the first 24 payments), after which time amortizing payments of principal and interest are required.

ii. The non-standard mortgage is consummated on February 15, 2014, and the first monthly payment is due on April 1, 2014. The loan is recast on the due date of the 24th monthly payment, which is March 1, 2016.

iii. On March 15, 2015, the creditor receives the consumer's written application for a refinancing, after the consumer has made 12 monthly on-time payments. The consumer has made no additional payments of principal.

iv. To calculate the non-standard mortgage payment that must be compared to the standard mortgage payment under § 1026.43(d)(2)(ii), the creditor must use:

A. The loan amount, which is the outstanding principal balance as of March 1, 2016, assuming all scheduled interest-only payments have been made and credited up to that date. In this example, the loan amount is $200,000.

B. An interest rate of 7 percent, which is the interest rate in effect at the time of consummation of this fixed-rate non-standard mortgage.

C. The remaining loan term as of March 1, 2016, the date of the recast, which is 28 years (336 monthly payments).

v. Based on these assumptions, the monthly payment for the non-standard mortgage for purposes of determining whether the standard mortgage monthly payment is lower than the non-standard mortgage monthly payment (*see* § 1026.43(d)(2)(ii)) is $1,359. This is the substantially equal, monthly payment of principal and interest required to repay the loan amount at the fully indexed rate over the remaining term.

8. *Payment calculation for a negative amortization loan*. Under § 1026.43(d)(5)(i), the monthly periodic payment for a negative amortization loan must be calculated based on several assumptions:

i. First, the calculation must be based on the maximum loan amount, determined after adjusting for the outstanding principal balance. If the consumer makes only the minimum periodic payments for the maximum possible time, until the consumer must begin making fully amortizing payments, the outstanding principal balance will be the maximum loan amount, as defined in § 1026.43(b)(7). In this event, the creditor complies with § 1026.43(d)(5)(i)(C)(*3*) by relying on the examples of how to calculate the maximum loan amount, see comment 43(b)(7)-3. If the consumer makes payments above the minimum periodic payments for the maximum possible time, the creditor must calculate the maximum loan amount based on the outstanding principal balance. In this event, the creditor complies with § 1026.43(d)(5)(i)(C)(*3*) by relying on the examples of how to calculate the maximum loan amount in comment 43(d)(5)(i)-10.

ii. Second, the calculation must be based on substantially equal monthly payments of principal and interest that will fully repay the maximum loan amount over the term of the loan remaining as of the date the loan is recast. For example, if the loan term is 30 years and the loan is recast on the due date of the 60th monthly payment, the creditor must assume a remaining loan term of 25 years (300 monthly payments).

iii. Third, the payment must be based on the fully indexed rate as of the date of the written application for the standard mortgage.

9. *Example of payment calculation for a negative amortization loan if only minimum payments made*. The following example illustrates the rule described in comment 43(d)(5)(i)-8:

i. A loan in an amount of $200,000 has a 30-year loan term. The loan agreement provides that the consumer can make minimum monthly payments that cover only part of the interest accrued each month until the date on which the principal balance increases to the negative amortization cap of 115 percent of the loan amount, or for the first five years of monthly payments (60 payments), whichever occurs first. The loan is an adjustable-rate mortgage that adjusts monthly according to a specified index plus a margin of 3.5 percent.

ii. The non-standard mortgage is consummated on February 15, 2014, and the first monthly payment is due on April 1, 2014. Assume that the consumer has made only the minimum periodic payments. Assume further that, based on the calculation of the maximum loan amount required under § 1026.43(b)(7) and associated commentary, the negative amortization cap of 115 percent would be reached on June 1, 2016, the due date of the 27th monthly payment.

iii. On March 15, 2015, the creditor receives the consumer's written application for a refinancing, after the consumer has made 12 monthly on-time payments. On this date, the index value is 4.5 percent.

iv. To calculate the non-standard mortgage payment that must be compared to the standard mortgage payment under § 1026.43(d)(2)(ii), the creditor must use:

A. The maximum loan amount of $229,251 as of June 1, 2016;

B. The fully indexed rate of 8 percent, which is the index value of 4.5 percent as of March 15, 2015 (the date on which the creditor receives the application for a refinancing) plus the margin of 3.5 percent; and

C. The remaining loan term as of June 1, 2016, the date of the recast, which is 27 years and nine months (333 monthly payments).

v. Based on these assumptions, the monthly payment for the non-standard mortgage for purposes of determining whether the standard mortgage monthly payment is lower than the non-standard mortgage monthly payment (*see* § 1026.43(d)(2)(ii)) is $1,716. This is the substantially equal, monthly payment of principal and interest required to repay the maximum loan amount at the fully indexed rate over the remaining term.

10. *Example of payment calculation for a negative amortization loan if payments above minimum amount made*. The following example illustrates the rule described in comment 43(d)(5)(i)-8:

i. A loan in an amount of $200,000 has a 30-year loan term. The loan agreement provides that the consumer can make minimum monthly payments that cover only part of the interest accrued each month until the date on which the principal balance increases to the negative amortization cap of 115 percent of the loan amount, or for the first five years of monthly payments (60 payments), whichever occurs first. The loan is an adjustable-rate mortgage that adjusts monthly according to a specified index plus a margin of 3.5 percent. The introductory interest rate at consummation is 1.5 percent. One month after consummation, the interest rate adjusts and will adjust monthly thereafter based on the specified index plus a margin of 3.5 percent. The maximum lifetime interest rate is 10.5 percent; there are no other periodic interest rate adjustment caps that limit how quickly the maximum lifetime rate may be reached. The minimum monthly payment for the first year is based on the initial interest rate of 1.5 percent. After that, the minimum monthly payment adjusts annually, but may increase by no more than 7.5 percent over the previous year's payment. The minimum monthly payment is $690 in the first year, $742 in the second year, $798 in the third year, $857 in the fourth year, and $922 in the fifth year.

ii. The non-standard mortgage is consummated on February 15, 2014, and the first monthly payment is due on April 1, 2014. Assume that the consumer has made more than the minimum periodic payments, and that after the consumer's 12th monthly on-time payment the outstanding principal balance is $195,000. Based on the calculation of the maximum loan amount after adjusting for this outstanding principal balance, the negative amortization cap of

115 percent would be reached on March 1, 2019, the due date of the 60th monthly payment.

iii. On March 15, 2015, the creditor receives the consumer's written application for a refinancing, after the consumer has made 12 monthly on-time payments. On this date, the index value is 4.5 percent.

iv. To calculate the non-standard mortgage payment that must be compared to the standard mortgage payment under § 1026.43(d)(2)(ii), the creditor must use:

A. The maximum loan amount of $229,219 as of March 1, 2019.

B. The fully indexed rate of 8 percent, which is the index value of 4.5 percent as of March 15, 2015 (the date on which the creditor receives the application for a refinancing) plus the margin of 3.5 percent.

C. The remaining loan term as of March 1, 2019, the date of the recast, which is exactly 25 years (300 monthly payments).

v. Based on these assumptions, the monthly payment for the non-standard mortgage for purposes of determining whether the standard mortgage monthly payment is lower than the non-standard mortgage monthly payment (*see* § 1026.43(d)(2)(ii)) is $1,769. This is the substantially equal, monthly payment of principal and interest required to repay the maximum loan amount at the fully indexed rate over the remaining term.

43(d)(5)(ii) Standard mortgage.

1. *Payment calculation for a standard mortgage*. In determining whether the monthly periodic payment for a standard mortgage is materially lower than the monthly periodic payment for a non-standard mortgage, the creditor must consider the monthly payment for the standard mortgage that will result in substantially equal, monthly, fully amortizing payments (as defined in § 1026.43(b)(2)) using the rate as of consummation. For guidance regarding the meaning of

“substantially equal” see comment 43(c)(5)(i)-4. For a mortgage with a single, fixed rate for the first five years after consummation, the maximum rate that will apply during the first five years after consummation will be the rate at consummation. For a step-rate mortgage, however, the rate that must be used is the highest rate that will apply during the first five years after consummation. For example, if the rate for the first two years after the date on which the first regular periodic payment will be due is 4 percent, the rate for the following two years is 5 percent, and the rate for the next two years is 6 percent, the rate that must be used is 6 percent.

2. *Example of payment calculation for a standard mortgage.* The following example illustrates the rule described in comment 43(d)(5)(ii)-1: A loan in an amount of $200,000 has a 30-year loan term. The loan agreement provides for an interest rate of 6 percent that is fixed for an initial period of five years, after which time the interest rate will adjust annually based on a specified index plus a margin of 3 percent, subject to a 2 percent annual interest rate adjustment cap. The creditor must determine whether the standard mortgage monthly payment is materially lower than the non-standard mortgage monthly payment (*see* § 1026.43(d)(2)(ii)) based on a standard mortgage payment of $1,199. This is the substantially equal, monthly payment of principal and interest required to repay $200,000 over 30 years at an interest rate of 6 percent.

43(e) Qualified mortgages.

43(e)(1) Safe harbor and presumption of compliance.

1. *General*. Section 1026.43(c) requires a creditor to make a reasonable and good faith determination at or before consummation that a consumer will be able to repay a covered transaction. Section 1026.43(e)(1)(i) and (ii) provide a safe harbor and presumption of compliance, respectively, with the repayment ability requirements of § 1026.43(c) for creditors and assignees of covered transactions that satisfy the requirements of a qualified mortgage under

§ 1026.43(e)(2), (e)(4), or (f). *See* § 1026.43(e)(1)(i) and (ii) and associated commentary.

43(e)(1)(i) Safe harbor for transactions that are not higher-priced covered transactions.

1. *Safe harbor*. To qualify for the safe harbor in § 1026.43(e)(1)(i), a covered transaction must meet the requirements of a qualified mortgage under § 1026.43(e)(2), (e)(4), or (f) and must not be a higher-priced covered transaction, as defined in § 1026.43(b)(4). For guidance on determining whether a loan is a higher-priced covered transaction, see comment 43(b)(4)-1.

43(e)(1)(ii) Presumption of compliance for higher-priced covered transactions.

1. *General*. Under § 1026.43(e)(1)(ii), a creditor or assignee of a qualified mortgage under § 1026.43(e)(2), (e)(4), or (f) that is a higher-priced covered transaction is presumed to comply with the repayment ability requirements of § 1026.43(c). To rebut the presumption, it must be proven that, despite meeting the standards for a qualified mortgage (including either the debt-to-income standard in § 1026.43(e)(2)(vi) or the standards of one of the entities specified in § 1026.43(e)(4)(ii)), the creditor did not have a reasonable and good faith belief in the consumer's repayment ability. Specifically, it must be proven that, at the time of consummation, based on the information available to the creditor, the consumer's income, debt obligations, alimony, child support, and the consumer's monthly payment (including mortgage-related obligations) on the covered transaction and on any simultaneous loans of which the creditor was aware at consummation would leave the consumer with insufficient residual income or assets other than the value of the dwelling (including any real property attached to the dwelling) that secures the loan with which to meet living expenses, including any recurring and material non-debt obligations of which the creditor was aware at the time of consummation, and that the creditor thereby did not make a reasonable and good faith determination of the consumer's repayment ability. For example, a consumer may rebut the presumption with evidence

demonstrating that the consumer's residual income was insufficient to meet living expenses, such as food, clothing, gasoline, and health care, including the payment of recurring medical expenses of which the creditor was aware at the time of consummation, and after taking into account the consumer's assets other than the value of the dwelling securing the loan, such as a savings account. In addition, the longer the period of time that the consumer has demonstrated 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 consumer 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 consumer had the reasonable ability to repay the loan.

43(e)(2) Qualified mortgage defined—general.

Paragraph 43(e)(2)(i).

1. *Regular periodic payments.* Under § 1026.43(e)(2)(i), a qualified mortgage must provide for regular periodic payments that may not result in an increase of the principal balance (negative amortization), deferral of principal repayment, or a balloon payment. Thus, the terms of the legal obligation must require the consumer to make payments of principal and interest, on a monthly or other periodic basis, that will fully repay the loan amount over the loan term. The periodic payments must be substantially equal except for the effect that any interest rate change after consummation has on the payment in the case of an adjustable-rate or step-rate mortgage. In addition, because § 1026.43(e)(2)(i) requires that a qualified mortgage provide for regular periodic payments, a single-payment transaction may not be a qualified mortgage.

2. *Deferral of principal repayment*. Under § 1026.43(e)(2)(i)(B), a qualified mortgage's regular periodic payments may not allow the consumer to defer repayment of principal, except as

provided in § 1026.43(f). A loan allows the deferral of principal repayment if one or more of the periodic payments may be applied solely to accrued interest and not to loan principal. Deferred principal repayment also occurs if the payment is applied to both accrued interest and principal but the consumer is permitted to make periodic payments that are less than the amount that would be required under a payment schedule that has substantially equal payments that fully repay the loan amount over the loan term. Graduated payment mortgages, for example, allow deferral of principal repayment in this manner and therefore may not be qualified mortgages.

Paragraph 43(e)(2)(ii).

1. *General.* The 30-year term limitation in § 1026.43(e)(2)(ii) is applied without regard to any interim period between consummation and the beginning of the first full unit period of the repayment schedule. For example, assume a covered transaction is consummated on March 20, 2014 and the due date of the first regular periodic payment is April 30, 2014. The beginning of the first full unit period of the repayment schedule is April 1, 2014 and the loan term therefore ends on April 1, 2044. The transaction would comply with the 30-year term limitation in § 1026.43(e)(2)(ii).

Paragraph 43(e)(2)(iv).

1. *Maximum interest rate during the first five years*. For a qualified mortgage, the creditor must underwrite the loan using a periodic payment of principal and interest based on the maximum interest rate that may apply during the first five years after the date on which the first regular periodic payment will be due. Creditors must use the maximum rate that could apply at any time during the first five years after the date on which the first regular periodic payment will be due, regardless of whether the maximum rate is reached at the first or subsequent adjustment during the five year period.

2. *Fixed-rate mortgage*. For a fixed-rate mortgage, creditors should use the interest rate in effect at consummation. "Fixed-rate mortgage" is defined in § 1026.18(s)(7)(iii).

3. *Interest rate adjustment caps*. For an adjustable-rate mortgage, creditors should assume the interest rate increases after consummation as rapidly as possible, taking into account the terms of the legal obligation. That is, creditors should account for any periodic interest rate adjustment cap that may limit how quickly the interest rate can increase under the terms of the legal obligation. Where a range for the maximum interest rate during the first five years is provided, the highest rate in that range is the maximum interest rate for purposes of § 1026.43(e)(2)(iv). Where the terms of the legal obligation are not based on an index plus margin or formula, the creditor must use the maximum interest rate that occurs during the first five years after the date on which the first regular periodic payment will be due. To illustrate:

i. *Adjustable-rate mortgage with discount for three years.* Assume an adjustable-rate mortgage has an initial discounted rate of 5 percent that is fixed for the first three years, measured from the first day of the first full calendar month following consummation, after which the rate will adjust annually based on a specified index plus a margin of 3 percent. The index value in effect at consummation is 4.5 percent. The loan agreement provides for an annual interest rate adjustment cap of 2 percent, and a lifetime maximum interest rate of 12 percent. The first rate adjustment occurs on the due date of the 36th monthly payment; the rate can adjust to no more than 7 percent (5 percent initial discounted rate plus 2 percent annual interest rate adjustment cap). The second rate adjustment occurs on the due date of the 48th monthly payment; the rate can adjust to no more than 9 percent (7 percent rate plus 2 percent annual interest rate adjustment cap). The third rate adjustment occurs on the due date of the 60th monthly payment; the rate can adjust to no more than 11 percent (9 percent rate plus 2 percent annual interest rate cap adjustment). The maximum interest rate during the first five years after the date on which the first regular periodic payment will be due is 11 percent (the rate on the due date of the 60th monthly payment). For further discussion of how to determine whether a rate adjustment occurs during the first five years after the date on which the first regular periodic payment will be due, see comment 43(e)(2)(iv)-7.

ii. *Adjustable-rate mortgage with discount for three years.* Assume the same facts as in paragraph 3.i except that the lifetime maximum interest rate is 10 percent, which is less than the maximum interest rate in the first five years after the date on which the first regular periodic payment will be due of 11 percent that would apply but for the lifetime maximum interest rate. The maximum interest rate during the first five years after the date on which the first regular periodic payment will be due is 10 percent.

iii. *Step-rate mortgage.* Assume a step-rate mortgage with an interest rate fixed at 6.5 percent for the first two years, measured from the first day of the first full calendar month following consummation, 7 percent for the next three years, and then 7.5 percent for the remainder of the loan term. The maximum interest rate during the first five years after the date on which the first regular periodic payment will be due is 7.5 percent.

4. *First five years after the date on which the first regular periodic payment will be due*. Under § 1026.43(e)(2)(iv)(A), the creditor must underwrite the loan using the maximum interest rate that may apply during the first five years after the date on which the first regular periodic payment will be due. To illustrate, assume an adjustable-rate mortgage with an initial fixed interest rate of 5 percent for the first five years, measured from the first day of the first full calendar month following consummation, after which the interest rate will adjust annually to the specified index plus a margin of 6 percent, subject to a 2 percent annual interest rate adjustment

cap. The index value in effect at consummation is 5.5 percent. The loan consummates on September 15, 2014, and the first monthly payment is due on November 1, 2014. The first rate adjustment to no more than 7 percent (5 percent plus 2 percent annual interest rate adjustment cap) occurs on the due date of the 60th monthly payment, which is October 1, 2019, and therefore, the rate adjustment occurs during the first five years after the date on which the first regular periodic payment will be due. To meet the definition of qualified mortgage under § 1026.43(e)(2), the creditor must underwrite the loan using a monthly payment of principal and interest based on an interest rate of 7 percent.

5. *Loan amount*. To meet the definition of qualified mortgage under § 1026.43(e)(2), a creditor must determine the periodic payment of principal and interest using the maximum interest rate permitted during the first five years after the date on which the first regular periodic payment will be due that repays either:

i. The outstanding principal balance as of the earliest date the maximum interest rate during the first five years after the date on which the first regular periodic payment will be due can take effect under the terms of the legal obligation, over the remaining term of the loan. To illustrate, assume a loan in an amount of $200,000 has a 30-year loan term. The loan agreement provides for a discounted interest rate of 5 percent that is fixed for an initial period of three years, measured from the first day of the first full calendar month following consummation, after which the interest rate will adjust annually based on a specified index plus a margin of 3 percent, subject to a 2 percent annual interest rate adjustment cap and a lifetime maximum interest rate of 9 percent. The index value in effect at consummation equals 4.5 percent. Assuming the interest rate increases after consummation as quickly as possible, the rate adjustment to the lifetime maximum interest rate of 9 percent occurs on the due date of the 48th monthly payment. The outstanding principal balance on the loan at the end of the fourth year (after the 48th monthly payment is credited) is $188,218. The creditor will meet the definition of qualified mortgage if it underwrites the covered transaction using the monthly payment of principal and interest of $1,564 to repay the outstanding principal balance of $188,218 over the remaining 26 years of the loan term (312 months) using the maximum interest rate during the first five years of 9 percent; or

ii. The loan amount, as that term is defined in § 1026.43(b)(5), over the entire loan term, as that term is defined in § 1026.43(b)(6). Using the same example above, the creditor will meet the definition of qualified mortgage if it underwrites the covered transaction using the monthly payment of principal and interest of $1,609 to repay the loan amount of $200,000 over the 30-year loan term using the maximum interest rate during the first five years of 9 percent.

6. *Mortgage-related obligations*. Section 1026.43(e)(2)(iv) requires creditors to take the consumer's monthly payment for mortgage-related obligations into account when underwriting the loan. For the meaning of the term "mortgage-related obligations," see § 1026.43(b)(8) and associated commentary.

7. *Examples*. The following are examples of how to determine the periodic payment of principal and interest based on the maximum interest rate during the first five years after the date on which the first regular periodic payment will be due for purposes of meeting the definition of qualified mortgage under § 1026.43(e) (all payment amounts shown are rounded, and all amounts are calculated using non-rounded values; all initial fixed interest rate periods are measured from the first day of the first full calendar month following consummation):

i. *Fixed-rate mortgage*. A loan in an amount of $200,000 has a 30-year loan term and a fixed interest rate of 7 percent. The maximum interest rate during the first five years after the date on which the first regular periodic payment will be due for a fixed-rate mortgage is the interest rate in effect at consummation, which is 7 percent under this example. The monthly fully amortizing payment scheduled over the 30 years is $1,331. The creditor will meet the definition of qualified mortgage if it underwrites the loan using the fully amortizing payment of $1,331.

ii. *Adjustable-rate mortgage with discount for three years*. A. A loan in an amount of $200,000 has a 30-year loan term. The loan agreement provides for a discounted interest rate of 5 percent that is fixed for an initial period of three years, after which the interest rate will adjust annually based on a specified index plus a margin of 3 percent, subject to a 2 percent annual interest rate adjustment cap and a lifetime maximum interest rate of 9 percent. The index value in effect at consummation is 4.5 percent. The loan is consummated on March 15, 2014, and the first regular periodic payment is due May 1, 2014. The loan agreement provides that the first rate adjustment occurs on April 1, 2017 (the due date of the 36th monthly payment); the second rate adjustment occurs on April 1, 2018 (the due date of the 48th monthly payment); and the third rate adjustment occurs on April 1, 2019 (the due date of the 60th monthly payment). Under this example, the maximum interest rate during the first five years after the date on which the first regular periodic payment due is 9 percent (the lifetime interest rate cap), which applies beginning on April 1, 2018 (the due date of the 48th monthly payment). The outstanding principal balance at the end of the fourth year (after the 48th payment is credited) is $188,218.

B. The transaction will meet the definition of a qualified mortgage if the creditor underwrites the loan using the monthly payment of principal and interest of $1,564 to repay the outstanding principal balance at the end of the fourth year of $188,218 over the remaining 26 years of the loan term (312 months), using the maximum interest rate during the first five years after the date on which the first regular periodic payment will be due of 9 percent. Alternatively, the transaction will meet the definition of a qualified mortgage if the creditor underwrites the loan using the monthly payment of principal and interest of $1,609 to repay the loan amount of $200,000 over the 30-year loan term, using the maximum interest rate during the first five years after the date on which the first regular periodic payment will be due of 9 percent.

iii. *Adjustable-rate mortgage with discount for five years*. A. A loan in an amount of $200,000 has a 30-year loan term. The loan agreement provides for a discounted interest rate of 6 percent that is fixed for an initial period of five years, after which the interest rate will adjust annually based on a specified index plus a margin of 3 percent, subject to a 2 percent annual interest rate adjustment cap. The index value in effect at consummation is 4.5 percent. The loan consummates on March 15, 2014 and the first regular periodic payment is due May 1, 2014. Under the terms of the loan agreement, the first rate adjustment to no more than 8 percent (6 percent plus 2 percent annual interest rate adjustment cap) is on April 1, 2019 (the due date of the 60th monthly payment), which occurs less than five years after the date on which the first regular periodic payment will be due. Thus, the maximum interest rate under the terms of the loan during the first five years after the date on which the first regular periodic payment will be due is 8 percent.

B. The transaction will meet the definition of a qualified mortgage if the creditor underwrites the loan using the monthly payment of principal and interest of $1,436 to repay the outstanding principal balance at the end of the fifth year of $186,109 over the remaining 25 years of the loan term (300 months), using the maximum interest rate during the first five years after the date on which the first regular periodic payment will be due of 8 percent. Alternatively, the transaction will meet the definition of a qualified mortgage if the creditor underwrites the loan using the monthly payment of principal and interest of $1,468 to repay the loan amount of $200,000 over the 30-year loan term, using the maximum interest rate during the first five years after the date on which the first regular periodic payment will be due of 8 percent.

iv. *Adjustable-rate mortgage with discount for seven years.* A. A loan in an amount of $200,000 has a 30-year loan term. The loan agreement provides for a discounted interest rate of 6 percent that is fixed for an initial period of seven years, after which the interest rate will adjust annually based on a specified index plus a margin of 3 percent, subject to a 2 percent annual interest rate adjustment cap. The index value in effect at consummation is 4.5 percent. The loan is consummated on March 15, 2014, and the first regular periodic payment is due May 1, 2014. Under the terms of the loan agreement, the first rate adjustment is on April 1, 2021 (the due date of the 84th monthly payment), which occurs more than five years after the date on which the first regular periodic payment will be due. Thus, the maximum interest rate under the terms of the loan during the first five years after the date on which the first regular periodic payment will be due is 6 percent.

B. The transaction will meet the definition of a qualified mortgage if the creditor underwrites the loan using the monthly payment of principal and interest of $1,199 to repay the loan amount of $200,000 over the 30-year loan term using the maximum interest rate during the first five years after the date on which the first regular periodic payment will be due of 6 percent.

iv. *Step-rate mortgage*. A. A loan in an amount of $200,000 has a 30-year loan term. The loan agreement provides that the interest rate is 6.5 percent for the first two years of the loan, 7 percent for the next three years, and then 7.5 percent for remainder of the loan term. The maximum interest rate during the first five years after the date on which the first regular periodic payment will be due is 7.5 percent, which occurs on the due date of the 60th monthly payment.

The outstanding principal balance at the end of the fifth year (after the 60th payment is credited) is $187,868.

B. The transaction will meet the definition of a qualified mortgage if the creditor underwrites the loan using a monthly payment of principal and interest of $1,388 to repay the outstanding principal balance of $187,868 over the remaining 25 years of the loan term (300 months), using the maximum interest rate during the first five years after the date on which the first regular periodic payment will be due of 7.5 percent. Alternatively, the transaction will meet the definition of a qualified mortgage if the creditor underwrites the loan using a monthly payment of principal and interest of $1,398 to repay $200,000 over the 30-year loan term using the maximum interest rate during the first five years after the date on which the first regular periodic payment will be due of 7.5 percent.

Paragraph 43(e)(2)(v).

1. *General*. For guidance on satisfying § 1026.43(e)(2)(v), a creditor may rely on commentary to § 1026.43(c)(2)(i) and (vi), (c)(3), and (c)(4).

2. *Income or assets*. Section 1026.43(e)(2)(v)(A) requires creditors to consider and verify the consumer's current or reasonably expected income or assets. For purposes of this requirement, the creditor must consider and verify, at a minimum, any income specified in appendix Q. A creditor may also consider and verify any other income in accordance with § 1026.43(c)(2)(i) and (c)(4); however, such income would not be included in the total monthly debt-to-income ratio determination required by § 1026.43(e)(2)(vi).

3. *Debts*. Section 1026.43(e)(2)(v)(B) requires creditors to consider and verify the consumer's current debt obligations, alimony, and child support. For purposes of this requirement, the creditor must consider and verify, at a minimum, any debt or liability specified

in appendix Q. A creditor may also consider and verify other debt in accordance with § 1026.43(c)(2)(vi) and (c)(3); however, such debt would not be included in the total monthly debt-to-income ratio determination required by § 1026.43(e)(2)(vi).

Paragraph 43(e)(2)(vi).

1. *Calculation of monthly payment on the covered transaction and simultaneous loans.* As provided in appendix Q, for purposes of § 1026.43(e)(2)(vi), creditors must include in the definition of "debt" a consumer's monthly housing expense. This includes, for example, the consumer's monthly payment on the covered transaction (including mortgage-related obligations) and on simultaneous loans. Accordingly, § 1026.43(e)(2)(vi)(B) provides the method by which a creditor calculates the consumer's monthly payment on the covered transaction and on any simultaneous loan that the creditor knows or has reason to know will be made.

43(e)(3) Limits on points and fees for qualified mortgages.

Paragraph 43(e)(3)(i).

1. *Total loan amount.* The term "total loan amount" is defined in § 1026.32(b)(4)(i). For an explanation of how to calculate the "total loan amount" under § 1026.43(e)(3)(i), see comment 32(b)(4)(i)-1.

2. *Calculation of allowable points and fees.* A creditor must determine which category the loan falls into based on the face amount of the note (the "loan amount" as defined in § 1026.43(b)(5)). For categories with a percentage limit, the creditor must apply the allowable points and fees percentage to the "total loan amount," which may be different than the loan amount. A creditor must calculate the allowable amount of points and fees for a qualified mortgage as follows:

i. First, the creditor must determine the “tier” into which the loan falls based on the loan amount. The loan amount is the principal amount the consumer will borrow, as reflected in the promissory note or loan contract. *See* § 1026.43(b)(5). For example, if the loan amount is $55,000, the loan falls into the tier for loans greater than or equal to $20,000 but less than $60,000, to which a 5 percent cap on points and fees applies. For tiers with a prescribed dollar limit on points and fees (*e.g.*, for loans from $60,000 up to $100,000, the limit is $3,000), the creditor does not need to do any further calculations.

ii. Second, for tiers with a percentage limit, the creditor must determine the total loan amount based on the calculation for the total loan amount under comment 32(b)(4)(i)-1. If the loan amount is $55,000, for example, the total loan amount may be a different amount, such as $52,000.

iii. Third, the creditor must apply the percentage cap on points and fees to the total loan amount. For example, for a loan of $55,000 where the total loan amount is $52,000, the allowable points and fees are 5 percent of $52,000, or $2,600.

3. *Sample determination of allowable points and fees.*

i. A covered transaction with a loan amount of $105,000 falls into the first points and fees tier, to which a points and fees cap of 3 percent of the total loan amount applies. *See* § 1026.43(e)(3)(i)(A). Therefore, if the calculation under comment 32(b)(4)(i)-1 results in a total loan amount of $102,000, then the allowable total points and fees for this loan are 3 percent of $102,000, or $3,060.

ii. A covered transaction with a loan amount of $75,000 falls into the second points and fees tier, to which a points and fees cap of $3,000 applies. *See* § 1026.43(e)(3)(i)(B). The allowable total points and fees for this loan are $3,000, regardless of the total loan amount.

iii. A covered transaction with a loan amount of $50,000 falls into the third points and fees tier, to which a points and fees cap of 5 percent of the total loan amount applies. *See* § 1026.43(e)(3)(i)(C). Therefore, if the calculation under comment 32(b)(4)(i)-1 results in a total loan amount of $48,000, then the allowable total points and fees for this loan are 5 percent of $48,000, or $2,400.

iv. A covered transaction with a loan amount of $15,000 falls into the fourth points and fees tier, to which a points and fees cap of $1,000 applies. *See* § 1026.43(e)(3)(i)(D). The allowable total points and fees for this loan are $1,000, regardless of the total loan amount.

v. A covered transaction with a loan amount of $10,000 falls into the fifth points and fees tier, to which a points and fees cap of 8 percent of the total loan amount applies. *See* § 1026.43(e)(3)(i)(E). Therefore, if the calculation under comment 32(b)(4)(i)-1 results in a total loan amount of $7,000, then the allowable total points and fees for this loan are 8 percent of $7,000, or $560.

Paragraph 43(e)(3)(ii).

1. *Annual adjustment for inflation*. The dollar amounts, including the loan amounts, in § 1026.43(e)(3)(i) will be adjusted annually on January 1 by the annual percentage change in the CPI-U that was in effect on the preceding June 1. The Bureau will publish adjustments after the June figures become available each year.

43(e)(4) Qualified mortgage defined—special rules.

1. *Alternative definition*. Subject to the sunset provided under § 1026.43(e)(4)(iii), § 1026.43(e)(4) provides an alternative definition of qualified mortgage to the definition provided in § 1026.43(e)(2). To be a qualified mortgage under §1026.43(e)(4), the creditor must satisfy the requirements under § 1026.43(e)(2)(i) through (iii), in addition to being one of the

types of loans specified in § 1026.43(e)(4)(ii)(A) through (E).

2. *Termination of conservatorship*. Section 1026.43(e)(4)(ii)(A) requires that a covered transaction be eligible for purchase or guarantee by the Federal National Mortgage Association ("Fannie Mae") or the Federal Home Loan Mortgage Corporation ("Freddie Mac") (or any limited-life regulatory entity succeeding the charter of either) operating under the conservatorship or receivership of the Federal Housing Finance Agency pursuant to section 1367 of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. 4617). The special rule under § 1026.43(e)(4)(ii)(A) does not apply if Fannie Mae or Freddie Mac (or any limited-life regulatory entity succeeding the charter of either) has ceased operating under the conservatorship or receivership of the Federal Housing Finance Agency. For example, if either Fannie Mae or Freddie Mac (or succeeding limited-life regulatory entity) ceases to operate under the conservatorship or receivership of the Federal Housing Finance Agency, § 1026.43(e)(4)(ii)(A) would no longer apply to loans eligible for purchase or guarantee by that entity; however, the special rule would be available for a loan that is eligible for purchase or guarantee by the other entity still operating under conservatorship or receivership.

3. *Timing*. Under § 1026.43(e)(4)(iii), the definition of qualified mortgage under paragraph (e)(4) applies only to loans consummated on or before January 10, 2021, regardless of whether Fannie Mae or Freddie Mac (or any limited-life regulatory entity succeeding the charter of either) continues to operate under the conservatorship or receivership of the Federal Housing Finance Agency. Accordingly, § 1026.43(e)(4) is available only for covered transactions consummated on or before the earlier of either:

i. The date Fannie Mae or Freddie Mac (or any limited-life regulatory entity succeeding the charter of either), respectively, cease to operate under the conservatorship or receivership of the Federal Housing Finance Agency pursuant to section 1367 of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. 4617); or

ii. January 10, 2021, as provided by § 1026.43(e)(4)(iii).

4. *Eligible for purchase, guarantee, or insurance*. To satisfy § 1026.43(e)(4)(ii), a loan need not be actually purchased or guaranteed by Fannie Mae or Freddie Mac or insured or guaranteed by the U.S. Department of Housing and Urban Development, U.S. Department of Veterans Affairs, U.S. Department of Agriculture, or Rural Housing Service. Rather, § 1026.43(e)(4)(ii) requires only that the loan be eligible (*i.e.*, meet the criteria) for such purchase, guarantee, or insurance. For example, for purposes of § 1026.43(e)(4), a creditor is not required to sell a loan to Fannie Mae or Freddie Mac (or any limited-life regulatory entity succeeding the charter of either) to be a qualified mortgage; however, the loan must be eligible for purchase or guarantee by Fannie Mae or Freddie Mac (or any limited-life regulatory entity succeeding the charter of either), including satisfying any requirements regarding consideration and verification of a consumer's income or assets, credit history, and debt-to-income ratio or residual income. To determine eligibility, a creditor may rely on an underwriting recommendation provided by Fannie Mae or Freddie Mac's Automated Underwriting Systems (AUSs) or written guide in effect at the time. Accordingly, a covered transaction is eligible for purchase or guarantee by Fannie Mae or Freddie Mac if:

i. The loan conforms to the standards set forth in the Fannie Mae Single-Family Selling Guide or the Freddie Mac Single-Family Seller/Servicer Guide; or

ii. The loan receives one of the following recommendations from the corresponding automated underwriting system:

A. An "Approve/Eligible" recommendation from Desktop Underwriter (DU); or

B. An “Accept and Eligible to Purchase” recommendation from Loan Prospector (LP).

43(f) Balloon-Payment qualified mortgages made by certain creditors.

43(f)(1) Exemption.

Paragraph 43(f)(1)(i).

1. *Satisfaction of qualified mortgage requirements.* Under § 1026.43(f)(1)(i), for a mortgage that provides for a balloon payment to be a qualified mortgage, the mortgage must satisfy the requirements for a qualified mortgage in paragraphs (e)(2)(i)(A), (e)(2)(ii), (iii), and (v). Therefore, a covered transaction with balloon payment terms must provide for regular periodic payments that do not result in an increase of the principal balance, pursuant to § 1026.43(e)(2)(i)(A); must have a loan term that does not exceed 30 years, pursuant to § 1026.43(e)(2)(ii); must have total points and fees that do not exceed specified thresholds pursuant to § 1026.43(e)(2)(iii); and must satisfy the consideration and verification requirements in § 1026.43(e)(2)(v).

Paragraph 43(f)(1)(ii).

1. *Example.* Under § 1026.43(f)(1)(ii), if a qualified mortgage provides for a balloon payment, the creditor must determine that the consumer is able to make all scheduled payments under the legal obligation other than the balloon payment. For example, assume a loan in an amount of $200,000 that has a five-year loan term, but is amortized over 30 years. The loan agreement provides for a fixed interest rate of 6 percent. The loan consummates on March 3, 2014, and the monthly payment of principal and interest scheduled for the first five years is $1,199, with the first monthly payment due on April 1, 2014. The balloon payment of $187,308 is required on the due date of the 60th monthly payment, which is April 1, 2019. The loan can be a qualified mortgage if the creditor underwrites the loan using the scheduled principal and

interest payment of $1,199, plus the consumer’s monthly payment for all mortgage-related obligations, and satisfies the other criteria set forth in § 1026.43(f).

2. *Creditor’s determination.* A creditor must determine that the consumer is able to make all scheduled payments other than the balloon payment to satisfy § 1026.43(f)(1)(ii), in accordance with the legal obligation, together with the consumer’s monthly payments for all mortgage-related obligations and excluding the balloon payment, to meet the repayment ability requirements of § 1026.43(f)(1)(ii). A creditor satisfies § 1026.43(f)(1)(ii) if it uses the maximum payment in the payment schedule, excluding any balloon payment, to determine if the consumer has the ability to make the scheduled payments.

Paragraph 43(f)(1)(iii).

1. *Debt-to-income or residual income.* A creditor must consider and verify the consumer’s monthly debt-to-income ratio or residual income to meet the requirements of § 1026.43(f)(1)(iii). To calculate the consumer’s monthly debt-to-income or residual income for purposes of § 1026.43(f)(1)(iii), the creditor may rely on the definitions and calculation rules in § 1026.43(c)(7) and its accompanying commentary, except for the calculation rules for a consumer’s total monthly debt obligations (which is a component of debt-to-income and residual income under § 1026.43(c)(7)). For purposes of calculating the consumer’s total monthly debt obligations under § 1026.43(f)(1)(iii), the creditor must calculate the monthly payment on the covered transaction using the payment calculation rules in § 1026.43(f)(1)(iv)(A), together with all mortgage-related obligations and excluding the balloon payment.

Paragraph 43(f)(1)(iv).

1. *Scheduled payments.* Under § 1026.43(f)(1)(iv)(A), the legal obligation must provide that scheduled payments must be substantially equal and determined using an amortization

period that does not exceed 30 years. Balloon payments often result when the periodic payment would fully repay the loan amount only if made over some period that is longer than the loan term. For example, a loan term of 10 years with periodic payments based on an amortization period of 20 years would result in a balloon payment being due at the end of the loan term. Whatever the loan term, the amortization period used to determine the scheduled periodic payments that the consumer must pay under the terms of the legal obligation may not exceed 30 years.

2. *Substantially equal.* The calculation of payments scheduled by the legal obligation under § 1026.43(f)(1)(iv)(A) are required to result in substantially equal amounts. This means that the scheduled payments need to be similar, but need not be equal. For further guidance on substantially equal payments, see comment 43(c)(5)(i)-4.

3. *Interest-only payments*. A mortgage that only requires the payment of accrued interest each month does not meet the requirements of § 1026.43(f)(1)(iv)(A).

Paragraph 43(f)(1)(v).

1. *Forward commitments.* A creditor may make a mortgage loan that will be transferred or sold to a purchaser pursuant to an agreement that has been entered into at or before the time the transaction is consummated. Such an agreement is sometimes known as a “forward commitment.” A balloon-payment mortgage that will be acquired by a purchaser pursuant to a forward commitment does not satisfy the requirements of § 1026.43(f)(1)(v), whether the forward commitment provides for the purchase and sale of the specific transaction or for the purchase and sale of transactions with certain prescribed criteria that the transaction meets. However, a purchase and sale of a balloon-payment qualified mortgage to another person that separately meets the requirements of § 1026.43(f)(1)(vi) is permitted. For example: assume a

creditor that meets the requirements of § 1026.43(f)(1)(vi) makes a balloon-payment mortgage that meets the requirements of § 1026.43(f)(1)(i) through (iv); if the balloon-payment mortgage meets the purchase criteria of an investor with which the creditor has an agreement to sell such loans after consummation, then the balloon-payment mortgage does not meet the definition of a qualified mortgage in accordance with § 1026.43(f)(1)(v). However, if the investor meets the requirement of § 1026.43(f)(1)(vi), the balloon-payment qualified mortgage retains its qualified mortgage status.

Paragraph 43(f)(1)(vi).

1. *Creditor qualifications.* Under § 1026.43(f)(1)(vi), to make a qualified mortgage that provides for a balloon payment, the creditor must satisfy three criteria that are also required under § 1026.35(b)(2)(iii)(A), (B) and (C), which require:

i. During the preceding calendar year, the creditor extended over 50 percent of its total first-lien covered transactions, as defined in § 1026.43(b)(1), on properties that are located in counties that are designated either “rural” or “underserved,” as defined in § 1026.35(b)(2)(iv), to satisfy the requirement of § 1026.35(b)(2)(iii)(A). Pursuant to § 1026.35(b)(2)(iv), a county is considered to be rural if it is neither in a metropolitan statistical area, nor a micropolitan statistical area adjacent to a metropolitan statistical area, as those terms are defined by the U.S. Office of Management and Budget. A county is considered to be underserved if no more than two creditors extend covered transactions secured by a first lien five or more times in that county during a calendar year. The Bureau determines annually which counties in the United States are rural or underserved and publishes on its public website lists of those counties to enable creditors to determine whether they meet this criterion. Thus, for example, if a creditor originated 90 first-lien covered transactions during 2013, the creditor meets this element of the exception in 2014 if at least 46 of those transactions are secured by first liens on properties located in one or more counties that are on the Bureau's lists for 2013.

ii. During the preceding calendar year, the creditor together with its affiliates originated 500 or fewer first-lien covered transactions, as defined by § 1026.43(b)(1), to satisfy the requirement of § 1026.35(b)(2)(iii)(B).

iii. As of the end of the preceding calendar year, the creditor had total assets that do not exceed the current asset threshold established by the Bureau, to satisfy the requirement of § 1026.35(b)(2)(iii)(C). For calendar year 2013, the asset threshold was $2,000,000,000.

43(f)(2) Post-consummation transfer of balloon-payment qualified mortgage

1. *Requirement to hold in portfolio*. Creditors generally must hold a balloon-payment qualified mortgage in portfolio to maintain the transaction's status as a qualified mortgage under § 1026.43(f)(1), subject to four exceptions. Unless one of these exceptions applies, a balloon-payment qualified mortgage is no longer a qualified mortgage under § 1026.43(f)(1) once legal title to the debt obligation is sold, assigned, or otherwise transferred to another person. Accordingly, unless one of the exceptions applies, the transferee could not benefit from the presumption of compliance for qualified mortgages under § 1026.43(f)(1) unless the loan also met the requirements of another qualified mortgage definition.

2. *Application to subsequent transferees*. The exceptions contained in § 1026.43(f)(2) apply not only to an initial sale, assignment, or other transfer by the originating creditor but to subsequent sales, assignments, and other transfers as well. For example, assume Creditor A originates a qualified mortgage under § 1026.43(f)(1). Six months after consummation, Creditor A sells the qualified mortgage to Creditor B pursuant to § 1026.43(f)(2)(ii) and the loan retains its qualified mortgage status because Creditor B complies with the limits on operating

predominantly in rural or underserved areas, asset size, and number of transactions. If Creditor B sells the qualified mortgage, it will lose its qualified mortgage status under § 1026.43(f)(1) unless the sale qualifies for one of the § 1026.43(f)(2) exceptions for sales three or more years after consummation, to another qualifying institution, as required by supervisory action, or pursuant to a merger or acquisition.

Paragraph 43(f)(2)(i).

1. *Transfer three years after consummation*. Under § 1026.43(f)(2)(i), if a balloon-payment qualified mortgage under § 1026.43(f)(1) is sold, assigned, or otherwise transferred three years or more after consummation, the balloon-payment qualified mortgage retains its status as a qualified mortgage under § 1026.43(f)(1) following the sale. The transferee need not be eligible to originate qualified mortgages under § 1026.43(f)(1)(vi). The balloon-payment qualified mortgage will continue to be a qualified mortgage throughout its life, and the transferee, and any subsequent transferees, may invoke the presumption of compliance for qualified mortgages under § 1026.43(f)(1).

Paragraph 43(f)(2)(ii).

1. *Transfer to another qualifying creditor*. Under § 1026.43(f)(2)(ii), a balloon-payment qualified mortgage under § 1026.43(f)(1) may be sold, assigned, or otherwise transferred at any time to another creditor that meets the requirements of § 1026.43(f)(1)(vi). That section requires that a creditor: (1) operate predominantly in a rural or underserved area during the preceding calendar year; (2) during the preceding calendar year, together with all affiliates, originated 500 or fewer first-lien covered transactions; and (3) had total assets less than $2 billion (as adjusted for inflation) at the end of the preceding calendar year. A balloon-payment qualified mortgage

under § 1026.43(f)(1) transferred to a creditor that meets these criteria would retain its qualified mortgage status even if it is transferred less than three years after consummation.

Paragraph 43(f)(2)(iii)

1. *Supervisory sales*. Section 1026.43(f)(2)(iii) facilitates sales that are deemed necessary by supervisory agencies to revive troubled creditors and resolve failed creditors. A balloon-payment qualified mortgage under § 1026.43(f)(1) retains its qualified mortgage status if it is sold, assigned, or otherwise transferred to another person pursuant to: (1) a capital restoration plan or other action under 12 U.S.C. 1831o; (2) the actions or instructions of any person acting as conservator, receiver, or bankruptcy trustee; (3) an order of a State or Federal government agency with jurisdiction to examine the creditor pursuant to State or Federal law; or (4) an agreement between the creditor and such an agency. A balloon-payment qualified mortgage under § 1026.43(f)(1) that is sold, assigned, or otherwise transferred under these circumstances retains its qualified mortgage status regardless of how long after consummation it is sold and regardless of the size or other characteristics of the transferee. Section 1026.43(f)(2)(iii) does not apply to transfers done to comply with a generally applicable regulation with future effect designed to implement, interpret, or prescribe law or policy in the absence of a specific order by or a specific agreement with a governmental agency described in § 1026.43(f)(2)(iii) directing the sale of one or more qualified mortgages under § 1026.43(f)(1) held by the creditor or one of the other circumstances listed in § 1026.43(f)(2)(iii). For example, a balloon-payment qualified mortgage under § 1026.43(f)(1) that is sold pursuant to a capital restoration plan under 12 U.S.C. 1831o would retain its status as a qualified mortgage following the sale. However, if the creditor simply chose to sell the same qualified mortgage as one way to comply with general regulatory capital requirements in the absence of supervisory action or agreement it would lose its status as

a qualified mortgage following the sale unless it qualifies under another definition of qualified mortgage.

Paragraph 43(f)(2)(iv)

1. *Mergers and acquisitions*. A qualified mortgage under § 1026.43(f)(1) retains its qualified mortgage status if a creditor merges with, is acquired by another person, or acquires another person regardless of whether the creditor or its successor is eligible to originate new balloon-payment qualified mortgages under § 1026.43(f)(1) after the merger or acquisition. However, the creditor or its successor can originate new balloon-payment qualified mortgages under § 1026.43(f)(1) only if it complies with all of the requirements of § 1026.43(f)(1) after the merger or acquisition. For example, assume a small creditor that originates 250 first-lien covered transactions each year and originates balloon-payment qualified mortgages under § 1026.43(f)(1) is acquired by a larger creditor that originates 10,000 first-lien covered transactions each year. Following the acquisition, the small creditor would no longer be able to originate balloon-payment qualified mortgages because, together with its affiliates, it would originate more than 500 first-lien covered transactions each year. However, the balloon-payment qualified mortgages originated by the small creditor before the acquisition would retain their qualified mortgage status.

43(g) Prepayment penalties.

43(g)(2) Limits on prepayment penalties.

1. *Maximum period and amount*. Section 1026.43(g)(2) establishes the maximum period during which a prepayment penalty may be imposed and the maximum amount of the prepayment penalty. A covered transaction may include a prepayment penalty that may be imposed during a shorter period or in a lower amount than provided under § 1026.43(g)(2). For

example, a covered transaction may include a prepayment penalty that may be imposed for two years after consummation and that equals 1 percent of the amount prepaid in each of those two years.

43(g)(3) Alternative offer required.

Paragraph 43(g)(3)(i).

1. *Same type of interest rate*. Under § 1026.43(g)(3)(i), if a creditor offers a consumer a covered transaction with a prepayment penalty, the creditor must offer the consumer an alternative covered transaction without a prepayment penalty and with an annual percentage rate that cannot increase after consummation. Under § 1026.43(g)(3)(i), if the covered transaction with a prepayment penalty is a fixed-rate mortgage, as defined in § 1026.18(s)(7)(iii), then the alternative covered transaction without a prepayment penalty must also be a fixed-rate mortgage. Likewise, if the covered transaction with a prepayment penalty is a step-rate mortgage, as defined in § 1026.18(s)(7)(ii), then the alternative covered transaction without a prepayment penalty must also be a step-rate mortgage.

Paragraph 43(g)(3)(iv).

1. *Points and fees*. Whether or not an alternative covered transaction without a prepayment penalty satisfies the points and fees conditions for a qualified mortgage is determined based on the information known to the creditor at the time the creditor offers the consumer the transaction. At the time a creditor offers a consumer an alternative covered transaction without a prepayment penalty under § 1026.43(g)(3), the creditor may know the amount of some, but not all, of the points and fees that will be charged for the transaction. For example, a creditor may not know that a consumer intends to buy single-premium credit unemployment insurance, which would be included in the points and fees for the covered

transaction. The points and fees condition under § 1026.43(g)(3)(iv) is satisfied if a creditor reasonably believes, based on information known to the creditor at the time the offer is made, that the amount of points and fees to be charged for an alternative covered transaction without a prepayment penalty will be less than or equal to the amount of points and fees allowed for a qualified mortgage under § 1026.43(e)(2)(iii).

Paragraph 43(g)(3)(v).

1. *Transactions for which the consumer likely qualifies*. Under § 1026.43(g)(3)(v), the alternative covered transaction without a prepayment penalty the creditor must offer under § 1026.43(g)(3) must be a transaction for which the creditor has a good faith belief the consumer likely qualifies. For example, assume the creditor has a good faith belief the consumer can afford monthly payments of up to $800. If the creditor offers the consumer a fixed-rate mortgage with a prepayment penalty for which monthly payments are $700 and an alternative covered transaction without a prepayment penalty for which monthly payments are $900, the requirements of § 1026.43(g)(3)(v) are not met. The creditor's belief that the consumer likely qualifies for the covered transaction without a prepayment penalty should be based on the information known to the creditor at the time the creditor offers the transaction. In making this determination, the creditor may rely on information provided by the consumer, even if the information subsequently is determined to be inaccurate.

43(g)(4) Offer through a mortgage broker.

1. *Rate sheet*. Under § 1026.43(g)(4), where the creditor offers covered transactions with a prepayment penalty to consumers through a mortgage broker, as defined in § 1026.36(a)(2), the creditor must present the mortgage broker an alternative covered transaction that satisfies the requirements of § 1026.43(g)(3). Creditors may comply with this requirement by providing a

rate sheet to the mortgage broker that states the terms of such an alternative covered transaction without a prepayment penalty.

2. *Alternative to creditor's offer*. Section 1026.43(g)(4)(ii) requires that the creditor provide, by agreement, for the mortgage broker to present the consumer an alternative covered transaction that satisfies the requirements of § 1026.43(g)(3) offered by either the creditor or by another creditor, if the other creditor offers a covered transaction with a lower interest rate or a lower total dollar amount of discount points and origination points or fees. The agreement may provide for the mortgage broker to present both the creditor's covered transaction and an alternative covered transaction offered by another creditor with a lower interest rate or a lower total dollar amount of origination discount points and points or fees. See comment 36(e)(3)-3 for guidance in determining which step-rate mortgage has a lower interest rate.

3. *Agreement*. The creditor's agreement with a mortgage broker for purposes of § 1026.43(g)(4) may be part of another agreement with the mortgage broker, for example, a compensation agreement. Thus, the creditor need not enter into a separate agreement with the mortgage broker with respect to each covered transaction with a prepayment penalty.

43(g)(5) Creditor that is a loan originator.

1. *Loan originator*. The definition of "loan originator" in § 1026.36(a)(1) applies for purposes of § 1026.43(g)(5). Thus, a loan originator includes any creditor that satisfies the definition of loan originator but makes use of "table-funding" by a third party. *See* comment 36(a)-1.i and ii.

2. *Lower interest rate*. Under § 1026.43(g)(5), a creditor that is a loan originator must present an alternative covered transaction without a prepayment penalty that satisfies the requirements of § 1026.43(g)(3) offered by either the assignee for the covered transaction or

another person, if that other person offers a transaction with a lower interest rate or a lower total dollar amount of origination points or fees or discount points. See comment 36(e)(3)-3 for guidance in determining which step-rate mortgage has a lower interest rate.

43(h) Evasion; open-end credit.

1. *Subject to closed-end credit rules.* Where a creditor documents a loan as open-end credit but the features and terms, or other circumstances, demonstrate that the loan does not meet the definition of open-end credit in § 1026.2(a)(20), the loan is subject to the rules for closed-end credit, including § 1026.43.