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BUREAU OF CONSUMER FINANCIAL PROTECTION

12 CFR Part 1026

Docket No. CFPB-2013-0002

RIN 3170-AA34

Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act (Regulation Z)

AGENCY: Bureau of Consumer Financial Protection.

ACTION: Final rule; official interpretations.

SUMMARY: The Bureau of Consumer Financial Protection (Bureau) is amending Regulation Z, which implements the Truth in Lending Act (TILA). Regulation Z generally prohibits a creditor from making a mortgage loan unless the creditor determines that the consumer will have the ability to repay the loan. The final rule provides an exemption to these requirements for creditors with certain designations, loans pursuant to certain programs, certain nonprofit creditors, and mortgage loans made in connection with certain Federal emergency economic stabilization programs. The final rule also provides an additional definition of a qualified mortgage for certain loans made and held in portfolio by small creditors and a temporary definition of a qualified mortgage for balloon loans. Finally, the final rule modifies the requirements regarding the inclusion of loan originator compensation in the points and fees calculation.

DATES: This rule is effective January 10, 2014.

FOR FURTHER INFORMATION CONTACT: Jennifer B. Kozma or Eamonn K. Moran, Counsels; Thomas J. Kearney or Mark Morelli, Senior Counsels; or Stephen Shin, Managing Counsel, Office of Regulations, at (202) 435-7700.

SUPPLEMENTARY INFORMATION:

I. Summary of the Final Rule

The Bureau is issuing this final rule to adopt certain exemptions, modifications, and clarifications to TILA's ability-to-repay requirements. TILA section 129C, as added by sections 1411, 1412, and 1414 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), generally requires creditors to make a reasonable, good faith determination of a consumer's ability to repay a mortgage loan and creates a presumption of compliance with these ability-to-repay requirements for certain loans designated as "qualified mortgages." On January 10, 2013, the Bureau issued a final rule (the 2013 ATR Final Rule) to implement these ability-to-repay requirements and qualified mortgage provisions. *See* 78 FR 6407 (Jan. 30, 2013). At the same time, the Bureau issued a proposed rule (the 2013 ATR Proposed Rule or Bureau's proposal) related to certain proposed exemptions, modifications, and clarifications to the ability-to-repay requirements. *See* 78 FR 6621 (Jan. 30, 2013). This final rule addresses the issues put forth for public comment in the 2013 ATR Proposed Rule. See part II.B below and part II.B-F of the 2013 ATR Final Rule for a complete discussion of the statutory and regulatory background to the ability-to-repay requirements.

Loan Originator Compensation and the Points and Fees Calculation

The Dodd-Frank Act generally provides that points and fees on a qualified mortgage may not exceed 3 percent of the loan balance and that points and fees in excess of 5 percent will trigger the protections for high-cost mortgages under the Home Ownership and Equity Protection

Act (HOEPA).[1] The Dodd-Frank Act also included a provision requiring that loan originator compensation be counted toward these thresholds, even if it is not paid up-front by the consumer directly to the loan originator.

The Bureau had solicited comment on how to apply the statutory requirements in situations in which payments pass from one party to another over the course of a mortgage transaction. The Bureau was particularly concerned about situations in which the creditor pays compensation to a mortgage broker or its own loan originator employees because there is no simple way to determine whether the compensation is paid from money the creditor collected from up-front charges to the consumer (which would already be counted against the points and fees thresholds) or from the interest rate on the loan (which would not be counted toward the thresholds).

The final rule excludes from points and fees loan originator compensation paid by a consumer to a mortgage broker when that payment has already been counted toward the points and fees thresholds as part of the finance charge under § 1026.32(b)(1)(i). The final rule also excludes from points and fees compensation paid by a mortgage broker to an employee of the mortgage broker because that compensation is already included in points and fees as loan originator compensation paid by the consumer or the creditor to the mortgage broker.

The final rule excludes from points and fees compensation paid by a creditor to its loan officers. The Bureau concluded that there were significant operational challenges to calculating individual employee compensation accurately early in the loan origination process, and that those challenges would lead to anomalous results for consumers. In addition, the Bureau concluded that structural differences between the retail and wholesale channels lessened risks to

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[1] *See* title I subtitle B of the Riegle Community Development and Regulatory Improvement Act of 1994, Public Law 103-325, 108 Stat. 2160 (Jan. 25, 1994).

consumers. The Bureau will continue to monitor the market to determine if additional protections are necessary and evaluate whether there are different approaches for calculating retail loan officer compensation consistent with the purposes of the statute.

The final rule retains an “additive” approach for calculating loan originator compensation paid by a creditor to a loan originator other than an employee of creditor. Under the additive approach, § 1026.32(b)(1)(ii) requires that a creditor include in points and fees compensation paid by the creditor to a mortgage broker, in addition to up-front charges paid by the consumer to the creditor that are included in points and fees under § 1026.32(b)(1)(i).

Exemptions for Certain Creditors and Lending Programs

Certain creditors and nonprofits. The final rule provides an exemption from the ability-to-repay requirements for extensions of credit made by certain types of creditors. Creditors designated by the U.S. Department of the Treasury as Community Development Financial Institutions and creditors designated by the U.S. Department of Housing and Urban Development as either a Community Housing Development Organization or a Downpayment Assistance Provider of Secondary Financing are exempt from the ability-to-repay requirements, under certain conditions. The final rule also generally exempts creditors designated as nonprofit organizations under section 501(c)(3) of the Internal Revenue Code of 1986 (26 U.S.C. 501(c)(3)) that extend credit no more than 200 times annually, provide credit only to low-to-moderate income consumers, and follow their own written procedures to determine that consumers have a reasonable ability to repay their loans.

Credit extended pursuant to certain lending programs. The final rule provides an exemption from the ability-to-repay requirements for extensions of credit made pursuant to programs administered by a housing finance agency and for an extension of credit made pursuant to an Emergency Economic Stabilization Act program, such as extensions of credit made pursuant to a State Hardest Hit Fund program.

Small Creditor Portfolio and Balloon-Payment Qualified Mortgages

The final rule contains several provisions that are designed to facilitate compliance and preserve access to credit from small creditors, which are defined as creditors with no more than $2 billion in assets that (along with affiliates) originate no more than 500 first-lien mortgages covered under the ability-to-repay rules per year. The Bureau had previously exercised authority under the Dodd-Frank Act to allow certain balloon-payment mortgages to be designated as qualified mortgages if they were originated and held in portfolio by small creditors operating predominantly in rural or underserved areas. In this final rule, the Bureau is:

- Adopting a new, fourth category of qualified mortgages for certain loans originated and held in portfolio for at least three years (subject to certain limited exceptions) by small creditors, even if they do not operate predominantly in rural or underserved areas. The loans must meet the general restrictions on qualified mortgages with regard to loan features and points and fees, and creditors must evaluate consumers' debt-to-income ratio or residual income. However, the loans are not subject to a specific debt-to-income ratio as they would be under the general qualified mortgage definition.
- Raising the threshold defining which qualified mortgages receive a safe harbor under the ability-to-repay rules for loans that are made by small creditors under the balloon-loan or small creditor portfolio categories of qualified mortgages. Because small creditors often have higher cost of funds, the final rule shifts the threshold separating qualified mortgages that receive a safe harbor from those that receive a rebuttable

presumption of compliance with the ability-to-repay rules from 1.5 percentage points above the average prime offer rate (APOR) on first-lien loans to 3.5 percentage points above APOR.

- Providing a two-year transition period during which small creditors that do not operate predominantly in rural or underserved areas can offer balloon-payment qualified mortgages if they hold the loans in portfolio. During the two-period transition period, the Bureau intends to study whether the definitions of "rural" or "underserved" should be adjusted and to work with small creditors to transition to other types of products, such as adjustable-rate mortgages, that satisfy other qualified mortgage definitions.

The ability-to-repay rules as revised by this final rule will take effect on January 10, 2014, along with various other rules implementing new mortgage protections under the Dodd-Frank Act.

II. Background

A. Mortgage Market Background

The mortgage market is the single largest market for consumer financial products and services in the United States. In 2007 and 2008 this market collapsed, greatly diminishing the wealth of millions of American consumers and sending the economy into a severe recession. A primary cause of the collapse was the steady deterioration of credit standards in mortgage lending. Evidence demonstrates that many mortgage loans were made solely against collateral and without consideration of ability to repay, particularly in the markets for ‘‘subprime’’ and ‘‘Alt-A’’ products, which more than doubled from $400 billion in originations in 2003 to $830 billion in originations in 2006.[2] Subprime products were sold primarily to consumers with poor

[2] Inside Mortg. Fin., *The 2011 Mortgage Market Statistical Annual* (2011).

or no credit history, while Alt-A loans were sold primarily to consumers who provided little or no documentation of income or other evidence of repayment ability.[3]

Because subprime and Alt-A loans involved additional risk, they were typically more expensive to consumers than "prime" mortgage loans, although many of them had very low introductory interest rates. While housing prices continued to increase, it was relatively easy for consumers to refinance their existing loans into more affordable products to avoid interest rate resets and other adjustments. When housing prices began to decline in 2005, however, refinancing became more difficult and delinquency rates on subprime and Alt-A products increased dramatically.[4] By the summer of 2006, 1.5 percent of loans less than a year old were in default, and this figure peaked at 2.5 percent in late 2007.[5] As the economy worsened, the rates of serious delinquency (90 or more days past due or in foreclosure) for the subprime and Alt-A products began a steep increase from approximately 10 percent in 2006, to 20 percent in 2007, to over 40 percent in 2010.[6] Although the mortgage market is recovering, consumers today continue to feel the effects of the financial crisis.

Community-Focused Lending Programs

While governmental and nonprofit programs have always been an important source of assistance for low- to moderate-income (LMI) consumers, these programs have taken on even

[3] There is evidence that some consumers who would have qualified for "prime" loans were steered into subprime loans as well. The Federal Reserve Board on July 18, 2011 issued a consent cease and desist order and assessed an $85 million civil money penalty against Wells Fargo & Company of San Francisco, a registered bank holding company, and Wells Fargo Financial, Inc., of Des Moines. The order addresses allegations that Wells Fargo Financial employees steered potential prime-eligible consumers into more costly subprime loans and separately falsified income information in mortgage applications. In addition to the civil money penalty, the order requires that Wells Fargo compensate affected consumers. *See* Press Release, Federal Reserve Board (July 20, 2011), *available at:* http://www.federalreserve.gov/newsevents/press/enforcement/20110720a.htm.

[4] U.S. Fin. Crisis Inquiry Comm'n, *The Financial Crisis Inquiry Report: Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States* at 215-217 (Official Gov't ed. 2011) (FCIC Report), *available at*: http://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf.

[5] *FCIC Report* at 215. CoreLogic Chief Economist Mark Fleming told the FCIC that the early payment default rate "certainly correlates with the increase in the Alt-A and subprime shares and the turn of the housing market and the sensitivity of those loan products." *Id.*

[6] *FCIC Report* at 217.

greater significance in light of current tight mortgage credit standards and Federal initiatives to stabilize the housing market. There are a variety of programs designed to assist LMI consumers with access to homeownership. These programs are generally offered through a nonprofit entity, local government, or a housing finance agency (HFA). These programs play an important role in the housing sector of the economy.

Types of financial assistance available. Community-focused lending programs typically provide LMI consumers with assistance ranging from housing counseling services to full mortgage loan financing. Some programs offer financial assistance through land trust programs, in which the consumer leases the real property and takes ownership of only the improvements. Many organizations provide "downpayment assistance" in connection with mortgage loan financing. This can be a gift, grant, or loan to the consumer to assist with the consumer's down payment, or to pay for some of the closing costs. These programs often rely on subsidies from Federal government funds, local government funds, foundations, or employer funding.[7] For example, many of these programs rely on funds provided through the HUD Home Investment Partnerships Program (HOME Program).[8]

Some programs offer first-lien mortgage loans designed to meet the needs of LMI consumers. These first-lien mortgage loans may have a discounted interest rate or limited origination fees or may permit high loan-to-value ratios. Many programs offer subordinate financing. Subordinate-financing options may be simple, such as a relatively inexpensive subordinate-lien loan to pay for closing costs. Other methods of subordinate financing may be complex. For example, one HFA program offers a 30-year, fixed-rate, subordinate-lien

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[7] Abigail Pound, *Challenges and Changes in Community-Based Lending for Homeownership*, NeighborWorks America, Joint Center for Housing Studies of Harvard University (Feb. 2011), *available at*: http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/w11-2_pound.pdf.

[8] The HOME Investment Partnerships Program is authorized under title II of the Cranston-Gonzalez National Affordable Housing Act of 1990, Public Law 101-625, 104 Stat. 4079 (1990). *See* 24 CFR 92.1 *et. seq.*

mortgage loan through partner creditors, with interest-only payments for the first 11 years of the loan's term, and with an interest subsidy for the LMI consumer, resulting in a graduated monthly payment between the fifth and eleventh year of the loan; an additional 30-year deferred, 0 percent subordinate-lien mortgage loan is extended by the HFA equal to the amount of the subsidy.[9] Some of the loans offered by these programs, whether first-lien or subordinate-financing, are structured as hybrid grant products that are commonly forgiven.

Housing finance agencies. For over 50 years, HFAs have provided LMI consumers with opportunities for affordable homeownership.[10] HFAs are governmental entities, chartered by either a State or a municipality, that engage in diverse housing financing activities for the promotion of affordable housing. Some HFAs are chartered to promote affordable housing goals across an entire State, while others' jurisdiction extends to only particular cities or counties.[11] Many of the State and Federal programs HFAs administer do not provide administrative funds; others provide limited administrative funds. Most HFAs operate independently and do not receive State operating funds. These agencies are generally funded through tax-exempt bonds but may receive funding from Federal, State, or other sources.[12] HFAs issue these tax-exempt bonds, also known as mortgage revenue bonds, and use the proceeds of the bond sale to finance affordable mortgage loans to LMI consumers. As of June 2012, the 51 State HFAs (including the District of Columbia) had $107 billion in outstanding tax-free municipal debt available. These mortgage revenue bonds funded approximately 100,000 first-time homeowners per year.

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[9] See http://www.mhp.net/homeownership/homebuyer/soft_second_works.php, describing the SoftSecond program offered by the Massachusetts Housing Partnership.

[10] The first State housing finance agency was established in New York in 1960. *See* New York State Housing Finance Agency Act, 1960 Laws of New York, 183rd Session, Chap. 671.

[11] For example, the Louisiana Housing Corporation administers affordable housing programs across all of Louisiana, while The Finance Authority of New Orleans administers programs only in Orleans Parish. *See* www.lhfa.state.la.us and www.financeauthority.org.

[12] Bonds issued by HFAs are tax-exempt if the proceeds are used to provide assistance to first-time or LMI-homebuyers. *See* 26 U.S.C. 143.

HFAs may also receive funding through Federal programs, such as the HOME Program, which is the largest Federal block grant for affordable housing.[13]

HFAs employ several methods of promoting affordable homeownership. These agencies may partner with local governments to develop and implement long-term community-development strategies. For example, HFAs may provide tax credits to companies that build or rehabilitate affordable housing.[14] These agencies may also administer affordable housing trust funds or other State programs to facilitate the affordable housing development.[15] Many HFAs also provide education, counseling, or training courses to first-time or LMI consumers.

HFAs also provide financial assistance directly to consumers. Typically, HFAs offer the first-lien mortgage loan, subordinate financing, and downpayment assistance programs described above. HFAs may also establish pooled loss reserves to self-insure mortgage loans originated pursuant to the program, thereby permitting LMI consumers to avoid private mortgage insurance. HFAs may also provide other assistance to LMI consumers, such as mortgage loan payment subsidies or assistance with the up-front costs of a mortgage loan. In 2010, HFAs provided about $10 billion in affordable financing.[16] In 2010, 89 percent of HFAs provided down payment assistance loan or grant assistance and 57 percent of HFAs provided assistance in conjunction with programs offered by the Federal Housing Administration (FHA) or the U.S.

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[13] *See* www.hud.gov/homeprogram.

[14] The Tax Reform Act of 1986, Public Law 99-514, 100 Stat. 2085 (1986), included the Low-Income Housing Tax Credit Program. Under this program, the IRS provides tax credits to HFAs. HFAs may transfer these tax credits to developers of affordable housing. Developers then sell these credits to fund the development program. *See* http://portal.hud.gov/hudportal/HUD?src=/program_offices/comm_planning/affordablehousing/training/web/lihtc/basics.

[15] The Massachusetts Affordable Housing Trust Fund provides funds to governmental subdivisions, nonprofit organizations, and other entities seeking to provide for the development of affordable housing. *See* www.masshousing.com. New York State's Mitchell-Lama program provides subsidies such as property tax exemptions to affordable housing developers. *See* http://www.nyshcr.org/Programs/mitchell-lama/.

[16] National Council of State Housing Agencies, *State HFA Factbook* (2010), p. 33.

Department of Agriculture (USDA).[17] However, HFAs generally do not provide direct financing to LMI consumers. Many HFAs are prohibited by law from directly extending credit in an effort by State governments to avoid competing with the private sector. HFAs generally partner with creditors, such as local banks, that extend credit pursuant to the HFA's program guidelines. Most HFA programs are "mortgage purchase" programs in which the HFA establishes program requirements (*e.g.*, income limits, purchase price limits, interest rates, points and term limits, underwriting standards, etc.), and agrees to purchase loans made by private creditors that meet these requirements.

Many HFAs expand on the underwriting standards of GSEs or Federal government agencies by applying even stricter underwriting standards than these guidelines or the ability-to-repay requirements, such as requiring mandatory counseling for all first-time homebuyers and strong loan servicing. For example, the State of New York Mortgage Agency (SONYMA)'s underwriting requirements generally include a two-year, stable history of earned income, a monthly payment-to-income ratio not to exceed 40 percent, a monthly debt-to-income ratio not to exceed 45 percent, and review of the consumer's entire credit profile to determine acceptable credit.[18]

HFAs extend credit only after conducting a lengthy and thorough analysis of a consumer's ability to repay. HFAs generally employ underwriting requirements that are uniquely tailored to meet the needs of LMI consumers, and which often account for nontraditional underwriting criteria, extenuating circumstances, and other elements that are indicative of creditworthiness, ability to repay, and responsible homeownership. In certain circumstances, some HFAs require the consideration of compensating factors and other elements

[17] *Id.* at 21-22, 35-36.
[18] *See* State of New York Mortgage Agency (SONYMA) Credit and Property Underwriting Notes, *available at:* http://www.nyshcr.org/assets/documents/1006.pdf.

that are different from the factors required to be considered and verified under the ability-to-repay requirements. For example, the Connecticut Housing Finance Agency (CHFA)'s underwriting requirements require the consideration of certain compensating factors (*e.g.*, ability to make a large down payment, demonstrated ability to accumulate savings, substantial documented cash reserves, etc.) for consumers with debt ratios that exceed the maximum CHFA monthly payment-to-income and debt-to-income ratio limits.[19] In addition, to be eligible for Virginia Housing Development Authority (VHDA) conventional financing, a consumer must demonstrate the willingness and ability to repay the mortgage debt and creditors must consider: employment and income; credit history; sufficient funds to close; monthly housing expenses; and monthly payment-to-income and debt-to-income ratios.[20] VHDA underwriting guidelines allow delegated underwriters to approve exceptions to the above debt-to-income ratios, provided that the ratios do not exceed 2 percent above the guidelines. The exceptions must be justified with strong compensating factors, which must indicate that the consumer can afford the repayment of the increased debt.[21] Through careful and regular oversight, however, HFAs help ensure that their lenders follow the HFAs' strict underwriting standards.

Private organizations. While entities such as HFAs develop and finance affordable housing programs, these mortgage loans are generally extended by private organizations. These organizations often are structured as nonprofit 501(c)(3) organizations. Under Internal Revenue Code section 501(c)(3), the designation is for nonprofit, tax-exempt, charitable organizations not

[19] *See* Connecticut Housing Finance Agency Operating Manual, Section 5—Underwriting, *available at:* http://www.chfa.org/content/CHFA%20Documents/Operating%20Manual%20-%20Section%2005%20Underwriting.pdf.

[20] *See* Virginia Housing Development Authority Origination Guide, Section 2.3 Underwriting Requirements (Aug. 2011), *available at:* http://www.vhda.com/BusinessPartners/Lenders/LoanInfoGuides/Loan%20Information%20and%20Guidelines/OriginationGuide.pdf.

[21] *See id.*

operated for the benefit of private interests.[22] Under Federal tax law, 501(c)(3) organizations are restricted from lobbying activities, while 501(c)(4) organizations, which must exist to promote social welfare, may engage in political campaigning and lobbying.[23] Most organizations that provide support to LMI consumers are structured as 501(c)(3) organizations. However, some organizations are structured as nonprofit 501(c)(4) organizations.

Various Federal programs establish eligibility requirements and provide ongoing monitoring of specific types of creditors that receive Federal grants and other support. For example, Community Development Financial Institutions (CDFIs) are approved by the U.S. Department of the Treasury (Treasury Department) to receive monetary awards from the Treasury Department's CDFI Fund, which was established to promote capital development and growth in underserved communities. Promoting homeownership and providing safe lending alternatives are among the Fund's main goals. The Treasury Department created the CDFI designation to identify and support small-scale creditors that are committed to community-focused lending but have difficulty raising the capital needed to provide affordable housing services.[24] CDFIs may operate on a for-profit or nonprofit basis, provided the CDFI has a primary mission of promoting community development.[25] These programs are also subject to other eligibility requirements.[26] As of July 2012, there were 999 such organizations in the U.S., 62 percent of which were classified as Community Development (CD) Loan Funds and 22

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[22] *See* http://www.irs.gov/Charities-&-Non-Profits/Charitable-Organizations/Exemption-Requirements-Section-501(c)(3)-Organizations.
[23] *See* http://www.irs.gov/Charities-&-Non-Profits/Other-Non-Profits/Social-Welfare-Organizations.
[24] *See* 68 FR 5704 (Feb. 4, 2003).
[25] *See* 12 CFR 1805.201(b).
[26] *Id.* Treasury Department eligibility requirements for CDFIs stipulate that an approved organization must: be a legal entity at the time of certification application; have a primary mission of promoting community development; be a financing entity; primarily serve one or more target markets; provide development services in conjunction with its financing activities; maintain accountability to its defined target market; and be a non-government entity and not be under control of any government entity (Tribal governments excluded).

percent as CD Credit Unions, while the rest were CD Banks, Thrifts, or CD Venture Capital Funds.[27]

The U.S. Department of Housing and Urban Development (HUD) may designate nonprofits engaging in affordable housing activities as Downpayment Assistance through Secondary Financing Providers (DAPs).[28] HUD established this designation as part of an effort to promote nonprofit involvement in affordable housing programs.[29] HUD-approved nonprofits may participate in FHA single-family programs that allow them to purchase homes at a discount, finance FHA-insured mortgages with the same terms and conditions as owner-occupants, or be able to finance secondary loans for consumers obtaining FHA-insured mortgages.[30] A DAP must be approved by HUD if it is a nonprofit or nonprofit instrumentality of government that provides downpayment assistance as a lien in conjunction with an FHA first mortgage; government entity DAPs and gift programs do not require approval.[31] As of May 2013 HUD listed 228 nonprofit agencies and nonprofit instrumentalities of government in the U.S. that are authorized to provide secondary financing.[32] HUD performs field reviews and requires annual reports of participating nonprofit agencies. Additionally, HUD's quality control plan requires periodic review for deficient policies and procedures and corrective actions. These approval and subsequent review procedures are intended to ensure that DAPs operate in compliance with

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[27] *See* http://www.cdfifund.gov/docs/certification/cdfi/CDFI List - 07-31-12.xls.
[28] *See* 24 CFR 200.194.
[29] "Nonprofit organizations are important participants in HUD's efforts to further affordable housing opportunities for low- and moderate-income persons through the FHA single family programs. FHA's single family regulations recognize a special role for nonprofit organizations in conjunction with the . . . provision of secondary financing." *See* 67 FR 39238 (June 6, 2002).
[30] DAPs generally rely on FHA program guidelines for underwriting purposes, but have additional requirements for determining eligibility for assistance. For example, the Hawaii Homeownership Center is a HUD-approved DAP with separate eligibility criteria, *available at:* http://www.hihomeownership.org/pdf/DPAL5_FAQ_JAN2013.pdf.
[31] *See* http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/sfh/np/sfhdap01.
[32] *See* https://entp.hud.gov/idapp/html/f17npdata.cfm.

HUD requirements and remain financially viable.[33] However, HUD recognizes that these nonprofits have limited resources and gives consideration to DAP viability when crafting regulations.[34]

Creditors may also be certified by HUD as Community Housing Development Organizations (CHDOs) in connection with HUD's HOME Program, which provides grants to fund a wide range of activities that promote affordable homeownership.[35] HUD Participating Jurisdictions confer CHDO certification only on community-focused nonprofits that are both dedicated to furthering a community's affordable housing goals and capable of complying with the requirements of the HOME Program.[36] Creditors designated as CHDOs are eligible to receive special CHDO set-aside funds from the HOME Program to fund local homebuyer assistance programs.[37] Applicants seeking CHDO status must meet rigorous requirements. For example, a CHDO must be designated as a nonprofit under section 501(c)(3) or (c)(4) of the Internal Revenue Code, adhere to strict standards of financial accountability, have among its purposes the provision of decent and affordable housing for LMI consumers, maintain accountability to the community, and have a proven record of capably and effectively serving

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[33] "It is vital that the Department periodically and uniformly assess the management and financial ability of participating nonprofit agencies to ensure they are not overextending their capabilities and increasing HUD's risk of loss as a mortgage insurance provider." 65 FR 9285, 9286 (Feb. 24, 2000).

[34] "HUD continues to strongly encourage the participation of nonprofit organizations, including community and faith-based organizations, in its programs. This proposed rule is not designed to place particular burdens on participation by nonprofit organizations. Rather, the proposed rule is designed to ensure that nonprofit organizations have the capacity, experience, and interest to participate in HUD's housing programs." 69 FR 7324, 7325 (Feb. 13, 2004).

[35] *See* http://portal.hud.gov/hudportal/HUD?src=/program_offices/comm_planning/affordablehousing/programs/home.

[36] "The Department believes that there was specific statutory intent to create an entitlement for community-based nonprofit organizations that would own, sponsor or develop HOME assisted housing. While partnerships with State and local government are critical to the development of affordable housing, these organizations are viewed as private, independent organizations separate and apart from State or local governments. One of the major objectives of the Department's technical assistance program is to increase the number of capable, successful CHDOs able and willing to use the CHDO set-aside [fund]." 61 FR 48736, 48737 (Sept. 16, 1996).

[37] *See* 24 CFR 92.300 *et. seq.*

low-income communities.[38] After the CHDO designation is obtained, CHDO creditors must operate under the supervision of a Participating Jurisdiction and in accordance with the requirements of the HOME Program.[39] HUD conducts annual performance reviews to determine whether funds have been used in accordance with program requirements.[40] While HUD continues to support affordable housing programs involving CHDOs, current market conditions have affected CHDO viability.[41]

CDFIs and CHDOs that provide mortgage loans generally employ underwriting guidelines tailored to the needs of LMI consumers. Unlike creditors that rely on industry-wide underwriting guidelines, which generally do not account for the unique credit characteristics of LMI consumers, CDFI and CHDO underwriting requirements include a variety of compensating factors. For example, these creditors often consider personal narratives explaining prior financial difficulties, such as gaps in employment or negative credit history.[42] Others consider the amount of time a consumer spends working on the construction or rehabilitation of affordable homes.[43] Some creditors also consider a consumer's general reputation, relying on references from a landlord or persons with whom the consumer does business.[44] In these transactions, a CDFI or

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[38] *See* 24 CFR 92.2.

[39] For example, no more than 5 percent of a Participating Jurisdiction's fiscal year HOME allocation may be used for CHDO operating expenses. 24 CFR 92.208(a).

[40] *See* 24 CFR 92.550 *et. seq.*

[41] "[Participating jurisdictions] have encountered new challenges in administering their programs and in managing their growing portfolios of older HOME projects. These challenges include reduced availability of states or local funding sources, reduced private lending, changes in housing property standards, and energy codes and reductions in states and local government workforces throughout the Nation. These challenges have been magnified by current housing and credit market conditions." 76 FR 78343, 78345 (Dec. 16, 2011).

[42] Neighborworks Anchorage, which is designated as both a CDFI and CHDO, requires letters of explanation regarding gaps in employment or derogatory credit history. *See* http://www.nwanchorage.org/home-ownership/buying-home/getting-loan-affordable-loans-lending-programs.

[43] The Community Development Corporation of Brownsville, which is designated as a CHDO, requires consumers to contribute 11 months of labor, or "sweat equity," as part of the approval process. *See* http://www.cdcb.org/h-h-programs.html#programs2. St. Lucie Habitat for Humanity, which is designated as a CHDO, requires 300 hours of labor as part of the approval process. *See* http://stluciehabitat.org/#.

[44] Habitat for Humanity affiliates, many of which are designated as a CHDO or CDFI, consider references from current and former landlords, creditors, and others. *See* Habitat for Humanity Affiliate Operations Manual, *available at:* http://www.medinahabitat.org/files/AffilOpFamilySelect.pdf.

CHDO may determine that the strength of these compensating characteristics outweigh weaknesses in other underwriting factors, such as negative credit history or irregular income. Including these compensating factors in the underwriting process enables CDFIs and CHDOs to appropriately underwrite LMI consumers, unlike more.

Nonprofit creditors may engage in community-focused lending without obtaining one of the designations described above. Such nonprofits often rely on HFA or Federal programs for funding, lending guidelines, and other support. However, some nonprofits offer credit to LMI consumers independent of these State or Federal programs. For example, nonprofits may make mortgage loans in connection with a GSE affordable housing program. The Federal Home Loan Bank (FHLB) System, Federal National Mortgage Association (Fannie Mae), and Federal Home Loan Mortgage Corporation (Freddie Mac) offer several programs to support affordable housing by facilitating mortgage financing for LMI consumers. For example, the FHLB Affordable Housing Program provides grants to member banks to fund programs that assist with closing costs or down payments, buy down principal amounts or interest rates, refinance an existing loan, or assist with rehabilitation or construction costs.[45] Fannie Mae and Freddie Mac also offer two programs focused on community-focused lending.[46]

Other options exist for nonprofits seeking to develop and fund community-focused lending programs. For example, a nonprofit may originate mortgage loans to LMI consumers and subsequently sell the loans to a bank, credit union, or other investor as part of a Community

[45] The Federal Home Loan Bank of Des Moines provides funds for member bank programs related to rural homeownership, urban first-time homebuyers, and Native American homeownership. *See* http://www.fhlbdm.com/community-investment/down-payment-assistance-programs/. The Federal Home Loan Bank of Chicago provides funds for member bank programs related to down payment and closing cost assistance or eligible rehabilitation costs for the purchase of a home. *See* http://ci.fhlbc.com/Grant_Pgms/DPP.shtml.

[46] Fannie Mae offers first-lien mortgage loans through the My Community Mortgage program and subordinate-lien loans through the Community Seconds program. Freddie Mac offers both first- and subordinate-lien mortgage loans through the Home Possible program.

Reinvestment Act partnership program.[47] Other nonprofits may operate a limited affordable housing assistance fund, funded entirely by private donations, under which LMI consumers may obtain subordinate financing. Nonprofits such as these often rely on the underwriting performed by the creditor for the first-lien mortgage loan, which is often a bank or credit union, to process, underwrite, and approve the LMI consumer's application. In addition, some nonprofits are self-supporting and offer full financing to LMI consumers. These nonprofits often establish lending programs with unique guidelines, such as requirements that LMI consumers devote a minimum number of hours towards the construction of affordable housing.

Homeownership Stabilization and Foreclosure Prevention Programs

During the early stages of the financial crisis the mortgage market significantly tightened mortgage loan underwriting requirements in response to uncertainty over the magnitude of potential losses due to delinquencies, defaults, and foreclosures.[48] This restriction in credit availability coincided with increasing unemployment, falling home values, and the onset of subprime ARM resets. As a result, many subprime ARM consumers could not afford their mortgage payments and were not able to obtain refinancings. This led to increases in delinquencies and foreclosures, which prompted further tightening of underwriting standards. Other subprime ARM consumers were able to remain current, but were not able to refinance because of a decrease in their loan-to-value ratio or an increase in their debt-to-income ratio.[49]

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[47] Under the Community Reinvestment Act (12 U.S.C. 2901), depository institutions may meet community reinvestment goals by directly originating or purchasing mortgage loans provided to LMI consumers. *See* 12 CFR 228.22.

[48] A 2011 OCC survey shows that 56 percent of supervised banks participating in the survey tightened residential real estate underwriting requirements between 2007 and 2008, and 73 percent tightened underwriting requirements between 2008 and 2009. *See* Office of the Comptroller of the Currency, *Survey of Credit Underwriting Practices 2011*, p. 11.

[49] "[W]ith house prices becoming flat or declining in many parts of the country during 2007, it has become increasingly difficult for many subprime ARM borrowers to refinance. While many such borrowers remain current on their loans or are still able to refinance at market rates or into FHA products, an increasing number have either fallen behind on their existing payments or face the prospect of falling behind when rates reset and they are unable

However, these consumers devoted most of their disposable income to mortgage payments, thereby lowering overall consumer demand and further weakening the national economy.[50]

Policymakers became concerned that the losses incurred from foreclosures on subprime mortgage loans would destabilize the entire mortgage market.[51] There was a particular concern that the uncertainty surrounding exposure to these losses would lead to a fear-induced downward economic spiral.[52] As the crisis worsened, industry stakeholders attempted to stop this self-reinforcing cycle through a series of measures intended to stabilize homeownership and prevent foreclosure. Beginning in late 2008, the Federal government, Federal agencies, and GSEs implemented programs designed to facilitate refinancings and loan modifications.

The Troubled Asset Relief Program. The U.S. government enacted and implemented several programs intended to promote economic recovery by stabilizing homeownership and preventing foreclosure. The Emergency Economic Stabilization Act of 2008,[53] as amended by the American Recovery and Reinvestment Act of 2009,[54] authorizes the Treasury Department to "use loan guarantees and credit enhancements to facilitate loan modifications to prevent avoidable foreclosures."[55] Pursuant to this authority, the Treasury Department established the Troubled Asset Relief Program (TARP), under which two programs were created to provide financial assistance directly to homeowners in danger of losing their homes: the Making Home

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to refinance." *Accelerating Loan Modifications, Improving Foreclosure Prevention and Enhancing Enforcement*, 110th Cong. (Dec. 6, 2007) (testimony of John C. Dugan, Comptroller, Office of the Comptroller of the Currency).

[50] By the third quarter of 2007, the ratio of mortgage-related financial obligations (which is comprised of mortgage debt, homeowners' insurance, and property tax) to disposable personal income reached an all-time high of 11.3 percent. *See* http://www.federalreserve.gov/releases/housedebt/.

[51] "[A]nalysts are concerned that mortgage foreclosures will climb significantly higher and, along with falling housing prices, overwhelm the ability of mortgage markets to restructure or refinance loans for creditworthy borrowers." Congressional Budget Office, Options for Responding to Short-Term Economic Weakness, p. 21 (Jan. 2008).

[52] "[A] breakdown of mortgage markets could put the economy on a self-reinforcing downward spiral of less lending, weaker economic activity, lower house prices, more foreclosures, even less lending, and so on, either causing or significantly worsening a recession." *Id.* pp. 21-22.

[53] 12 U.S.C. 5201 *et. seq.*; Public Law 110-343 (Oct. 3, 2008).

[54] *See* Sec. 7002 of Public Law 111-5 (Jan. 6, 2009).

[55] 12 U.S.C. 5219(a)(1).

Affordable (MHA) program and the Hardest Hit Fund (HHF) program. The MHA program is operated by the Treasury Department and seeks to provide Federally-directed assistance to consumers who are at risk of default, foreclosure, or were otherwise harmed by the financial crisis.[56] The HHF program provides funds to certain HFAs in States where the Treasury Department has determined that locally-directed stabilization programs are required.[57]

MHA began with the introduction of the Home Affordable Modification Program (HAMP) in March 2009.[58] HAMP is intended to assist employed homeowners by replacing the consumer's current mortgage loan with a more affordable mortgage loan.[59] HAMP produced nearly 500,000 trial modifications during the first six months of the program.[60] MHA offerings expanded with the creation of the Second Lien Modification Program in August 2009 and the Home Affordable Foreclosure Alternatives Program in November 2009.[61] The Treasury Department subsequently modified these programs several times in response to the changing needs of distressed consumers and the mortgage market.[62]

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[56] *See* www.makinghomeaffordable.gov.

[57] *See* http://www.treasury.gov/initiatives/financial-stability/TARP-Programs/housing/hhf/Pages/default.aspx.

[58] *See* Press Release, Treasury Department, *Relief for Responsible Homeowners* (Mar. 4, 2009), *available at*: http://www.treasury.gov/press-center/press-releases/Pages/200934145912322.aspx.

[59] Generally speaking, a loan can be modified under HAMP only if it yields a positive net present value using series of tests involving "waterfalls." Under the waterfall method, servicers must repeatedly project amortizations based on sequential decreases in the interest rate and, if necessary, principal forgiveness, until arriving at a potential loan modification with a target front-end DTI ratio of 31 percent. *See* United States Department of the Treasury, "Home Affordable Modification Program, Base Net Present Value (NPV) Model v5.02, Model Documentation" (April 1, 2012), *available at*: https://www.hmpadmin.com/portal/programs/docs/hamp_servicer/npvmodeldocumentationv502.pdf. *See also* Consumer Compliance Outlook, Federal Reserve Bank of Philadelphia (Third Quarter 2009), *available at*: http://www.philadelphiafed.org/bank-resources/publications/consumer-compliance-outlook/2009/third-quarter/q3_02.cfm.

[60] *See* Troubled Asset Relief Program (TARP) Monthly Report to Congress - September 2009.

[61] *See* United States Department of the Treasury Office of Financial Stability, "Troubled Asset Relief Program: Two Year Retrospective" (Oct. 2010).

[62] *See e.g.*, Supplemental Directive 10-02 (Mar. 24, 2010), modifying HAMP, Supplemental Directive 11-07 (July 25, 2011), expanding eligibility for the Home Affordable Unemployment Program, and Supplemental Directive 12-02 (Mar. 9, 2012), expanding HAMP eligibility.

MHA programs are currently scheduled to expire on December 31, 2013, although there is continuing debate about whether to extend them.[63] As of December 2012, ten programs have been established under MHA. The Treasury Department operates five MHA programs.[64] The remaining five MHA programs are operated in conjunction with U.S. Department of Veterans Affairs (VA), FHA, or USDA programs.[65] Many consumers facing default or foreclosure have received assistance under these programs. For example, from the beginning of the HAMP program to March 2013, over 1.1 million permanent HAMP modifications have been completed, saving distressed consumers an estimated $19.1 billion.[66]

In March 2010 the Treasury Department established the HHF program to enable the States most affected by the financial crisis to develop innovative assistance programs.[67] Nineteen programs have been established under the HHF fund, which is currently scheduled to expire on December 31, 2017. These programs provide assistance to homeowners in the District of Columbia and the 18 States most affected by the economic crisis.[68] The HHF provides funds directly to HFAs in these States, which are used to create foreclosure-avoidance programs. As of April 2013, approximately $2.2 billion has been allocated to support the 63 programs established

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[63] Press Release, Treasury Department, *Expanding our Efforts to Help More Homeowners and Strengthen Hard-hit Communities* (Jan. 27, 2012), *available at*: http://www.treasury.gov/connect/blog/Pages/Expanding-our-efforts-to-help-more-homeowners-and-strengthen-hard-hit-communities.aspx.

[64] In addition to HAMP, the Second Lien Modification Program, and the Home Affordable Foreclosure Alternatives Program, the Treasury Department also operates the Principal Reduction Alternative Program and the Home Affordable Unemployment Program.

[65] These programs are the FHA Home Affordable Modification Program, USDA Special Loan Servicing, Veterans Affairs Home Affordable Modification, FHA Second Lien Modification Program, and the FHA Short Refinance Program.

[66] *See* March 2013 Making Home Affordable Program Performance Report.

[67] *See* Hardest Hit Fund Program Guidelines Round 1, *available at*: http://www.treasury.gov/initiatives/financial-stability/TARP-Programs/housing/Documents/HFA_Proposal_Guidelines_-_1st_Rd.pdf.

[68] The HHF provides funds to HFAs located in Alabama, Arizona, California, Florida, Georgia, Illinois, Indiana, Kentucky, Michigan, Mississippi, Nevada, New Jersey, North Carolina, Ohio, Oregon, Rhode Island, South Carolina, Tennessee, and Washington, D.C.

to assist distressed consumers in these localities.[69] In California alone, nearly 17,000 consumers have received over $166 million in assistance since the beginning of the program.[70]

As with the MHA programs discussed above, these HHF programs have evolved over time. The Treasury Department originally encouraged HFAs to establish programs for mortgage modifications, principal forbearance, short sales, principal reduction for consumers with high loan-to-value ratios, unemployment assistance, and second-lien mortgage loan reduction or modification.[71] No HFAs were able to establish all of these programs in the early stages of the HHF. However, through 2011 and 2012 State HHF programs were significantly modified and expanded.[72] The 19 HFAs continue to modify these programs to develop more effective and efficient methods of providing assistance to at-risk consumers. For example, in September 2012 the Nevada HHF program was amended for the tenth time.[73]

Federal agency programs. In response to the financial crisis, the FHA, the VA, and the USDA expanded existing programs and implemented new programs intended to facilitate refinancings for consumers at risk of delinquency or default. Some of these programs operate in conjunction with the Treasury Department's MHA program, while others are run solely by the particular Federal agency. In 2008 Congress expanded access to refinancings under the VA's Interest Rate Reduction Refinancing Loan program by raising the maximum loan-to-value ratio to 100 percent and increasing the maximum loan amount of loans eligible to be guaranteed under

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[69] *See* Troubled Asset Relief Program (TARP) Monthly Report to Congress - April 2013.
[70] *See* Keep Your Home California 2012 Fourth Quarterly Report.
[71] *See* Hardest Hit Fund Program Guidelines Round 1, *available at*: http://www.treasury.gov/initiatives/financial-stability/TARP-Programs/housing/Documents/HFA_Proposal_Guidelines_-_1st_Rd.pdf.
[72] From 2011-2012, the program agreements between the 19 HFAs and the Treasury Department were modified 55 times. *See* http://www.treasury.gov/initiatives/financial-stability/TARP-Programs/housing/hhf/Pages/Archival-information.aspx.
[73] *See* Tenth Amendment to Commitment to Purchase Financial Instrument and HFA Participation Agreement, *available at*: http://www.treasury.gov/initiatives/financial-stability/TARP-Programs/housing/Pages/Program-Documents.aspx.

the program.[74] In February 2009 HUD increased the maximum loan amount for FHA-insured mortgages.[75] This change expanded access to refinancings available under the FHA's Streamline Refinance Program.[76] Several months later, the FHA created the Short Refinance Option program to assist consumers with non-FHA mortgage loans.[77] This program, which operates in conjunction with TARP, permits underwater consumers to refinance if the current creditor agrees to write down 10 percent of the outstanding principal balance. Similarly, in August 2010 the Rural Housing Service of the USDA (RHS) adopted rules intended to facilitate loan modifications for consumers struggling to make payments on USDA Guaranteed Loans.[78] The USDA subsequently created the Single Family Housing Guaranteed Rural Refinance Pilot Program, which was intended to refinance USDA borrowers into more stable and affordable mortgage loans.[79]

These efforts have enabled many consumers to receive refinancings under these programs. In 2011, the FHA accounted for 5.6 percent of the mortgage refinance market, with originations totaling $59 billion.[80] However, the number of consumers receiving assistance under these programs varies. For example, between April 2009 and December 2011, the FHA

[74] *See* Sec. 504 of the Veterans' Benefits Improvement Act of 2008, Public Law 110-389 (Oct. 10, 2008).
[75] *See* HUD Mortgagee Letter 2009-07. Section 1202(b) of the American Recovery and Reinvestment Act of 2009, Public Law 111-5 (Jan. 6, 2009), authorized the Secretary of Housing and Urban Development to increase the loan limit.
[76] The FHA Streamline Refinance Program contains reduced underwriting requirements for consumers with FHA mortgage loans seeking to refinance into a new FHA mortgage loan with a reduced interest rate. The FHA has offered streamline refinances for over thirty years. *See* HUD Mortgagee Letter 1982-23.
[77] *See* HUD Mortgagee Letter 2010-23.
[78] *See* 75 FR 52429 (Aug. 26, 2010).
[79] *See* Rural Dev. Admin. Notice No. 4615 (1980-D) (Feb. 1, 2012).
[80] This number represents FHA's market share by dollar volume. By number of originations, the FHA controlled 6.5 percent of the refinance market, with 312,385 refinances originated. *See* FHA-Insured Single-Family Mortgage Originations and Market Share Report 2012 – Q2, *available at*: http://portal.hud.gov/hudportal/documents/huddoc?id=fhamktq2_2012.pdf.

started 5.6 million mortgage loan modifications.[81] During a similar time period, nearly 997,000 FHA Streamline Refinances were consummated.[82] In contrast, between February 2010 and September 2012, only 1,772 mortgage loans were refinanced under the Short Refinance Option program.[83] Efforts continue to develop and enhance these programs to assist distressed homeowners while improving the performance of existing mortgage loans owned, insured, or guaranteed by these agencies.

HARP and other GSE refinancing programs. After the GSEs were placed into conservatorship in late 2008, the Federal Housing Finance Agency (FHFA) took immediate steps to reduce GSE losses by mitigating foreclosures.[84] In November 2008 FHFA and the GSEs, in coordination with the Treasury Department and other stakeholders, announced the Streamlined Modification Program, which was intended to help delinquent consumers avoid foreclosure by affordably restructuring mortgage payments.[85] This program was the precursor to the Home Affordable Refinance Program (HARP) that was announced in March 2009.[86] The HARP program was originally set to expire in June 2010 and limited to consumers with a loan-to-value ratio that did not exceed 105 percent. However, HARP was modified over time to account for the deteriorating mortgage market. In July 2010 the maximum loan-to-value ratio was increased

[81] *See* Hearing on FY13 Federal Housing Administration's Budget Request, 112th Cong. (Mar. 8, 2012) (testimony of Carol Galante, Acting Assistant Secretary for Housing/Federal Housing Administration Commissioner for the U.S. Department of Housing and Urban Development).

[82] A total of 996,871 mortgage loans were endorsed under the FHA Streamline Refinance program from Fiscal Year 2009 through 2012. *See* FHA Outlook Reports for Fiscal Years 2009, 2010, 2011, and 2012, *available at*: http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/rmra/oe/rpts/ooe/olmenu.

[83] *See* Office of the Special Inspector General for the Troubled Asset Relief Program, Quarterly Report to Congress, p. 64 (Oct. 25, 2012).

[84] *See* Press Release, FHFA, *Statement of FHFA Director James B. Lockhart* (Sept. 7, 2008), *available at*: http://www.fhfa.gov/webfiles/23/FHFAStatement9708final.pdf.

[85] *See* Press Release, FHFA, *FHFA Announces Implementation Plans for Streamlined Loan Modification Program*, (Dec. 18, 2008), *available at*: http://www.fhfa.gov/webfiles/267/SMPimplementation121808.pdf.

[86] *See* Press Release, Treasury Department, *Relief for Responsible Homeowners* (Mar. 4, 2009), *available at*: http://www.treasury.gov/press-center/press-releases/Pages/200934145912322.aspx.

from 105 percent to 125 percent.[87] Nine months later FHFA extended the HARP expiration date by one year, to June 30, 2011.[88]

Many of the nearly five million eligible consumers were expected to receive refinancings under HARP.[89] However, by mid-2011 fewer than one million consumers had received HARP refinances. Fannie Mae, Freddie Mac, and FHFA responded by significantly altering the HARP program.[90] Perhaps most significantly, the maximum loan-to-value ratio was removed, facilitating refinances for all underwater consumers who otherwise fit HARP's criteria. More HARP refinances were completed during the first six months of 2012 than in all of 2011.[91] These changes were especially effective in assisting consumers with high loan-to-value ratios. In September 2012, consumers with loan-to-value ratios in excess of 125 percent received 26 percent of all HARP refinances.[92]

The GSEs have implemented other streamline refinance programs intended to facilitate the refinancing of existing GSE consumers into more affordable mortgage loans. These programs are available for consumers who are not eligible for a refinancing under HARP. For example, a consumer with a loan-to-value ratio of less than 80 percent is eligible for a streamline refinancing through Fannie Mae's Refi Plus program or Freddie Mac's Relief Refinance program. These programs comprise a significant share of GSE refinancing activity. From January through September 2012, 45 percent of GSE streamline refinances were non-HARP

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[87] *See* Press Release, FHFA, *FHFA Authorized Fannie Mae and Freddie Mac to Expand Home Affordable Refinance Program to 125 Percent Loan-to-Value* (July 1, 2009), *available at*: http://www.fhfa.gov/webfiles/13495/125_LTV_release_and_fact_sheet_7_01_09%5B1%5D.pdf.
[88] *See* Press Release, FHFA, *FHFA Extends Refinance Program By One Year* (Mar. 1, 2010), *available at*: http://www.fhfa.gov/webfiles/15466/HARPEXTENDED3110%5B1%5D.pdf.
[89] *See* Treasury Department Press Release *supra* note 94.
[90] *See* Press Release, FHFA, *FHFA, Fannie Mae and Freddie Mac Announce HARP Changes to Reach More Borrowers* (Oct. 24, 2011), *available at*: http://www.fhfa.gov/webfiles/22721/HARP_release_102411_Final.pdf.
[91] *See* Federal Housing Finance Agency Refinance Report (June 2012).
[92] *See* Federal Housing Finance Agency Refinance Report (Sept. 2012).

refinances.[93] FHFA and the GSEs remain committed to continue modifying these programs to enhance access to refinancing credit for distressed consumers.[94] In April 2013, FHFA extended the HARP expiration date to December 31, 2015.[95]

The Mortgage Loan Market for Small Portfolio Creditors

Traditionally, underwriting standards were determined at the branch or local bank level. These practices heavily emphasized the relationship between the bank and the consumer.[96] Starting in the mid-1990s, much of the mortgage market began to move toward standardized underwriting practices based on quantifiable and verifiable data points, such as a consumer's credit score.[97] The shift toward standardized, electronic underwriting lowered costs for creditors and consumers, thereby increasing access to mortgage credit. Standardized loan-level data made it easier to analyze individual loans for compliance with underwriting requirements, which facilitated the expansion of private mortgage securitizations. This shift from portfolio-focused to securitization-focused mortgage lending also altered the traditional risk calculations undertaken by creditors, as creditors no longer retained the risks associated with poorly underwritten loans.[98] Additionally, in another departure from the traditional mortgage lending model, these creditors increasingly relied on the fees earned by originating and selling mortgage loans, as opposed to the interest revenue derived from the loan itself.

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[93] *Id.*

[94] "Today, we continue to meet with lenders to ensure HARP is helping underwater borrowers refinance at today's historical low interest rates. As we continue to gain insight from the program we will make additional operational adjustments as needed to enhance access to this program." Edward J. DeMarco, Acting Director Federal Housing Finance Agency, Remarks at the American Mortgage Conference (Sept. 10, 2012), *available at*: http://www.fhfa.gov/webfiles/24365/2012DeMarcoNCSpeechFinal.pdf.

[95] *See* Press Release, FHFA, *FHFA Extends HARP to 2015* (Apr. 11, 2013), *available at*: http://www.fhfa.gov/webfiles/22721/HARP_release_102411_Final.pdf.

[96] "[C]ommunity banks tend to base credit decisions on local knowledge and nonstandard data obtained through long-term relationships and are less likely to rely on the models-based underwriting used by larger banks." Federal Deposit Insurance Corporation, *FDIC Community Banking Study*, p. 1-1 (Dec. 2012) (FDIC Community Banking Study).

[97] *See FCIC Report* at 72.

[98] *See FCIC Report* at 89.

Small community creditor access to the secondary mortgage market was limited. Many small creditors originated "non-conforming" loans which could not be purchased by the GSEs. Also, many community creditors chose to retain the relationship model of underwriting, rather than fully adopting standardized data models popular with larger banks. Retaining these traditional business methods had important consequences during the subprime crisis. While large lending institutions generally depended on the secondary market for funding, small community banks and credit unions generally remained reliant on deposits to fund mortgage loans held in portfolio. As a result, community creditors were less affected by the contraction in the secondary mortgage market during the financial crisis.[99] For example, the percentage of mortgage-backed securities in relation to the total assets of credit unions actually declined by more than 1.5 percent as subprime lending expanded.[100]

Furthermore, by retaining mortgage loans in portfolio community creditors also retain the risk of delinquency or default on those loans. The presence of portfolio lending within this market remains an important influence on the underwriting practices of community banks and credit unions. These institutions generally rely on long-term relationships with a small group of consumers. Therefore, the reputation of these community banks and credit unions is largely dependent on serving their community in ways that cause no harm. Thus, community creditors have an added incentive to engage in thorough underwriting to protect their balance sheet as well as their reputation. To minimize portfolio performance risk, small community creditors have developed underwriting standards that are different than those employed by larger institutions.

[99] Between 2005 and 2008, while loan originations at banks with assets in excess of $10 billion fell by 51 percent, loan originations at banks with assets between $1 and $10 billion declined by 31 percent, and loan originations at banks with less than $1 billion in assets declined by only 10 percent. *See* Federal Reserve Bank of Kansas City, *Financial Industry Perspectives* (Dec. 2009).

[100] In December 2003, the ratio of mortgage-backed securities to total assets at credit unions was 4.67 percent. By December 2006, this ratio had decreased to 3.21 percent. *See Accelerating Loan Modifications, Improving Foreclosure Prevention and Enhancing Enforcement*, 110th Cong. (Dec. 6, 2007) (testimony of Gigi Hyland, Board Member of the National Credit Union Administration).

Small creditors generally engage in "relationship banking," in which underwriting decisions rely on qualitative information gained from personal relationships between creditors and consumers.[101] This qualitative information, often referred to as "soft" information, focuses on subjective factors such as consumer character and reliability, which "may be difficult to quantify, verify, and communicate through the normal transmission channels of a banking organisation."[102] Evidence suggests that underwriting based on such "soft" information yields loan portfolios that perform better than those underwritten according to "hard" information, such as credit score and consumer income levels.[103] For example, one recent study found that delinquency and default rates were significantly lower for consumers receiving mortgage loans from institutions relying on soft information for underwriting decisions.[104] This is consistent with market-wide data demonstrating that mortgage loan delinquency and charge-off rates are significantly lower at smaller banks than larger ones.[105] Current data also suggests that that these

[101] "Many customers . . . value the intimate knowledge their banker has of their business and/or total relationship and prefer dealing consistently with the same individuals whom they do not have to frequently reeducate about their own unique financial and business situations. Such customers are consequently willing to pay relatively more for such service. Relationship lending thus provides a niche for community institutions that many large banks find less attractive or are less capable of providing." *See* Federal Reserve Bank of Atlanta, *On the Uniqueness of Community Banks* (Oct. 2005).

[102] *See* Allen N. Berger and Gregory F. Udell, *Small Business Credit Availability and Relationship Lending: The Importance of Bank Organisational Structure*, Economic Journal (2002).

[103] "Moreover, a comparison of loss rates on individual loan categories suggests that community banks may also do a better job of underwriting loans than noncommunity institutions (see Table 4.4)." *FDIC Community Banking Study,* p. 4-6. *See also* Sumit Agarwal, Brent W. Ambrose, Souphala Chomsisengphet, and Chunlin Liu, *The Role of Soft Information in a Dynamic Contract Setting: Evidence from the Home Equity Market*, 43 Journal of Money, Credit and Banking 633, 649 (Oct. 2011) (analyzing home equity lending, the authors "find that the lender's use of soft information can successfully reduce the risks associated with *ex post* credit losses.").

[104] "In particular, we find evidence that selection and soft information prior to purchase are significantly associated with reduced delinquency and default. And, in line with relationship lending, we find that this effect is most pronounced for borrowers with compromised credit (credit scores below 660), who likely benefit the most from soft information in the lending relationship. This suggests that for higher risk borrowers, relationship with a bank may be about more than the mortgage transaction." O. Emre Ergungor and Stephanie Moulton, *Beyond the Transaction: Depository Institutions and Reduced Mortgage Default for Low-Income Homebuyers*, Federal Reserve Bank of Cleveland Working Paper 11-15 (Aug. 2011).

[105] Federal Reserve Board, *Charge-Off and Delinquency Rates on Loans and Leases at Commercial Banks* (Nov. 2012), *available at*: http://www.federalreserve.gov/releases/chargeoff/default.htm. These data show that residential real estate charge-offs were higher at large banks than small ones for 12 of the previous 87 quarters, dating to the start of the small bank survey in 1991. For example, in the fourth quarter of 2009 large banks had a 3.16 percent charge-off rate, while the rate at small banks was 1.2 percent. Delinquency rates demonstrate a similar effect.

relationship-based lending practices lead to more accurate underwriting decisions during cycles of both lending expansion and contraction.[106]

Although the number of community banks has declined in recent years, these institutions remain an important source of nonconforming credit and of mortgage credit generally in areas commonly considered "rural" or "underserved." The Bureau's estimates based on Home Mortgage Disclosure Act (HMDA) and the Consolidated Report of Condition and Income (Call Report) data suggest that approximately one half of all nonconforming loans are originated by creditors with assets less than $2 billion and approximately one quarter are originated by creditors with total assets less than $2 billion that originate fewer than 500 first-lien mortgages annually. In 2011, community banks held over 50 percent of all deposits in micropolitan areas and over 70 percent of all deposits held in rural areas.[107] Similarly, in 2011, there were more than 600 counties where community banks operated offices but where no noncommunity bank offices were present, and more than 600 additional counties where community banks operated offices but where fewer than three noncommunity bank offices were present.[108] These counties have a combined population of more than 16 million people and include both rural and metropolitan areas.[109] It is important to note that the cost of credit offered by these community institutions is generally higher than the cost of similar products offered by larger institutions. One reason for this increased expense stems from the nature of relationship-based underwriting decisions. Such qualitative evaluations of creditworthiness tend to take more time, and therefore

[106] "In two retail loan categories—residential real estate loans and loans to individuals—community banks consistently reported lower average loss rates from 1991 through 2011, the period for which these data are available." *FDIC Community Banking Study*, p. 4-6.
[107] *FDIC Community Banking Study*, p. 3-6.
[108] *FDIC Community Banking Study*, p. 3-5.
[109] *Id*.

are more expensive, than underwriting decisions based on standardized points of data.[110] Also, the cost of funds for community banks tends to be higher than the cost for larger institutions.[111]

B. Statutory and Regulatory Background

For over 20 years, consumer advocates, legislators, and regulators have raised concerns about creditors originating mortgage loans without regard to the consumer's ability to repay the loan. Beginning in about 2006, these concerns were heightened as mortgage delinquencies and foreclosure rates increased dramatically, caused in part by the gradual deterioration in underwriting standards. *See* 73 FR 44524 (Jul. 30, 2008). For detailed background information, including a summary of the legislative and regulatory responses to this issue, which culminated in the enactment of the Dodd-Frank Act on July 21, 2010, the Board of Governors of the Federal Reserve System's (the Board) issuance of a proposed rule on May 11, 2011 to implement certain amendments to TILA made by the Dodd-Frank Act, and the Bureau's issuance of the 2013 ATR Final Rule, see the discussion in the 2013 ATR Final Rule. *See* 78 FR 6410-6420 (Jan. 30, 2013).

The Bureau's ATR Final Rule

The Bureau's 2013 ATR Final Rule implemented the ability-to-repay requirements under TILA section 129C. Consistent with the statute, the Bureau's 2013 ATR Final Rule adopted § 1026.43(a), which applies the ability-to-repay requirements to any consumer credit transaction secured by a dwelling, except an open-end credit plan, timeshare plan, reverse mortgage, or temporary loan.

As adopted, § 1026.43(c) provides that a creditor is prohibited from making a covered

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[110] *FCIC Report* at 72.

[111] *FDIC Community Banking Study*, p. 4-5; Government Accountability Office, *Community Banks and Credit Unions: Impact of the Dodd-Frank Act Depends Largely on Future Rulemakings*, p. 10 (Sept. 2012) (GAO Community Banks and Credit Unions Report).

mortgage loan unless the creditor makes a reasonable and good faith determination, based on verified and documented information, that the consumer will have a reasonable ability to repay the loan, including any mortgage-related obligations (such as property taxes and mortgage insurance). Section 1026.43(c) describes certain requirements for making ability-to-repay determinations, but does not provide comprehensive underwriting standards to which creditors must adhere. At a minimum, however, the creditor must consider and verify eight underwriting factors: (1) current or reasonably expected income or assets; (2) current employment status; (3) the monthly payment on the covered transaction; (4) the monthly payment on any simultaneous loan; (5) the monthly payment for mortgage-related obligations; (6) current debt obligations; (7) the monthly debt-to-income ratio or residual income; and (8) credit history.

Section 1026.43(c)(3) generally requires the creditor to verify the information relied on in determining a consumer's repayment ability using reasonably reliable third-party records, with special rules for verifying a consumer's income or assets. Section 1026.43(c)(5)(i) requires the creditor to calculate the monthly mortgage payment based on the greater of the fully indexed rate or any introductory rate, assuming monthly, fully amortizing payments that are substantially equal. Section 1026.43(c)(5)(ii) provides special payment calculation rules for loans with balloon payments, interest-only loans, and negative amortization loans.

Section 1026.43(d) provides special rules for complying with the ability-to-repay requirements for a creditor refinancing a "non-standard mortgage" into a "standard mortgage." This provision is based on TILA section 129C(a)(6)(E), which contains special rules for the refinancing of a "hybrid loan" into a "standard loan." The purpose of this provision is to provide flexibility for creditors to refinance a consumer out of a risky mortgage into a more stable one without undertaking a full underwriting process. Under § 1026.43(d), a non-standard mortgage is defined as an adjustable-rate mortgage with an introductory fixed interest rate for a period of one year or longer, an interest-only loan, or a negative amortization loan. Under this option, a creditor refinancing a non-standard mortgage into a standard mortgage does not have to consider the eight specific underwriting criteria listed under § 1026.43(c), if certain conditions are met.

Section 1026.43(e) specifies requirements for originating "qualified mortgages," as well as standards for when the presumption of compliance with ability-to-repay requirements can be rebutted. Section 1026.43(e)(1)(i) provides a safe harbor under the ability-to-repay requirements for loans that satisfy the definition of a qualified mortgage and are not higher-priced covered transactions (*i.e.*, the APR does not exceed APOR[112] plus 1.5 percentage points for first-lien loans or 3.5 percentage points for subordinate-lien loans). Section 1026.43(e)(1)(ii) provides a rebuttable presumption for qualified mortgage loans that are higher-priced covered transactions (*i.e.*, the APR exceeds APOR plus 1.5 percent for first lien or 3.5 percent for subordinate lien). Under the 2013 ATR Final Rule, section 1026.43 also provides three options for creditors to originate a qualified mortgage:

Qualified mortgage—general. Under the general definition for qualified mortgages in § 1026.43(e)(2), a creditor must satisfy the statutory criteria restricting certain product features and points and fees on the loan, consider and verify certain underwriting requirements that are part of the general ability-to-repay standard, and confirm that the consumer has a total (or "back-end") debt-to-income ratio that is less than or equal to 43 percent. To determine whether the consumer meets the specific debt-to-income ratio requirement, the creditor must calculate the consumer's monthly debt-to-income ratio in accordance with appendix Q. A loan that satisfies these criteria and is not a higher-priced covered transaction receives a legal safe harbor from the

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[112] TILA section 129C(b)(2)(B) defines the average prime offer rate as "the average prime offer rate for a comparable transaction as of the date on which the interest rate for the transaction is set, as published by the Bureau." 15 U.S.C. 1639c(b)(2)B).

ability-to-repay requirements. A loan that satisfies these criteria and is a higher-priced covered transaction receives a rebuttable presumption of compliance with the ability-to-repay requirements.

Qualified mortgage—special rules. The second option for originating a qualified mortgage provides a temporary alternative to the general definition in § 1026.43(e)(2). This option is intended to avoid unnecessarily disrupting the mortgage market at a time when it is especially fragile, as a result of the recent mortgage crisis. Section 1026.43(e)(4) provides that a loan is a qualified mortgage if it meets the statutory limitations on product features and points and fees, satisfies certain other requirements, and is eligible for purchase, guarantee, or insurance by one of the following entities:

- Fannie Mae or Freddie Mac, while 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;
- Any limited-life regulatory entity succeeding the charter of either Fannie Mae or Freddie Mac pursuant to section 1367(i) of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992;
- The U.S. Department of Housing and Urban Development under the National Housing Act (FHA);
- The U.S. Department of Veterans Affairs (VA);
- The U.S. Department of Agriculture (USDA); or
- The U.S. Department of Agriculture Rural Housing Service (RHS).

With respect to GSE-eligible loans, this temporary provision expires when conservatorship of the GSEs ends. With respect to each other category of loan, this provision expires on the effective date of a rule issued by each respective Federal agency pursuant to its authority under TILA section 129C(b)(3)(ii) to define a qualified mortgage. In any event, this temporary provision expires no later than January 10, 2021.

Qualified mortgage—balloon-payment loans by certain creditors. The third option for originating qualified mortgages is included under § 1026.43(f), which provides that a small creditor operating predominantly in rural or underserved areas can originate a balloon-payment qualified mortgage. The Dodd-Frank Act generally prohibits balloon-payment mortgages from being qualified mortgages. However, the statute creates a limited exception, with special underwriting rules, for loans made by a creditor that: (1) operates predominantly in rural or underserved areas; (2) together with affiliates, has total annual residential mortgage loan originations that do not exceed a limit set by the Bureau; and (3) retains the balloon loans in portfolio. The purpose of this definition is to preserve credit availability in rural or underserved areas by assuring that small creditors offering loans that cannot be sold on the secondary market, and therefore must be placed on the creditor's balance sheet, are able to use a balloon-payment structure as a means of controlling interest rate risk.

Section 1026.43(f)(1)(vi) limits eligibility to creditors that originated 500 or fewer covered transactions secured by a first-lien in the preceding calendar year and that have assets of no more than $2 billion (to be adjusted annually). In addition, to originate a balloon-payment qualified mortgage more than 50 percent of a creditor's total first-lien covered transactions must have been secured by properties in counties that are "rural" or "underserved," as designated by the Bureau. A county is "rural" if, during a calendar year, it is located in neither 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 “underserved” if no more than two creditors extend covered transactions five or more times in that county during a calendar year. Also, except as provided, the balloon-payment qualified mortgage must generally be held in portfolio for at least three years. Balloon loans by such creditors are eligible for qualified mortgage status if they meet the statutory limitations on product features and points and fees, and if the creditor follows certain other requirements that are part of the general ability-to-repay standard.

The Bureau’s 2013 ATR Final Rule added two additional requirements to § 1026.43. Section 1026.43(g) implements the Dodd-Frank Act limits on prepayment penalties. Section 1026.43(h) prohibits a creditor from structuring a closed-end extension of credit as an open-end plan to evade the ability-to-repay requirements.

III. Summary of the Rulemaking Process

A. The Bureau’s Proposal

As discussed above, TILA section 129C, as added by sections 1411, 1412, and 1414 of the Dodd-Frank Act, generally requires creditors to make a reasonable, good faith determination of a consumer’s ability to repay the loan. On January 10, 2013, the Bureau issued the 2013 ATR Final Rule to implement these ability-to-repay requirements. *See* 78 FR 6407 (Jan. 30, 2013). At the same time, the Bureau issued the 2013 ATR Proposed Rule related to certain proposed exemptions, modifications, and clarifications to the ability-to-repay requirements and qualified mortgage provisions. *See* 78 FR 6621 (Jan. 30, 2013). The 2013 ATR Proposed Rule contained three major elements.

First, the Bureau proposed certain exemptions from the ability-to-repay requirements for housing finance agencies, certain nonprofit creditors, certain homeownership stabilization and foreclosure prevention programs, and certain Federal agency and GSE refinancing programs.

The Bureau was concerned that the ability-to-repay requirements were substantially different from the underwriting requirements employed by these creditors or required under these programs, which would discourage participation in and frustrate the purposes of these programs and significantly impair access to responsible, affordable credit for certain consumers.

Second, the Bureau proposed modifications related to certain small creditors. Specifically, the Bureau proposed an additional definition of a qualified mortgage for certain loans made and held in portfolio by small creditors. The proposed new category would include certain loans originated by small creditors[113] that: (1) have total assets of $2 billion or less at the end of the previous calendar year; and (2) together with all affiliates, originated 500 or fewer first-lien covered transactions during the previous calendar year. The proposed new category would include only loans held in portfolio by these creditors. The loans also would have to conform to all of the requirements under the general definition of a qualified mortgage except the 43 percent limit on monthly debt-to-income ratio. The Bureau also proposed to allow small creditors and small creditors operating predominantly in rural and underserved areas to charge a higher annual percentage rate for first-lien qualified mortgages in the proposed new category and still benefit from a conclusive presumption of compliance or "safe harbor." A qualified mortgage in the proposed new category would be conclusively presumed to comply if the annual percentage rate is equal to or less than APOR plus 3.5 percentage points for both first-lien and subordinate-lien loans. The Bureau also posed and solicited comment on a specific question regarding whether there is a need for transition mechanisms for existing balloon loans that may end soon after the new rule takes effect.

[113] The $2 billion threshold reflects the purposes of the proposed category and the structure of the mortgage lending industry. The Bureau's choice of $2 billion in assets as a threshold for purposes of TILA section 129C does not imply that a threshold of that type or of that magnitude would be an appropriate way to distinguish small firms for other purposes or in other industries.

Finally, the Bureau proposed several additional interpretive comments concerning the inclusion of loan originator compensation in the points and fees calculation under the qualified mortgage provisions and the high-cost mortgage provisions under HOEPA. The proposed comments addressed situations in which payments flow from one party to another over the course of a mortgage transaction and whether to count compensation separately where it may already have been counted toward points and fees under another element of the regulatory definition. In addition, the Bureau sought feedback on whether additional clarification was warranted in light of the Bureau's separate rulemaking to implement provisions of the Dodd-Frank Act restricting certain loan originator compensation practices.

B. Comments and Post-Proposal Outreach

In response to the proposed rule, the Bureau received approximately 1,150 letters from commenters, including members of Congress, creditors, consumer groups, trade associations, mortgage and real estate market participants, and individual consumers. The comments focused on all aspects of the proposal, including:

- the calculation of loan originator compensation for inclusion in points and fees for the qualified mortgage and high-cost mortgage points and fees limits;
- the proposed exemptions from the ability-to-repay requirements for housing finance agencies, certain nonprofit creditors, certain homeownership stabilization and foreclosure prevention programs, and certain Federal agency and GSE refinancing programs;
- the proposed definition of a fourth category of qualified mortgages including loans originated and held in portfolio by certain small creditors; and
- the proposed amendments to the definition of higher-priced covered transaction with respect to qualified mortgages that are originated and held in portfolio by small creditors

and with respect to balloon-payment qualified mortgages originated and held in portfolio by small creditors operating predominantly in rural or underserved areas.

Materials submitted were filed in the record and are publicly available at http://www.regulations.gov. The Bureau also elected to consider the comments received after the expiration of the comment period. As discussed in more detail below, the Bureau has considered these comments in adopting this final rule.

IV. Legal Authority

The Bureau is issuing this proposed rule pursuant to its authority under TILA and the Dodd-Frank Act. *See* 15 U.S.C. 1604(a), 12 U.S.C. 5512(b)(1).

A. TILA Ability-to-Repay and Qualified Mortgage Provisions

As discussed above, the Dodd-Frank Act amended TILA to provide that, in accordance with regulations prescribed by the Bureau, no creditor may make a residential mortgage loan unless the creditor makes a reasonable and good faith determination based on verified and documented information that, at the time the loan is consummated, the consumer has a reasonable ability to repay the loan, according to its terms, and all applicable taxes, insurance (including mortgage guarantee insurance), and assessments. TILA section 129C(a)(1); 15 U.S.C. 1639c(a)(1). As described below in part IV.B, the Bureau has authority to prescribe regulations to carry out the purposes of TILA pursuant to TILA section 105(a). 15 U.S.C. 1604(a). In particular, it is the purpose of TILA section 129C, as amended by the Dodd-Frank Act, to assure that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay the loans and that are understandable and not unfair, deceptive, or abusive. TILA section 129B(a)(2); 15 U.S.C. 1639b(a)(2).

TILA, as amended by the Dodd-Frank Act, also provides creditors originating "qualified mortgages" special protection from liability under the ability-to-repay requirements. TILA section 129C(b), 15 U.S.C. 1639c(b). TILA generally defines a "qualified mortgage" as a residential mortgage loan for which: the loan does not contain negative amortization, interest-only payments, or balloon payments; the term does not exceed 30 years; the points and fees generally do not exceed 3 percent of the loan amount; the income or assets are considered and verified; and the underwriting is based on the maximum rate during the first five years, uses a payment schedule that fully amortizes the loan over the loan term, and takes into account all mortgage-related obligations. TILA section 129C(b)(2), 15 U.S.C. 1639c(b)(2). In addition, to constitute a qualified mortgage a loan must meet "any guidelines or regulations established by the Bureau relating to ratios of total monthly debt to monthly income or alternative measures of ability to pay regular expenses after payment of total monthly debt, taking into account the income levels of the borrower and such other factors as the Bureau may determine are relevant and consistent with the purposes described in [TILA section 129C(b)(3)(B)(i)]."

TILA, as amended by the Dodd-Frank Act, also provides the Bureau with authority to prescribe regulations that revise, add to, or subtract from the criteria that define a qualified mortgage upon a finding that such regulations are necessary or proper to ensure that responsible, affordable mortgage credit remains available to consumers in a manner consistent with the purposes of the ability-to-repay requirements; or are necessary and appropriate to effectuate the purposes of the ability-to-repay requirements, to prevent circumvention or evasion thereof, or to facilitate compliance with TILA sections 129B and 129C. TILA section 129C(b)(3)(B)(i), 15 U.S.C. 1639c(b)(3)(B)(i). In addition, TILA section 129C(b)(3)(A) provides the Bureau with authority to prescribe regulations to carry out the purposes of the qualified mortgage provisions -

- to ensure that responsible, affordable mortgage credit remains available to consumers in a manner consistent with the purposes of TILA section 129C. TILA section 129C(b)(3)(A), 15 U.S.C. 1939c(b)(3)(A). As discussed in the section-by-section analysis below, the Bureau is issuing certain provisions of this rule pursuant to its authority under TILA section 129C(b)(3)(B)(i).

In addition, for purposes of defining "qualified mortgage," TILA section 129C(b)(2)(A)(vi) provides the Bureau with authority to establish guidelines or regulations relating to monthly debt-to-income ratios or alternative measures of ability to repay. As discussed in the section-by-section analysis below, the Bureau is issuing certain provisions of this rule pursuant to its authority under TILA sections 129C(b)(2)(A)(vi).

B. Other Rulemaking and Exception Authorities

This final rule also relies on the rulemaking and exception authorities specifically granted to the Bureau by TILA and the Dodd-Frank Act, including the authorities discussed below.

TILA

TILA section 105(a). As amended by the Dodd-Frank Act, TILA section 105(a), 15 U.S.C. 1604(a), directs the Bureau to prescribe regulations to carry out the purposes of TILA, and provides that such regulations may contain additional requirements, classifications, differentiations, or other provisions, and may provide for such adjustments and exceptions for all or any class of transactions, that the Bureau judges are necessary or proper to effectuate the purposes of TILA, to prevent circumvention or evasion thereof, or to facilitate compliance therewith. A purpose of TILA is "to assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit." TILA section 102(a), 15 U.S.C. 1601(a). This stated purpose is informed by Congress's finding that "economic stabilization would be enhanced and the competition among the various financial institutions and other firms engaged in the extension of consumer credit would be strengthened by the informed use of credit[.]" TILA section 102(a). Thus, strengthened competition among financial institutions is a goal of TILA, achieved through the effectuation of TILA's purposes.

As amended by section 1402 of the Dodd-Frank Act, section 129B(a)(2) of TILA provides that a purpose of section 129C of TILA is "to assure that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay the loans." This stated purpose is informed by Congress's finding that "economic stabilization would be enhanced by the protection, limitation, and regulation of the terms of residential mortgage credit and the practices related to such credit, while ensuring that responsible, affordable mortgage credit remains available to consumers." Thus, ensuring that responsible, affordable mortgage credit remains available to consumers is a goal of TILA, achieved through the effectuation of TILA's purposes.

Historically, TILA section 105(a) has served as a broad source of authority for rules that promote the informed use of credit through required disclosures and substantive regulation of certain practices. However, Dodd-Frank Act section 1100A clarified the Bureau's section 105(a) authority by amending that section to provide express authority to prescribe regulations that contain "additional requirements" that the Bureau finds are necessary or proper to effectuate the purposes of TILA, to prevent circumvention or evasion thereof, or to facilitate compliance. This amendment clarified the authority to exercise TILA section 105(a) to prescribe requirements beyond those specifically listed in the statute that meet the standards outlined in section 105(a). The Dodd-Frank Act also clarified the Bureau's rulemaking authority over certain high-cost mortgages pursuant to section 105(a). As amended by the Dodd-Frank Act, TILA section 105(a) authority to make adjustments and exceptions to the requirements of TILA applies to all transactions subject to TILA, except with respect to the provisions of TILA section 129, 15 U.S.C. 1639, that apply to the high-cost mortgages defined in TILA section 103(bb), 15 U.S.C. 1602(bb).

As discussed in the section-by-section analysis below, the Bureau is issuing regulations to carry out TILA's purposes, including such additional requirements, adjustments, and exceptions as, in the Bureau's judgment, are necessary and proper to carry out the purposes of TILA, prevent circumvention or evasion thereof, or to facilitate compliance. In developing these aspects of the final rule pursuant to its authority under TILA section 105(a), the Bureau has considered the purposes of TILA, including ensuring that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay the loans, ensuring meaningful disclosures, facilitating consumers' ability to compare credit terms, and helping consumers avoid the uninformed use of credit, and the findings of TILA, including regulating the terms of residential mortgage credit and the practices related to such credit to ensure that responsible, affordable mortgage credit remains available to consumers, strengthening competition among financial institutions, and promoting economic stabilization.

TILA section 105(f). Section 105(f) of TILA, 15 U.S.C. 1604(f), authorizes the Bureau to exempt from all or part of TILA all or any class of transactions (other than transactions involving any mortgage described in TILA section 103(aa), which are high-cost mortgages) if the Bureau determines that TILA coverage does not provide a meaningful benefit to consumers in the form of useful information or protection. In exercising this authority, the Bureau must consider the factors identified in section 105(f) of TILA and publish its rationale at the time it proposes an exemption for public comment. Specifically, the Bureau must consider:

(a) The amount of the loan and whether the disclosures, right of rescission, and other provisions provide a benefit to the consumers who are parties to such transactions, as determined by the Bureau;

(b) The extent to which the requirements of TILA complicate, hinder, or make more expensive the credit process for the class of transactions;

(c) The status of the borrower, including—

(1) Any related financial arrangements of the borrower, as determined by the Bureau;

(2) The financial sophistication of the borrower relative to the type of transaction; and

(3) The importance to the borrower of the credit, related supporting property, and coverage under TILA , as determined by the Bureau;

(d) Whether the loan is secured by the principal residence of the consumer; and

(e) Whether the goal of consumer protection would be undermined by such an exemption.

As discussed in the section-by-section analysis below, the Bureau is adopting exemptions for certain classes of transactions from the requirements of TILA pursuant to its authority under TILA section 105(f). In determining which classes of transactions to exempt under TILA section 105(f), the Bureau has considered the relevant factors and determined that the exemptions are appropriate.

The Dodd-Frank Act

Dodd-Frank Act section 1022(b). Section 1022(b)(1) of the Dodd-Frank Act authorizes the Bureau to prescribe rules "as may be necessary or appropriate to enable the Bureau to administer and carry out the purposes and objectives of the Federal consumer financial laws, and to prevent evasions thereof." 12 U.S.C. 5512(b)(1). TILA and title X of the Dodd-Frank Act are Federal consumer financial laws. Accordingly, the Bureau is exercising its authority under Dodd-Frank Act section 1022(b) to prescribe rules that carry out the purposes and objectives of TILA and title X and prevent evasion of those laws.

V. Section-by-Section Analysis

Section 1026.32 Requirements for High-Cost Mortgages

32(b) Definitions

32(b)(1)

32(b)(1)(ii)

Background

TILA section 129C(b)(2)(A)(vii), as added by section 1412 of the Dodd-Frank Act, defines a "qualified mortgage" as a loan for which, among other things, the total "points and fees" payable in connection with the transaction generally do not exceed 3 percent of the total loan amount. Section 1431(a) of the Dodd-Frank Act amended HOEPA's points and fees coverage test to provide in TILA section 103(bb)(1)(A)(ii) that a mortgage is a high-cost mortgage if the total points and fees payable in connection with the transaction exceed 5 percent of the total transaction amount (for transactions of $20,000 or more), or the lesser of 8 percent of the total transaction amount or $1,000 (for transactions of less than $20,000) or other prescribed amount. The Bureau finalized the Dodd-Frank Act's amendments to TILA concerning the points and fees limit for qualified mortgages and the points and fees coverage threshold for high-cost mortgages in the 2013 ATR Final Rule and in the final rule implementing the Dodd-Frank Act's amendments to HOEPA,[114] respectively.

[114] 78 FR 6856 (Jan. 31, 2013) (2013 HOEPA Final Rule).

Those rulemakings also adopted the Dodd-Frank Act's amendments to TILA concerning the exclusion of certain bona fide third-party charges and up to two bona fide discount points from the points and fees calculation for both qualified mortgages and high-cost mortgages. With respect to bona fide discount points in particular, TILA sections 129C(b)(2)(C)(ii)(I) and 103(dd)(1) provide for the exclusion of up to and including two bona fide discount points from points and fees for qualified mortgages and high-cost mortgages, respectively, but only if the interest rate for the transaction before the discount does not exceed by more than one percentage point the average prime offer rate, as defined in § 1026.35(a)(2). Similarly, TILA sections 129C(b)(2)(C)(ii)(II) and 103(dd)(2) provide for the exclusion of up to and including one bona fide discount point from points and fees, but only if the interest rate for the transaction before the discount does not exceed the average prime offer rate by more than two percentage points.[115] The Bureau's 2013 ATR and HOEPA Final Rules implemented the bona fide discount point exclusions from points and fees in § 1026.32(b)(1)(i)(E) and (F) (closed-end credit) and (b)(2)(i)(E) and (F) (open-end credit), respectively.

TILA section 129C(b)(2)(C) defines "points and fees" for qualified mortgages and high-cost mortgages to have the same meaning as set forth in TILA section 103(aa)(4) (renumbered as section 103(bb)(4)).[116] Points and fees for the high-cost mortgage threshold are defined in § 1026.32(b)(1) (closed-end credit) and (2) (open-end credit), and § 1026.43(b)(9) provides that, for a qualified mortgage, "points and fees" has the same meaning as in § 1026.32(b)(1).

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[115] The 2013 ATR and HOEPA Final Rules also adopted the special calculation, prescribed under TILA for high-cost mortgages, for completing the bona fide discount point calculation for loans secured by personal property.

[116] The Dodd-Frank Act renumbered existing TILA section 103(aa), which contains the definition of "points and fees," for the high-cost mortgage points and fees threshold, as section 103(bb). *See* § 1100A(1)(A) of the Dodd-Frank Act. However, in defining points and fees for the qualified mortgage points and fees limits, TILA section 129C(b)(2)(C) refers to TILA section 103(aa)(4) rather than TILA section 103(bb)(4). To give meaning to this provision, the Bureau concluded that the reference to TILA section 103(aa)(4) in TILA section 129C(b)(2)(C) is mistaken and therefore interpreted TILA section 129C(b)(2)(C) as referring to the points and fees definition in renumbered TILA section 103(bb)(4).

Section 1431 of the Dodd-Frank Act amended TILA to require that "all compensation paid *directly or indirectly* by a consumer *or creditor* to a mortgage originator from any source, including a mortgage originator that is also the creditor in a table-funded transaction," be included in points and fees. TILA section 103(bb)(4)(B) (emphases added). Prior to the amendment, TILA had provided that only compensation paid by a consumer to a mortgage broker at or before closing should count toward the points and fees threshold for high-cost mortgages. Under amended TILA section 103(bb)(4)(B), however, compensation paid to anyone that qualifies as a "mortgage originator" is to be included in points and fees for the points and fees thresholds for both qualified mortgages and high-cost mortgages.[117] Thus, in addition to mortgage brokerage firms, other mortgage originators, including employees of a creditor (*i.e.*, loan officers) or of a brokerage firm (*i.e.*, individual brokers) are included in "mortgage originator." In addition, the Dodd-Frank Act removed the phrase "payable at or before closing" from the high-cost mortgage points and fees test and did not apply the "payable at or before closing" limitation to the points and fees cap for qualified mortgages. *See* TILA sections 103(bb)(1)(A)(ii) and 129C(b)(2)(A)(vii) and (C).

The 2013 ATR Final Rule. The Bureau's 2013 ATR Final Rule amended § 1026.32(b)(1) to implement revisions to the definition of "points and fees" under section 1431 of the Dodd-Frank Act, for the purposes of both HOEPA and qualified mortgages. Among other things, the Dodd-Frank Act added loan originator compensation to the definition of "points and fees" that had previously applied to high-cost mortgages under HOEPA. Section 1431 of the Dodd-Frank

[117] "Mortgage originator" is generally defined to include "any person who, for direct or indirect compensation or gain, or in the expectation of direct or indirect compensation or gain—(i) takes a residential mortgage loan application; (ii) assists a consumer in obtaining or applying to obtain a residential mortgage loan; or (iii) offers or negotiates terms of a residential mortgage loan." TILA section 103(cc)(2)(A). The statute excludes certain persons from the definition, including a person who performs purely administrative or clerical tasks; an employee of a retailer of manufactured homes who does not take a residential mortgage application or offer or negotiate terms of a residential mortgage loan; and, subject to certain conditions, real estate brokers, sellers who finance three or fewer properties in a 12-month period, and servicers. TILA section 103(cc)(2)(C) through (F).

Act also amended TILA to provide that open-end credit plans (*i.e.*, home equity lines of credit or HELOCs) are covered by HOEPA. The Bureau's 2013 HOEPA Final Rule thus separately amended § 1026.32(b)(2) to provide for the inclusion of loan originator compensation in points and fees for HELOCs, to the same extent as such compensation is required to be counted for closed-end credit transactions. Under § 1026.32(b)(1)(ii) (for closed-end credit) and § 1026.32(b)(2)(ii) (for open-end credit), all compensation paid directly or indirectly by a consumer or creditor to a loan originator, as defined in § 1026.36(a)(1), that can be attributed to that transaction at the time the interest rate is set, is required to be included in points and fees. The commentary to § 1026.32(b)(1)(ii) as adopted in the 2013 ATR Final Rule provides details for applying this requirement for closed-end credit transactions (*e.g.*, by clarifying when compensation must be known to be counted). The commentary to § 1026.32(b)(2)(ii) as adopted in the 2013 HOEPA Final Rule cross-references the commentary adopted in § 1026.32(b)(1)(ii) for interpretive guidance.

In the 2013 ATR Final Rule, the Bureau noted that, in response to the Board's 2011 proposal (Board's 2011 ATR Proposal or Board's proposal)[118] and the Bureau's 2012 proposal to implement the Dodd-Frank Act's amendments to HOEPA,[119] the Bureau received extensive feedback regarding the inclusion of loan originator compensation in the qualified mortgage and high-cost mortgage points and fees calculation. In the context of both rulemakings, several industry commenters argued that including loan originator compensation in points and fees would result in "double-counting" because creditors often compensate loan originators with funds collected from consumers at consummation. The commenters argued that money collected in up-front charges to consumers should not be counted a second time toward the points and fees

[118] 76 FR 27390 (May 11, 2011).
[119] 77 FR 49090 (Aug. 15, 2012) (2012 HOEPA Proposal).

thresholds if it is passed on to a loan originator. Consumer advocates urged the Bureau not to assume that loan originator compensation is funded through up-front consumer payments to creditors rather than through the interest rate. They noted that, in the wholesale channel, if the parties to a transaction would like to fund loan originator compensation through up-front payments, a consumer can pay the mortgage broker directly instead of paying origination charges to the creditor and having the creditor pass through payments to the mortgage broker.

The literal language of TILA section 103(bb)(4) as amended by the Dodd-Frank Act defines points and fees to include all items included in the finance charge (except interest or the time-price differential), all compensation paid directly or indirectly by a consumer or creditor to a loan originator, "and" various other enumerated items. The 2013 ATR Final Rule noted that both the use of "and" and the reference to "all" compensation paid "directly or indirectly" and "from any source" supports counting compensation as it flows downstream from one party to another so that it is counted each time that it reaches a loan originator, whatever the previous source.

The Bureau stated that it believes the statute would be read to require that loan originator compensation be treated as additive to the other elements of points and fees and should be counted as it flows downstream from one party to another so that it is included in points and fees each time it reaches a loan originator, whatever the previous source. The Bureau indicated that it did not believe that an automatic literal reading of the statute in all cases would be in the best interest of either consumers or industry, but it did not believe that it yet had sufficient information with which to choose definitively between the additive approach provided for in the statutory language and other potential methods of accounting for payments in all circumstances, given the multiple practical and complex policy considerations involved. Accordingly, the

Bureau finalized the rule without a qualifying interpretation on this issue and included in the 2013 ATR Proposed Rule several comments to explain how to calculate loan originator compensation in connection with particular payment streams between particular parties. However, the 2013 ATR Final Rule itself implemented the additive approach of the statute.

The 2013 Loan Originator Final Rule. Earlier this year, the Bureau issued a final rule to implement various provisions of the Dodd-Frank Act that addressed compensation paid to loan originators. 78 FR 11280 (Feb. 15, 2013) (2013 Loan Originator Final Rule). As the Bureau noted, the Board had proposed rules in 2009, that, among other things, would have prohibited payments to a loan originator based on the transaction's terms or conditions; prohibited a loan originator from receiving dual compensation (*i.e.*, compensation from both a consumer and another person in the same transaction); and prohibited a loan originator from steering consumers to transactions not in their interest to increase the loan originator's compensation. In section 1403 of the Dodd-Frank Act, Congress amended TILA section 129B to codify significant elements of the Board's 2009 proposal. In a final rule issued in 2010, the Board finalized its proposed rules, while acknowledging that further rulemaking would be required to address certain issues and adjustments made by the Dodd-Frank Act. 75 FR 58509 (Sept. 24, 2010) (2010 Loan Originator Final Rule). As discussed below, the Bureau's 2013 Loan Originator Final Rule implemented certain provisions of TILA section 129B, including rules expanding and clarifying some of the prohibitions adopted by the Board in the 2010 Loan Originator Final Rule.

The Bureau's 2013 Loan Originator Final Rule clarified the scope of § 1026.36(d)(1), which prohibits basing a loan originator's compensation on any of the transaction's terms. This provision was intended to eliminate incentives for the loan originator to, for example, persuade the consumer to accept a higher interest rate or a prepayment penalty, in exchange for the loan originator receiving higher compensation. The Bureau retained the core prohibition in § 1026.36(d)(1), but it clarified the meaning of a "term" of the transaction and clarified the standard for determining when compensation is impermissibly based on a proxy for a term of the transaction. It also permitted certain bonuses and retirement profit-sharing plans to be based on the terms of multiple loan originators' transactions and permitted a loan originator to participate in a defined benefit plan without restrictions on whether the benefits may be based on the terms of a loan originator's transactions. *See* § 1026.36(d)(1)(iii) and (iv). Consistent with the statute, the Bureau also revised § 1026.36(d)(1) so that it also applies in transactions in which the consumer pays a mortgage broker directly.

The 2013 Loan Originator Final Rule also clarified the scope of § 1026.36(d)(2), which prohibits a loan originator from receiving compensation from both the consumer and other persons in the same transaction. This provision was designed to address consumer confusion over mortgage broker loyalties when brokers received payments both from the consumer and the creditor. The 2013 Loan Originator Final Rule retained this prohibition but provided an exception to permit mortgage brokers to pay their employees or contractors commissions (although the commissions cannot be based on the terms of the loans they originate).

In addition, the Bureau used its exception authority to adopt a complete exemption to the statutory ban on up-front fees set forth in TILA section 129B(c)(2)(B)(ii). *See* § 1026.36(d)(2)(ii). That statutory ban would have permitted a loan originator to receive an origination fee or charge from someone other than the consumer only if: (1) the loan originator did not receive any compensation directly from the consumer; and (2) the consumer did not make an up-front payment of discount points, origination points, or fees (other than bona fide third-party charges not retained by the loan originator, creditor, or an affiliate of either). Thus, the Bureau's exemption permits the consumer to pay origination charges or fees to the creditor in transactions in which the creditor is paying compensation to the mortgage broker.

The Bureau also clarified the safe harbor for loan originators to comply with existing § 1026.36(e)(1), which prohibits a loan originator from steering a consumer to consummate a particular transaction so that the loan originator will receive greater compensation. The Bureau clarified how to determine which loans a creditor must offer to consumers to take advantage of the safe harbor. *See* § 1026.36(e)(3)(i)(C) and comment 36(e)(3)-3. The Bureau did not, however, implement the portion of section 1403 of the Dodd-Frank Act that requires the Bureau to prescribe additional regulations to prohibit certain types of steering, abusive or unfair lending practices, mischaracterization of credit histories or appraisals, and discouraging consumers from shopping with other mortgage originators. The Bureau noted that it intends to prescribe those regulations in a future rulemaking. *See* 78 FR 11292 n.55.

The 2013 ATR Proposed Rule

In the 2013 ATR Proposed Rule, the Bureau proposed commentary to address situations in which loan originator compensation passes from one party to another. The Bureau indicated that it believed that Congress included loan originator compensation in points and fees because of concern that loans with high loan originator compensation may be more costly and riskier to consumers. Despite the statutory language, the Bureau questioned whether it would serve the statutory purpose to apply a strict additive rule that would automatically require that loan originator compensation be counted against the points and fees thresholds even if it has already been included in points and fees. The Bureau indicated that it did not believe that it is necessary or appropriate to count the same payment between a consumer and a mortgage broker firm twice, simply because it is both part of the finance charge and loan originator compensation. Similarly, the Bureau indicated that, where a payment from either a consumer or a creditor to a mortgage broker is counted toward points and fees, it would not be necessary or appropriate to count separately funds that the broker then passes on to its individual employees. In each case, any costs and risks to the consumer from high loan originator compensation are adequately captured by counting the funds a single time against the points and fees cap; thus, the Bureau stated that it did not believe the purposes of the statute would be served by counting some or all of the funds a second time, and was concerned that doing so could have negative impacts on the price and availability of credit.

Proposed comment 32(b)(1)(ii)-5.i thus would have provided that a payment from a consumer to a mortgage broker need not be counted toward points and fees twice because it is both part of the finance charge under § 1026.32(b)(1)(i) and loan originator compensation under § 1026.32(b)(1)(ii). Similarly, proposed comment 32(b)(1)(ii)-5.ii would have clarified that § 1026.32(b)(1)(ii) does not require a creditor to include payments by a mortgage broker to its individual loan originator employee in the calculation of points and fees. For example, assume a consumer pays a $3,000 fee to a mortgage broker, and the mortgage broker pays a $1,500 commission to its individual loan originator employee for that transaction. The $3,000 mortgage broker fee is included in points and fees, but the $1,500 commission is not included in points and fees because it has already been included in points and fees as part of the $3,000 mortgage broker fee. The Bureau stated that it believed that any costs to the consumer from loan originator compensation are adequately captured by counting the funds a single time against the points and fees cap. The Bureau sought comment regarding these proposed comments.

The Bureau noted that determining the appropriate accounting method is significantly more complicated when a consumer pays some up-front charges to the creditor and the creditor pays loan originator compensation to either its own employee or to a mortgage broker firm. As described in the 2013 ATR Final Rule, a creditor can fund compensation to its own loan officer or to a mortgage broker in two different ways. First, the payment could be funded by origination charges paid by the consumer to the creditor. Second, the payment could be funded through the interest rate, in which case the creditor forwards funds to the loan originator at consummation which the creditor recovers through profit realized on the subsequent sale of the mortgage or, for portfolio loans, through payments by the consumer over time. Because money is fungible, tracking how a creditor spends money it collects in up-front charges versus amounts collected through the rate to cover both loan originator compensation and its other overhead expenses would be extraordinarily complex and cumbersome. The Bureau stated that, to facilitate compliance, it believed it would be appropriate and necessary to adopt generalized rules regarding the accounting of various payments, but did not have sufficient information to make those choices in the 2013 ATR Final Rule. However, the 2013 ATR Final Rule itself implemented the additive approach of the statute.

The Bureau noted in the 2013 ATR Proposed Rule that the potential downstream effects of different accounting methods may be significant. Under the "additive" approach where no netting of up-front consumer payments against creditor-paid loan originator compensation is allowed, some loans might be precluded from being qualified mortgages or may exceed the high-cost mortgage threshold because of the combination of loan originator compensation with other charges that are included in points and fees, such as fees paid to affiliates for settlement services. In other cases, creditors whose combined loan originator compensation and up-front charges would otherwise exceed the points and fees limits would have strong incentives to cap their up-front charges for other overhead expenses under the threshold and instead recover those expenses by increasing interest rates to generate higher gains on sale. This would adversely affect consumers who prefer to pay a lower interest rate over time in return for higher up-front costs and, at the margins, could result in some consumers being unable to qualify for credit. Additionally, to the extent creditors responded to an "additive" rule by increasing interest rates, this could increase the number of qualified mortgages that receive a rebuttable presumption of compliance, rather than a safe harbor from liability, under the ability-to-repay provisions adopted by the 2013 ATR Final Rule.

The Bureau noted that one alternative would be to allow all consumer payments of up-front points and fees to be netted against creditor-paid loan originator compensation. However, this "netting" approach would allow creditors to offset much higher levels of up-front points and fees against expenses paid through rate before the heightened consumer protections required by the Dodd-Frank Act would apply. For example, a consumer could pay three percentage points in origination charges and be charged an interest rate sufficient to generate a 3 percent loan originator commission, and the loan could still fall within the 3 percent cap for qualified mortgages. The consumer could be charged five percentage points in origination charges and an interest rate sufficient to generate a 5 percent loan originator commission and still stay under the HOEPA points and fees trigger, thereby denying consumers the special protections afforded to loans with high up-front costs. In markets that are less competitive, this would create an opportunity for creditors or brokerage firms to take advantage of their market power to harm consumers.

The Bureau sought comment on two alternative versions of proposed comment 32(b)(1)(ii)-5.iii. The first—the additive approach—would have explicitly precluded netting, consistent with the literal language of the statute, by specifying that § 1026.32(b)(1)(ii) requires a creditor to include compensation paid by a consumer or creditor to a loan originator in the calculation of points and fees in addition to any fees or charges paid by the consumer to the creditor. This proposed comment contained an example to illustrate this principle: Assume that a consumer pays to the creditor a $3,000 origination fee and that the creditor pays to its loan officer employee $1,500 in compensation attributed to the transaction. Assume further that the consumer pays no other charges to the creditor that are included in points and fees under § 1026.32(b)(1)(i) and the loan officer receives no other compensation that is included in points and fees under § 1026.32(b)(1)(ii). For purposes of calculating points and fees, the $3,000 origination fee would be included in points and fees under § 1026.32(b)(1)(i) and the $1,500 in loan officer compensation would be included in points and fees under § 1026.32(b)(1)(ii), equaling $4,500 in total points and fees, provided that no other points and fees are paid or compensation received.

The second alternative—the netting approach—would have provided that, in calculating the amount of loan originator compensation to include in points and fees, creditors would be permitted to net consumer payments of up-front fees and points against creditor payments to the loan originator. Specifically, it would have provided that § 1026.32(b)(1)(ii) permits a creditor to reduce the amount of loan originator compensation included in the points and fees calculation under § 1026.32(b)(1)(ii) by any amount paid by the consumer to the creditor and included in the points and fees calculation under § 1026.32(b)(1)(i). This proposed comment contained an example to illustrate this principle: Assume that a consumer pays to the creditor a $3,000 origination fee and that the creditor pays to the loan originator $1,500 in compensation attributed to the transaction. Assume further that the consumer pays no other charges to the creditor that are included in points and fees under § 1026.32(b)(1)(i) and the loan originator receives no other compensation that is included in points and fees under § 1026.32(b)(1)(ii). For purposes of calculating points and fees, the $3,000 origination fee would be included in points and fees under § 1026.32(b)(1)(i), but the $1,500 in loan originator compensation need not be included in points and fees. If, however, the consumer pays to the creditor a $1,000 origination fee and the creditor pays to the loan originator $1,500 in compensation, then the $1,000 origination fee would be included in points and fees under § 1026.32(b)(1)(i), and $500 of the loan originator compensation would be included in points and fees under § 1026.32(b)(1)(ii), equaling $1,500 in total points and fees, provided that no other points and fees are paid or compensation received.

The Bureau solicited feedback regarding all aspects of both alternatives. In addition, the Bureau specifically requested feedback regarding whether there are differences in various types of loans, consumers, loan origination channels, or market segments which would justify applying different netting or additive rules to such categories. The Bureau also sought feedback as to whether, if netting were permitted, the creditor should be allowed to reduce the loan originator compensation by the full amount of points and fees included in the finance charge or whether the reduction should be limited to that portion of points and fees denominated as general origination charges.

The Bureau also sought comment on the implications of each alternative on protecting consumers pursuant to the ability-to-repay requirements, qualified mortgage provisions, and the high-cost mortgage provisions of HOEPA. The Bureau also sought comment on the likely market reactions and impacts on the pricing of and access to credit of each alternative, particularly as to how such reactions might affect interest rate levels, the safe harbor and rebuttable presumption afforded to particular qualified mortgages, and application of the separate rate threshold for high-cost mortgages under HOEPA and whether adjustment to the final rule would be appropriate. The Bureau further sought comment on the implications of both of the above proposed alternatives in light of the fact that both the qualified mortgage and HOEPA provisions allow certain bona fide discount points and bona fide third party charges to be excluded from the calculation of points and fees, but do not do so for affiliate charges.

The Bureau adopted in the 2013 HOEPA Final Rule a requirement that creditors include compensation paid to originators of open-end credit plans in points and fees, to the same extent that such compensation is required to be included for closed-end credit transactions. The Bureau did not receive comments in response to the 2012 HOEPA Proposal indicating that additional or different guidance would be needed to calculate loan originator compensation in the open-end credit context. The Bureau noted in the 2013 ATR Proposed Rule that it would be useful to provide the public with an additional opportunity to comment. Thus, the Bureau solicited input on what guidance, if any, beyond that provided for closed-end credit transactions, would be helpful for creditors in calculating loan originator compensation in the open-end credit context.

Finally, the Bureau sought comment generally on whether additional guidance or regulatory approaches regarding the inclusion of loan originator compensation in points and fees would be useful to protect consumers and facilitate compliance. In particular, the Bureau sought comment on whether it would be helpful to provide for additional adjustment of the rules or additional commentary to clarify any overlaps in definitions between the points and fees provisions in the ability-to-repay and HOEPA rulemakings and the provisions that the Bureau was separately finalizing in connection with the Bureau's 2012 Loan Originator Proposal (since adopted in the 2013 Loan Originator Final Rule). For example, the Bureau sought comment on whether additional guidance would be useful with regard to treatment of compensation by persons who are "loan originators" but are not employed by a creditor or mortgage broker, given that the 2013 Loan Originator Final Rule implemented provisions of the Dodd-Frank Act that specify when employees of retailers of manufactured homes, servicers, and other parties are loan originators for Dodd-Frank Act purposes.

Comments Received

The Bureau received numerous comments regarding the calculation of loan originator compensation for inclusion in points and fees for the qualified mortgage and high-cost mortgage points and fees limits. Many of the comments were substantially similar letters submitted by mortgage brokers. Many of the comments responded to the Bureau's proposed commentary regarding potential double counting of loan originator compensation. As described below, however, some comments also raised other issues regarding loan originator compensation.

Few commenters addressed the Bureau's proposed comments 32(b)(1)(ii)-5.i and 32(b)(1)(ii)-5.ii, which would have provided that payments by consumers to mortgage brokers (where those payments already have been included in points and fees under § 1026.32(b)(1)(i)) and payments by mortgage brokers to their individual loan originator employees need not be counted as loan originator compensation and included in points and fees. Nearly all commenters that addressed these proposed comments supported them. One industry commenter, however, argued that the Bureau should not adopt the proposed comments unless the Bureau also excludes from points and fees compensation paid by creditors to their own loan officers. That commenter claimed that it would be inequitable to exclude from points and fees compensation paid to individual loan originators employed by a mortgage broker firm but not to exclude compensation paid to individual loan originators employed by the creditor.

Many more commenters addressed the Bureau's two alternatives for proposed comment 32(b)(1)(ii)-5.iii. Consumer advocates urged the Bureau to adopt an additive approach for transactions in the wholesale channel, *i.e.*, transactions originated through a mortgage broker. They argued that the statutory provision was intended to limit the total up-front charges and loan originator compensation in loans designated as qualified mortgages (and to ensure that loans with charges and compensation above the threshold are subject to the special protection as high-cost mortgages). They maintained that a netting rule would in essence double the points and fees thresholds for qualified mortgages and high-cost mortgages. As a result, loans of $100,000 or more could have up-front charges of 3 percent of the total loan amount and loan originator compensation paid by the creditor equal to another 3 percent, yet the loan could still be a qualified mortgage.[120] Similarly, loans of $20,000 or more could have up-front charges of 5 percent of the total loan amount and creditor-paid compensation equal to another 5 percent, yet the loan would still not qualify as a high-cost mortgage.[121]

Some consumer advocates also argued that consumers have difficulty understanding and evaluating the cost of creditor-paid compensation to mortgage brokers. They contend that, as a result, creditor-paid compensation historically has resulted in more costly loans for consumers, with a higher risk of default, particularly when consumers also have made up-front payments. They argued that an additive rule provides important protection because the Bureau elected in the 2013 Loan Originator Final Rule to permit creditors to continue charging up-front fees to consumers when creditors compensate loan originators. They maintained that a netting rule would encourage creditors and mortgage brokers to combine creditor-paid compensation with up-front charges paid by consumers to creditors because such compensation then would not be included in points and fees. They argued that this combination is less transparent and more

[120] For loans less than $100,000, the qualified mortgage points and fees limits are more than 3 percent of the total loan amount. *See* § 1026.43(e)(3).
[121] For loans less than $20,000, the points and fees thresholds for high-cost mortgages are more than 5 percent of the loan amount. *See* § 1026.32(a)(1)(ii).

confusing to consumers than a model in which the consumer pays a mortgage broker directly or pays all charges through the rate.

Some consumer advocates also argued that the additive approach was necessary to complement the protections contained in § 1026.36(d) and (e) prohibiting or restricting certain loan originator compensation practices. They contended that mortgage brokers could develop problematic business models that would not violate the prohibition in § 1026.36(d)(1) against basing compensation on loan terms and the prohibition in § 1026.36(e) against steering consumers to consummate particular transactions to maximize loan originator compensation. For example, some consumer advocates noted that, without violating these prohibitions, mortgage brokers could specialize in subprime transactions with high up-front charges and high interest rates and could induce creditors to compete for such transactions and offer high loan originator compensation, so long as the compensation did not vary with the terms of individual loans. Alternatively, they suggested that mortgage brokers could do business with a mix of high-cost creditors that pay high compensation and creditors offering more competitive loans that pay lower compensation to brokers. For consumers that mortgage brokers believe would be more likely to agree to more costly loans, mortgage brokers could take advantage of the safe harbor in the anti-steering rules by providing three quotes from high-cost creditors but could continue providing other customers with more competitive loans through other creditors. Consumer advocates argued that an additive approach would deter such practices because creditors charging high up-front fees and paying high compensation to mortgage brokers would find it more difficult to remain below the qualified mortgage points and fees limits and the high-cost mortgage points and fees threshold.

Some consumer advocates also argued that the Bureau lacks the authority to adopt a netting approach for high-cost mortgages under HOEPA. They claimed that the Bureau would need to use its exception authority to adopt the netting approach and that TILA section 105(a) does not permit the Bureau to use its exception authority to modify the items included in points and fees for high-cost mortgages. Thus, they argued that the Bureau can adopt a netting approach only for calculating loan originator compensation for the qualified mortgage points and fees limits. They maintained that creating different measures for loan originator compensation for qualified mortgages and high-cost mortgages would be confusing and create compliance difficulties.

Some consumer advocates also argued that double-counting concerns could be addressed simply by having the consumer pay the mortgage broker directly. They noted that this approach to structuring mortgage pricing would permit a consumer to pay up-front charges to reduce the amount of the interest rate. The consumer payment to the broker would be counted in points and fees only one time. Some consumer advocates maintained that there is little justification for combining creditor-paid compensation to mortgage brokers with up-front charges paid by consumers. They claimed that, historically, the rationale for creditor-paid compensation for mortgage brokers was that it provided an option for consumers that did not have sufficient funds or did not want to pay a mortgage broker directly and instead preferred to pay such compensation through a higher interest rate. They noted that such a rationale does not make sense in a transaction in which creditor-paid compensation is combined with up-front charges paid by the consumer. Some consumer advocates also suggested that double-counting concerns could be addressed by permitting creditors to net origination payments from consumers against loan originator compensation, so long as the creditors provided more detailed disclosures to consumers when such payments would be passed through as compensation to loan originators.

Some consumer advocates argued that the Bureau should treat all loan originators the same and should therefore also adopt an additive rule for transactions in the retail channel. They maintained that, while problematic loan originator compensation practices historically may have been more prevalent in the wholesale channel, there were also similar problems in the retail channel. They also argued that, despite the prohibitions on steering and term-based compensation, creditors will find ways to encourage retail loan officers to steer consumers to higher-cost loans. For example, they suggested that creditors may use deferred compensation plans to provide some incentives for retail loan officers to steer consumers toward higher cost loans. They therefore argued that the same protections provided by an additive approach are necessary in the retail channel.

Some consumer advocates, however, argued that the Bureau should adopt a different rule for transactions in the retail channel. They argued that Congress was particularly concerned with transactions with creditor-paid compensation to mortgage brokers and that such transactions historically tended to be more costly and to have higher rates of default. They claimed that the risks of consumer injury from loan originator compensation practices are significantly lower in the retail channel. They contended that, in the retail channel, creditors and their loan officers would have far greater difficulties in structuring their businesses to evade the prohibitions against steering and term-based compensation in § 1026.36(d)(1) and § 1026.36(e). They noted that retail loan officers cannot pick and choose different loans from different creditors offering different levels of loan originator compensation. They also argued that mortgage brokers may be more successful in convincing consumers to accept more costly loans because consumers perceive that their mortgage broker is a trusted advisor and mistakenly believe that the broker is obligated to provide them with the lowest cost loan.

Some consumer advocates also argued that the double-counting concerns are more pronounced in the retail channel because consumers do not have the option to pay retail loan officers directly. Under an additive approach, any loan originator compensation paid by the creditor to its loan officers would be included in points and fees in addition to any up-front charges paid by the consumer to the creditor. Because the consumer cannot pay up-front charges directly to the retail loan officer, the consumer would have less flexibility to pay up-front charges to receive a lower interest rate and still remain under the points and fees limits.

In developing the final rule, the Bureau consulted with several Federal agencies, as required by section 1022(b)(2)(B) of the Dodd-Frank Act. Three agencies, the Federal Deposit Insurance Corporation (FDIC), HUD, and the Office of the Comptroller of the Currency (OCC) submitted formal comment letters. The FDIC and HUD submitted a joint comment stating their view that compensation paid to mortgage brokers should be included in points and fees whether the consumer pays such compensation directly through up-front charges or indirectly through the creditor and funded through the interest rate. The FDIC and HUD stated that yield spread premiums (YSPs), *i.e.*, compensation paid by a creditor and funded out of the interest rate, have been offered as a payment option for consumers that prefer lower up-front costs and a higher interest rate but that a consumer's choice to use a YSP to compensate a broker should not affect the calculation of loan originator compensation for points and fees. The FDIC and HUD maintained that the netting approach would undercount points and fees. They also stated that a netting approach would create incentives for transactions to include both up-front origination charges and YSPs because the up-front charges could be netted against the YSPs to reduce or eliminate the loan originator compensation that would be included in points and fees. The FDIC and HUD argued that evidence shows that transactions with both up-front charges and "back-end" payments tend to be the most costly for consumers and are the most difficult for them to evaluate when shopping for a mortgage.

The FDIC and HUD supported the proposal to exclude compensation paid by a mortgage broker to its employees but argued that the Bureau should also exclude compensation paid by a creditor to its employees. The FDIC and HUD argued that including in points and fees compensation paid by a creditor to its employee would increase compliance costs and make it difficult for them to create compliant systems by the January 2014 effective date. They also stated that including such compensation in points and fees could result in variations in points and fees for loans with identical costs to the consumer, merely because, for example, one transaction involved a high-performing loan officer. They argued that excluding from points and fees compensation paid by a creditor to its employees would not compromise the consumer protection goals of the points and fees provision because of the loan originator compensation restrictions in § 1026.36(d). They noted that employees of creditors have no ability to choose among creditors, further reducing the risk that consumers would be steered toward more costly loans.

The OCC also submitted a comment stating its support for excluding from points and fees loan originator compensation paid by a consumer to a mortgage broker when that payment already is included in points and fees as part of the finance charge; excluding from points and fees compensation paid by a mortgage broker to its employees; excluding from points and fees compensation paid by a creditor to its employees; and using an additive approach to include in points and fees both origination charges paid by a consumer to a creditor and loan originator compensation paid by a creditor to a mortgage broker. The OCC stated that a netting approach would permit YSPs and origination fees to be charged in the same transaction without including both in points and fees and argued that this would not serve the interest of consumers or of a transparent, competitive mortgage market. The OCC noted that a netting approach would permit a qualified mortgage to have up-front charges equal to 3 percent of the loan amount and an interest rate sufficient to generate a 3 percent loan origination commission; similarly, a netting approach would permit a mortgage loan to have up-front charges equal to 5 percent of the loan amount and an interest rate sufficient to generate a 5 percent loan origination commission. The OCC also maintained that including both origination charges and YSPs increases the complexity of mortgage transactions and confuses consumers, particularly those who are most vulnerable and have the fewest credit choices.

As noted above, the OCC supported excluding from points and fees compensation paid by a creditor to its loan officers. The OCC noted that the banking industry expressed concerns about the operational burden of attempting to track compensation and about the potential uncertainty of whether, because of changes in loan originator compensation, a transaction would be a qualified mortgage. The OCC argued that excluding from points and fees compensation paid by a creditor to its loan officers would not adversely affect consumer protection. The OCC noted that individual employees in both the retail and wholesale channels are prohibited from steering a consumer to a more costly loan to increase their compensation but that there is an added layer of protection because a creditor's loan officers generally do not have the ability to select from different creditors when presenting loan options to consumers.

Repeating arguments they made in response to the Board's 2011 ATR Proposal, many industry commenters, including creditors and their representatives and mortgage brokers and their representatives, again urged the Bureau to exclude loan originator compensation from points and fees altogether. They argued that loan originator compensation has little or no bearing on a consumer's ability to repay a mortgage and that it therefore is unnecessary to include such compensation in points and fees. They also maintained that other regulatory protections, including the prohibition in § 1026.36(d)(1) on compensating loan originators based on the terms of the transaction and the prohibition in § 1026.36(e) on steering consumers to consummate particular transactions to increase loan originator compensation, are sufficient to protect consumers against problematic loan originator compensation practices. They claimed that including loan originator compensation in points and fees would impose a significant compliance burden and make it far more difficult to offer qualified mortgages, leading to higher costs for credit and reduced access to credit.

A trade group representing mortgage brokers and many individual mortgage brokers submitted substantially similar comments recommending that the Bureau exclude all compensation paid by creditors to loan originators. They argued that the Board's 2010 Loan Originator Final Rule already restricted loan originator compensation to prevent steering of consumers to more costly mortgages.

One industry commenter recommended that, if the Bureau declines to exclude all loan originator compensation from points and fees, the Bureau should consider whether compensation paid by a creditor to a mortgage broker should be included in points and fees only for higher-priced mortgage loans because competition may not be as robust for such loans. The commenter suggested that the Bureau consider excluding such compensation entirely from points and fees for mortgage loans in the prime market and excluding only a certain amount for higher-priced mortgage loans.

Many industry commenters advocated that, if the Bureau declines to exclude loan originator compensation altogether, the Bureau should exclude from points and fees any compensation paid to loan originator employees. Many creditors and their representatives argued that compensation paid to loan originators employed by creditors, as well as loan originators employed by mortgage brokers, should be excluded from points and fees. They raised a number of different arguments to support excluding compensation paid to individual loan originators, including retail loan officers.

First, they asserted that calculating loan originator compensation for individual loan originators would impose a substantial burden, particularly for employees of creditors. They noted that retail loan officers often receive a substantial part of their compensation after a mortgage loan is consummated, making it difficult to track and attribute compensation to a transaction before that transaction is consummated. They argued that, for retail loan officers, it would create significant compliance burdens to track compensation paid to each loan officer and attribute that compensation to each transaction. They noted that their existing systems are unable to track and attribute compensation for each loan officer for each transaction, and stated that they would have to develop new systems that could track compensation in real time and communicate with loan origination systems to calculate points and fees. They also asserted that it would impose substantial compliance risk because of the difficulty in accurately calculating such compensation.

Second, they argued that calculating loan originator compensation at the time the interest rate is set would result in an inaccurate measure of compensation and would result in significant anomalies. They noted that various types of compensation, including salary and bonuses based on factors such as loan quality and customer satisfaction, would not be included in loan originator compensation because they cannot be attributed to a particular transaction. However, they asserted that the amount of compensation that is included in points and fees may have little bearing on how much the consumer actually pays for a given transaction. For example, they noted that two transactions with identical interest rates and up-front charges may nevertheless have different loan originator compensation merely because one transaction involved an experienced, more highly compensated loan officer or because the interest rate in a transaction was set at the end of the month when a loan officer had qualified for a higher commission.

Finally, they argued that employee compensation is merely another overhead cost that already is captured in the interest rate or in origination charges and has little, if any, bearing on a consumer's ability to repay a mortgage. They argued that compensation typically is already captured in points and fees as origination charges and that including employee loan originator compensation would constitute double counting.

One industry commenter recommended that, if the Bureau declines to exclude compensation paid to individual loan originators from points and fees, the Bureau should consider other methods to simplify the calculation of loan originator compensation. That commenter suggested that the Bureau permit a creditor to include as loan originator compensation a fixed amount based on average costs for loan originator compensation over a prior period of time. The commenter noted that such an approach would ease the burden and complexity of tracking compensation for each loan.

A trade group representing mortgage brokers and many individual mortgage brokers submitted substantially similar comments urging the Bureau to include in points and fees only compensation received by the originating entity for loan origination activities. They argued that fees associated with creditors or wholesale lenders should not be included in points and fees. They also maintained that originators should be permitted to charge various percentages for their loan origination activities, provided they do not exceed the qualified mortgage 3 percent cap and that non-bank originators should be permitted to receive compensation from the consumer, creditor, or a combination of both, as long as total compensation does not exceed 3 percent of the loan amount.

Many industry commenters argued that, if the Bureau elects not to exclude loan originator compensation from points and fees altogether, or to exclude compensation paid to loan originator employees, the Bureau should adopt the netting rule in proposed alternative 2 of comment 32(b)(1)(ii)-5.iii. They argued that the additive rule in proposed alternative 1 of comment 32(b)(1)(ii)-5.iii would result in significant double counting and could cause many loans to exceed the qualified mortgage points and fees limits and could cause some loans to exceed the high-cost mortgage threshold.

One commenter asserted that the inclusion of loan originator compensation in points and fees, along with limitations on the number of discount points that may be excluded from points and fees, would limit the ability of nonprofit organizations to assist consumers in obtaining affordable mortgages. The commenter argued that the Bureau should adopt a rule permitting creditors to exclude payments to loan originators if the costs of such payments are absorbed by creditors and not passed along to consumers. As an alternative, the commenter supported comments 32(b)(1)(ii)-5.i and 32(b)(1)(ii)-5.ii, and the second alternative of comment 32(b)(1)(ii)-5.iii, arguing that these comments minimize double-counting. The commenter also urged the Bureau to permit consumers to exclude from points and fees more than two bona fide discount points, recommending that the Bureau exclude from points and fees any amounts used to buy down an interest rate that starts at or below the average 30-year fixed prime offer rate.

Commenters also raised other issues related to loan originator compensation. Several industry and nonprofit commenters requested additional guidance regarding the calculation of loan originator compensation for transactions involving manufactured homes. They noted that, under § 1026.36(a), as amended by the Bureau's 2013 Loan Originator Final Rule, manufactured home retailers and their employees could qualify as loan originators. Industry commenters requested additional guidance on what activities would cause a manufactured home retailer and its employees to qualify as loan originators. They stated that it remains unclear what activities a retailer and its employees could engage in without qualifying as loan originators and causing their compensation to be included in points and fees. Industry commenters also noted that, because the creditor had limited knowledge of and control over the activities of the retailer's employees, it would be difficult for the creditor to know whether the retailer and its employees had engaged in activities that would require their compensation to be included in points and fees. They therefore urged the Bureau to adopt a bright-line rule under which compensation would be included in points and fees only if paid to an employee of a creditor or a mortgage broker.

Industry commenters also requested that the Bureau clarify what compensation must be included in points and fees when a manufactured home retailer and its employees qualify as loan originators. They argued that it is not clear whether the sales price or the sales commission in a transaction should be considered, at least in part, loan originator compensation. They urged the Bureau to clarify that compensation paid to a retailer and its employees in connection with the sale of a manufactured home should not be counted as loan originator compensation.

Finally, a number of industry commenters again advocated excluding certain other items from points and fees. In particular, several industry commenters urged the Bureau to exclude from points and fees real-estate related charges paid to affiliates of the creditor and up-front charges to recover the costs of loan-level price adjustments (LLPAs) imposed by the GSEs.

The Final Rule

The Bureau addresses below various issues regarding the inclusion of loan originator compensation in points and fees. Specifically, the final rule provides that payments by consumers to mortgage brokers need not be counted as loan originator compensation where such payments already have been included in points and fees as part of the finance charge. In addition, compensation paid by a mortgage broker to its employees need not be included in points and fees. The Bureau also concludes that compensation paid by a creditor to its own loan officers need not be included in points and fees. The Bureau determines, however, that it should not use its exception authority to alter the requirement that compensation paid by a creditor to a mortgage broker is included in points and fees in addition to any origination charges paid by a consumer to the creditor. Finally, the Bureau provides further guidance on how to calculate the amount of loan originator compensation for transactions involving manufactured homes.

Compensation paid by consumers to mortgage brokers. In the 2013 ATR Proposed Rule, the Bureau stated that the broad statutory language requiring inclusion of "all" compensation paid "directly or indirectly" and "from any source" supports counting compensation in points and fees each time it is paid to a loan originator. Thus, the Bureau reads the express language of the statute as providing for the inclusion of loan originator compensation in points and fees, even if some or all of that compensation may already have been included in points and fees under other elements of the definition, and the 2013 ATR Final Rule adopted this statutory approach.

However, as noted in the 2013 ATR Proposed Rule, the Bureau does not believe it would be in the interest of consumers or industry to adhere to this "additive" approach when it is clear that the compensation already has been captured in points and fees. Thus, as explained below, the Bureau is using its adjustment and exception authority and its authority to revise the criteria that define a qualified mortgage to eliminate double counting in such situations.

As noted above, the Bureau proposed in the 2013 ATR Proposed Rule three different examples (one of which had two alternatives) for calculating loan originator compensation when such compensation may already have been included in points and fees. The first example, proposed comment 32(b)(1)(ii)-5.i, would have provided that a consumer payment to a mortgage broker that is included in points and fees under § 1026.32(b)(1)(i) (because it is included in the finance charge) does not have to be counted in points and fees again under § 1026.32(b)(1)(ii) (as loan originator compensation). The Bureau noted in the 2013 ATR Proposed Rule that it did not believe that counting a single payment to a mortgage broker twice would advance the purpose of the points and fees limits. Few comments addressed this proposed example, and, with one exception, which is discussed below in connection with proposed comment 32(b)(1)(ii)-5.ii, those comments supported the Bureau's proposal that such payments should not be included in points and fees under § 1026.32(b)(1)(ii) if they already are included in points and fees under § 1026.32(b)(1)(i).

The Bureau is therefore adopting comment 32(b)(1)(ii)-5.i as proposed and renumbered as 32(b)(1)(ii)-4.i. The Bureau also is adopting new § 1026.32(b)(1)(ii)(A) to provide that loan originator compensation paid by a consumer to a mortgage broker, as defined in § 1026.36(a)(2), is not included in points and fees if it already has been included in points and fees because it is included in the finance charge under § 1026.32(b)(1)(i). The term "mortgage broker" is defined in § 1026.36(a)(2) to mean any loan originator other than an employee of a creditor. Under this definition, persons whose primary business is not originating mortgage loans may nevertheless be mortgage brokers if they qualify as a "loan originator" under § 1026.36(a)(1) and are not employees of a creditor. The use of the term "mortgage broker" in § 1026.32(b)(1)(ii)(A) is appropriate because compensation is excluded from points and fees under § 1026.32(b)(1)(ii)(A) only if such compensation already has been included in points and fees under § 1026.32(b)(1)(i).

The Bureau is adopting new § 1026.32(b)(1)(ii)(A) pursuant to its authority under TILA section 105(a) to make such adjustments and exceptions for any class of transactions as the Bureau finds necessary or proper to facilitate compliance with TILA and to effectuate the purposes of TILA, including the purposes of TILA section 129C of ensuring that consumers are offered and receive residential mortgage loans that reasonably reflect their ability to repay the loans. The Bureau's understanding of this purpose is informed by the findings related to the purposes of section 129C of ensuring that responsible, affordable mortgage credit remains available to consumers. The Bureau believes that using its exception authorities to ensure that a single payment to a mortgage broker will not be counted twice in points and fees will facilitate compliance with the points and fees regulatory regime by allowing creditors to count the payment to a broker once without requiring further investigation into the mortgage broker's employee compensation practices, and by making sure that all creditors apply the provision consistently. It will also effectuate the purposes of TILA by preventing the points and fees calculation from being artificially inflated, thereby helping to keep mortgage loans available and affordable by ensuring that they are subject to the appropriate regulatory framework with respect to qualified mortgages and the high-cost mortgage threshold. The Bureau is also invoking its authority under TILA section 129C(b)(3)(B) to revise, add to, or subtract from the criteria that define a qualified mortgage consistent with applicable standards. For the reasons explained above, the Bureau has determined that it is necessary and proper to ensure that responsible, affordable mortgage credit remains available to consumers in a manner consistent with the purposes of TILA section 129C and necessary and appropriate to effectuate the purposes of this section and to facilitate compliance with section 129C. With respect to its use of TILA section 129C(b)(3)(B) here and elsewhere in this section, the Bureau believes this authority includes adjustments and exceptions to the definitions of the criteria for qualified mortgages and that it is consistent with the purpose of facilitating compliance to extend use of this authority to the points and fees definitions for high-cost mortgage in order to preserve the consistency of the qualified mortgage and high-cost mortgage definitions. As noted above, by helping to ensure that the points and fees calculation is not artificially inflated by counting a single payment to a mortgage broker twice, the Bureau is helping to ensure that responsible, affordable mortgage credit remains available to consumers.

Some consumer advocates argued that the Bureau lacks exception authority to exclude loan originator compensation from the points and fees calculation for the high-cost mortgage threshold under HOEPA.[122] However, while the Bureau's authority under TILA section 105(a) does not extend to the substantive protections for high-cost mortgages in TILA section 129, the provision that defines high-cost mortgages, including the points and fees definitions, is part of TILA section 103. Thus, although the Bureau cannot use its authority under TILA section 105(a) to alter the substantive protections accorded to high-cost mortgages under TILA section 129, it can use that authority to adjust the criteria used to define a high-cost mortgage, including the method for calculating points and fees, as specified elsewhere in TILA.

Compensation paid by mortgage brokers to their loan originator employees. The second example, proposed comment 32(b)(1)(ii)-5.ii, would have provided that compensation paid by a

[122] The consumer advocate commenters made this argument to oppose the Bureau's using exception authority to exclude from points and fees (or use a netting approach for) compensation paid by creditors to loan originators. However, because this argument would also apply to the Bureau's use of exception authority to exclude from points and fees compensation paid by a consumer to a mortgage broker or by a mortgage broker to its employees, the Bureau addresses this argument here with respect to this and other uses of its exception authority in this rulemaking to exclude certain loan originator compensation from points and fees.

mortgage broker to its individual loan originator employees is not included in points and fees under § 1026.32(b)(1)(ii). The Bureau stated in the 2013 ATR Proposed Rule that the exclusion from points and fees was warranted because a payment from either a consumer or creditor to a mortgage broker firm already is counted in points and fees, and that it would not be necessary or appropriate to also include in points and fees any funds that the mortgage broker firm passes on to its individual loan originator employees. Again, few commenters addressed this example, and, with one exception, they supported the Bureau's proposed comment.

As noted above, one creditor argued that it would be unfair to adopt proposed comments 32(b)(1)(ii)-5.i and 32(b)(1)(ii)-5.ii without adopting a similar exclusion for compensation paid by a creditor to its employee loan originators (*i.e.*, its own loan officers). For the reasons set forth below, the Bureau is using its exception authority to permit creditors to exclude from points and fees compensation paid to their own loan officers.

Accordingly, the Bureau is adopting comment 32(b)(1)(ii)-5.ii substantially as proposed and renumbered as 32(b)(1)(ii)-4.ii, and is adopting new § 1026.32(b)(1)(ii)(B) to provide that a payment from a mortgage broker, as defined in § 1026.36(a)(2), to a loan originator who is an employee of the mortgage broker is not included in points and fees. As noted above, the term "mortgage broker" is defined in § 1026.36(a)(2) to mean any loan originator other than an employee of a creditor. Under this definition, persons whose primary business is not originating mortgage loans may nevertheless be mortgage brokers if they qualify as a "loan originator" under § 1026.36(a)(1) and are not employees of a creditor. To qualify as a loan originator under § 1026.36(a)(1), a person must engage in loan origination activities in expectation of compensation. The use of the term "mortgage broker" in § 1026.32(b)(1)(ii)(B) is appropriate because, as discussed above, compensation that a mortgage broker receives from a consumer or creditor is included in points and fees, and this compensation provides the funds for any compensation that is paid by the mortgage broker to its employee.

TILA section 103(bb)(4)(B) provides that compensation paid by a "consumer or creditor" to a loan originator is included in points and fees. The Bureau notes that a mortgage broker firm is neither a consumer nor a creditor, so the statute could plausibly be read so that points and fees would not include payments from a mortgage broker firm to loan originators who work for the firm. However, TILA section 103(bb)(4)(B) provides that compensation must be included in points and fees if it is paid "directly or indirectly" by a consumer or creditor "from any source." Because compensation by a mortgage broker firm to its employees is funded from consumer or creditor payments, such compensation could be interpreted as being paid indirectly by a consumer or creditor.

Given the ambiguity, the Bureau is also invoking its authority under TILA section 105(a) to make such adjustments and exceptions for a class of transactions as the Bureau finds necessary or proper to facilitate compliance with TILA and to effectuate the purposes of TILA, including the purposes of TILA section 129C of ensuring that consumers are offered and receive residential mortgage loans that reasonably reflect their ability to repay the loans. The Bureau's understanding of this purpose is informed by the findings related to the purposes of section 129C of ensuring that responsible, affordable mortgage credit remains available to consumers. Because payments by mortgage brokers to their employees already have been captured in the points and fees calculation, excluding such payments will facilitate compliance with the points and fees regulatory regime by eliminating the need for further investigation into the mortgage brokers' employee compensation practices, and by making sure that all creditors apply the provision consistently. It will also effectuate the purposes of TILA by preventing the points and fees calculation from being artificially inflated, thereby helping to keep mortgage loans available and affordable by ensuring that they are subject to the appropriate regulatory framework with respect to qualified mortgages and the high-cost mortgage threshold. The Bureau is also invoking its authority under TILA section 129C(b)(3)(B) to revise, add to, or subtract from the criteria that define a qualified mortgage consistent with applicable standards. For the reasons explained above, the Bureau has determined that it is necessary and proper to ensure that responsible, affordable mortgage credit remains available to consumers in a manner consistent with the purposes of TILA section 129C and necessary and appropriate to effectuate the purposes of this section and to facilitate compliance with section 129C.

Compensation paid by creditors. As noted in the 2013 ATR Proposed Rule, it is significantly more complicated to devise a rule for calculating loan originator compensation when the consumer pays some up-front charges to the creditor and the creditor pays loan originator compensation to either its own loan officer or to a mortgage broker. That is because the creditor can fund the compensation in two different ways: either through origination charges paid by the consumer (which would be included in points and fees) or through the interest rate (which would not be included in points and fees). There is no practicable method for the Bureau to determine by rule the extent to which compensation paid by the creditor was funded through origination charges and, thereby, already captured in the points and fees calculation. The Bureau therefore indicated that it believed that bright-line rules would be necessary to facilitate compliance.

As discussed below, the Bureau concludes that it is appropriate to apply different requirements to loan originator compensation paid by the creditor to its own loan officers and to compensation paid by the creditor to other loan originators. Specifically, the Bureau is using its exception authority to exclude from points and fees compensation paid by the creditor to its own loan officers. Compensation paid by the creditor to other loan originators is included in points and fees, and such compensation must be counted in addition to any up-front charges that are included in points and fees.

Compensation paid by creditors to their own loan officers. In response to the Board's 2011 ATR Proposal, many creditors and organizations representing creditors urged the Bureau to exclude all compensation paid to individual loan originators. Among other things, these commenters had argued that compensation paid to loan originators already is included in the cost of loan, either in the interest rate or in origination charges; that having to track individual loan originators' compensation and attribute it to specific transactions would impose a significant compliance burden; and that including compensation paid to individual loan originators would cause anomalous results, with otherwise identical loans having different amounts of loan originator compensation included in points and fees because of the timing of the loan or the identity of the loan originator. *See* 78 FR 6433-34 (Jan. 30, 2013).

In the 2013 ATR Final Rule, the Bureau acknowledged the concerns about including in points and fees compensation paid to individual loan originators. Nevertheless, the Bureau declined to exclude such compensation, noting that the statutory language provided that points and fees include compensation paid to "mortgage originators," which is defined to include individual loan officers. *Id*. at 6436. The Bureau also noted that excluding from points and fees compensation paid by creditors to their loan officers would exacerbate the differential treatment between the retail and wholesale channels, as creditors in retail transactions would not be required to include any loan originator compensation in points and fees, while creditors in wholesale transactions would be required to include in points and fees compensation paid by either consumers or creditors to mortgage brokers. *Id*.

The Bureau notes that, in responding to the Board's 2011 ATR Proposal, commenters did not have the benefit of considering how including loan originator compensation in points and fees would interact with the rules regarding loan originator compensation that were proposed by the Bureau in the 2012 Loan Originator Proposal and finalized in the 2013 Loan Originator Final Rule. In response to the 2013 ATR Proposed Rule, the Bureau received detailed comments analyzing whether, in light of the protections in the 2013 Loan Originator Final Rule, it would be appropriate to include various types of loan originator compensation in points and fees. The Bureau also received more extensive explanations from creditors and organizations representing creditors about the difficulties of calculating compensation paid by creditors to their own loan officers.

After carefully considering the comments received in response to the 2013 ATR Proposed Rule, the Bureau believes it is appropriate to reconsider whether compensation paid to individual loan originators should be excluded from points and fees. As noted above, the Bureau already has determined that compensation paid by a mortgage broker to its loan originator employees need not be included in points and fees. The Bureau concludes that it should use its exception authority to exclude the compensation that creditors pay to their loan officers from points and fees as well. As discussed in more detail below, the Bureau determines that including compensation paid by creditors to their loan officers in points and fees at this time not only would impose a severe compliance burden on the industry, but also would lead to distortions in the market for mortgage loans and produce anomalous results for consumers. The Bureau also believes that there are structural and operational reasons why not including in points and fees compensation paid to retail loan officers poses a limited risk of harm to consumers. As a result, the Bureau believes that including such compensation in points and fees would not effectuate the purposes of the statute and in fact would frustrate efforts to implement and comply with the points and fees limits and with the broader statutory and regulatory regime for qualified mortgages and high-cost mortgages that must be implemented by January 2014. The Bureau has decided at this time to exclude compensation paid by creditors to their own loan officers. The Bureau will continue to gather data to determine the need for and the best method for counting compensation paid by creditors to their loan officers consistent with the purpose of the statute. The Bureau will closely monitor the market as it considers this issue to determine if further action is warranted.

As indicated above, several factors support this conclusion.[123] Attributing overall individual loan officer compensation to specific transactions is an extraordinarily difficult task. The Bureau considered these difficulties in the 2013 ATR Final Rule, when it revised § 1026.32(b)(1)(ii) to provide that creditors must include in points and fees loan originator compensation that can be attributed to that transaction at the time the interest rate is set. The requirement that the compensation is included only if it can be attributed to the transaction at the time the interest rate is set was intended to permit creditors to calculate compensation sufficiently early in the process so that they could know well before consummation whether a loan would be a qualified mortgage or a high-cost mortgage. *See* 78 FR 6437 (Jan. 30, 2013).

[123] Some creditors and organizations representing creditors had argued that it would be appropriate to exclude from points and fees compensation paid by creditors to their loan officers because compensation paid to loan originator employees of a mortgage brokerage firm would also be excluded. As noted above, compensation paid to employees of mortgage brokerage firms is excluded from points and fees because such compensation already is captured in points and fees in the payments by consumers or creditors to the mortgage brokerage firms. By contrast, as noted above, compensation paid to a retail loan officer may be funded either through origination charges or through the interest rate, so there is no guarantee that such compensation already has been included in points and fees. As discussed below, however, the Bureau concludes that additional factors justify excluding from points and fees compensation paid by creditors to their own loan officers.

This calculation is straightforward for compensation paid by creditors to mortgage brokers: For each transaction, creditors typically pay a commission to mortgage brokers pursuant to a pre-existing contract between the creditor and the broker, and that commission is known at the time the interest rate is set. Furthermore, because the commission structure is known in advance it can be built into the price of the loan, either through up-front charges or through the interest rate.

The calculation of loan originator compensation is significantly more complicated for retail loan officers.[124] As noted by industry commenters, compensation for retail loan officers often is not determined until after the end of the month or some other, longer time period (such as a quarter) and in many cases is based upon the number or dollar volume of the transactions that have been consummated during the preceding month or other time period. However, for purposes of determining whether a particular transaction is a qualified mortgage (or a high-cost mortgage), the calculation of points and fees (and thus loan originator compensation) must be performed prior to consummation. Thus, to calculate loan originator compensation for retail loan officers for purposes of applying the qualified mortgage and high-cost mortgage thresholds, creditors would have to determine, at the time the interest rate is set, what compensation a retail loan officer would be entitled to receive if a particular transaction were consummated. As noted above, this calculation often would be based on the number or dollar amount of transactions already consummated during the time period in which compensation is set (*e.g.*, the month or quarter or other time period). This calculation may produce an artificial measure of compensation because, for the transaction for which compensation is being calculated, the date the interest rate is set may fall in a different time period than the date the transaction is

[124] The calculation of compensation paid by mortgage brokerage firms to their individual loan originator employees could be similarly complicated. However, as discussed above, the Bureau is excluding such compensation from points and fees because such compensation already has been captured in the points and fees calculation.

consummated and actual compensation is set.[125] If the interest rate were to be reset (if, for example, a rate lock expires or underwriting identifies risk factors which leads to an increase in the interest rate), the compensation would have to be recalculated.

The Bureau understands from industry comments that creditors' existing systems generally do not track compensation for each loan officer for each specific transaction. Thus, creditors would have to develop new systems or reprogram existing systems to track and attribute compensation for each transaction. Depending on the compensation structure, these systems would have to be dynamic so that they could track at the time the interest rate is set what compensation a loan officer would be entitled to receive if a given transaction were consummated.[126] Further, the systems would have to feed into the creditors' origination systems so that the points-and-fee calculation could be made. The Bureau is also concerned that creditors may have difficulty in implementing these systems by January 2014, when the ATR Final Rule becomes effective.

In addition, the Bureau is concerned that requiring creditors to calculate loan originator compensation for their loan officers may create uncertainty about the points and fees calculations and thus about whether loans satisfy the standards for qualified mortgages and remain below the threshold for high-cost mortgages. As noted above, if compensation paid to creditors' loan officers were included in points and fees, creditors would have to calculate at the time the interest rate is set what compensation a loan officer would be entitled to receive in the future.

[125] The Bureau recognizes that a more accurate measure of compensation could be calculated at the time of consummation. However, as noted in the 2013 ATR Final Rule, creditors need to know in advance of consummation whether a transaction will be a qualified mortgage or a high-cost mortgage and therefore need to be able to calculate loan originator compensation, and points and fees generally, prior to consummation. Thus, the Bureau does not believe that is appropriate to require that loan originator compensation be calculated at consummation.

[126] Moreover, the Bureau understands that some consumers prefer to float the interest rate and other consumers lock their interest rate but have the right to relock one time at a lower rate. Thus, in these circumstances, creditors would have to calculate (or recalculate) loan originator compensation later in the process.

This compensation often would depend on the timing of other loans (*i.e.*, how many loans have been consummated or the dollar value of loans consummated by the loan officer at the time the interest rate is set), introducing complexity and potential for errors into the calculation. Moreover, counting retail compensation in points and fees would introduce significant uncertainty into transactions in which the interest rate is not locked well in advance of consummation. For instance, if the consumer elected at the time of application to allow the interest rate to float, the interest rate may not be set until several days before consummation. In such cases, the creditor might be uncertain as to whether the transaction was a qualified mortgage or a high-cost mortgage until that time. Similarly, even if the interest rate is locked in early in the process, it may subsequently be re-set, either because the rate lock expires or because the terms of the transaction are renegotiated after underwriting. In those cases, a transaction that was expected to be a qualified mortgage may lose that status because the loan originator compensation is recalculated at the time the interest rate is finally set. The uncertainty of calculating compensation highlights the difficulty creditors would face in complying with a rule that includes compensation to the creditors' employees in points and fees, and the Bureau is concerned that this uncertainty could be disruptive to the market.

The burden and uncertainty of requiring creditors to calculate loan originator compensation for their loan officers with respect to each individual transaction as of the time the interest rate is set are of particular concern because it does not appear that this calculation would further the purposes of the statute. The Bureau believes that Congress expanded the scope of loan originator compensation to be included in points and fees because of concerns that a loan with high loan originator compensation is likely to be more costly and may pose greater risk for consumers. However, for the reasons discussed below, the Bureau does not believe that calculating at the time the interest rate is set the compensation to be paid by creditors to their own loan officers is likely to be an accurate measure of the actual compensation the loan officer will receive if the loan is consummated or of the costs passed along to consumers.

First, the compensation as calculated may be inaccurate and incomplete. As noted above, compensation would be calculated at the time the interest rate is set, so the actual compensation that a loan officer would receive may be different from the amount that would be included in points and fees. Moreover, various types of compensation, such as salary and bonuses for factors such as loan performance and customer satisfaction, cannot be attributed to specific transactions and therefore would not be included in loan originator compensation for calculating points and fees. As a result, the calculation would produce an incomplete measure of compensation, and creditors would have substantial flexibility to restructure their compensation systems to reduce the amount of loan originator compensation that they would have to include in points and fees. To the extent that increasing numbers of creditors were to restructure compensation to avoid the impact of the rules, the inclusion of loan originator compensation in points and fees would become even less meaningful or consistent over time.

Second, because of the limitations on calculating compensation, counting retail loan originator compensation in points and fees would produce arbitrary outcomes because the amount of compensation that would be attributed to a particular transaction often will be unrelated to the costs or risks borne by the consumer. For example, two retail transactions with identical interest rates and up-front charges could have different loan originator compensation, and therefore different points and fees, simply because a senior, more highly compensated loan officer was involved in one of the transactions. Similarly, two transactions involving the same loan officer could have different loan originator compensation amounts depending on whether the interest rates are set at the end of the month, when the loan officer might qualify for a higher commission for meeting a monthly quota for loans closed, rather than at the beginning of the month, when such a quota is unlikely to have been met.[127] By contrast, the costs to the consumer, as reflected in origination charges and the interest rate, are not likely to vary based on the seniority of the loan originator handling the transaction or the loan officer's satisfaction of the creditor's monthly quota for obtaining a higher commission.

The Bureau is also concerned that including in points and fees compensation paid by a creditor to its own loan officer would place additional limits on consumers' ability to structure their preferred combination of up-front charges and interest rate. The points and fees limits themselves restrict consumers' ability to pay up-front charges and still obtain a qualified mortgage (or avoid a high-cost mortgage). However, these limits would permit even less flexibility in the retail channel because consumers cannot pay retail loan officers directly. For example, assume a consumer is seeking a $100,000 loan and wants to pay $2,500 in up-front charges at closing rather than paying those costs through a higher interest rate. Assume that the up-front charges would all be included in points and fees and that the transaction is being originated through a creditor's loan officer, whose compensation is $1,500. Under an additive approach, if the consumer pays $2,500 in origination charges to the creditor and the creditor pays $1,500 to its loan officer, the points and fees would be $4,000 and the loan could not be a qualified mortgage. In contrast with a transaction originated through a mortgage broker, the consumer would not have the option of paying $1,500 directly to the loan officer. The $1,500 in

[127] Another arbitrary result could occur when a consumer relocks at a lower interest rate. At the time of the initial rate set, the creditor could calculate loan originator compensation and determine that points and fees do not exceed the qualified mortgage points and fees limit or the high-cost mortgage threshold. However, after the rate is reset, the creditor would have to recalculate loan originator compensation, and, if the loan originator has satisfied a creditor's monthly quota for obtaining a higher commission, it is possible that the higher loan originator compensation could cause the points and fees to exceed the qualified mortgage limits (or the high-cost mortgage threshold).

loan originator compensation would count toward the points and fees limits, so the consumer therefore would not be able to pay all of the $2,500 up-front without exceeding the points and fees limit for a qualified mortgage.[128] The consumer would have to pay other costs through a higher interest rate and the resulting higher monthly payments. Thus, under an additive rule, consumers in the retail channel would have less flexibility to pay up-front charges to achieve a lower interest rate and have the transaction remain below the points and fees limits for qualified mortgages and below the threshold for high-cost mortgages. For certain consumers, such as those who do not qualify for a higher interest rate, the impact could affect their access to credit. Excluding from points and fees loan originator compensation paid by a creditor to its loan officers would address this concern.

The Bureau recognizes that creditors may earn greater profits when consumers receive more costly loans and that, in the absence of regulatory protections, creditors could adopt compensation arrangements that create incentives for their loan officers to originate loans that are more costly for consumers. Including loan officer compensation in points and fees would have imposed some limits on the ability of creditors to offer higher compensation to its loan officers. The Bureau believes, however, that the prohibition on terms-based compensation in § 1026.36(d)(1) will provide substantial protection against problematic loan originator compensation practices in the retail channel. The Bureau concludes that these protections will significantly diminish the risk of consumer injury from excluding from points and fees compensation paid by creditors to their retail loan officers. The prohibition in § 1026.36(d)(1) prevents a creditor from paying higher compensation to its loan officer for a transaction that, for example, has a higher interest rate or higher up-front charges. Moreover, the Bureau agrees with

[128] If the consumer's payments satisfy the standards of § 1026.32(b)(1)(i)(E) or (F), the up-front fees could be excluded from points and fees as bona fide discount points.

consumer advocate commenters and comments by the FDIC and HUD and by the OCC that argue that retail loan officers would have greater difficulty than mortgage brokers in trying to maneuver around the margins of § 1026.36(d)(1). Unlike a mortgage broker, a retail loan officer works with only one creditor and therefore cannot choose among different creditors paying different compensation in deciding which loans to offer a consumer.

As noted above, some consumer advocates argued that creditors would still be able to structure loan originator compensation to create incentives for their loan officers to direct consumers toward higher-cost loans. For example, they noted that the 2013 Loan Originator Final Rule adopted § 1026.36(d)(1)(iii) and (iv), which permit creditors to offer, under certain conditions, deferred compensation plans and non-deferred profits-based compensation to their loan officers that otherwise would violate the prohibition on term-based compensation. They suggested that such arrangements could be structured to encourage loan officers to induce consumers to accept more costly loans. The Bureau is sensitive to the risk that unscrupulous creditors may look for gaps and loopholes in regulations; however, the Bureau notes that the referenced provisions of § 1026.36(d)(1) were carefully crafted to attenuate any incentives for directing consumers to higher-cost loans to increase compensation. The Bureau recognizes that creditors have significant incentives to work around the margins of the rules and, as noted above, is committed to monitoring compensation practices closely for problematic developments that may require further action.

In light of these concerns about the significant compliance burden and the questionable accuracy of the calculation for retail loan officer compensation, the Bureau believes it is appropriate at this time to exclude such compensation from points and fees. The Bureau will continue to monitor and gather information about loan originator compensation practices to determine if there are methods that are practicable and consistent with the purposes of the statute for including in points and fees loan originator compensation paid by creditors to their loan officers. As part of the Bureau's ongoing monitoring of the mortgage market and for the purposes of the Dodd-Frank Act section 1022(d) five-year review, the Bureau will assess how the exclusion from points and fees of compensation paid by creditors to their loan officers is affecting consumers. If the Bureau were to find that the exclusion for retail loan officer compensation was harming consumers, the Bureau could issue a new proposal to narrow or eliminate the exclusion. The Bureau is aware that problematic loan originator compensation practices occurred in the past in the retail channel and that questionable practices may occur again. The Bureau will carefully monitor the marketplace to respond to any such abusive practices, including through the use of its supervisory and enforcement authority.

The Bureau stated in the 2013 ATR Final Rule that it was reluctant to exclude from points and fees compensation paid to individual loan originators because it would treat the retail and wholesale channels differently. As discussed above, however, after considering the information received in response to the 2013 ATR Proposed Rule, the Bureau believes there are significant difficulties in calculating loan originator compensation in the retail channel. By contrast, in transactions involving mortgage brokers, there is little compliance burden in calculating loan originator compensation, and compensation typically can be calculated with relative ease and accuracy. Moreover, the Bureau believes that there is less risk of consumer injury from excluding loan originator compensation from points and fees in the retail channel. The Bureau is concerned that that mortgage brokers may have the flexibility to structure their business model to evade the prohibitions of § 1026.36(d)(1) and § 1026.36(e) and that the risk of consumer injury from problematic loan originator compensation practices is therefore higher in the wholesale channel than in the retail channel. The Bureau is also concerned that unscrupulous creditors seeking to originate more costly loans could use the wholesale channel to expand their operations more rapidly and with limited investment. Historical evidence also suggests that the risks of consumer injury may be greater in the wholesale channel. As noted above, some consumer advocates cited evidence that, particularly in the subprime market, loans originated with mortgage brokers were on average more expensive and more likely to default than loans originated in the retail channel.[129] Thus, for the reasons discussed above, the Bureau believes that it is necessary and proper to use its exception authority to exclude from points and fees compensation paid by creditors to their loan officers.

The Bureau considered options other than excluding from points and fees compensation paid by a creditor to its loan officers. The Bureau considered adopting a netting rule for compensation paid by a creditor to its loan officers. This approach would have addressed the concern that an additive methodology would unduly restrict a consumers' ability to structure their preferred combination of up-front charges and interest rate. However, a netting rule would not alleviate the compliance burden or address the other implementation concerns associated

[129] *See, e.g.,* Keith Ernst, Debbie Bocian, Wei Li, Ctr. for Responsible Lending, *Steered Wrong: Brokers, Borrowers, and Subprime Loans* (2008); Antje Berndt, Burton Hollifield, and Patrik Sandas, *What Broker Charges Reveal About Mortgage Credit Risk,* (2012); Susan E. Woodward, A Study of Closing Costs for FHA Mortgages available at http://www.huduser.org/Publications/pdf/FHA_closing_cost.pdf. The Bureau's review of studies generally supports this view, though the evidence is not unequivocal. Wei Jiang, Ashlyn Aiko Nelson, and Edward Vytacil, *Liar's Loan? Effects of Origination Channel and Information Falsification on Mortgage Delinquency*, SSRN working paper 142162 (2009) use a dataset from one bank with approximately 700,000 loans originated between 2004 and 2008. They report that "the Broker subsamples have delinquency probabilities that are 10-14 percentage points (or more than 50%) higher than the Bank subsamples, a manifestation of the misalignment of incentives for brokers who issue loans on the bank's behalf for commissions but do not bear the long-term consequences of low-quality loans." They also show that loan pricing does not compensate for the loan performance differences. Michael LaCour-Little, *The Pricing of Mortgages by Brokers: An Agency Problem?*, J. of Real Estate Research, 31(2), 235-263 (2009) showcases the agency problems in the brokerage channel, and provides a deep literature review. This paper's results "suggest loans originated by brokers cost borrowers about 20 basis points more, on average, than retail loans and that this premium is higher for lower-income and lower credit score borrowers." In contrast, Amany El-Anshany, Gregory Elliehausen, and Yoshiaki Shimazaki, *Mortgage Brokers and the Subprime Mortgage Market,* Proceedings, Federal Reserve Bank of Chicago (2005), find that consumers buying through brokers paid less for their loans, by a similar magnitude as in the LaCour-Little paper.

with including in points and fees compensation paid by creditors to their loan officers. One industry commenter recommended that, if the Bureau declines to exclude compensation paid to retail loan officers from points and fees, it should consider permitting creditors to include in points and fees an average measure of loan originator compensation over a prior period of time as an alternative to calculating compensation on a transaction-by-transaction basis. The Bureau considered such an approach as an alternative for alleviating the compliance burden and eliminating some of the anomalies between transactions. However, the Bureau has concerns about whether this approach is consistent with the statutory purpose of identifying transactions that, because of high up-front charges and high loan originator compensation, should not be eligible for the presumption of compliance of a qualified mortgage or that should receive the protections for high-cost mortgages. Moreover, permitting creditors to employ an average measure of loan originator compensation would raise significant issues. For example, the Bureau would have to determine what compensation would be included in the measure of average compensation, the period for which the average would be calculated, and whether the average would be for an entire firm, for a business unit, for a limited geographic area, or even for individual loan originators. In light of the limited time remaining before the effective date of the rules, the Bureau does not believe it would be practicable to attempt to implement this alternative.

To implement the exclusion from points and fees of compensation paid by a creditor to its loan officers, the Bureau is adding new § 1026.32(b)(1)(ii)(C), which excludes compensation paid by a creditor to a loan originator that is an employee of the creditor. The Bureau also is adding language to comment 32(b)(1)(ii)-1 to clarify that compensation paid by a creditor to a loan originator that is an employee of the creditor is not included in points and fees.

As the Bureau noted in the 2013 ATR Final Rule, the Dodd-Frank Act provides that points and fees include all compensation paid by a consumer or creditor to a “mortgage originator.” In addition, as noted above, the Bureau reads the statutory language as requiring that loan originator compensation be included in points and fees in addition to any other items that are included in points and fees, even if the loan originator compensation may have been funded through charges that already are included in points and fees. Moreover the Bureau reads the statutory provision on compensation as meaning that compensation is added as it flows downstream from one party to another so that it is counted each time that it reached a loan originator, whatever its previous source. Given this statutory language, the Bureau believes that, to exclude from points and fees compensation paid by a creditor to its loan officers, the Bureau must use its exception authority. As provided in new § 1026.32(b)(1)(ii)(C), the Bureau is excluding compensation paid by creditors to their loan officers pursuant to its authority under TILA section 105(a) to make such adjustments and exceptions for a class of transactions as the Bureau finds necessary or proper to facilitate compliance with TILA and its purposes and to effectuate the purposes of TILA, including the purposes of TILA section 129C of ensuring that consumers are offered and receive residential mortgage loans that reasonably reflect their ability to repay the loans. The Bureau’s understanding of this purpose is informed by the findings related to the purposes of section 129C of ensuring that responsible, affordable mortgage credit remains available to consumers. The Bureau has determined that excluding compensation paid to retail loan officers will facilitate compliance with TILA and these purposes by helping to reduce the burden and uncertainty of calculating points and fees in the retail context and by helping to assure that, as of the effective date of the rule, creditors will have systems in place that are capable of making this calculation. At the same time, the Bureau has determined that excluding compensation paid to retail loan officers will effectuate the purposes of TILA by helping to ensure that loans are not arbitrarily precluded from satisfying the criteria for a qualified mortgage or arbitrarily designated as high-cost mortgages because of potential anomalies in how loan originator compensation would be calculated for the points and fees limits. Thus, the exclusion will help ensure the availability of reasonably repayable credit, given that the points and fees threshold will continue to provide limits, apart from compensation not included in finance charge, on costs related to loans.

The Bureau is also relying upon its authority under TILA section 129C(b)(3)(B) to revise, add to, or subtract from the criteria that define a qualified mortgage consistent with applicable standards. For the reasons explained above, the Bureau has determined that it is necessary and proper to ensure that responsible, affordable mortgage credit remains available to consumers in a manner consistent with the purposes of TILA section 129C and necessary and appropriate to effectuate the purposes of this section and to facilitate compliance with section 129C.

Certain commentary adopted in the 2013 ATR Final Rule is no longer necessary in light of the Bureau's decisions discussed above. Comment 32(b)(1)(ii)-2 describes certain types of compensation that would and would not be included in points and fees for individual loan originators. Portions of comment 32(b)(1)(ii)-3 discuss how the timing affects what compensation paid to individual loan originators must be included in points and fees. Comment 32(b)(1)(ii)-4 provides examples for calculating compensation for individual loan originators. Because compensation paid by mortgage brokers to their individual loan originator employees and compensation paid by creditors to their loan officers is no longer included in points and fees, the guidance for calculating compensation for individual loan originators is no longer necessary.

Accordingly, the Bureau is deleting portions of comments 32(b)(1)(ii)-2.ii and -3, and, the entirety of comment 32(b)(1)(ii)-4.

Compensation paid by creditors to mortgage brokers. In response to the Board's 2011 ATR Proposal, many industry commenters urged the Bureau to exclude loan originator compensation from points and fees altogether. *See* 78 FR 6433 (Jan. 30, 2013). Among other things, industry commenters had argued that compensation paid to loan originators already is included in the cost of the loan and has little, if any bearing on a consumer's ability to repay a mortgage loan. They also argued that other statutory provisions and rules already provide adequate protection from abusive loan originator compensation practices and that it therefore is unnecessary to include loan originator compensation in points and fees. Finally, they argued that including loan originator compensation in points and fees would cause many loans to exceed the qualified mortgage points and fees limits, which would result in an increase in the cost of credit and diminished access to credit.

In the 2013 ATR Final Rule, the Bureau acknowledged the concerns about including loan originator compensation in points and fees. However, the Bureau noted that, in light of the express statutory language and Congress's evident concern with increasing consumer protections in connection with loan originator compensation practices, the Bureau did not believe it appropriate to use its exception authority to exclude loan originator compensation entirely from points and fees. In response to the 2013 ATR Proposed Rule, many industry commenters, including mortgage brokers and their representatives and some creditors and their representatives, again urged the Bureau to exclude loan originator compensation from points and fees altogether (or to at least exclude from points and fees all compensation paid by creditors to loan originators). Repeating many of the same arguments made in response to the Board's 2011

ATR Proposal, these commenters argued that loan originator compensation already is included in the cost of the loan and has little or no effect on consumers' ability to repay the loan. They claimed that other protections adopted by the Bureau and the Board adequately protect consumers against harmful loan originator compensation practices and that it therefore is unnecessary to include loan originator compensation in points and fees. Finally, they argued that including loan originator compensation in points and fees would cause many loans to exceed the qualified mortgage points and fees cap or the high-cost mortgage threshold and that, as a result, many loans would not be made, including in particular smaller loans.

The Bureau does not believe that it is consistent with the standards for its use of exception and adjustment authority to exclude from points and fees compensation paid by creditors to loan originators that are not employees of creditors. As noted above, in excluding from points and fees compensation paid by creditors to their loan originator employees, the Bureau invoked its exception and adjustment authority to facilitate compliance and, generally speaking, to meet purposes of ensuring that credit is available to consumers on reasonably repayable terms. These factors do not support excluding compensation paid by creditors to loan originators not employed by creditors. The compliance burden of calculating compensation paid by creditors to loan originators other than their own employees is minimal and does not provide a basis for exclusion based on a rationale related to facilitating compliance. As noted above, this calculation is straightforward for compensation paid by creditors to mortgage brokers: For each transaction, creditors typically pay a commission to mortgage brokers pursuant to a pre-existing contract between the creditor and the broker, and that commission is known at the time the interest rate is set.[130] Moreover, as discussed below, the Bureau believes that there remain some risks of consumer injury from business models in which mortgage brokers attempt to steer consumers to more costly transactions. Including in points and fees compensation paid by creditors to mortgage brokers should help reduce those risks. Accordingly, the Bureau declines to use its exception authority to exclude such compensation from points and fees.

The Bureau also does not believe it is appropriate to use its exception authority to exclude loan originator compensation payments from creditors to mortgage brokers in certain types of transactions. As noted above, one industry commenter urged the Bureau to consider whether compensation paid by creditors to mortgage brokers should be included in points and fees only in subprime transactions. The commenter did not provide data or other evidence to support this approach. In addition, subprime transactions already have less flexibility than prime transactions under the points and fees limits because bona fide discount points may not excluded from points and fees for transactions with interest rates greater than 2 percentage points above APOR, *see* § 1026.32(b)(1)(i)(E) and (F), and the Bureau is concerned about widening the disparity in treatment under the points and fees limits. Accordingly, the Bureau does not believe it is appropriate to use its exception authority to create different requirements for loan originator compensation in the prime and subprime markets. Another commenter requested that, to avoid impairing affordable lending programs offered by nonprofit organizations, the Bureau exclude such payments when the creditor absorbs the costs of the payments and does not pass along the costs to consumers.[131] The Bureau believes it would be difficult, if not impossible, to determine

[130] As discussed above, the compliance burden of calculating compensation paid by creditors to their own loan officers is substantial and offsets the limited potential consumer protection benefits of including such compensation in points and fees.
[131] As discussed below, the Bureau is adopting § 1026.43(a)(3)(v), which exempts certain creditors, including certain nonprofit creditors, from the ability-to-repay requirements.

when a creditor was in fact not passing along loan origination costs to consumers and that any exemption, even if well-intentioned, could be susceptible to abuse.

In the 2013 ATR Proposed Rule, the Bureau proposed two alternatives—an "additive" approach and a "netting" approach— for calculating compensation. As discussed above, proposed alternative 1 of comment 32(b)(1)(ii)-5.iii would have adopted an additive approach in which loan originator compensation would have been included in points and fees in addition to any charges paid by the consumer to the creditor. Proposed alternative 2 of comment 32(b)(1)(ii)-5.iii would have permitted creditors to net origination charges against loan originator compensation to calculate the amount of loan originator compensation that is included in points and fees. As discussed above, a creditor's payments to a loan originator may be funded by up-front charges to the consumer, through the interest rate, or through some combination. The up-front charges to the consumer would be captured in points and fees, but compensation funded through the interest rate would not be captured. Thus, when a consumer pays up-front charges, it is not clear whether a creditor's payments to a loan originator are captured in such points and fees.[132]

As noted above, the Bureau reads the statutory language as requiring that loan originator compensation be included in points and fees in addition to any other items that are included in points and fees, even if the loan originator compensation may have been funded through charges that already are included in points and fees. Moreover the Bureau reads the statutory provision on compensation as meaning that compensation is added as it flows downstream from one party to another so that it is counted each time that it reached a loan originator, whatever its previous source. After carefully considering the comments, the Bureau has determined that, for

[132] It is doubtful that Congress contemplated this issue because, as noted above, absent the Bureau's use of exception authority, TILA section 129B(c)(2)(B)(ii) would have prohibited a creditor from imposing origination fees or charges if the creditor were compensating a loan originator.

calculating compensation paid by creditors to mortgage brokers, it is not necessary or proper to revise the additive approach prescribed by the statute and adopted in the 2013 ATR Final Rule.

For creditor payments to loan originators not employed by creditors, calculating loan originator compensation under an additive approach does not impose a significant compliance burden. As noted above, this calculation is straightforward for compensation paid by creditors to mortgage brokers: For each transaction, creditors typically pay a commission to mortgage brokers pursuant to a pre-existing contract between the creditor and the broker, and that commission is known at the time the interest rate is set.

For transactions in the wholesale channel, brokers and creditors can obviate double counting concerns by having consumers pay brokers directly. [133] Under new comment 32(b)(1)(ii)-5.i, the consumer's payment to the mortgage broker would be included in points and fees only one time. For example, assume a consumer is seeking a $100,000 loan and wants to pay $2,500 in up-front charges at closing rather than paying those costs through a higher interest rate. The transaction is being originated through a mortgage broker firm, which charges $1,500. Under an additive approach, if the consumer pays $2,500 in origination charges to the creditor and the creditor pays $1,500 to the mortgage broker firm, the points and fees would be $4,000 and the loan could not be a qualified mortgage. However, if the consumer pays $1,500 directly to the mortgage broker firm and then pays $1,000 in origination charges to the creditor, then the points and fees would be $2,500 and would not prevent the loan from being a qualified

[133] The Bureau does not believe that the potential double counting of loan originator compensation and origination charges could be adequately addressed by permitting a netting approach in combination with more detailed disclosures to consumers. The Bureau notes that, because money is fungible, creditors could adjust their accounting so that they could disclose that they are recovering loan originator compensation through up-front charges and other origination costs through the interest rate. Thus, this disclosure-based approach would permit creditors to reduce the amount of loan originator compensation they include in points and fees without changing the amount of up-front fees or the interest rate they charge. Moreover, given the complex interaction between loan originator compensation, up-front charges, and the interest rate, the Bureau has concerns that consumers would not understand the disclosures.

mortgage. Moreover, if the consumer pays the mortgage broker directly, then the creditor would no longer be responsible for the cost of compensating the mortgage broker; as a result, the interest rate should be the same whether the consumer pays $1,500 to the mortgage broker and $1,000 to the creditor or the consumer pays $2,500 to the creditor and the creditor pays $1,500 to the mortgage broker. In light of the options that direct consumer payments provide in the wholesale channel, the Bureau believes that affordable credit will continue to be available in connection with wholesale loans and that use of adjustment authorities to achieve statutory purposes is not necessary.

The Bureau is concerned that, as noted by the FDIC and HUD, by the OCC, and by some consumer advocate commenters, a netting rule in the wholesale channel could create incentives for mortgage brokers and creditors to structure transactions so that loan originator compensation is paid by the creditor to the mortgage broker, rather than by the consumer to the mortgage broker. Under a netting rule, creditors could impose origination charges on the consumer and net those charges against the compensation the creditor pays the mortgage broker when calculating points and fees. By contrast, in a transaction in which the consumer pays the mortgage broker directly, the consumer's payment to the mortgage broker would be included in points and fees in addition to any origination charges imposed by the creditor. Thus, a netting rule likely would provide creditors with a greater ability to charge up-front fees and still remain under the points and fees limits.[134] The Bureau believes it would be anomalous to treat wholesale transactions differently for purposes of the qualified mortgage and high-cost mortgage points and fees limits

[134] As consumer advocates noted in their comments, mortgage brokers historically have defended arrangements in which creditors pay compensation to mortgage brokers by arguing that this approach permits consumers to obtain mortgage loans when they do not have sufficient funds to compensate mortgage brokers directly. *See Nat'l Assoc. of Mortgage Brokers v. Fed. Reserve Bd.*, 773 F.Supp. 2d 151, 158 (D.D.C 2011). This rationale for creditors' paying compensation to mortgage brokers has little if any force if the consumer is paying up-front charges to the creditor.

simply because in one transaction the consumer paid compensation directly to the mortgage broker and in another transaction the consumer paid the compensation indirectly. Such an anomaly would actually disserve the broad purposes of TILA to inform consumers because in the transaction that would be favored (*i.e.*, the transaction in which the broker's commission is bundled in the fees paid to the creditor or in the interest rate) the costs would be less transparent than in the disfavored transaction (*i.e.*, the transaction in which the consumer paid the compensation directly to the broker).

Finally, an additive approach would place some additional limits on the ability of mortgage brokers to obtain high compensation for loans that are more costly to consumers. As noted above, consumer advocates have identified two ways in which mortgage brokers potentially could extract high compensation for delivering loans that are more costly to consumers (and possibly more profitable for creditors) would not appear to violate the prohibitions on steering and compensating loan originators based on loan terms. First, mortgage brokers could specialize in providing creditors with loans that are more costly to consumers in exchange for high compensation, so long as that compensation does not vary based on the terms of individual loans.

Second, mortgage brokers could do business with a mix of creditors, some offering more costly loans (and paying high compensation to mortgage brokers) and some offering loans with more favorable terms (and paying lower compensation to brokers). Mortgage brokers could attempt to steer borrowers that are less sophisticated and less likely to shop for better terms to the creditors with more costly loans, and they potentially could evade the anti-steering prohibition by offering quotes from at least three such creditors.[135] An additive approach likely would reduce

[135] Competitive market pressures and the difficulties of specializing in (or at least identifying and steering) vulnerable consumers may constrain mortgage brokers' ability to exploit gaps in the regulatory structure.

the potential consumer injury by limiting the ability of creditors to impose high up-front charges and pay high loan originator compensation, unless creditors are willing to exceed the qualified mortgage points and fees limits and, potentially, to bear the burden of originating high-cost mortgages under HOEPA.[136]

The Bureau recognizes that an additive approach makes it more difficult for creditors to impose up-front charges and still remain under the qualified mortgage points and fees limits and the high-cost mortgage threshold. Commenters provided limited data regarding the magnitude of the effects of an additive approach. Nevertheless, even in transactions in which a mortgage broker's compensation is two percentage points of the loan amount—which the Bureau understands to be at the high end of mortgage broker commissions—the creditor would still be able to charge up to one point in up-front charges that would count toward the qualified mortgage points and fees limits. As noted above, the creditor may reduce the costs it needs to recover from origination charges or through the interest rate by having the consumer pay the mortgage broker directly. In addition, creditors in the wholesale channel that prefer to originate only qualified mortgages in many cases will have the flexibility to recover more of their origination costs through the interest rate to ensure that their transactions remain below the points and fees limits.[137]

For the reasons discussed above, the Bureau believes that it is neither necessary nor appropriate to deviate from the additive approach prescribed by the statute and adopted in the 2013 ATR Final Rule to calculate compensation paid by creditors to mortgage brokers. The

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Nevertheless, the Bureau is concerned about the potential for consumer injury, particularly for consumers who are less sophisticated or less likely to shop for competitive terms.

[136] The Bureau recognizes that an additive approach would not preclude creditors from paying mortgage brokers above-market compensation (up to the points and fees limits) and recovering the costs of compensating the mortgage brokers and other costs through an above-market interest rate. However, as consumer advocates noted in their comments, consumers may shop more effectively when comparing a single variable, such as the interest rate.

[137] Moreover, to the extent that consumers prefer to pay up-front charges to reduce the interest rate, creditors may be able to exclude as many as two bona fide discount points under § 1026.32(b)(1)(i)(E) or (F).

Bureau believes that affordable credit will continue to be available in connection with loans in the wholesale channel and that use of adjustment authorities to achieve statutory purposes is not necessary and proper. As noted above, the Bureau believes that, to the extent that the additive approach limits the ability of mortgage brokers to steer consumers toward more costly loans, the additive approach is consistent with the statutory purposes. Accordingly, the Bureau concludes that it should not exercise its exception authority to alter the additive approach prescribed by the statute. Accordingly, as adopted by this final rule, comment 32(b)(1)(ii)-4.iii clarifies that, for loan originators that are not employees of the creditor, (*i.e.*, mortgage brokers, as defined in § 1026.36(a)(2)) loan originator compensation is included in points and fees in addition to any origination charges that are paid by the consumer to the creditor.

As noted above, the term "mortgage broker" is defined in § 1026.36(a)(2) to mean any loan originator other than an employee of a creditor. The Bureau believes that the additive approach is appropriate for all mortgage brokers, including persons whose primary business is not originating mortgage loans but who nevertheless qualify as a "mortgage broker" under § 1026.36(a)(2). In general, calculating compensation paid by a consumer or creditor to such persons for loan origination activities should be straightforward and would impose little compliance burden. However, as discussed below, the Bureau intends to provide additional guidance for calculating loan originator compensation for manufactured home transactions.

Loan originator compensation for open-end credit plans. For the high-cost mortgage points and fees threshold, the 2013 HOEPA Final Rule applied the same requirements for including loan originator compensation in points and fees in open-end credit plans as for closed-end credit transactions. In the 2013 ATR Proposed Rule, the Bureau solicited comment about whether different or additional guidance is appropriate for calculating loan originator compensation for open-end credit plans. The Bureau received few comments that addressed open-end credit plans, and they did not advocate for different or additional guidance. Accordingly, the Bureau believes that it is appropriate to continue to apply the same requirements for calculating loan originator compensation for points and fees in closed-end credit transactions and open-end credit plans. The Bureau is therefore revising § 1026.32(b)(2)(ii), which addresses loan originator compensation for open-end credit plans, to incorporate the same exclusions from points and fees as those discussed above for closed-end credit transactions in § 1026.32(b)(1)(ii). The Bureau is not adopting additional guidance for open-end credit plans.

Calculation of loan originator compensation for manufactured home transactions. As noted above, several industry and nonprofit commenters requested clarification of what compensation must be included in points and fees in connection with transactions involving manufactured homes. They requested additional guidance on what activities would cause a manufactured home retailer and its employees to qualify as loan originators. The 2013 Loan Originator Final Rule had provided additional guidance on what activities would cause such a retailer and its employees to qualify as loan originators in light of language in the Dodd-Frank Act creating an exception from the definition of loan originator for employees of manufactured home retailers performing certain limited activities. *See* § 1026.36(a)(1)(i)(B) and comments 36(a)-1.i.A and 36(a)-4. The commenters nevertheless argued that it remains unclear what activities a retailer and its employees could engage in without qualifying as loan originators and causing their compensation to be included in points and fees. Industry commenters also noted that, because a creditor has limited knowledge of and control over the activities of a retailer and its employees, it would be difficult for a creditor to know whether a retailer and its employees had engaged in activities that would require their compensation to be included in points and fees. Industry commenters therefore urged the Bureau to adopt a bright-line rule that would exclude from points and fees compensation paid to manufactured home retailers and their employees. They also requested that the Bureau clarify that, in any event, compensation received by the manufactured home retailer or its employee for the sale of the home should not be counted as loan originator compensation and included in points and fees.

The Bureau does not believe it is appropriate to exclude compensation that is paid to a manufactured home retailer for loan origination activities. In such circumstances, the retailer is functioning as a mortgage broker and compensation for the retailer's loan origination activities should be captured in points and fees. The Bureau recognizes, however, that it may be difficult for a creditor to ascertain whether a retailer engages in loan origination activities and, if so, what compensation that retailer receives for those activities, at least when such compensation was not paid directly by the creditor itself. Accordingly, the Bureau intends to propose additional guidance on these issues prior to the effective date of the 2013 ATR Final Rule to facilitate compliance.

With respect to employees of manufactured home retailers, the Bureau believes that, in most circumstances, new § 1026.32(b)(1)(ii)(B) will make it unnecessary for creditors to determine whether employees of retailers have engaged in loan origination activities that would cause them to qualify as loan originators. As discussed above, § 1026.32(b)(1)(ii)(B) excludes compensation paid by mortgage brokers to their loan originator employees. In the usual case, when an employee of a retailer would qualify as a loan originator, the retailer would qualify as a mortgage broker. If the retailer is a mortgage broker, any compensation paid by the retailer to the employee would be excluded from points and fees under § 1026.32(b)(1)(ii)(B).

Nevertheless, as part of its proposal to provide additional guidance as noted above, the Bureau intends to request comment on whether additional guidance is necessary for calculating loan originator compensation for employees of manufactured home retailers.

Other issues related to points and fees. As noted above, many commenters requested that the Bureau reconsider whether certain items should be included in points and fees. In particular, many commenters urged that real-estate related charges paid to affiliates and up-front charges imposed by creditors on consumers to recover the costs of LLPAs should not be included in points and fees. Commenters also asked the Bureau to permit the creditor to exclude more than two bona fide discount points from points and fees. The Bureau is not reconsidering its decision that, as provided in the statute, real-estate related charges paid to affiliates of the creditor are included in points and fees. The Bureau also declines to reconsider its decision that, where a creditor recovers the costs of LLPAs through up-front charges to the consumer, those charges are included in points and fees. Finally, the Bureau is not reconsidering its decision that, as provided in the statute, creditors may exclude no more than two bona fide discount points from points and fees.

Many individual mortgage brokers and a trade group representing mortgage brokers urged the Bureau to reconsider certain restrictions on loan originator compensation in § 1026.36(d)(1) and (2), arguing that these restrictions are unnecessary because the points and fees limits for qualified mortgages effectively cap loan origination compensation at 3 percent of the loan amount.[138] The 2013 Loan Originator Final Rule clarified and expanded § 1026.36(d)(1) and (2), and the Bureau declines to revisit those provisions in this rulemaking.

Section 1026.35 Prohibited Acts or Practices in Connection with Higher-Priced Mortgage Loans

[138] The Bureau notes that the general 3 percent points and fees limit applies only to qualified mortgages and would not restrict the loan originator compensation paid to mortgage brokers in mortgage transactions that are not qualified mortgages.

35(b) Escrow Accounts

35(b)(2) Exemptions

35(b)(2)(iii)

As discussed further below, the Bureau proposed § 1026.43(e)(5) to create a new type of qualified mortgage for certain portfolio loans originated and held by small creditors. The Bureau proposed to adopt the same parameters defining small creditor for purposes of the new category of qualified mortgage as it had used in implementing provisions of the Dodd-Frank Act that allow certain balloon loans to receive qualified mortgage status and an exemption from the requirement to maintain an escrow accounts for certain higher priced mortgage loans where such loans are made by small creditors operating predominantly in rural or underserved areas. The size thresholds for purposes of the rural balloon and escrow provisions are set forth in § 1026.35(b)(2)(iii), as adopted by the 2013 Escrows Final Rule, which provides that an escrow account need not be established in connection with a mortgage if the creditor, within applicable time periods, annually extends more than 50 percent of its covered first-lien transactions on properties that are located in rural or underserved counties, originates (with its affiliates) 500 or fewer first-lien covered transactions per year, and has total assets of less than $2 billion (adjusted annually for inflation), in addition to other escrow account limitations.

The Bureau did not propose to make any specific amendments to the escrows provision in § 1026.35(b)(2), but indicated that if the provisions creating a new type of small creditor portfolio qualified mortgage in proposed § 1026.43(e)(5) were adopted with changes inconsistent with § 1026.35(b)(2), the Bureau would consider and might adopt parallel amendments to § 1026.35(b)(2) to keep these sections of the regulation consistent.

The Bureau solicited comment on the advantages and disadvantages of maintaining consistency between § 1026.35(b)(2) and § 1026.43(e)(5). Commenters did not specifically address the importance of consistency. However, several small creditors and a small creditor trade group raised concerns regarding the cost and burden associated with the escrow requirements and urged the Bureau to expand or adopt exceptions to those requirements. For example, commenters suggested broadening the § 1026.35(b)(2)(iii) exemption and exempting home improvement loans and loans secured by mobile homes.

As discussed below in the section-by-section analysis of § 1026.43(e)(5), the Bureau is adopting § 1026.43(e)(5) consistent with existing § 1026.35(b)(2) with regard to the asset size and annual loan origination thresholds defining a small creditor. The Bureau did not propose and did not solicit comment regarding other amendments to the escrow provisions in § 1026.35(b)(2). The Bureau therefore is not reconsidering the issues raised by commenters at this time and is not adopting any changes to § 1026.35(b)(2) in this rulemaking.

Section 1026.43 Minimum Standards for Transactions Secured by a Dwelling

43(a) Scope

43(a)(3)

Background

Section 129C(a)(1) of TILA, as added by section 1411 of the Dodd-Frank Act, states that, in accordance with regulations prescribed by the Bureau, no creditor may make a residential mortgage loan unless the creditor makes a reasonable and good faith determination based on verified and documented information that, at the time the loan is consummated, the consumer has a reasonable ability to repay the loan, according to its terms, and all applicable taxes, insurance (including mortgage guarantee insurance), and assessments. Section 1401 of the Dodd-Frank Act adds new TILA section 103(cc)(5), which defines “residential mortgage loan” to mean, with some exceptions, any consumer credit transaction secured by a mortgage, deed of trust, or other equivalent consensual security interest on “a dwelling or on residential real property that includes a dwelling.” TILA section 103(v) defines “dwelling” to mean a residential structure or mobile home which contains one- to four-family housing units, or individual units of condominiums or cooperatives. Thus, a “residential mortgage loan” generally includes all mortgage loans, except mortgage loans secured by a structure with more than four residential units. However, TILA section 103(cc)(5) specifically excludes from the term “residential mortgage loan” an open-end credit plan and an extension of credit secured by an interest in a timeshare plan, for purposes of the ability-to-repay requirements under TILA section 129C as well as provisions concerning prepayment penalties and other restrictions. In addition, TILA section 129C(a)(8) exempts reverse mortgages and temporary or “bridge” loans with a term of 12 months or less from the ability-to-repay requirements. Thus, taken together, the ability-to-repay requirements of TILA section 129C(a) apply to all closed-end mortgage loans secured by a one- to four-unit dwelling, except loans secured by a consumer’s interest in a timeshare plan, reverse mortgages, or temporary or “bridge” loans with a term of 12 months or less.

The Bureau’s 2013 ATR Final Rule adopted provisions on scope that are substantially similar to the statute, which included modifications to conform to the terminology of Regulation Z. However, feedback provided to the Bureau suggested that the ability-to-repay requirements would impose an unsustainable burden on certain creditors, such as housing finance agencies (HFAs) and certain nonprofit organizations, offering mortgage loan programs for low- to moderate-income (LMI) consumers. The Bureau was concerned that the ability-to-repay requirements adopted in the 2013 ATR Final Rule would undermine or frustrate application of the uniquely tailored underwriting requirements employed by these creditors and programs, and would require a significant diversion of resources to compliance, thereby significantly reducing access to credit. The Bureau was also concerned that some of these creditors would not have the resources to implement and comply with the ability-to-repay requirements, and may have ceased or severely limited extending credit to low- to moderate-income consumers, which would result in the denial of responsible, affordable mortgage credit. In addition, the Bureau was concerned that the ability-to-repay requirements may have frustrated the purposes of certain homeownership stabilization and foreclosure prevention programs, such as Hardest-Hit-Fund (HHF) programs and the Home Affordable Refinance Program (HARP). Accordingly, the Bureau proposed several exemptions intended to ensure that responsible, affordable mortgage credit remained available for LMI and financially distressed consumers.

43(a)(3)(iv)

The Bureau's Proposal

As discussed above, neither TILA nor Regulation Z provide an exemption to the ability-to-repay requirements for extensions of credit made pursuant to a program administered by a Housing Finance Agency (HFA), as defined under 24 CFR 266.5. However, the Bureau was concerned that the ability-to-repay requirements may unnecessarily impose additional requirements onto the underwriting requirements of HFA programs and impede access to credit available under these programs. The Bureau was especially concerned that the costs of implementing and complying with the requirements of § 1026.43(c) through (f) would endanger the viability and effectiveness of these programs. The Bureau was concerned that the burden could prompt some HFAs to severely curtail their programs and some private creditors that partner with HFAs to cease participation in such programs, both of which could reduce mortgage credit available to LMI consumers. The Bureau was also concerned that the ability-to-repay requirements may affect the ability of HFAs to apply customized underwriting criteria or offer customized credit products that are designed to meet the needs of LMI consumers while promoting long-term housing stability.

Based on these concerns and to obtain additional information regarding these potential effects, the Bureau proposed an exemption and solicited feedback on several issues. Proposed § 1026.43(a)(3)(iv) would have provided an exemption to the ability-to-repay requirements for credit extended pursuant to a program administered by an HFA. The Bureau solicited comment on every aspect of this approach. In particular, the Bureau sought comment on the premise that the ability-to-repay requirements could impose significant implementation and compliance burdens on HFA programs even if credit extended under the HFA programs were granted a presumption of compliance as qualified mortgages. The Bureau also sought comment on whether HFAs have sufficiently rigorous underwriting standards and monitoring processes to protect the interests of consumers in the absence of TILA's ability-to-repay requirements. The Bureau also requested data related to the delinquency, default, and foreclosure rates of consumers participating in these programs. In addition, the Bureau solicited feedback regarding whether such an exemption could harm consumers, such as by denying consumers the ability to pursue claims arising under violations of § 1026.43(c) through (f) against creditors extending credit in connection with these programs. Finally, the Bureau also requested feedback on any alternative approaches that would preserve the availability of credit under HFA programs while ensuring that consumers receive mortgage loans that reasonably reflect consumers' ability to repay.

Comments Received

In response to the proposed rule, some commenters completely opposed the proposed exemption from the ability-to-repay requirements for extensions of credit made pursuant to programs administered by HFAs. These commenters generally argued that the rules should apply equally to all creditors. These commenters contended that granting exemptions to certain creditors would create market distortions and steer consumers towards certain creditors, thereby reducing consumer choice and ability to shop. Other commenters suggested alternative modifications to address HFA programs. One industry commenter favored creating special ability-to-repay requirements tailored to the unique underwriting characteristics of LMI consumers. Another industry commenter supported some type of exemption from the ability-to-repay requirements but advocated for conditions or the provision of authority to HFAs to impose their own ability-to-repay standards, as various Federal agencies (the Department of Housing and Urban Development, the Department of Veterans Affairs, and the Department of Agriculture), are authorized to do. The majority of industry and consumer group commenters, however, asserted that the proposed exemption to the ability-to-repay requirements for credit extended pursuant to a program administered by an HFA is necessary because these programs meet the customized needs of LMI consumers who are creditworthy but may not otherwise qualify for mortgage credit under the Bureau’s ability-to-repay requirements.

The latter group of commenters generally supported the Bureau’s goal of preserving access to affordable credit for LMI consumers and favored the Bureau’s proposal to exempt community-focused lending programs from the ATR requirements altogether. These commenters contended that HFA loan products balance access to residential mortgage credit for LMI consumers with a focus on the consumer’s ability to repay. Consumer group commenters argued that HFA lending programs typically offer low-cost mortgage products, require full documentation of income and demonstrated ability to repay, and often include extensive financial counseling with the consumer. Commenters argued that HFA homeowner assistance programs are tailored to the credit characteristics of LMI consumers that HFAs serve and noted that these organizations only extend credit after conducting their own lengthy and thorough analysis of an applicant's ability to repay, which often account for nontraditional underwriting criteria, income sources that do not fall within typical mortgage underwriting criteria, extenuating circumstances, and other subjective factors that are indicative of responsible homeownership and ability to repay. An industry commenter noted that, for first-time homebuyer lending, HFAs use a combination of low-cost financing and traditional fixed-rate, long-term products; flexible, but prudent, underwriting with careful credit evaluation; diligent loan documentation and income verification; down payment and closing cost assistance; homeownership counseling; and proactive counseling and servicing. This commenter stated that many HFAs elaborate beyond the underwriting standards of Federal government agencies, such as FHA, USDA, or RHS loans, and that HFAs also oversee creditors involved in these programs carefully by ensuring the HFA's strict underwriting standards and lending requirements are followed. Comments provided to the Bureau state that a New York State HFA considers the consumer's entire credit history rather than consider only a consumer's credit score, which allows it to help those consumers who may have a lower credit score due to a prior financial hardship. Whereas creditors do not need to engage in separate verification where a consumer's application lists a debt that is not apparent from the consumer's credit report pursuant to § 1026.43(c), comments provided to the Bureau also state that the Pennsylvania Housing Finance Agency's underwriting standards require that the creditor provide a separate verification of that obligation, indicating the current balance, the monthly payment, and the payment history of the account.

Commenters also provided data related to the relative performance of HFA loans as further justification to support the proposed exemption from the ability-to-repay requirements for extensions of credit made pursuant to a program administered by a HFA. Although comprehensive data for HFA loan performance are not available, commenters reported that the delinquency, default, and foreclosure statistics for consumers who receive mortgage loans from HFA programs are generally lower than for those of the general populace, which demonstrates that HFA programs ensure that consumers are extended credit on reasonably repayable terms.[139] Commenters reported that a limited review of HFA loan data conducted by Fannie Mae in 2011 found that HFA-financed loans performed significantly better than other Fannie Mae affordable housing loans. Also, comments cited a 2011 National Council of State Housing Agencies (NCSHA) study of HFA-financed and non-HFA-financed loans insured by FHA that found that, in a large majority of States, HFA-financed loans had lower long-term delinquency and foreclosure rates than non-HFA loans.

A number of commenters argued that, in the absence of an exemption, HFA homeowner assistance programs would not be able to continue to meet the needs of LMI consumers or

[139] For example, as of September 30, 2012, just 3.7 percent of SONYMA's single-family borrowers were 60 or more days delinquent, compared with 10.9 percent of all borrowers. Data from the Pennsylvania Housing Finance Agency show that for the third quarter of 2012, its conventional loans had 90-plus day delinquency and foreclosure rates of 2.98 percent and .99 percent, respectively, which are well below the equivalent rates for all conventional loans in the State of Pennsylvania. Data from the Massachusetts Housing Partnership's SoftSecond Program show that the foreclosure rate for program loans is substantially lower than the rate for prime loans in the State of Massachusetts (0.87 percent for SoftSecond loans as compared to 1.72 percent for prime loans). FHA-insured loans purchased by the Connecticut Housing Finance Agency have lower foreclosure rates than comparable FHA loans in the northeast, and loans financed by the Delaware State Housing Authority and serviced by U.S. Bank have a 60 days or more delinquency rate of just over 2 percent, compared with a national 60 days or more rate of 8.3 percent. Finally, Virginia Housing Development Authority loan foreclosure rates on FHA and conventional loans both fall under 1 percent. This is 3.2 percentage points under the national FHA foreclosure rate and 2.5 percentage points lower than the national foreclosure rate for conventional loans in New York State, according to the Mortgage Bankers Association. Prior to the recent mortgage crisis, SONYMA's 60-plus day default rate had never exceeded 2 percent.

distressed borrowers as intended. Commenters generally stated that requiring HFAs to comply with the ability-to-repay requirements would be unduly burdensome and would have a negative impact on their ability to offer consumers loan products that fit their unique needs, thereby endangering the viability and effectiveness of these programs. Commenters also argued that HFAs, which are governmental entities chartered by either a State or a municipality and are taxpayer-supported, may not have sufficient resources to implement and comply with the ability-to-repay requirements. According to commenters, some HFAs may respond to the burden by severely curtailing the credit offered under these programs and others may divert resources from lending to compliance, which may also reduce access to credit for LMI consumers.

Commenters noted that, because most HFAs operate in partnership with private creditors who participate voluntarily in HFA programs, the Bureau’s proposed HFA exemption would help encourage eligible creditors to continue making loans that might not otherwise be originated due to constraints under, or concerns about, the Bureau’s ability-to-repay requirements. Commenters argued that the ability-to-repay requirements would impose significant implementation and compliance burdens on participating private creditors, and this would likely discourage creditors from participating in HFA programs and would result in the denial of mortgage credit to LMI consumers.

A number of industry commenters argued that the proposed exemption from the ability-to-repay requirements is in the best interests of consumers and the nation as a whole, as the exemption will allow homeowners to remain in their homes and help stabilize communities that were harmed by the mortgage crisis and limit the degree to which future LMI consumers have difficulty obtaining access to credit. Creditors also generally supported clarifying that the exemption applies regardless of whether the credit is extended directly by an HFA to the consumer or through an intermediary that is operating pursuant to a program administered by an HFA, and to include all HFA programs regardless of structure (*e.g.*, mortgage revenue bonds or mortgage credit certificates).

The Final Rule

Based on these comments and considerations, the Bureau believes that it is appropriate to exempt credit extended pursuant to an HFA program from the ability-to-repay requirements. The comments received confirm that HFA programs generally employ underwriting requirements that are uniquely tailored to meet the needs of LMI consumers, such that applying the more generalized statutory ability-to-repay requirements would provide little or no net benefit to consumers and instead could be unnecessarily burdensome by diverting the focus of HFAs and their private creditor partners from mission activities to managing compliance and legal risk from two overlapping sets of underwriting requirements. The Bureau is concerned that absent an exemption, this diversion of resources would significantly reduce access to responsible mortgage credit for many LMI borrowers.

As discussed above in part II.A, many HFAs expand on the underwriting standards of GSEs or Federal government agencies by applying even stricter underwriting standards than these guidelines, such as requiring mandatory counseling for all first-time homebuyers and strong loan servicing. As HFAs extend credit to promote long-term housing stability, rather than for profit, HFAs generally extend credit after performing a complex and lengthy analysis of a consumer's ability to repay. As also discussed above in part II.A, the Bureau finds that, as compared to traditional underwriting criteria, under which LMI borrowers may be less likely to qualify for credit, the underwriting standards of some HFAs allow greater weight for (and sometimes require) the consideration of nontraditional underwriting elements, extenuating circumstances, and other subjective compensating factors that are indicative of responsible homeownership. The Bureau notes, however, that HFAs do conduct regular and careful oversight of their lenders, helping ensure that they follow the HFAs' strict underwriting standards.

The Bureau is concerned that HFAs, which are governmental entities and taxpayer-supported, may not have sufficient resources to implement and comply with the ability-to-repay requirements, or that the additional compliance burdens would at least significantly reduce the resources available to HFAs for the purpose of providing homeowner assistance. As discussed above in part II.A, many of the State and Federal programs that HFAs administer do not provide administrative funds; others provide limited administrative funds. Most HFAs operate independently and do not receive State operating funds. Consequently, HFAs may not have enough resources to increase compliance efforts without negatively impacting their missions. In the absence of an exemption from the ability-to-repay requirements, HFAs would have to dedicate substantially more time and resources to ensure their programs and lending partners are in compliance.

Moreover, because many HFAs must conduct their programs through partnerships with private creditors, the Bureau is concerned that absent an exemption private creditor volunteers would determine that complying with both the ability-to-repay requirements and the specialized HFA program requirements is too burdensome or the liability risks too great. For example, needing to comply with both the HFA underwriting requirements that often account for (and sometimes require the consideration of) nontraditional underwriting criteria, extenuating circumstances, and compensating factors, as discussed above in part II.A, and the ability-to-repay requirements may cause some private creditors to cease participation in such programs. This too would reduce access to mortgage credit to LMI consumers.

With respect to the comment suggesting that a better approach would be to allow HFAs to establish their own ability-to-repay and qualified mortgage guidelines, the Bureau notes that Congress has the authority to determine which agencies and programs have the authority under TILA to prescribe rules related to the ability-to-repay requirements or the definition of qualified mortgage. The Bureau is mindful that Congress has not authorized HFAs to prescribe rules related to the ability-to-repay requirements or the definition of qualified mortgage.

Regarding the comment favoring the creation of special ability-to-repay requirements tailored to the unique underwriting characteristics of LMI consumers, the Bureau does not believe it is appropriate to establish alternative conditions. HFA programs have strong but flexible ability-to-repay requirements tailored to the unique needs and credit characteristics of the LMI consumers they serve. The Bureau is concerned that imposing uniform alternative requirements by regulation would curtail this flexibility and ultimately reduce access to responsible and affordable credit for this population.

No commenters addressed whether credit extended pursuant to a program administered by an HFA should be granted a presumption of compliance as qualified mortgages, and, if so, under what conditions. However, the Bureau does not believe that extending qualified mortgage status to these loans would be as effective in addressing the concerns raised above as an exemption. Even if credit extended under the HFA programs were granted a presumption of compliance as qualified mortgages, HFA programs could be impacted by significant implementation and compliance burdens. Furthermore, as discussed above, many loans extended under these programs would not appear to satisfy the qualified mortgage standards under

§ 1026.43(e)(2). Thus, a creditor extending such a mortgage loan would still be required to comply with the ability-to-repay requirements of § 1026.43(c) and the potential liability of noncompliance would cease or severely curtail mortgage lending.

The Bureau received a number of comments completely opposed to the proposed exemptions from the ability-to-repay requirements on the grounds that the rules should apply equally to all creditors. However, pursuant to section 105(a) of TILA, the Bureau generally may prescribe regulations that provide for such adjustments and exceptions for all or any class of transactions that the Bureau judges are necessary or proper to effectuate the purposes of TILA, among other things. In addition, pursuant to TILA section 105(f) the Bureau may exempt by regulation from all or part of this title all or any class of transactions for which in the determination of the Bureau coverage does not provide a meaningful benefit to consumers in the form of useful information or protection, if certain conditions specified in that section are met. For the reasons discussed in each relevant section, the Bureau believes that the exemptions adopted in this final rule are necessary and proper to effectuate the purposes of TILA, which include purposes of section 129C, by ensuring that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay. Furthermore, without the exemptions the Bureau believes that consumers in these demographics are at risk of being denied access to the responsible, affordable credit offered under these programs, which is contrary to the purposes of TILA.

Accordingly, the Bureau believes that the proposed exemption for credit made pursuant to programs administered by an HFA is appropriate under the circumstances. The Bureau believes that consumers who receive extensions of credit made pursuant to a program administered by an HFA do so after a determination of ability to repay using specially tailored criteria. The exemption adopted by the Bureau is limited to creditors or transactions with certain characteristics and qualifications that ensure consumers are offered responsible, affordable credit on reasonably repayable terms. The Bureau thus finds that coverage under the ability-to-repay requirements provides little if any meaningful benefit to consumers in the form of useful protection, given the nature of the credit extended through HFAs. At the same time, the Bureau is concerned that the narrow class of creditors subject to the exemption may either cease or severely curtail mortgage lending if the ability-to-repay requirements are applied to their transactions, resulting in a denial of access to credit. Accordingly, the Bureau is adopting § 1026.43(a)(3)(iv) as proposed, which provides that an extension of credit made pursuant to a program administered by an HFA, as defined under 24 CFR 266.5, is exempt from § 1026.43(c) through (f).

The Bureau is adopting new comment 43(a)(3)(iv)-1 to provide additional clarification which will facilitate compliance. As discussed above, the Bureau understands that most HFA programs are “mortgage purchase” programs in which the HFA establishes program requirements (*e.g.,* income limits, purchase price limits, interest rates, points and term limits, underwriting standards, etc.), and agrees to purchase loans made by private creditors that meet these requirements. As a result, the success of these programs in large part depends upon the participation of private creditors. The Bureau intended the exemption to apply to both extensions of credit by HFAs and extensions of credit by private creditors under a mortgage purchase or similar HFA program. The comment clarifies that both extensions of credit made by HFAs directly to consumers as well as extensions of credit made by other creditors pursuant to a program administered by an HFA are exempt from the requirements of § 1026.43(c) through (f). In addition, as discussed above in part II.A, the Bureau understands that HFAs are generally funded through tax-exempt bonds (also known as mortgage revenue bonds), but may receive other types of funding, including funding through Federal programs such as the HOME Program, which is the largest Federal block grant for affordable housing. The Bureau intended the exemption to apply to extensions of credit made pursuant to a program administered by an HFA, regardless of the funding source. The comment clarifies that the creditor is exempt from the requirements of § 1026.43(c) through (f) regardless of whether the program administered by an HFA receives funding from Federal, State, or other sources.

Section 1026.43(a)(3)(iv) is adopted pursuant to the Bureau's authority under section 105(a) and (f) of TILA. Pursuant to section 105(a) of TILA, the Bureau generally may prescribe regulations that provide for such adjustments and exceptions for all or any class of transactions that the Bureau judges are necessary or proper to effectuate the purposes of TILA, among other things. For the reasons discussed in more detail above, the Bureau believes that this exemption is necessary and proper to effectuate the purposes of TILA, which include purposes of section 129C, by ensuring that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay. The Bureau believes that mortgage loans originated pursuant to programs administered by HFAs sufficiently account for a consumer's ability to repay, and the exemption ensures that consumers are able to receive assistance under these programs. Furthermore, without the exemption the Bureau believes that consumers in this demographic are at risk of being denied access to the responsible, affordable credit offered under these programs, which is contrary to the purposes of TILA. This exemption is consistent with the findings of TILA section 129C by ensuring that consumers are able to obtain responsible, affordable credit from the creditors discussed above.

The Bureau has considered the factors in TILA section 105(f) and believes that, for the reasons discussed above, an exemption is appropriate under that provision. Pursuant to TILA section 105(f) the Bureau may exempt by regulation from all or part of this title all or any class of transactions for which in the determination of the Bureau coverage does not provide a meaningful benefit to consumers in the form of useful information or protection. In determining which classes of transactions to exempt the Bureau must consider certain statutory factors. For the reasons discussed above, the Bureau exempts an extension of credit made pursuant to a program administered by an HFA because coverage under the ability-to-repay regulations does not provide a meaningful benefit to consumers in the form of useful protection in light of the nature of the credit extended through HFAs. Consistent with its rationale in the proposed rule, the Bureau believes that the exemption is appropriate for all affected consumers to which the exemption would apply, regardless of their other financial arrangements, financial sophistication, or the importance of the loan to them. Similarly, the Bureau believes that the exemption is appropriate for all affected loans covered under the exemption, regardless of the amount of the loan and whether the loan is secured by the principal residence of the consumer. Furthermore, the Bureau believes that, on balance, the exemption will simplify the credit process without undermining the goal of consumer protection, denying important benefits to consumers, or increasing the expense of the credit process. Based on these considerations and the analysis discussed elsewhere in this final rule, the Bureau believes that the exemptions are appropriate. Therefore all credit extended through the Housing Finance Agencies is subject to the exemption.

43(a)(3)(v)

Background

As discussed above, neither TILA nor Regulation Z provides an exemption to the ability-to-repay requirements for creditors, such as nonprofits, that primarily engage in community development lending. However, feedback provided to the Bureau suggested that the ability-to-repay requirements might impose an unsustainable burden on certain creditors offering mortgage loan programs for LMI consumers. The Bureau was concerned that these creditors would not have the resources to implement and comply with the ability-to-repay requirements, and would have ceased or severely limited extending credit to LMI consumers, which would result in the unavailability of responsible, affordable mortgage credit. Accordingly, the Bureau proposed several exemptions intended to ensure that responsible, affordable mortgage credit remained available for LMI consumers.

Credit Extended by CDFIs, CHDOs, and DAPs

The Bureau's proposal. The Bureau proposed to exempt from the ability-to-repay requirements several types of creditors that focus on extending credit to LMI consumers. Proposed § 1026.43(a)(3)(v)(A) would have exempted an extension of credit made by a creditor designated as a Community Development Financial Institution (CDFI), as defined under 12 CFR 1805.104(h). Proposed § 1026.43(a)(3)(v)(B) would have exempted an extension of credit made by a creditor designated as a Downpayment Assistance Provider of Secondary Financing (DAP) operating in accordance with regulations prescribed by the U.S. Department of Housing and Urban Development applicable to such persons. Proposed § 1026.43(a)(3)(v)(C) would have exempted an extension of credit made by a creditor designated as a Community Housing Development Organization (CHDO), as defined under 24 CFR 92.2, operating in accordance with regulations prescribed by the U.S. Department of Housing and Urban Development applicable to such persons. The Bureau requested feedback regarding whether the requirements imposed in connection with obtaining and maintaining these designations were sufficient to ensure that such creditors provide consumers with responsible and affordable credit, and regarding whether unscrupulous or irresponsible creditors would be able to use these designations to evade the requirements of TILA, extend credit without regard to the consumer's ability to repay, or otherwise harm consumers.

Comments received. The Bureau received many comments addressing the proposed exemptions for creditors designated as a CDFI, CHDO, or DAP. A large number of industry commenters completely opposed the proposed exemptions. These commenters generally argued that the rules should apply equally to all creditors. However, many industry and consumer advocate commenters supported the proposed exemptions. Twenty-five commenters supported the proposed exemption for creditors designated as CDFIs. Also, in response to the Bureau's request for feedback, several commenters provided data related to CDFI underwriting requirements and loan performance. Some commenters specifically discussed and supported the proposed exemption for CHDOs. While several commenters supported the proposed exemption for DAPs, the Bureau received no specific feedback related to these creditors. A few commenters asked the Bureau to consider exemptions for other types of designations or lending programs. For example, a few commenters requested that the Bureau provide a similar exemption for creditors that are chartered members of the NeighborWorks Network, while other commenters requested an exemption for creditors approved as Counseling Intermediaries by HUD.

The Bureau received feedback from several industry commenters requesting that the Bureau provide an exemption for credit unions designated as low-income credit unions (LICUs) by the National Credit Union Administration (NCUA). These commenters explained that the

NCUA's LICU designation is similar to the Treasury Department's CDFI designation. However, these commenters stated that most credit unions choose to obtain the LICU designation instead of the CDFI designation. Some commenters suggested that many credit unions are not eligible for CDFI status.

The final rule. The Bureau is adopting the exemptions in a form that is substantially similar to the version proposed. For the reasons discussed below, the Bureau has concluded that a creditor designated as a CDFI or DAP should be exempt from the ability-to-repay requirements, provided these creditors meet certain other applicable requirements. As comments confirmed, creditors seeking these designations must undergo a screening process related to the ability of applicants to provide affordable, responsible credit to obtain the designation and must operate in accordance with the requirements of these programs, including periodic recertification.[140] Comments provided to the Bureau also confirmed that the ability-to-repay requirements generally differ from the unique underwriting criteria which are related to the characteristics of the consumers served by these creditors. The ability-to-repay requirements primarily consist of quantitative underwriting considerations, such as an analysis of the consumer's debt-to-income ratio. In contrast, as discussed in part II.A above, the Bureau understands that creditors with these designations typically engage in a lengthy underwriting process that is specifically tailored to the needs of these consumers by incorporating a variety of compensating factors. Also, although market-wide data is not available for the delinquency rates of credit extended by CHDOs, comments provided to the Bureau related to CDFI loan performance reflect the low default levels associated with these creditors' programs, which

[140] 24 CFR 200.194(d) provides that HUD certification as an approved nonprofit expires after two years, and nonprofits must reapply for approval prior to the expiration of the two year period. Also, on February 4, 2013 the CDFI Fund required recertification of most CDFIs. *See* http://www.cdfifund.gov/news_events/CDFI-2013-06-CDFI_Fund_Releases_Mandatory_Recertification_Guidelines_for_CDFIs.asp.

strongly suggest that consumers are extended credit on reasonably repayable terms. Finally, commenters confirmed that these creditors serve consumers that have difficulty obtaining responsible and affordable credit, and that the burdens imposed by the ability-to-repay requirements would significantly impair the ability of these creditors to continue serving this market. Taken together, this feedback demonstrates that creditors with these designations provide residential mortgage loans on reasonably repayable terms, that these exemptions are necessary and proper to ensure that responsible, affordable mortgage credit remains available to consumers served by these creditors, and that the government approval and oversight associated with these designations ensures that there is little risk that consumers would be subject to abusive lending practices. Thus, the Bureau has determined that it is appropriate to adopt § 1026.43(a)(3)(v)(A) and (B) as proposed.

The Bureau has also concluded that a creditor designated as a CHDO should be exempt from the ability-to-repay requirements. Comments illustrated that, like CDFIs and DAPs, CHDOs generally extend credit on reasonably repayable terms and ensure that LMI consumers have access to responsible, affordable mortgage credit. However, HUD provided comments to the Bureau suggesting that the exemption be narrowed. A person may obtain a CHDO designation for reasons unrelated to residential mortgage lending, such as to acquire tax credits to assist in the development of affordable rental properties. The Bureau believes that it is appropriate to narrow the exemption to only those persons that obtain the CHDO designation for purposes of residential mortgage lending. A person seeking CHDO status to engage in residential mortgage lending must enter into a commitment with the participating jurisdiction developing the project under the HOME Program. The Bureau also believes that providing specific citations to the relevant regulations prescribed by HUD would facilitate compliance.

Thus, the Bureau is adopting § 1026.43(a)(3)(v)(C) with language similar to that proposed, but with the additional condition that the creditor designated as a CHDO has entered into a commitment with a participating jurisdiction and is undertaking a project under the HOME Program, pursuant to the provisions of 24 CFR 92.300(a), and as the terms community housing development organization, commitment, participating jurisdiction, and project are defined under 24 CFR 92.2.

The Bureau acknowledges that creditors with other types of designations also provide valuable homeownership assistance to certain types of consumers or communities. However, the Bureau does not believe that it would be appropriate to provide exemptions for the designations suggested by commenters. For example, while Counseling Intermediaries must be approved by HUD, this approval is not related to the ability of an applicant to provide consumers with responsible and affordable mortgage credit. Furthermore, the Bureau is unaware of evidence suggesting that approval as a Counseling Intermediary is sufficient to ensure that consumers are offered and receive residential mortgage loans on reasonably repayable terms. With respect to the feedback suggesting that the Bureau consider providing an exemption for creditors that are chartered members of the NeighborWorks Network, the Bureau acknowledges that these creditors are also subject to government oversight and seem to provide responsible and affordable mortgage credit. However, the Bureau does not believe that providing an exemption to these creditors would be necessary to ensure access to responsible and affordable credit, as many of these creditors would qualify for one of the exemptions adopted in § 1026.43(a)(3)(v)(A) through (D). Therefore, the Bureau declines to adopt exemptions for the other designations or lending programs suggested by commenters.

In response to feedback provided regarding creditors designated as low-income credit unions, the Bureau conducted additional research and analysis to determine whether an exemption for these creditors would be appropriate. LICUs, like CDFIs, provide credit to low-income consumers. However, NCUA regulations require LICUs to serve only "predominantly" low-income consumers, thereby permitting LICUs to extend credit to many consumers with higher incomes.[141] Thus, such an exemption would be too broad and would affect consumers for whom access to credit is not a concern. In addition, the Bureau believes that the small creditor portfolio qualified mortgage loan provisions adopted in § 1026.43(e)(5) will address the concerns raised by commenters and accommodate the needs of small creditors, such as LICUs, while providing consumers with valuable protections. Therefore, the Bureau does not believe that it would be appropriate to provide an exemption for creditors with an LICU designation.

Credit Extended by Certain Nonprofits

The Bureau's proposal. Proposed § 1026.43(a)(3)(v)(D) would have exempted an extension of credit made by a creditor with a tax exemption ruling or determination letter from the Internal Revenue Service under section 501(c)(3) of the Internal Revenue Code of 1986 (26 CFR 1.501(c)(3)-1), provided that certain other conditions were satisfied. Under proposed § 1026.43(a)(3)(iv)(D)(*1*), the exemption would have been available only if the creditor extended credit secured by a dwelling no more than 100 times in the calendar year preceding receipt of the consumer's application. Proposed § 1026.43(a)(3)(v)(D)(*2*) would have further conditioned the exemption on the creditor, in the calendar year preceding receipt of the consumer's application, extending credit secured by a dwelling only to consumers with income that did not exceed the qualifying limit for moderate-income families, as established pursuant to section 8 of the United States Housing Act of 1937 and amended from time to time by the U.S. Department of Housing

[141] "The term *predominantly* is defined as a simple majority." 12 CFR 701.34(a)(3).

and Urban Development. Proposed § 1026.43(a)(3)(v)(D)(*3*) would have made the proposed exemption available only if the extension of credit was to a consumer with income that did not exceed this qualifying limit. Finally, proposed § 1026.43(a)(3)(v)(D)(*4*) would have made the proposed exemption contingent upon the creditor determining, in accordance with written procedures, that the consumer had a reasonable ability to repay the extension of credit.

Proposed comment 43(a)(3)(v)(D)-1 would have clarified that an extension of credit is exempt from the requirements of § 1026.43(c) through (f) if the credit is extended by a creditor described in § 1026.43(a)(3)(v)(D), provided the conditions specified in that section are satisfied. The conditions specified in § 1026.43(a)(3)(v)(D)(*1*) and (*2*) are determined according to activity that occurred in the calendar year preceding the calendar year in which the consumer's application was received. Section 1026.43(a)(3)(v)(D)(*2*) provides that, during the preceding calendar year, the creditor must have extended credit only to consumers with income that did not exceed the qualifying limit then in effect for moderate-income families, as specified in regulations prescribed by HUD pursuant to section 8 of the United States Housing Act of 1937. For example, a creditor has satisfied the requirements of § 1026.43(a)(3)(v)(D)(*2*) if the creditor demonstrates that the creditor extended credit only to consumers with income that did not exceed the qualifying limit in effect on the dates the creditor received each consumer's individual application. The condition specified in § 1026.43(a)(3)(v)(D)(*3*), which relates to the current extension of credit, provides that the extension of credit must be to a consumer with income that does not exceed the qualifying limit specified in § 1026.43(a)(3)(v)(D)(*2*) in effect on the date the creditor received the consumer's application. For example, assume that a creditor with a tax exemption ruling under section 501(c)(3) of the Internal Revenue Code of 1986 has satisfied the conditions identified in § 1026.43(a)(3)(v)(D)(*1*) and (*2*). If, on May 21, 2014, the creditor in this example extends credit secured by a dwelling to a consumer whose application reflected income in excess of the qualifying limit identified in § 1026.43(a)(3)(v)(D)(*2*), the creditor has not satisfied the condition in § 1026.43(a)(3)(v)(D)(*3*) and this extension of credit is not exempt from the requirements of § 1026.43(c) through (f).

The Bureau solicited comment regarding whether the proposed exemption was appropriate. The Bureau also specifically requested feedback on whether the proposed 100 transaction limitation was appropriate, on the costs of implementing and complying with the ability-to-repay requirements that would be incurred by creditors that extend credit secured by a dwelling more than 100 times a year, the extent to which this proposed condition would affect access to responsible, affordable credit, and whether the limit of 100 transactions per year should be increased or decreased. The Bureau also requested comment regarding the costs that nonprofit creditors would incur in connection with the ability-to-repay requirements, the extent to which these additional costs would affect the ability of nonprofit creditors to extend credit to LMI consumers, and whether consumers could be harmed by the proposed exemption. The Bureau solicited comment regarding whether the proposed exemption should be extended to creditors designated as nonprofits under section 501(c)(4) of the Internal Revenue Code of 1986. The Bureau also requested financial reports and mortgage lending activity data supporting the argument that the marginal cost of implementing and complying with the ability-to-repay requirements would cause 501(c)(4) nonprofit creditors to cease, or severely limit, extending credit to LMI consumers.

Comments received. The Bureau received many comments addressing this proposed exemption. Many commenters completely opposed the proposed exemption for community-focused creditors. These commenters generally argued that the rules should apply equally to all creditors. One industry commenter argued that a better approach would be to create special ability-to-repay requirements tailored to the unique underwriting characteristics of LMI consumers. Many other commenters approved of the proposed exemption, including the Bureau's proposed conditions. Several commenters stated that an exemption for certain nonprofits was necessary, but requested various modifications. Most of the commenters that approved of the proposed exemption were concerned that the exemption could be used as a loophole to harm consumers and agreed that conditions were needed to address this potential risk.

Many commenters, including industry, consumer advocate, and nonprofit commenters, explicitly supported the proposed limitation of 100 extensions of credit. These commenters generally explained that the 100-extension limitation was an appropriate limit that would make it difficult for sham nonprofit creditors to harm consumers. However, several commenters asked the Bureau to raise the transaction limitation. The commenters were primarily concerned that the limitation would force nonprofits to limit certain types lending. For example, a few commenters stated that nonprofits that offer both home-purchase mortgage loans and small-dollar mortgage loans, such as for home energy improvement, would limit small-dollar lending to remain under the 100-extension limitation. One nonprofit commenter argued that, for creditors that provide first- and subordinate-lien financing to LMI consumers on the same transaction, the 100-extension limit is effectively a 50-transaction limit. Another nonprofit commenter suggested that the Bureau either apply the 100-extension limit to first-lien mortgage loans, or raise the limit to 500 for total transactions. One consumer advocate commenter suggested raising the limit to 250 transactions per calendar year to address these concerns. A few commenters asked that the Bureau remove the limitation completely. For example, one commenter argued that the Bureau's proposed limit of 100 extensions of credit would harm LMI consumers by raising the cost of credit obtained from larger-scale nonprofit organizations.

One commenter argued that the proposed exemption was too narrow and urged the Bureau to expand the exemption in several ways. First, this commenter argued that the exemption should not be limited to extensions of credit by creditors, but rather should be extended to all transactions in which a nonprofit organization dedicated to providing opportunities for affordable, long-term homeownership is involved, but is not the creditor. This commenter also asked the Bureau to provide no-action letters that would provide a safe harbor for certain mortgage lending programs. In addition, this commenter argued that the proposed references to the low- to moderate-income threshold under section 8 of the National Housing Act was inappropriate because use of the threshold would result in the denial of credit to consumers with income slightly above the threshold. Furthermore, this commenter asserted that it would be arbitrary and unjustified for the Bureau to extend an exemption to State HFAs but not provide an exemption to organizations that rely on underwriting criteria similar to those used by State HFAs, such as the consideration of a consumer’s life circumstances. Finally, this commenter disputed the Bureau’s justification for the proposed exemptions—that access to credit for LMI consumers would be impaired if certain creditors did not have the resources to implement and comply with the ability-to-repay requirements and ceased or severely limited extending credit—by arguing that LMI consumers are harmed when any creditor, regardless of size, spends money on regulatory compliance that would otherwise have been lent to LMI consumers.

One consumer advocate group opposed providing an exemption for nonprofit creditors and instead suggested several modifications to the ability-to-repay requirements intended to address the Bureau’s concerns regarding nonprofits. This commenter argued that, rather than providing an exemption for the proposed categories of nonprofit creditor, the Bureau should provide a rebuttable presumption of compliance for these nonprofit creditors, without requiring the nonprofits to satisfy the requirements of § 1026.43(c) through (f). Also, this commenter argued, these provisions should apply to only bona fide nonprofits, so that consumers would be provided legal recourse against unscrupulous creditors operating sham nonprofits. Further, this commenter suggested that the Bureau should expand the anti-evasion provisions of § 1026.43(h) to include the adoption of nonprofit status for purposes of avoiding the ability-to-repay requirements. This commenter argued that such modifications would provide genuine nonprofits with relief from the regulatory and compliance burdens associated with the ability-to-repay requirements, while enabling consumers to seek recourse against abusive, sham nonprofits.

The Bureau did not receive feedback regarding whether the proposed exemption should be extended to creditors designated as nonprofits under section 501(c)(4) of the Internal Revenue Code of 1986. However, several credit unions and State credit union associations requested that the Bureau expand the nonprofit exemption to all credit unions, as credit unions are designated as nonprofits under sections 501(c)(1) and 501(c)(14) of the Internal Revenue Code of 1986. These commenters generally explained that credit unions, like the nonprofit creditors addressed in the Bureau's proposal, are often small businesses that have difficulty complying with regulatory burdens. Industry commenters also requested an exemption for certain creditors that extend credit to LMI consumers, or for certain programs intended to facilitate access to credit for LMI consumers. For example, some commenters argued that the Bureau should provide an exemption for credit unions operating in certain areas, such as areas defined as "underserved" under the Federal Credit Union Act, while others argued that the Bureau should provide an exemption for loans that meet the regulatory requirements of the Community Reinvestment Act or similar programs. These commenters generally argued that such an exemption would facilitate access to credit for LMI consumers by minimizing the regulatory burdens imposed by the ability-to-repay requirements.

A few industry and consumer advocate commenters asked the Bureau to establish a publicly accessible database of all nonprofits that qualified for the exemption. These commenters argued that such a database would facilitate compliance and allow consumers to determine if nonprofit creditors were actually exempt from the requirements. A State attorney general expressed concern about potential abuse and asked the Bureau to consider vigorous oversight of nonprofits eligible for the exemption.

The final rule. The Bureau is adopting § 1026.43(a)(3)(v)(D) in a form that is substantially similar to the version proposed, except that the Bureau is increasing the annual originations limit from 100 to 200 extensions of credit. For the reasons discussed below, the Bureau has concluded that the exemption should apply provided that, in additional to the annual originations limit: (1) the creditor is designated as a nonprofit organization under section 501(c)(3) of the Internal Revenue Code; (2) the extension of credit is to a consumer with income that does not exceed the limit for low- and moderate-income households as established pursuant regulations prescribed by the U.S. Department of Housing and Urban Development; (3) during the calendar year preceding receipt of the consumer's application the creditor extended credit only to consumers with income that did not exceed the above limit; and (4) the creditor determines, in accordance with written procedures, that the consumer has a reasonable ability to repay the extension of credit. Comments provided to the Bureau generally confirmed that these conditions were reasonable and appropriate measures to ensure that the exemption would not be used as a loophole to avoid the ability-to-repay requirements. Thus, the Bureau has determined that it is appropriate to adopt § 1026.43(a)(3)(v)(D)(*2*), (*3*), and (*4*) generally as proposed, but with technical modifications to paragraphs (a)(3)(v)(D)(*2*) and (*3*), as discussed below.

However, upon further consideration of the comments received, the Bureau has determined that it is appropriate to raise the threshold in proposed § 1026.43(a)(3)(v)(D)(*1*) from 100 to 200 extensions of credit. Most commenters agreed with the rationale advanced in the 2013 ATR Proposed Rule that a limitation is necessary to prevent the exemption from being exploited by unscrupulous creditors seeking to harm consumers. The Bureau strongly believes that this risk outweighs the costs that a limitation may impose on some nonprofit creditors. While many commenters approved of the proposed 100-extension limitation, the Bureau is concerned that this limitation could lead to unintended consequences. The Bureau is particularly concerned that nonprofit creditors providing primary and subordinate financing on the same transaction effectively would be limited to 50 transactions per year. The Bureau did not intend to propose such a strict limitation. The Bureau has concluded that a 200-extension limitation, doubling the 100-extension limit to capture creditors making first- and subordinate-lien loans on the same transaction, would address the concerns raised by commenters while achieving the original intent of the proposed condition. The Bureau does not agree with the suggestions proposed by some commenters that separate limits for first- and subordinate-lien loans should be implemented. The Bureau believes that such a restriction would be needlessly restrictive, and it would be more efficient to allow nonprofit creditors to determine the most efficient allocation of funds between primary and subordinate financing. Furthermore, the Bureau does not agree with the arguments raised by commenters that the threshold should be raised above 200, such as to 500 transactions. As explained in the 2013 ATR Proposed Rule, the Bureau intended to narrowly tailor the exemption to small nonprofits that did not have the resources to bear the burdens associated with the ability-to-repay requirements, and solicited feedback regarding whether a 100 extension of credit limit was indicative of such a resource limitation.[142] While feedback indicated that a 200-extension limitation would more appropriately address the Bureau's intentions, the Bureau received no feedback indicating that nonprofit creditors making more than 200 extensions of credit lacked the resources to implement and comply with the ability-to-repay requirements. The Bureau believes that creditors originating such a number of mortgage loans likely have the resources to bear the implementation and compliance burden associated with the ability-to-repay requirements, unlike smaller nonprofit creditors that make fewer loans. Therefore, as adopted, § 1026.43(a)(3)(v)(D)(*1*) conditions the exemption from the ability-to-repay requirements on the creditor extending credit secured by a dwelling no more than 200 times during the calendar year preceding receipt of the consumer's application.

As discussed above, one commenter argued that the Bureau should limit the exemption to bona fide nonprofit creditors. Adding a bona fide nonprofit condition would provide another avenue for consumers to seek redress against harmful lending practices, which may deter persons from using the exemption as a loophole. However, the Bureau believes that the requirements of § 1026.43(a)(3)(v)(D) are narrowly tailored to protect consumers and limit the risk that an unscrupulous creditor could create a nonprofit for the purpose of extending credit in a harmful, reckless, or abusive manner. Therefore, the Bureau declines to adopt an additional bona fide nonprofit requirement at this time. As with the other exemptions to the ability-to-repay requirements, the Bureau will monitor the mortgage market and may reevaluate this issue if circumstances warrant reconsideration.

As discussed above, one commenter suggested that the Bureau adopt a qualified mortgage definition with a rebuttable presumption of compliance instead of an exemption to the

[142] *See* 78 FR 6644 (Jan. 30, 2013).

ability-to-repay requirements. The Bureau does not believe it is necessary to adopt a qualified mortgage definition for nonprofit creditors meeting the conditions of § 1026.43(a)(3)(v)(D). The Bureau believes that an exemption is a more effective method of addressing the concerns discussed above. The Bureau believes that a rebuttable presumption would re-introduce the compliance burdens on certain nonprofits that the Bureau seeks to alleviate. Furthermore, the line between a safe harbor and a rebuttable presumption was determined based on pricing thresholds and providing a rebuttable presumption based on other criteria is inconsistent with the approach taken in the 2013 ATR Final Rule. Nor does the Bureau believe that modifying the anti-evasion provisions of § 1026.43(h) is necessary. Either approach would increase regulatory complexity for these creditors, and may frustrate the goals the Bureau seeks to achieve in accommodating nonprofit creditors. The Bureau also has decided that it is inappropriate to provide no-action letters for certain creditors, as suggested by one commenter. For the reasons discussed in this section, the Bureau believes that the exemptions adopted in this final rule are the optimal approach for providing access to responsible, affordable credit while ensuring that consumers are offered and receive mortgage credit on reasonably repayable terms.

The Bureau has also determined that it is appropriate to limit the exemption to creditors designated as nonprofits under section 501(c)(3), but not 501(c)(4), of the Internal Revenue Code of 1986. The Bureau recognizes that these creditors also may be affected by the ability-to-repay requirements. However, the Bureau believes that this distinction is appropriate. As discussed in the 2013 ATR Proposed Rule, this exemption is premised on the belief that the additional costs imposed by the ability-to-repay requirements will force certain nonprofit creditors to cease extending credit, or substantially limit credit activities, thereby harming low- to moderate-income consumers.[143] The Bureau solicited comment regarding whether the exemption should be extended to creditors designated as nonprofits under section 501(c)(4) of the Internal Revenue Code of 1986. The Bureau also requested financial reports and mortgage lending activity data supporting the argument that the marginal cost of implementing and complying with the ability-to-repay requirements would cause 501(c)(4) nonprofit creditors to cease, or severely limit, extending credit to low- to moderate-income consumers. The Bureau received no comment in response to this request. Thus, the Bureau concludes that it is appropriate to limit the exemption to creditors designated as nonprofits under section 501(c)(3) of the Internal Revenue Code of 1986, and adopts § 1026.43(a)(3)(v)(D) as proposed.

As noted above, the Bureau received a comment suggesting that the exemption should not be limited to extensions of credit by a creditor but, rather, should be extended to other transactions in which a nonprofit organization that is dedicated to providing opportunities for affordable, long-term homeownership is involved, but is not the creditor. While the Bureau believes that such organizations provide valuable assistance to LMI consumers, the Bureau has determined that it would be inappropriate to extend the exemption in this manner. The exemptions adopted by the Bureau are limited to creditors or transactions where the Bureau believes that consumers are offered and receive residential mortgage loans on reasonably repayable terms. The proposed exemption involves creditors with certain characteristics that ensure consumers are offered responsible, affordable credit on reasonably repayable terms. In these narrow circumstances the Bureau has determined that there is little risk of harm to consumers. However, adopting the approach suggested in this comment effectively would expand the exemption to all creditors, as any creditor could involve such a nonprofit organization in some capacity during the origination process. Such a broad expansion would not be necessary

[143] *See* 78 FR 6645 (Jan. 30, 2013).

or proper to effectuate the purposes of TILA; to the contrary, it would instead exempt a potentially large number of creditors from the ability-to-repay requirements. The Bureau would not be able to determine if each potential creditor extended credit only on reasonably repayable terms and does not believe it would be appropriate to assume that any involvement by a nonprofit organization is sufficient to ensure that consumers were not harmed by the exemption. Therefore, the Bureau declines to extend the exemption to transactions involving nonprofit organizations that are dedicated to providing opportunities for affordable homeownership.

With respect to the comment disputing the Bureau's justification for the proposed exemptions, the Bureau believes that this criticism results from a misunderstanding of the Bureau's rationale for the proposed exemptions. As explained in the 2013 ATR Proposed Rule, the Bureau may provide an exemption to the ability-to-repay requirements if the statutory conditions for the use of such an exemption are met.[144] Providing an exemption for a particular class of creditors requires a careful balancing of considerations, including the nature of credit extended, safeguards or other factors that may protect consumers from harm, and the extent to which application of the regulatory requirements would affect access to responsible, affordable credit. As discussed in the Bureau's proposal, the Bureau was concerned about creditors that would be forced to cease or severely limit lending to LMI consumers.[145] Based on feedback provided in response to this question, the Bureau has adopted an exemption narrowly tailored to the situations where an exemption is necessary and proper.

The Bureau also disagrees with the arguments advanced that limiting the exemption to creditors extending credit to consumers with income below the qualifying limit for moderate income families as established pursuant to section 8 of the United States Housing Act of 1937 is

[144] *See* 78 FR 6635-36 (Jan. 30, 2013).
[145] *Id.* at 6643.

arbitrary. The Bureau acknowledges that there may be cases where a consumer with income slightly above the LMI threshold is unable to secure credit. However, most commenters agreed that these conditions helped ensure that the proposed exemption would not become a regulatory loophole by which consumers could be harmed. Thus, the Bureau believes that it is necessary to draw a line, and the section 8 income limitations are clear and well-known. Such an approach will facilitate compliance while ensuring that the exemption is narrowly tailored to address the consumers for whom access to credit is a concern. Therefore, the Bureau has concluded that it is appropriate to refer to these qualifying income limits. Furthermore, the Bureau intends to monitor these qualifying income limits in the future to ensure that the exemption remains narrowly tailored. The Bureau has determined that it is necessary to make a technical change to the proposed language. Although HUD's qualifying income limits are colloquially referred to as "section 8 limits," the thresholds were established by section 102 of the Housing and Community Development Act of 1974, which amended the National Housing Act of 1937. The Bureau believes that it is appropriate to identify the thresholds by the exact statutory and regulatory reference. Accordingly, the Bureau is adopting § 1026.43(a)(3)(v)(D)(*2*) and (*3*) generally as proposed, but with a technical modification that refers to the low- and moderate-income household limit as established pursuant to section 102 of the Housing and Community Development Act of 1974.

As discussed above, several commenters asked the Bureau to remain engaged with the nonprofit community to ensure that the exemption is not used as a loophole to harm consumers. For example, some commenters asked the Bureau to establish a database of creditors that qualify for the § 1026.43(a)(3)(v)(D) exemption. The Bureau intends to keep abreast of developments in the mortgage market, including lending programs offered by nonprofit creditors pursuant to this exemption. However, the Bureau does not believe that it is necessary to develop a formal oversight mechanism, such as a database of creditors eligible for this exemption, at this time. Instead, the Bureau will continue to collect information related to the effectiveness of the ability-to-repay requirements, including the § 1026.43(a)(3)(v)(D) exemption, and will pursue additional rulemakings or data collections if the Bureau determines in the future that such action is necessary.

The Bureau has also carefully considered the comments requesting a full or limited exemption from the ability-to-repay requirements for certain creditors or for certain programs intended to facilitate access to credit for LMI consumers. For example, as discussed above, several industry commenters argued that the Bureau should provide an exemption for all credit unions, which are designated as nonprofit organizations under sections 501(c)(1) and 501(c)(14) of the Internal Revenue Code of 1986. Other industry commenters argued that the Bureau should provide an exemption for credit unions operating in certain areas, such as areas defined as "underserved" under the Federal Credit Union Act. The Bureau agrees with the arguments advanced by commenters that credit unions were not the source of the financial crisis, have historically employed responsible underwriting requirements, and are often an important source of credit for LMI consumers. However, the Bureau does not believe that any of the requested exemptions for credit unions are necessary. The Bureau understands that many credit unions will qualify for the additional qualified mortgage definitions discussed below in the section-by-section analyses of § 1026.43(e)(5) and (e)(6). Also, given the thoroughness of the traditional underwriting methods employed by credit unions, the Bureau does not believe that larger credit unions will have difficulty complying with the general ability-to-repay requirements or qualified mortgage provisions. Further, absent evidence suggesting that the ability-to-repay requirements would force these credit unions to cease or severely curtail extending credit to LMI consumers, the Bureau does not believe that an exemption would be appropriate. For similar reasons, the Bureau declines to expand the exemption to loans that meet the regulatory requirements of the Community Reinvestment Act or similar programs. The Bureau is not persuaded that such an expansive exemption is necessary to ensure that LMI consumers have access to responsible, affordable credit.

To summarize, the Bureau has determined that an exemption to the ability-to-repay requirements is appropriate for certain nonprofit creditors. The Bureau has modified the proposed exemption in a manner that addressed the concerns raised by various commenters. As adopted, § 1026.43(a)(3)(v)(D) exempts an extension of credit made by a creditor with a tax exemption ruling or determination letter from the Internal Revenue Service under section 501(c)(3) of the Internal Revenue Code of 1986 (26 U.S.C. 501(c)(3); 26 CFR 1.501(c)(3)-1), provided that all of the conditions in § 1026.43(a)(3)(v)(D)(*1*) through (*4*) are satisfied. Section 1026.43(a)(3)(v)(D)(*1*) conditions the exemption on the requirement that, during the calendar year preceding receipt of the consumer's application, the creditor extended credit secured by a dwelling no more than 200 times. Section 1026.43(a)(3)(v)(D)(*2*) conditions the exemption on the requirement that, during the calendar year preceding receipt of the consumer's application, the creditor extended credit secured by a dwelling only to consumers with income that did not exceed the low- and moderate-income household limit as established pursuant to section 102 of the Housing and Community Development Act of 1974 (42 U.S.C. 5302(a)(20)) and amended from time to time by the U.S. Department of Housing and Urban Development, pursuant to 24 CFR 570.3. Section 1026.43(a)(3)(v)(D)(*3*) conditions the exemption on the requirement that the extension of credit is to a consumer with income that does not exceed the above limit. Section 1026.43(a)(3)(v)(D)(*4*) conditions the exemption on the requirement that the creditor determines, in accordance with written procedures, that the consumer has a reasonable ability to repay the extension of credit. The Bureau is also adopting comment 43(a)(3)(v)(D)-1 generally as proposed, but with technical modifications that reflect the appropriate references to HUD's low- and moderate-income household limit, as described above.

Legal Authority

Section 1026.43(a)(3)(v) is adopted pursuant to the Bureau's authority under section 105(a) and (f) of TILA. Pursuant to section 105(a) of TILA, the Bureau generally may prescribe regulations that provide for such adjustments and exceptions for all or any class of transactions that the Bureau judges are necessary and proper to effectuate the purposes of TILA, among other things. For the reasons discussed in more detail above, the Bureau has concluded that this exemption is necessary and proper to effectuate the purposes of TILA, which include the purposes of TILA section 129C. By ensuring the viability of the low- to moderate-income mortgage market, this exemption would ensure that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay. The Bureau also believes that mortgage loans originated by these creditors generally account for a consumer's ability to repay. Without the exemption the Bureau believes that low- to moderate-income consumers are at risk of being denied access to the responsible and affordable credit offered by these creditors, which is contrary to the purposes of TILA. This exemption is consistent with the finding of TILA section 129C by ensuring that consumers are able to obtain responsible, affordable credit from the nonprofit creditors discussed above which inform the Bureau's understanding of its purposes.

The Bureau has considered the factors in TILA section 105(f) and has concluded that, for the reasons discussed above, an exemption is appropriate under that provision. Pursuant to TILA section 105(f) the Bureau may exempt by regulation from all or part of this title all or any class of transactions for which in the determination of the Bureau coverage does not provide a meaningful benefit to consumers in the form of useful information or protection. In determining which classes of transactions to exempt, the Bureau must consider certain statutory factors. For the reasons discussed above, the Bureau exempts an extension of credit made by the creditors and under conditions provided in § 1026.43(a)(3)(v) because coverage under the ability-to-repay requirements does not provide a meaningful benefit to consumers in the form of useful protection in light of the protection the Bureau believes that the credit extended by these creditors already provides to consumers. Consistent with its rationale in the 2013 ATR Proposed Rule, the Bureau believes that the exemptions are appropriate for all affected consumers to which the exemption applies, regardless of their other financial arrangements and financial sophistication and the importance of the loan to them. Similarly, the Bureau believes that the exemptions are appropriate for all affected loans covered under the exemption, regardless of the amount of the loan and whether the loan is secured by the principal residence of the consumer. Furthermore, the Bureau believes that, on balance, the exemptions will simplify the credit process without undermining the goal of consumer protection, denying important benefits to consumers, or increasing the expense of the credit process. The Bureau recognizes that its exemption and exception authorities apply to a class of transactions, and has decided to apply these authorities to the loans covered under the final rule of the entities subject to the adopted exemptions.

43(a)(3)(vi)

The Bureau's Proposal

As discussed above, neither TILA nor Regulation Z provides an exemption to the ability-to-repay requirements for Federal programs designed to stabilize homeownership or mitigate the risks of foreclosure. However, the Bureau was concerned that the ability-to-repay requirements would inhibit the effectiveness of these Federal programs. As a result, the Bureau proposed § 1026.43(a)(3)(vi), which would have provided that an extension of credit made pursuant to a program authorized by sections 101 and 109 of the Emergency Economic Stabilization Act of 2008 (12 U.S.C. 5211; 5219) (EESA) is exempt from § 1026.43(c) through (f).

Proposed comment 43(a)(3)(vi)-1 would have explained that the requirements of § 1026.43(c) through (f) did not apply to a mortgage loan modification made in connection with a program authorized by sections 101 and 109 of EESA. If a creditor is underwriting an extension of credit that is a refinancing, as defined by § 1026.20(a), that will be made pursuant to a program authorized by sections 101 and 109 of the Emergency Economic Stabilization Act of 2008, the creditor also need not comply with § 1026.43(c) through (f). Thus, a creditor need not determine whether the mortgage loan modification is considered a refinancing under § 1026.20(a) for purposes of determining applicability of § 1026.43; if the transaction is made in connection with these programs, the requirements of § 1026.43(c) through (f) do not apply.

The Bureau solicited general feedback regarding whether this proposed exemption was appropriate. In particular, the Bureau sought comment regarding whether applicability of the ability-to-repay requirements would constrict the availability of credit offered under these programs and whether consumers have suffered financial loss or other harm by creditors participating in these programs. The Bureau also requested information on the extent to which the requirements of these Federal programs account for a consumer’s ability to repay. The Bureau also sought comment regarding whether, if the Bureau determined that a full exemption is not warranted, what modifications to the general ability-to-repay standards would be warranted and whether qualified mortgage status should be granted instead, and, if so, under what conditions.

Comments Received

The Bureau received several comments addressing this proposed exemption. One consumer advocate commenter opposed the exemption and stated that these programs lack meaningful underwriting guidance. Many industry and consumer advocate commenters supported the exemption. These commenters generally argued that the ability-to-repay requirements would make these programs unworkable, which would frustrate the public policy purposes of EESA and harm consumers in need of assistance. A few industry commenters requested that the Bureau provide an exemption for homeownership stabilization and foreclosure prevention programs, other than those authorized by sections 101 and 109 of EESA, such as a creditor's proprietary program intended to provide assistance to consumers who have experienced a loss of employment or other financial difficulty.

The Final Rule

The Bureau is adopting § 1026.43(a)(3)(vi) and comment 43(a)(3)(vi)-1 as proposed. For the reasons discussed below, the Bureau has determined that an exemption from the ability-to-repay requirements is necessary and appropriate for extensions of credit made pursuant to a program authorized by sections 101 and 109 of EESA. Commenters agreed with the Bureau that the ability-to-repay requirements would interfere with, or are inapplicable to, these programs, which are intended to address the unique underwriting requirements of certain consumers at risk of default or foreclosure. By significantly impairing the effectiveness of these programs, the Bureau believes that there is a considerable risk that the ability-to-repay requirements would actually prevent at-risk consumers from receiving mortgage credit provided in an affordable and responsible manner.

With respect to the feedback provided opposing this exemption, the Bureau believes that, based on the existence of Federal oversight and the EESA requirements, the risk of consumer harm is low. Additionally, as discussed in part II.A above, the Bureau understands that these EESA programs have highly detailed requirements, created and maintained by the Treasury Department, to determine whether EESA assistance will benefit distressed consumers.[146] In addition to satisfying these Treasury Department requirements, consumers receiving assistance under an EESA program must meet EESA eligibility requirements and creditor program requirements.[147] Thus, the Bureau believes that credit available under these programs is extended on reasonably repayable terms and conditions.

Several industry commenters asked the Bureau to consider an exemption for proprietary foreclosure mitigation and homeownership stabilization programs. While the Bureau believes that these programs likely benefit many consumers, the Bureau has determined that an exemption from the ability-to-repay requirements is inappropriate. Proprietary programs are not under the jurisdiction of the U.S. Department of the Treasury, as EESA programs are. This lack of accountability increases the risk that an unscrupulous creditor could harm consumers. Furthermore, EESA programs will expire by 2017 and are intended to provide assistance to a narrow set of distressed consumers. In contrast, the exemption suggested by commenters is potentially indefinite and indeterminate. Also, the Bureau believes that creditors seeking to provide assistance to consumers in distress without incurring the obligations associated with the

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[146] *See* United States Department of the Treasury, "Home Affordable Modification Program, Base Net Present Value (NPV) Model v5.02, Model Documentation" (April 1, 2012).

[147] *See* http://www.makinghomeaffordable.gov/programs/Pages/default.aspx. For example, the EESA PRA program contains several eligibility requirements in addition to program requirements. *See* http://www.makinghomeaffordable.gov/programs/lower-payments/Pages/pra.aspx.

ability-to-repay requirements may do so by providing a consumer with a workout or similar modification that does not constitute a refinancing under § 1026.20(a). Thus, the Bureau declines to provide an exemption for these proprietary programs.

No commenters addressed whether credit extended pursuant to an EESA program should be granted a presumption of compliance as qualified mortgages, and, if so, under what conditions. However, the Bureau does not believe that extending qualified mortgage status to these loans would be as effective in addressing the concerns raised above as an exemption. Even if credit extended under EESA programs were granted a presumption of compliance as qualified mortgages, creditors extending credit pursuant to these programs could be impacted by significant implementation and compliance burdens. Furthermore, as discussed above, many loans extended under these programs would not appear to satisfy the qualified mortgage standards under § 1026.43(e)(2). For example, consumers receiving assistance under EESA programs may have DTI ratios in excess of the § 1026.43(e)(2)(vi) threshold.[148] Thus, a creditor extending such a mortgage loan—assuming the loan does not qualify for another qualified mortgage definitions—would be required to comply with the ability-to-repay requirements of § 1026.43(c) and, in response to the potential liability for noncompliance, would cease or severely curtail lending under the voluntary EESA programs.

Accordingly, the Bureau believes that the proposed exemption for credit made pursuant to an EESA program is appropriate under the circumstances. The Bureau believes that consumers who receive extensions of credit made pursuant to an EESA program do so after a determination of ability to repay using criteria unique to the distressed consumers seeking

[148] Consumers receiving assistance under EESA programs may have back-end DTI ratios in excess of 50 percent. *See* United States Department of the Treasury, *Making Home Affordable Program Performance Report* (March 2013), page 9, *available at*: http://www.treasury.gov/initiatives/financial-stability/reports/Documents/March%202013%20MHA%20Report%20Final.pdf.

assistance under the program. The exemption adopted by the Bureau is limited to creditors or transactions with certain characteristics and qualifications that ensure consumers are offered responsible, affordable credit on reasonably repayable terms. The Bureau thus finds that coverage under the ability-to-repay requirements provides little if any meaningful benefit to consumers in the form of useful protection, given the nature of the credit offered under EESA programs. At the same time, the Bureau is concerned that the narrow class of creditors subject to the exemption may either cease or severely curtail mortgage lending if the ability-to-repay requirements are applied to their transactions, resulting in a denial of access to credit. Accordingly, the Bureau is adopting § 1026.43(a)(3)(vi) as proposed.

Section 1026.43(a)(3)(vi) is adopted pursuant to the Bureau's authority under section 105(a) and (f) of TILA. Pursuant to section 105(a) of TILA, the Bureau generally may prescribe regulations that provide for such adjustments and exceptions for all or any class of transactions that the Bureau judges are necessary and proper to effectuate the purposes of TILA, among other things. As discussed in more detail above, the Bureau has concluded that this exemption is necessary and proper to effectuate the purposes of TILA, which include the purposes of TILA section 129C. This exemption would ensure that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay. In the Bureau's judgment extensions of credit made pursuant to a program authorized by sections 101 and 109 of the Emergency Economic Stabilization Act of 2008 sufficiently account for a consumer's ability to repay, and the exemption ensures that consumers are able to receive assistance under these programs. Furthermore, without the exemption the Bureau believes that consumers at risk of default or foreclosure would be denied access to the responsible, affordable credit offered under these programs, which is contrary to the purposes of TILA. This exemption is consistent with the finding of TILA section 129C by ensuring that consumers are able to obtain responsible, affordable credit from the nonprofit creditors discussed above which inform the Bureau's understanding of its purposes.

The Bureau has considered the factors in TILA section 105(f) and has concluded that, for the reasons discussed above, an exemption is appropriate under that provision. Pursuant to TILA section 105(f) the Bureau may exempt by regulation from all or part of this title all or any class of transactions for which in the determination of the Bureau coverage does not provide a meaningful benefit to consumers in the form of useful information or protection. In determining which classes of transactions to exempt, the Bureau must consider certain statutory factors. The Bureau exempts an extension of credit pursuant to a program authorized by sections 101 and 109 of the Emergency Economic Stabilization Act of 2008 because coverage under the ability-to-repay requirements does not provide a meaningful benefit to consumers in the form of useful protection in light of the protection the Bureau believes that the credit extended through these programs already provides to consumers. Consistent with its rationale in the 2013 ATR Proposed Rule, the Bureau believes that the exemptions are appropriate for all affected consumers to which the exemption applies, regardless of their other financial arrangements and financial sophistication and the importance of the loan to them. Similarly, the Bureau believes that the exemptions are appropriate for all affected loans covered under the exemption, regardless of the amount of the loan and whether the loan is secured by the principal residence of the consumer. Furthermore, the Bureau believes that, on balance, the exemptions will simplify the credit process without undermining the goal of consumer protection, denying important benefits to consumers, or increasing the expense of the credit process. The Bureau recognizes that its exemption and exception authorities apply to a class of transactions, and has decided to apply these authorities to the loans covered under the final rule of the entities subject to the adopted exemptions.

43(a)(3)(vii)

The Bureau's Proposal

As discussed above, neither TILA nor Regulation Z provide an exemption to the ability-to-repay requirements for refinancing programs offered by the Department of Housing and Urban Development (HUD), the Department of Veterans Affairs (VA), or the U.S. Department of Agriculture (USDA). However, comments provided to the Bureau during the development of the 2013 ATR Final Rule suggested that the ability-to-repay requirements would restrict access to credit for consumers seeking to obtain a refinancing under certain Federal agency refinancing programs, that the ability-to-repay requirements adopted by the Bureau should account for the requirements of Federal agency refinancing programs, and that Federal agency refinancing programs should be exempt from several of the ability-to-repay requirements. TILA section 129C(b)(3)(B)(ii), as amended by section 1411 of the Dodd-Frank Act, requires these Federal agencies to prescribe rules related to the definition of qualified mortgage. These Federal agencies have not yet prescribed rules related to the definition of qualified mortgage. Section 1411 of the Dodd-Frank Act addresses refinancing of existing mortgage loans under the ability-to-repay requirements. As amended by the Dodd-Frank Act, TILA section 129C(a)(5) provides that Federal agencies may create an exemption from the income and verification requirements for certain streamlined refinancings of loans made, guaranteed, or insured by various Federal agencies. 15 U.S.C. 1639(a)(5). These Federal agencies also have not yet prescribed rules related to the ability-to-repay requirements for refinancing programs. Section 1026.43(e)(4), as adopted in the 2013 ATR Final Rule, provides temporary qualified mortgage status for mortgage loans eligible to be insured, guaranteed, or made pursuant to a program administered by one of these Federal agencies, until the effective date of the agencies' qualified mortgage rules prescribed pursuant to TILA section 129C(b)(3)(B)(ii). However, the Bureau was concerned that the ability-to-repay requirements would impede access to credit available under these programs. Based on these concerns and to gather more information about the potential effect of the ability-to-repay requirements on Federal agency refinancing programs, the Bureau proposed an exemption for certain refinancings under specified Federal programs and solicited feedback on several issues.

Specifically, proposed § 1026.43(a)(3)(vii) would have provided that an extension of credit that is a refinancing, as defined under § 1026.20(a) but without regard for whether the creditor is the creditor, holder, or servicer of the original obligation, that is eligible to be insured, guaranteed, or made pursuant to a program administered by the FHA, VA, or USDA, is exempt from § 1026.43(c) through (f), provided that the agency administering the program under which the extension of credit is eligible to be insured, guaranteed, or made has not prescribed rules pursuant to section 129C(a)(5) or 129C(b)(3)(B)(ii) of TILA. The Bureau solicited comment regarding whether this exemption is appropriate, whether there are any additional conditions that should be required, whether the ability-to-repay requirements would negatively affect the availability of credit offered under Federal agency programs, and whether consumers could be harmed by exempting these extensions of credit from the ability-to-repay requirements.

Comments Received

In response to the proposed rule, most commenters supported the proposed exemption. Industry commenters stated that the Federal agency refinancing programs have successfully provided significant benefits to many individual consumers and have helped stabilize the housing and real estate markets. Industry commenters and an association of State bankers noted that Federal agency refinancing programs are subject to comprehensive requirements and limitations that account for a consumer's ability to repay (*e.g.*, demonstrated payment history), and participating creditors must document and certify program compliance. These commenters also noted that these refinancing programs are in the interest of consumers because they specifically require a demonstrated consumer benefit such as a lower interest rate, lower payment amount, shorter loan term, or more stable mortgage product. Industry commenters and an association of State bankers argued that subjecting these Federal agency refinancing programs to the ability-to-repay requirements would conflict with the objectives of the programs, limit participation and access to these programs, and raise the cost for consumers. Without an exemption from the ability-to-repay requirements, they feared that most Federal agency refinancing programs would not be used, causing communities and homeowners to suffer. Industry commenters noted that the exemption from the ability-to-repay requirements for Federal agency refinancing programs would encourage broad participation in such programs, which are a critical component of the housing market recovery, and in light of the improving, but continued fragile state, of the housing market and broader economy, help support market stability. Industry commenters argued that the exemption would provide more certainty for creditors, which would lead to more of these types of loans being originated.

Several commenters asked the Bureau to clarify which Federal agency refinancing programs would qualify, as programs change, may be replaced, and new programs may develop in the future. In addition, an industry commenter suggested clarifying that events occurring after closing of a loan would not remove the exemption from the ability-to-repay requirements, in order to provide greater certainty for creditors. An industry trade group commenter also argued that the Bureau should exempt not only loans that are eligible for a Federal agency refinancing program, but also loans that are or would be accepted into such program except for a good faith mistake, because otherwise creditors will underwrite to the ability-to-repay requirements in all cases and the benefits of exemption will be severely diminished, if not lost completely.

No commenters addressed whether Federal agency refinancings should or should not be exempt from the ability-to-repay requirements given that FHA, VA, and USDA loans, including refinances, are afforded qualified mortgage status under the Bureau's 2013 ATR Final Rule. Specifically, no commenters addressed the premise that the ability-to-repay requirements could impose significant implementation and compliance burdens on the designated creditors and programs even if credit extended by the designated creditors or under the designated programs were granted a presumption of compliance as qualified mortgages.

Some consumer advocate commenters were strongly opposed to the exemption, asserting that assessment of a consumer's ability to repay is of paramount importance under the statutory scheme. These commenters contended that consumers could be harmed by exempting these extensions of credit from the ability-to-repay requirements. The primary arguments were that serial refinancings (and the resulting equity-stripping) were a root cause of the financial crisis, and that the proposed exemption would leave consumers with no recourse. These commenters argued that such serial refinancings were often not voluntarily chosen by the consumer, but, instead, were temporary measures that delayed foreclosure or were driven by a loan originator seeking more business. Consumer group commenters argued that Federal agency refinance guidelines do not contain adequate assurances of ability to repay, and asserted that FHA streamlined refinances are available with no requirement to underwrite for affordability and VA streamlined refinances are also available without any proof of income or appraisal. One consumer group commenter stressed that the ability-to-repay requirements were intended to protect consumers from equity-stripping or other forms of predatory refinancing practices that harmed so many consumers, and that refinancing an unaffordable loan with other loans that are not responsible or affordable does not help consumers. This commenter argued that consumers do not benefit when they receive loans they cannot afford, nor do they benefit when a refinance that costs money and strips the consumer of equity simply delays the inevitable reality that the consumer cannot afford his or her home. This commenter also stated that the proposed exemption would immunize creditors from TILA liability with respect to refinancings offered to some of the most vulnerable consumers, enabling unscrupulous creditors to engage in serial refinancings that harm consumers. This commenter also disputed the contention raised by others that the ability-to-repay requirements are costly and burdensome by asserting that the Bureau's provisions comprise basic underwriting requirements that all creditors should consider before extending refinancing credit. This commenter argued that it is not difficult to determine a consumer's ability to repay a loan, and that the Bureau's ability-to-repay requirements are straightforward, streamlined, and should become the industry standard for all loans, whether purchase money or refinancings. A State attorney general also argued that the proposed exemption would affect a large segment of the mortgage market, thereby potentially placing a large number of consumers at risk while undermining the Bureau's goal of providing uniform standards for the entire mortgage loan industry.

Consumer group commenters and a State attorney general also observed that these Federal agencies have not yet prescribed rules related to the ability-to-repay requirements for refinances, pursuant to TILA section 129C(a)(5), or the definition of qualified mortgage, pursuant to TILA section 129C(b)(3)(B)(ii), but that they have nearly a year before the 2013

Final Rule goes into effect, which is ample time for them to issue their own rules under the Dodd-Frank Act. Accordingly, the State attorney general argued that consumers' access to credit will not be seriously prejudiced by a temporary application of the ability-to-repay requirements because these Federal agency rules are likely forthcoming. Consumer group commenters and the State attorney general argued that Federal agencies should be bound by the ability-to-repay requirements between now and the time they issue their own new rules. These commenters argued that exempting Federal agency refinancing programs from the ability-to-repay requirements before they have promulgated their own rules removes an incentive for the agencies to promulgate their own rules in a timely manner while opening up the possibility that creditors acting pursuant to Federal agency refinancing programs could originate loans that are not responsible or affordable in the interim, thereby endangering the most vulnerable consumers who receive these loans.

The Final Rule

The Bureau is withdrawing the proposed exemption for the reasons below. Upon further review and consideration of the comments received, the Bureau has determined that the proposed exemption would be inappropriate. As discussed in the Bureau's proposal, the Bureau was concerned that the ability-to-repay requirements and qualified mortgage provisions would restrict access to credit for certain consumers seeking to obtain a refinancing. After performing additional analysis prompted by the comments received, the Bureau believes that the qualified mortgage provision under § 1026.43(e)(4), which generally provides qualified mortgage status to loans that are eligible for purchase, insurance, or guarantee by the specified Federal agencies, including refinancings, strikes the appropriate balance between preserving consumers' rights to seek redress for violations of TILA and ensuring access to responsible, affordable credit during the current transition period.

The Bureau agrees with the arguments raised by commenters that Federal agency refinancing programs have helped stabilize the housing and real estate markets. The Bureau also acknowledges that these programs are subject to comprehensive underwriting requirements that account for a consumer's ability to repay, which helps ensure that consumers receive access to credit. Although many commenters approved of the proposed exemption for the above reasons, these commenters did not address the costs and benefits of the proposed exemption in light of the qualified mortgage status granted to loans that are eligible for purchase, insurance, or guarantee by the specified Federal agencies under the Bureau's 2013 ATR Final Rule. Specifically, even absent an exemption from the ability-to-repay requirements, FHA, VA, and USDA loans, including refinancings, are given qualified mortgage status under the Bureau's 2013 ATR Final Rule, which provides for a temporary category of qualified mortgages for loans that satisfy the underwriting requirements of, and are therefore eligible to be purchased, guaranteed, or insured by HUD, VA, USDA, or RHS. This temporary provision will expire when qualified mortgage regulations issued by the various Federal agencies become effective, and in any event after seven years.

Section 1026.43(e)(4) addresses any inconsistencies that may occur between the general ability-to-repay and qualified mortgage provisions of the 2013 ATR Final Rule and Federal agency requirements, which should maintain the status quo in the Federal agency refinancing market and ensure that consumers are able to obtain responsible, affordable refinancing credit under these programs. Under the temporary qualified mortgage provisions in § 1026.43(e)(4), for instance, creditors need only comply with the documentation and underwriting requirements established by the respective Federal agencies, and need not apply the 43 percent debt-to-income ratio or follow the documentation and underwriting procedures applicable to the general category of qualified mortgages under § 1026.43(e)(3) and appendix Q. Since the Federal agency eligibility generally satisfies the requirements of § 1026.43(e)(4), the Bureau does not believe that the qualified mortgage provisions are inconsistent with the requirements of Federal agency refinancing programs.

Under the qualified mortgage provision in § 1026.43(e)(4), a loan that is eligible to be purchased, guaranteed, or insured by the specified Federal agencies would still need to meet certain minimum requirements imposed by the Dodd-Frank Act. To receive qualified mortgage status, in addition to Federal agency-eligibility, § 1026.43(e)(4)(i)(A) provides that a mortgage loan may not include the higher-risk loan terms identified in § 1026.43(e)(2)(i) (*e.g.*, negative amortization and interest-only payments), may not have a loan term that exceeds 30 years, and may not impose points and fees in excess of the thresholds in § 1026.43(e)(3). However, while some Federal agency refinancings may not be eligible for qualified mortgage status, the Bureau does not believe that many Federal agency refinancings would fail to meet these minimum requirements. Although some Federal agency refinancings may contain the risky features identified in § 1026.43(e)(2)(i) and provide for loan terms in excess of 30 years, the Bureau does not believe that many consumers receive such loans. Further, while market-wide data regarding points and fees on Federal agency refinancings is not available, the Bureau does not believe that many Federal agency refinancings would provide for points and fees in excess of the § 1026.43(e)(3) thresholds. Refinancings are usually less complicated than purchase transactions. Therefore, refinancings generally require fewer costs, which makes it unlikely that a Federal agency refinancing would exceed the points and fees thresholds and loans under these programs. In addition, the Bureau did not receive comment suggesting that points and fees on Federal agency refinancings exceed the § 1026.43(e)(3) thresholds. In any event, to the extent that eligibility for qualified mortgage status based upon these minimum requirements becomes an issue, the Bureau notes that the various Federal agencies can address any eligibility concerns when they prescribe their own detailed regulations concerning qualified mortgages and refinancings. Importantly, as discussed in the 2013 ATR Final Rule, the Bureau believes that Congress intended for loans with these risky features, long loan terms, or high points and fees to be excluded from the scope of the qualified mortgage definition. As the Bureau believes that few Federal agency refinancings would fail to meet these minimum statutory requirements, the Bureau does not believe that a modification is necessary to ensure access to responsible, affordable credit.

The Bureau believes that the temporary qualified mortgage provisions will help ensure that Federal agency refinancing programs will continue to be used and provide more certainty for creditors, which will lead to more of these types of loans being originated, and encourage broad participation in such programs, which will help support market stability. Thus, the Bureau disagrees with the concerns raised by some commenters that the withdrawal of the exemption would conflict with the objectives of the programs, limit participation and access to these programs, impair the effectiveness of such programs, or raise the cost for consumers. The Bureau believes that it has provided a sufficient transition mechanism until the various Federal agencies can prescribe their own regulations concerning qualified mortgages and refinancings.

In addition, the Bureau believes that the temporary qualified mortgage definition more appropriately balances risks to consumers than a full exemption until such time as the Federal agencies can address the concerns raised by commenters in their own detailed rulemakings. The

Bureau agrees that the ability-to-repay requirements were intended, in part, to prevent harmful practices such as equity stripping and other forms of predatory refinancings. The Bureau's temporary qualified mortgage provision provides additional protection to consumers and preserves potential claims in the event of abuse. For higher-priced qualified mortgages, consumers will still have the ability to assert a claim under TILA section 130(a) and (k) and prove that, despite the presumption of compliance attached to the qualified mortgage, the creditor nonetheless failed to comply with the ability-to-repay requirements. A consumer who prevails on such a claim may be able to recover special statutory damages equal to the sum of all finance charges and fees paid within the first three years after consummation, among other damages and costs, and may be able to assert the creditor's failure to comply to obtain recoupment or setoff in a foreclosure action even after the statute of limitations for affirmative claims has passed. The Bureau received no persuasive evidence that the qualified mortgage provisions of § 1026.43(e)(4) fail to strike the appropriate balance between consumer protection and the needs of the mortgage lending market during the current transition period.

Based on these considerations, the Bureau has determined that the withdrawal of this proposed exemption would ensure that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay. Based on the qualified mortgage status, the Bureau does not believe that the ability-to-repay requirements would significantly interfere with requirements of these Federal agency refinancing programs, make it more difficult for many consumers to qualify for these programs, or increase the cost of credit for those who do. The Bureau believes that the temporary qualified mortgage definition for loans that are eligible for purchase, insurance, or guarantee by the specified Federal agencies adequately addresses concerns about overlapping underwriting requirements while also preserving consumers' rights to seek redress if an abuse occurs. Accordingly, the Bureau concludes that this temporary exemption is not necessary to preserve access to affordable and responsible credit, and, therefore, is withdrawing the proposed exemption.

As discussed above, several industry commenters requested various modifications to the proposed language. For example, some commenters asked the Bureau to clarify which Federal agency refinancing programs would qualify for the exemption from the ability-to-repay requirements, as programs change, may be replaced, and new programs may develop in the future. An industry commenter suggested clarifying that events occurring after closing of a loan would not remove the exemption from the ability-to-repay requirements, in order to provide greater certainty for creditors. In addition, an industry trade group commenter argued that the Bureau should exempt not only loans that are eligible for a Federal agency refinance program, but also loans that are or would be accepted into such program except for a good faith mistake. As the Bureau has decided to withdraw proposed § 1026.43(a)(3)(vii), the issues addressed in these and similar comments are moot. As discussed above, mortgage loans that are eligible for purchase, insurance, or guarantee by the specified Federal agencies receive the temporary qualified mortgage status under § 1026.43(e)(4), provided the requirements of that paragraph are met.

43(a)(3)(viii)

The Bureau's Proposal

As discussed above, neither TILA nor Regulation Z provides an exemption to the ability-to-repay requirements for particular lending programs. However, comments provided to the Bureau during the development of the 2013 ATR Final Rule suggested that the ability-to-repay requirements would restrict access to credit for consumers seeking to obtain a refinancing under certain GSE programs for mortgage loans with high loan-to-value ratios or for consumers harmed by the financial crisis. These programs include HARP, which was defined as an "eligible targeted refinancing program" in regulations promulgated by FHFA, to replace high loan-to-value mortgage loans with affordable refinancings.[149] To gather more information about the potential effect of the ability-to-repay requirements on programs such as HARP and explore a potential exemption, the Bureau proposed § 1026.43(a)(3)(viii), which would have provided that an extension of credit that is a refinancing, as defined under § 1026.20(a) but without regard for whether the creditor is the creditor, holder, or servicer of the original obligation, that is eligible for purchase or guarantee by Fannie Mae or Freddie Mac is exempt from § 1026.43(c) through (f). This proposed exemption would have applied provided that: (1) the refinancing is made pursuant to an eligible targeted refinancing program, as defined under 12 CFR 1291.1; (2) such entities are operating under the conservatorship or receivership of the FHFA pursuant to section 1367 of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. 4617(i)) on the date the refinancing is consummated; (3) the existing obligation satisfied and replaced by the refinancing is owned by Fannie Mae or Freddie Mac; (4) the existing obligation satisfied and replaced by the refinancing was not consummated on or after January 10, 2014; and (5) the refinancing was not consummated on or after January 10, 2021.

Proposed comment 43(a)(3)(viii)-1 would have explained that § 1026.43(a)(3)(viii) provides an exemption from the requirements of § 1026.43(c) through (f) for certain extensions of credit that are considered refinancings, as defined in § 1026.20(a) but without regard for whether the creditor is the creditor, holder, or servicer of the original obligation, that are eligible for purchase or guarantee by Fannie Mae or Freddie Mac. The comment would also have explained that the exemption provided by § 1026.43(a)(3)(viii) would be available only while

[149] *See*, *e.g.*, 12 CFR 1291.1; 74 FR 38514, 38516 (Aug. 4, 2009).

these entities remain in conservatorship. The proposed comment also contained illustrative examples of this provision.

The Bureau expressed concern that unscrupulous creditors would be able to use the exemption to engage in loan-flipping or other harmful practices. Thus, the Bureau requested feedback on whether this exemption was generally appropriate. In particular, the Bureau requested feedback regarding whether consumers could be harmed by the proposed exemption and whether this exemption would ensure access to responsible and affordable refinancing credit. The Bureau also requested feedback regarding the reference to eligible targeted refinancing programs under proposed § 1026.43(a)(3)(viii)(A). Specifically, the Bureau requested comment regarding whether it would be more appropriate to refer to another public method of identifying refinancing programs similar to HARP, and, if so, what method of public identification would be appropriate. The Bureau also solicited feedback regarding whether reference to a notice published by FHFA pursuant to 12 CFR 1253.3 or 1253.4 would facilitate compliance more effectively than the proposed reference in § 1026.43(a)(3)(viii)(A).

Comments Received

Many commenters supported the proposed exemption. Several industry commenters argued that the exemption was necessary to prevent the imposition of unnecessary costs on consumers. These commenters generally believed that the ability-to-repay requirements were too burdensome and that creditors would be forced to raise costs to comply with the regulations. One government-sponsored enterprise commenter argued that the exemption was necessary to preserve access to credit for consumers eligible for a refinancing under HARP. This commenter argued that many HARP loans would be subject to the rebuttable presumption of compliance, and that industry would refuse to make any loans that fell outside of the safe harbor for qualified mortgages. Several industry commenters and a Federal agency commenter argued that the Bureau's proposed reference to FHFA regulations was unnecessary. These commenters asserted that FHFA oversight was sufficient to ensure that consumers would not be harmed by creditors offering mortgage loans eligible for purchase or guarantee by the GSEs. For similar reasons, these commenters argued that the Bureau's proposed date on which the exemption would expire was unnecessary, as consumers would always benefit from a GSE-eligible refinancing, regardless of when the consumer's original loan was consummated or when the consumer obtained the refinancing. Finally, several industry commenters and a Federal agency commenter argued that limiting the refinancing exemption to HARP-eligible consumers was unnecessary, as all consumers could benefit from a GSE refinancing program and limiting the exemption to HARP-eligible consumers would impose needless costs on all other consumers. Some of these commenters also asked the Bureau to define eligible refinancings by reference to the Fannie Mae or Freddie Mac selling or servicing guides, and some asked the Bureau to expand the exemption to include refinancings eligible for non-GSE streamlined refinancing programs.

One consumer advocate commenter strongly opposed the proposed exemption. This commenter stressed that predatory refinancings were one of the primary causes of the financial crisis and that the ability-to-repay requirements were intended to protect consumers from the abusive equity-stripping practices that harmed so many consumers. This commenter stated that the proposed exemption would immunize creditors from TILA liability with respect to refinancings offered to some of the most vulnerable consumers, enabling unscrupulous creditors to engage in serial refinancings that harm consumers. This commenter also disputed the contention raised by others that the ability-to-repay requirements are costly and burdensome by asserting that the Bureau's provisions comprise basic underwriting requirements that all creditors should consider before extending refinancing credit. A State attorney general also opposed the proposed exemption for similar reasons. This commenter also argued that the proposed exemption would affect a large segment of the mortgage market, thereby potentially placing a large number of consumers at risk while undermining the Bureau's goal of providing uniform standards for the entire mortgage loan industry.

The Final Rule

The Bureau is withdrawing the proposed exemption for the reasons discussed below. Upon further review and consideration of the comments received, the Bureau has determined that the proposed exemption would be inappropriate. As discussed in the Bureau's proposal, the Bureau was concerned that the ability-to-repay requirements and qualified mortgage provisions would restrict access to credit for certain consumers seeking to obtain a refinancing. After performing additional analysis prompted by the comments received, the Bureau believes that the special qualified mortgage provision under § 1026.43(e)(4), which generally provides qualified mortgage status to GSE-eligible mortgage loans, including refinancings, strikes the appropriate balance between preserving consumers' rights to seek redress for violations of TILA and ensuring access to responsible, affordable credit during the current transition period.

The Bureau acknowledges that, under the qualified mortgage provision in § 1026.43(e)(4), a HARP loan would still need to meet certain minimum requirements imposed by the Dodd-Frank Act. To receive qualified mortgage status, in addition to GSE-eligibility, § 1026.43(e)(4)(i)(A) provides that a mortgage loan may not include the higher-risk loan terms identified in § 1026.43(e)(2)(i) (*e.g.*, negative amortization and interest-only payments), may not have a loan term that exceeds 30 years, and may not impose points and fees in excess of the thresholds in § 1026.43(e)(3). However, while some HARP refinancings may not be eligible for this qualified mortgage status, the Bureau does not believe that many HARP loans would fail to meet these minimum requirements. Currently, HARP refinancings generally may not contain the risky features identified in § 1026.43(e)(2)(i).[150] While, HARP programs permit refinancings that provide for loan terms in excess of 30 years, the Bureau does not believe that many consumers receive such loans.[151] Furthermore, while market-wide data regarding points and fees on HARP loans is not available, the Bureau does not believe that many HARP loans would provide for points and fees in excess of the § 1026.43(e)(3) thresholds. Refinancings are usually less complicated than purchase transactions. Therefore, refinancings generally require fewer costs, which makes it unlikely that a HARP loan would exceed the points and fees thresholds, and loans under this program would not likely be subject to some types of pricing abuses related to refinancings generally. In addition, the Bureau did not receive comment suggesting that points and fees on HARP loans exceed the § 1026.43(e)(3) thresholds. Importantly, as discussed in the 2013 ATR Final Rule, the Bureau believes that Congress intended for loans with these risky features, long loan terms, or high points and fees to be excluded from the scope of the qualified mortgage definition.[152] As the Bureau believes that few HARP loans would fail to meet these minimum statutory requirements, the Bureau does not believe that a modification is necessary to ensure access to responsible, affordable credit.

Although many commenters approved of the proposed exemption, these commenters generally did not address the costs and benefits of the proposed exemption in light of the special

[150] As of April, 2013, HARP refinancings offered by Fannie Mae may not include negative amortization or interest-only features. *See* Fannie Mae, Single-Family Selling Guide, Chapter 5 (April 9, 2013), *available at* https://www.fanniemae.com/content/guide/sel040913.pdf. Freddie Mac does not offer mortgage loans with interest-only features and prohibits negative amortization on refinancings made under its HARP program. *See* Freddie Mac, Single-Family Seller/Servicer Guide, Vol. I, Chapters 22.4 and A24.3, *available at*: http://www.freddiemac.com/sell/guide/.

[151] Data on HARP loans with 40-year loan terms is not publicly available. *See* Federal Housing Finance Agency Refinance Report (June 2012), *available at:* http://www.fhfa.gov/webfiles/25164/Feb13RefiReportFinal.pdf.

[152] *See* 78 FR 6516-20 (Jan. 30, 2013).

qualified mortgage status granted to GSE-eligible loans under the Bureau's January 2013 ATR Final Rule. For example, several commenters asserted that the ability-to-repay requirements were incompatible with HARP program requirements. However, given that GSE eligibility generally satisfies the requirements of § 1026.43(e)(4), the Bureau does not believe that the special qualified mortgage provisions are inconsistent with the requirements of HARP or similar programs. For the same reasons, the Bureau does not agree with the arguments advanced by several commenters that the ability-to-repay requirements would add costs that would make these programs unsustainable. These comments did not explain what additional costs would be imposed by the regulation beyond the costs creditors would incur in determining GSE eligibility, which would be required even in the absence of the Bureau's requirements. Based on the comments provided, the Bureau does not believe that the requirements of § 1026.43(e)(4) impose any additional meaningful costs on creditors. Thus, it does not appear that the ability-to-repay requirements would impair the effectiveness of programs such as HARP.

While one GSE commenter addressed the potential difference between the proposed exemption and the qualified mortgage provisions, the Bureau is not persuaded by the arguments that creditors would rather cease extending credit than make a qualified mortgage loan subject to the rebuttable presumption. As discussed above, as GSE eligibility generally satisfies the requirements of § 1026.43(e)(4), the Bureau does not believe that creditors making qualified mortgages would incur any meaningful additional risk by making mortgage loans pursuant to the eligibility requirements prescribed by GSEs. The Bureau believes that the ability-to-repay requirements and qualified mortgage provisions reflect standard industry underwriting practices, and that creditors that make a reasonable effort to determine a consumer's ability to repay would not be concerned with potential litigation risk that may result from the rebuttable presumption.

Thus, based on the feedback provided, the Bureau does not believe that a creditor would incur much, if any, additional cost by extending refinancing credit under the qualified mortgage provisions of § 1026.43(e)(4) as opposed to the exemption under proposed § 1026.43(a)(3)(viii). Absent evidence that the special qualified mortgage provisions for GSE-eligible loans impose significant costs on creditors, the Bureau does not believe that consumers are at risk of being denied responsible, affordable mortgage credit.

On the other hand, there is a risk that consumers could be harmed by the proposed exemption. The Bureau is persuaded by the arguments that the proposed exemption could potentially enable unscrupulous creditors to harm consumers. The Bureau agrees that the ability-to-repay requirements were intended, in part, to prevent harmful practices such as equity-stripping. While the abuses of the past are seemingly absent from today's mortgage market, the Bureau does not believe it would be appropriate to deny consumers the means to seek redress for TILA violations. As discussed above, the § 1026.43(e)(4) qualified mortgage provision provides additional protection to consumers and preserves potential claims in the event of abuse. For higher-priced qualified mortgages, consumers will still have the ability to assert a claim under TILA section 130(a) and (k) and prove that, despite the presumption of compliance attached to the qualified mortgage, the creditor nonetheless failed to comply with the ability-to-repay requirements. Thus the cost to consumers of an exemption could be significant, as opposed to the relatively insignificant costs associated with complying with the special qualified mortgage provisions. Furthermore, given the detailed GSE eligibility requirements, the Bureau does not believe it is likely that a creditor operating a legitimate mortgage lending operation would face meaningful litigation risk by originating qualified mortgages, even those subject to the rebuttable presumption. The Bureau received no persuasive comments contradicting the Bureau's belief that the special qualified mortgage provisions of § 1026.43(e)(4) strikes the appropriate balance between consumer protection and the needs of the mortgage lending market during the current transition period. Absent persuasive evidence that the qualified mortgage provisions would endanger access to credit for the consumers addressed by the proposal, the Bureau does not believe that permitting this risk of consumer abuse is appropriate. Thus, the Bureau concludes that the proposed exemption is neither necessary nor proper, and proposed § 1026.43(a)(3)(viii) is withdrawn.

As discussed above, several industry commenters and a Federal agency commenter requested various modifications to the proposed language. For example, some commenters argued that the exemption should refer to the Fannie Mae or Freddie Mac selling guide, some commenters requested that the Bureau provide an exemption for all streamlined refinancing programs, and some commenters asked the Bureau to adopt the proposed exemption without the time limitations in proposed § 1026.43(a)(3)(viii)(D) and (E). As the Bureau has decided to withdraw proposed § 1026.43(a)(3)(viii), the issues addressed in these and similar comments are moot. As discussed above, mortgage loans made under a streamlined refinancing program are eligible for the temporary qualified mortgage status under § 1026.43(e)(4), provided the requirements of that paragraph are met.

43(b) Definitions

43(b)(4)

Background

TILA section 129C(a)(1) through (4) and the Bureau's rules thereunder, § 1026.43(c), prohibit a creditor from making a residential mortgage loan unless the creditor makes a reasonable, good faith determination, based on verified and documented information, that the consumer has a reasonable ability to repay the loan. TILA section 129C(b) provides a presumption of compliance with regard to these ability-to-repay requirements if a loan is a qualified mortgage. Creditors may view qualified mortgage status as important at least in part because TILA section 130(a) and (k) provide that, if a creditor fails to comply with the ability-to-repay requirements, a consumer may be able to recover special statutory damages equal to the sum of all finance charges and fees paid within the first three years after consummation, among other damages and costs, and may be able to assert the creditor's failure to comply to obtain recoupment or setoff in a foreclosure action even after the statute of limitations for affirmative claims has passed. TILA section 129C(b)(3)(B)(i) authorizes the Bureau to prescribe regulations that revise, add to, or subtract from the criteria that define a qualified mortgage upon a finding that such regulations are, among other things, necessary or proper to ensure that responsible, affordable credit remains available to consumers in a manner consistent with the purposes of TILA section 129C.

Section 1026.43(e)(1) specifies the strength of presumption of compliance regardless of which regulatory definition of qualified mortgage applies. Under § 1026.43(e)(1)(i), a qualified mortgage that is not a higher-priced covered transaction as defined in § 1026.43(b)(4) is subject to a conclusive presumption of compliance, or safe harbor. In contrast, under § 1026.43(e)(1)(ii) a qualified mortgage that is a higher-priced covered transaction is subject to a rebuttable presumption of compliance.

Section 1026.43(b)(4) defines a higher-priced covered transaction to mean a transaction within the scope of § 1026.43 with an annual percentage rate that exceeds the average prime offer rate for a comparable transaction as of the date the interest rate is set by 1.5 or more percentage points for a first-lien covered transaction or by 3.5 or more percentage points for a subordinate-lien covered transaction. The average prime offer rates are published weekly by the Federal Financial Institutions Examination Council based on a national survey of creditors, the Freddie Mac Primary Mortgage Market Survey®. The average prime offer rates estimate the national average APR for first-lien mortgages offered to consumers with good credit histories and low-risk transaction features (*e.g.*, loan-to-value ratios of 80 percent or less). The higher-priced covered transaction thresholds generally conform to the thresholds for "higher-priced mortgage loans" under § 1026.35, which contains escrow requirements and other special protections adopted after the financial crisis for loans that have traditionally been considered subprime.

Section 1026.43(e) and (f) defines three categories of qualified mortgages. First, § 1026.43(e)(2) provides a general definition of a qualified mortgage. Second, § 1026.43(e)(4) provides that loans that are eligible to be purchased, guaranteed, or insured by certain government agencies or Fannie Mae or Freddie Mac are qualified mortgages, subject to certain restrictions including restrictions on product features and points and fees. Section 1026.43(e)(4) expires after seven years and may expire sooner with respect to some loans if other government agencies exercise their rulemaking authority under TILA section 129C or if Fannie Mae or Freddie Mac exit conservatorship.

Third, § 1026.43(f) provides that certain balloon-payment loans are qualified mortgages if they are made by a small creditor that:

- Had total assets less than $2 billion (adjusted annually for inflation) as of the end of the preceding calendar year;
- Together with all affiliates, extended 500 or fewer first-lien mortgages during the preceding calendar year; and

- Extended more than 50 percent of its total mortgages secured by properties that are in rural or underserved areas during the preceding calendar year.

Section 1026.43(f) includes only balloon-payment loans held in portfolio for at least three years by these small creditors, subject to certain exceptions. Further, it includes only loans that were not subject, at consummation, to a commitment to be acquired by any person other than another qualified small creditor.

As discussed in the section-by-section analysis of § 1026.43(e)(5) below, the Bureau proposed and is adopting an additional fourth category of qualified mortgages that includes certain loans originated and held in portfolio by small creditors. Like § 1026.43(f), § 1026.43(e)(5) includes loans originated and held in portfolio by creditors that had total assets less than $2 billion (adjusted annually for inflation) as of the end of the preceding calendar year and, together with all affiliates, extended 500 or fewer first-lien mortgages during the preceding calendar year. Unlike § 1026.43(f), new § 1026.43(e)(5) is not limited to creditors that operate predominantly in rural or underserved areas and does not include loans with a balloon payment.

Proposal Regarding Higher-Priced Covered Transactions

The Bureau proposed to amend the definition of higher-priced covered transaction in § 1026.43(b)(4) with respect to qualified mortgages that are originated and held in portfolio by small creditors as described in § 1026.43(e)(5) and with respect to balloon-payment qualified mortgages originated and held in portfolio by small creditors operating predominantly in rural or underserved areas as described in § 1026.43(f). The Bureau proposed to amend § 1026.43(b)(4) to provide that a first-lien loan that is a qualified mortgage under § 1026.43(e)(5) or (f) is a higher-priced covered transaction if the annual percentage rate exceeds APOR for a comparable transaction by 3.5 or more percentage points. This would have the effect of extending the qualified mortgage safe harbor described in § 1026.43(e)(1)(i) to first-lien loans that are qualified mortgages under § 1026.43(e)(5) or (f) that have an annual percentage rate between 1.5 and 3.5 percentage points above APOR. As discussed in more detail below, the Bureau understands that small creditors often charge higher rates and fees than larger creditors for reasons including their higher cost of funds. The Bureau proposed this amendment to § 1026.43(b)(4) because it believes that many loans made by small creditors will exceed the existing qualified mortgage safe harbor threshold. Without the proposed amendment to § 1026.43(b)(4), these loans would be considered higher-priced covered transactions and would fall under the rebuttable presumption of compliance described in § 1026.43(e)(1)(ii). The Bureau was concerned that small creditors would be less likely to make such loans due to concerns about liability risk, thereby reducing access to responsible credit.

Comments Received

The Bureau solicited comment on several issues related to the proposed amendments to § 1026.43(b)(4). First, the Bureau solicited comment regarding whether the proposed amendments to § 1026.43(b)(4) are necessary to preserve access to responsible, affordable mortgage credit and regarding any adverse effects the proposed amendments would have on consumers. Most commenters agreed that small creditors may charge more than larger creditors for legitimate business reasons; that amending the definition of higher-priced covered transaction for these types of qualified mortgages is necessary to preserve access to responsible, affordable mortgage credit; and that the rule would provide appropriate protection for consumers even with a higher interest rate threshold. Commenters expressing this view included some consumer advocacy organizations, coalitions of State regulators, national and State trade groups representing creditors, national and State mortgage bankers associations, a national association representing home builders, one very large creditor, and many small creditors.

A much smaller number of commenters opposed the proposed amendments. These included other consumer advocacy organizations, a trade group representing very large creditors, a national organization representing mortgage brokers, a letter submitted in substantially similar form by several individual mortgage brokers, and one very large creditor. These commenters generally argued that a consumer's ability to repay does not depend on the creditor's size and that the same standards therefore should apply to all creditors. One of these commenters argued that small creditors do not need to charge higher rates and fees because their higher costs are offset by lower default rates.

The Bureau also solicited comment on the proposed 3.5 percentage point threshold and whether another threshold would be more appropriate. While many commenters supported the proposed 3.5 percentage point threshold, several commenters argued that the proposed 3.5 percentage point threshold was not sufficient and should be raised. Commenters expressing this view included a national trade group representing creditors, State bankers associations, and several small creditors. These commenters generally suggested thresholds between 4.0 and 5.5 percentage points above APOR. Several of these commenters, including the national trade group, cited the traditional principle that small creditors generally must charge consumers 4.0 percentage points above the creditor's cost of funds in order to operate safely and soundly.

Finally, the Bureau solicited comment on whether, to preserve access to mortgage credit, the Bureau also should raise the threshold for subordinate-lien covered transactions that are qualified mortgages under § 1026.43(e)(5) and (f), and, if so, what threshold would be appropriate for those loans. A small number of commenters, including a State bankers association and several small creditors, urged the Bureau to adopt a higher threshold for subordinate-lien covered transactions. These commenters generally argued that subordinate-lien loans entail inherently greater credit risk and that a higher threshold was needed to account for this additional risk. Most commenters did not address the threshold for subordinate-lien loans.

The Final Rule

The amendments to § 1026.43(b)(4) are adopted as proposed. The Bureau believes the amendments are warranted to preserve access to responsible, affordable mortgage credit for some consumers, including consumers who do not qualify for conforming mortgage credit and consumers in rural and underserved areas, as described below.

As discussed above in part II.A, the Bureau understands that small creditors are a significant source of loans that do not conform to the requirements for government guarantee and insurance programs or purchase by entities such as Fannie Mae and Freddie Mac. The Bureau also understands that larger creditors may be unwilling to make at least some of these loans because the consumers or properties involved cannot be accurately assessed using the standardized underwriting criteria employed by larger creditors or are illiquid because they are non-conforming and therefore entail greater risk. For similar reasons, the Bureau understands that larger creditors may be unwilling to purchase such loans. Small creditors often are willing to evaluate the merits of unique consumers and properties using flexible underwriting criteria and make highly individualized underwriting decisions. Small creditors often hold these loans on their balance sheets, retaining the associated credit, liquidity, and other risks.

The Bureau also understands that small creditors are a significant source of credit in rural and underserved areas. As discussed above in part II.A, small creditors are significantly more likely than larger creditors to operate offices in rural areas, and there are hundreds of counties nationwide where the only creditors are small creditors and hundreds more where larger creditors have only a limited presence.

The Bureau also understands that small creditors, including those operating in rural and underserved areas, may charge consumers higher interest rates and fees than larger creditors for several legitimate business reasons. As discussed above in part II.A, small creditors may pay more for funds than larger creditors. Small creditors generally rely heavily on deposits to fund lending activities and therefore pay more in expenses per dollar of revenue as interest rates fall and the spread between loan yields and deposit costs narrows. Small creditors also may rely more on interest income than larger creditors, as larger creditors obtain higher percentages of their income from noninterest sources such as trading, investment banking, and fiduciary services.

In addition, small creditors may find it more difficult to limit their exposure to interest rate risk than larger creditors and therefore may charge higher rates to compensate for that exposure. Similarly, any individual loan poses a proportionally more significant credit risk to a smaller creditor than to a larger creditor, and small creditors may charge higher rates or fees to compensate for that risk. Consumers obtaining loans that cannot readily be sold into the securitization markets also may pay higher interest rates and fees to compensate for the risk associated with the illiquidity of such loans.

Small creditors, including those operating in rural and underserved areas, have repeatedly asserted to the Bureau and to other regulators that they are unable or unwilling to assume the risk of litigation associated with lending outside the qualified mortgage safe harbor. The Bureau does not believe that the regulatory requirement to make a reasonable and good faith determination based on verified and documented evidence that a consumer has a reasonable ability to repay would entail significant litigation risk for small creditors, especially where their loan meets a qualified mortgage definition and qualifies for a rebuttable presumption of compliance. As discussed in part II.A above, small creditors as a group have consistently experienced lower credit losses for residential mortgage loans than larger creditors. The Bureau believes this is strong evidence that small creditors have historically engaged in responsible mortgage underwriting that includes considered determinations of consumers' ability to repay, at least in part because they bear the risk of default associated with loans held in their portfolios. The Bureau also believes that because many small creditors use a lending model based on maintaining ongoing relationships with their customers and have specialized knowledge of the community in which they operate, they therefore may have a more comprehensive understanding of their customers' financial circumstances and may be better able to assess ability to repay than larger creditors. In addition, the Bureau believes that small creditors operating in limited geographical areas may face significant risk of harm to their reputation within their community if they make loans that consumers cannot repay. At the same time, because of the relationship small creditors have with their customers, the Bureau believes that the likelihood of litigation between a customer and his or her community bank or credit union is low.

However, the Bureau acknowledges that due to their size small creditors may find even a remote prospect of litigation risk to be so daunting that they may change their business models to avoid it. The Bureau also believes that the exit of small creditors from the residential mortgage market could create substantial short-term access to credit issues.

The Bureau continues to believe that raising the interest rate threshold as proposed is necessary and appropriate to preserve access to responsible, affordable credit for consumers that are unable to obtain loans from other creditors because they do not qualify for conforming loans or because they live in rural or underserved areas. The existing qualified mortgage safe harbor applies to first-lien loans only if the annual percentage rate is less than 1.5 percentage points above APOR for comparable transactions. The Bureau believes that many loans made by small creditors, including those operating in rural and underserved areas, will exceed that threshold but will not pose risks to consumers. These small creditors have repeatedly asserted to the Bureau and other regulators that they will not continue to extend mortgage credit unless they can make loans that are covered by the qualified mortgage safe harbor. The Bureau therefore believes that, unless § 1026.43(b)(4) is amended as proposed, small creditors operating in rural and underserved areas may reduce the number of mortgage loans they make or stop making mortgage loans altogether, limiting the availability of nonconforming mortgage credit and of mortgage credit in rural and underserved areas.

The Bureau is sensitive to concerns about the consistency of protections for all consumers and about maintaining a level playing field for market participants, but believes that a differentiated approach is justified here. The commenters who suggested that consumers' interests are best served by subjecting all creditors to the same standards provided nothing substantive that refutes the points raised in the Bureau's proposal regarding the lending track records and business models of small creditors, their concerns about litigation risk and compliance burden, and the potential access to credit problems the Bureau believes will arise if § 1026.43(b)(4) is not amended. For example, these commenters have not indicated that large creditors would be able and willing to fulfill the role currently played by small creditors in providing access to responsible, affordable nonconforming credit or credit in rural and underserved areas, nor have they provided evidence that the Bureau's concerns about limitations on access to credit if the interest rate threshold is not raised are unfounded. One commenter asserted that small creditors' lower credit losses are sufficient to offset their higher costs, making it unnecessary to raise the interest rate threshold. While the Bureau understands that small creditors have historically had lower credit losses, this commenter provided no evidence that these lower losses are sufficient to offset small creditors' higher cost of funds and greater reliance on interest income and the greater risks associated with holding loans in a comparatively small portfolio, and the Bureau is not aware of any such evidence.[153] In addition, these commenters have provided no evidence to challenge the Bureau's view, as described in the proposal, above, and in the section-by-section analysis of § 1026.43(e)(5) below, that the combination of the small creditors' relationship lending model, local knowledge, and other characteristics and the inherent incentives of portfolio lending are sufficient to protect consumers.

The Bureau does not believe, however, that it is necessary to raise the threshold for first-lien covered transactions above APOR plus 3.5 percentage points for either first-lien or subordinate-lien loans as suggested by some commenters. The Bureau estimated the average cost of funds for small creditors from publicly available call reports filed by small creditors between 2000 and 2012. These estimates suggest that the majority of first-lien mortgage loans priced by a small creditor at the creditor's cost of funds plus 4.0 percentage points, the traditional principle of small creditor safe and sound lending noted by several commenters, would fall below even the original threshold of APOR plus 1.5 percentage points. However, the Bureau acknowledges that its estimates are averages that do not reflect individual or regional differences

[153] The FDIC Community Banking Study, to which the Bureau has referred as authority for the point that small creditors have historically incurred lower credit losses than larger creditors, indicates that despite their lower credit losses and lower non-interest expenses, community banks on average have lower (worse) pre-tax return on assets and a higher and increasing (worse and deteriorating) ratio of noninterest expense to net operating revenue than noncommunity banks. The study attributes these in large part to community banks' reliance on interest income and the narrowing of the spread between asset yields and funding costs due to a prolonged period of historically low interest rates. *FDIC Community Banking Study*, p. IV - V, 4-1 – 4-11. *See also GAO Community Banks and Credit Unions Report*, p. 10-11.

in cost of funds and do not reflect the additional credit risk associated with subordinate-lien loans. The Bureau believes that the additional 2.0 percentage points afforded by the APOR plus 3.5 percentage point standard are sufficient to address these differences. The Bureau therefore believes that amending § 1026.43(b)(4) as proposed will allow small creditors to lend at a sustainable rate and still fall within the qualified mortgage safe harbor, thereby preserving access to affordable, responsible credit.

As discussed below in the section-by-section analysis of § 1026.43(e)(6), the Bureau is providing a two-year transition period during which small creditors may make balloon-payment qualified mortgages regardless of whether they operate predominantly in rural or underserved areas. The Bureau therefore is amending § 1026.43(b)(4) to include references to § 1026.43(e)(6) and to provide that a first-lien loan that is a qualified mortgage under § 1026.43(e)(6) is a higher priced covered transaction if the annual percentage rate exceeds APOR for a comparable transaction by 3.5 or more percentage points. This provision would apply to the same creditors and loans as § 1026.43(e)(5) and (f). The Bureau therefore believes that the rationales regarding raising the interest rate threshold for qualified mortgages under § 1026.43(e)(5) and (f) described above apply with equal force to qualified mortgages under this new provision.

Accordingly, the Bureau is exercising its authority under TILA sections 105(a) to amend § 1026.43(b)(4) substantially as proposed, with conforming amendments as described above. Pursuant to TILA section 105(a) the Bureau generally may prescribe regulations that provide for such adjustments and exceptions for all or any class of transactions that the Bureau judges are necessary or proper to effectuate the purposes of TILA, among other things. In the 2013 ATR Final Rule the Bureau stated that it interpreted TILA section 129C(b)(1) to create a rebuttable presumption for qualified mortgages generally and exercised its adjustment authority under TILA 105(a) with respect to prime loans (loans with an APR that do not exceed APOR by 1.5 percentage points for first liens and 3.5 percentage points for second liens), to provide a conclusive presumption (*e.g.*, safe harbor).[154] In this final rule the Bureau uses its TILA section 105(a) adjustment authority to further expand the safe harbor to include certain covered transactions (those subject to the qualified mortgage definition under paragraph (e)(5), (e)(6) or (f)) that have an APR that exceeds the prime offer rate for a comparable transaction as of the date the interest rate is set by 3.5 percentage points for a first-lien covered transaction.

The Bureau believes that this adjustment to also provide a safe harbor for these loans is necessary and proper to facilitate compliance with and to effectuate the purposes of TILA, including to assure that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay the loans.[155] As described above, the Bureau believes that, unless § 1026.43(b)(4) is amended, small creditors will be less likely to make residential mortgage loans. Because small creditors are a significant source of nonconforming mortgage credit and mortgage credit generally in rural or underserved areas, this would significantly limit access to mortgage credit for some consumers. The Bureau also believes that the relationship lending model, qualitative local knowledge, and size of small creditors, combined with the intrinsic incentives of portfolio lending, provide strong assurances that these creditors will make reasonable and good faith determinations of consumers' ability to repay.

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[154] *See* 78 FR 6514.

[155] These adjustments are also consistent with the Bureau's authority under TILA section 129C(b)(3)(B)(i) to prescribe regulations that revise, add to, or subtract from the criteria that define a qualified mortgage upon a finding that such regulations are necessary or proper to ensure that responsible, affordable mortgage credit remains available to consumers in a manner consistent with the purposes of this section, necessary and appropriate to effectuate the purposes of TILA section 129B and section 129C, to prevent circumvention or evasion thereof, or to facilitate compliance with such section.

Providing a safe harbor for these loans facilitates compliance with the ability-to-repay standards in a manner consistent with the purposes of TILA.

43(e) Qualified Mortgages

43(e)(1) Safe Harbor and Presumption of Compliance

The Bureau is adopting two additional provisions regarding qualified mortgages, as discussed in the section-by-section analyses of § 1026.43(e)(5) and (6) below. The Bureau therefore is adopting conforming changes to § 1026.43(e)(1) to include references to these new provisions. Like other qualified mortgages, qualified mortgages under § 1026.43(e)(5) and (6) are covered by the safe harbor described in § 1026.43(e)(1)(i) if they are not higher-priced covered transactions and are subject to the rebuttable presumption of compliance described in § 1026.43(e)(1)(ii) if they are higher-priced covered transactions. However, the Bureau is adopting a different definition of higher-priced covered transaction to first-lien qualified mortgages under § 1026.43(e)(5) and (6). The section-by-section analysis of § 1026.43(b)(4), above, describes the alternate definition of higher-priced covered transactions.

43(e)(2) Qualified Mortgage Defined—General

The Bureau is adopting conforming amendments to § 1026.43(e)(2) to include references to § 1026.43(e)(5) and (6), as described in the section-by-section analyses of those sections, below.

43(e)(5) Qualified Mortgage Defined—Small Creditor Portfolio Loans

Background

TILA section 129C(a)(1) through (4) and the Bureau's rules thereunder, § 1026.43(c), prohibit a creditor from making a residential mortgage loan unless the creditor makes a reasonable, good faith determination, based on verified and documented information, that the consumer has a reasonable ability to repay the loan. TILA section 129C(b) provides that a creditor or assignee may presume that a loan has met the ability-to-repay requirements if a loan is a qualified mortgage. Creditors may view qualified mortgage status as important at least in part because TILA section 130 provides that, if a creditor fails to comply with the ability-to-repay requirements, a consumer may be able to recover special statutory damages equal to the sum of all finance charges and fees paid within the first three years after consummation, among other damages and costs, and may be able to assert the creditor's failure to comply to obtain recoupment or setoff in a foreclosure action even after the statute of limitations on affirmative claims has expired. TILA section 129C(b)(2)(A)(vi) authorizes, but does not require, the Bureau to establish limits on debt-to-income ratio or other measures of a consumer's ability to pay regular expenses after making payments on mortgage and other debts. TILA section 129C(b)(3)(B)(i) authorizes the Bureau to revise, add to, or subtract from the criteria that define a qualified mortgage upon a finding that such regulations are, among other things, necessary or proper to ensure that responsible, affordable credit remains available to consumers in a manner consistent with the purposes of TILA section 129C or necessary and appropriate to effectuate the purposes of TILA sections 129B and 129C.

Section 1026.43(e) and (f) defines three categories of qualified mortgages. First, § 1026.43(e)(2) prescribes the general definition of a qualified mortgage. Second, § 1026.43(e)(4) provides that certain loans that are eligible to be purchased, guaranteed, or insured by certain Federal government agencies or Fannie Mae or Freddie Mac while operating under conservatorship are qualified mortgages. Section 1026.43(e)(4) expires seven years after its effective date and may expire earlier with respect to certain loans if other Federal government agencies exercise their rulemaking authority under TILA section 129C or if the GSEs exit conservatorship. Third, § 1026.43(f) provides that certain loans with a balloon payment made by small creditors operating predominantly in rural or underserved areas are qualified mortgages.

The Bureau's Proposal

The Bureau proposed to define a fourth category of qualified mortgages including loans originated and held in portfolio by certain small creditors in new § 1026.43(e)(5). This additional category of qualified mortgages would have been similar in several respects to § 1026.43(f), which provides that certain balloon loans made by small creditors operating predominantly in rural or underserved areas are qualified mortgages. As under § 1026.43(f), the additional category would have included loans originated by small creditors, as defined by asset-size and transaction thresholds, and held in portfolio by those creditors for at least three years, subject to certain exceptions. However, proposed § 1026.43(e)(5) would have included small creditors that do not operate predominantly in rural or underserved areas and would not have included loans with a balloon payment.

Specifically, the new category would have included certain loans originated by creditors that:

- Have total assets that do not exceed $2 billion as of the end of the preceding calendar year (adjusted annually for inflation); and
- Together with all affiliates, extended 500 or fewer first-lien mortgages during the preceding calendar year.

The proposed additional category would have included only loans held in portfolio by these creditors. Specifically, proposed § 1026.43(e)(5) would have provided that a loan would lose its qualified mortgage status under § 1026.43(e)(5) if it is sold, assigned, or otherwise transferred, subject to exceptions for transfers that are made three or more years after consummation, to another qualifying institution, as required by a supervisory action, or pursuant to a merger or acquisition. In addition, proposed § 1026.43(e)(5) would have provided that a loan must not be subject at consummation to a commitment to be acquired by any person other than a person that also meets the above asset and origination criteria.

The loan also would have had to conform to all of the requirements under the § 1026.43(e)(2) general definition of a qualified mortgage except with regard to debt-to-income ratio. In other words, the loan could not have:

- Negative-amortization, interest-only, or balloon-payment features;
- A term longer than 30 years; or
- Points and fees greater than 3 percent of the total loan amount (or, for smaller loans, a specified amount).

When underwriting the loan the creditor would have been required to take into account the monthly payment for any mortgage-related obligations, and:

- Use the maximum interest rate that may apply during the first five years and periodic payments of principal and interest that will repay the full principal;
- Consider and verify the consumer's current and reasonably expected income or assets other than the value of the property securing the loan; and
- Consider and verify the consumer's current debt obligations, alimony, and child support.

The creditor also would have been required to consider the consumer's debt-to-income ratio or residual income and to verify the underlying information generally in accordance with § 1026.43(c)(7). Section 1026.43(c)(7) describes how creditors must calculate a consumers' debt-to-income ratio or residual income for purposes of complying with the ability-to-repay rules set forth in § 1026.43(c). Section 1026.43(c)(7) specifies that a creditor must consider the ratio of or difference between a consumer's total monthly debt obligations and total monthly income. Section 1026.43(c)(7)(i)(A) specifies that a consumer's total monthly debt obligations includes the payment on the covered transaction as calculated according to § 1026.43(c)(5). However, for purposes of § 1026.43(e)(5), the calculation of the payment on the covered transaction must be determined in accordance with § 1026.43(e)(2)(iv) instead of § 1026.43(c)(5).

In contrast, the general definition of a qualified mortgage in § 1026.43(e)(2) requires a creditor to calculate the consumer's debt-to-income ratio according to instructions in appendix Q[156] and specifies that the consumer's debt-to-income ratio must be 43 percent or less.

As with all qualified mortgages, a qualified mortgage under § 1026.43(e)(5) would have received either a rebuttable presumption of compliance with, or a safe harbor from liability for violating, the ability-to-repay requirements in § 1026.43(c), depending on the annual percentage rate. However, as described above in the section-by-section analysis of § 1026.43(b)(4), the Bureau also proposed and is adopting an alternate definition of higher-priced covered transaction for first-lien covered transactions that are qualified mortgages under proposed § 1026.43(e)(5). Amended as proposed, § 1026.43(b)(4) provides that a first-lien covered transaction that is a qualified mortgage under proposed § 1026.43(e)(5) is a higher-priced covered transaction if the annual percentage rate exceeds APOR for a comparable transaction by 3.5 or more percentage points. This extends the qualified mortgage safe harbor described in § 1026.43(e)(1)(i) to first-lien qualified mortgages defined under proposed § 1026.43(e)(5) even if those loans have annual percentage rates between 1.5 and 3.5 percentage points higher than APOR. Without the

[156] The Bureau has proposed certain revisions to Appendix Q. *See* 78 FR 25,638-25,662 (May 2, 2013). Comments on this proposal must be received on or before June 3, 2013.

amendment to § 1026.43(b)(4), such loans would have been covered by the rebuttable presumption of compliance described in § 1026.43(e)(1)(ii).

The Bureau proposed ten comments to clarify the requirements described in proposed § 1026.43(e)(5). Proposed comment 43(e)(5)-1 would have provided additional guidance regarding the requirement to comply with the general definition of a qualified mortgage under § 1026.43(e)(2). The proposed comment would have restated the regulatory requirement that a covered transaction must satisfy the requirements of the § 1026.43(e)(2) general definition of qualified mortgage, except with regard to debt-to-income ratio, to be a qualified mortgage under § 1026.43(e)(5). As an example, the proposed comment would have explained that a qualified mortgage under § 1026.43(e)(5) may not have a loan term in excess of 30 years because longer terms are prohibited for qualified mortgages under § 1026.43(e)(2)(ii). As another example, the proposed comment would have explained that a qualified mortgage under § 1026.43(e)(5) may not result in a balloon payment because § 1026.43(e)(2)(i)(C) provides that qualified mortgages may not have balloon payments except as provided under § 1026.43(f). Finally, the proposed comment would have clarified that a covered transaction may be a qualified mortgage under § 1026.43(e)(5) even though the consumer's monthly debt-to-income ratio exceeds 43 percent, § 1026.43(e)(2)(vi) notwithstanding.

Proposed comment 43(e)(5)-2 would have clarified that § 1026.43(e)(5) does not prescribe a specific monthly debt-to-income ratio with which creditors must comply. Instead, creditors must consider a consumer's debt-to-income ratio or residual income calculated generally in accordance with § 1026.43(c)(7) and verify the information used to calculate the debt-to-income ratio or residual income in accordance with § 1026.43(c)(3) and (4). The proposed comment would have explained that § 1026.43(c)(7) refers creditors to § 1026.43(c)(5) for instructions on calculating the payment on the covered transaction and that § 1026.43(c)(5) requires creditors to calculate the payment differently than § 1026.43(e)(2)(iv). The proposed comment would have clarified that, for purposes of the qualified mortgage definition in § 1026.43(e)(5), creditors must base their calculation of the consumer's debt-to-income ratio or residual income on the payment on the covered transaction calculated according to § 1026.43(e)(2)(iv) instead of according to § 1026.43(c)(5). Finally, the proposed comment would have clarified that creditors are not required to calculate the consumer's monthly debt-to-income ratio in accordance with appendix Q as is required under the general definition of qualified mortgages by § 1026.43(e)(2)(vi).

Proposed comment 43(e)(5)-3 would have noted that the term "forward commitment" is sometimes used to describe a situation where a creditor originates 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. The proposed comment would have clarified that a mortgage that will be acquired by a purchaser pursuant to a forward commitment does not satisfy the requirements of § 1026.43(e)(5), 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, the proposed comment also would have clarified that a forward commitment to another person that also meets the requirements of § 1026.43(e)(5)(i)(D) is permitted. The proposed comment would have given the following example: Assume a creditor that is eligible to make qualified mortgages under § 1026.43(e)(5) makes a mortgage. If that mortgage meets the purchase criteria of an investor with which the creditor has an agreement to sell such loans after consummation, then the loan does not meet the definition of a qualified mortgage under § 1026.43(e)(5). However, if the investor meets the requirements of § 1026.43(e)(5)(i)(D), the mortgage will be a qualified mortgage if all other applicable criteria also are satisfied.

Proposed comment 43(e)(5)-4 would have reiterated that, to be eligible to make qualified mortgages under § 1026.43(e)(5), a creditor must satisfy the requirements of § 1026.35(b)(2)(iii)(B) and (C). For ease of reference, the comment would have stated that § 1026.35(b)(2)(iii)(B) requires that, during the preceding calendar year, the creditor and its affiliates together originated 500 or fewer first-lien covered transactions and that § 1026.35(b)(2)(iii)(C) requires that, as of the end of the preceding calendar year, the creditor had total assets of less than $2 billion, adjusted annually for inflation.

Proposed comment 43(e)(5)-5 would have clarified that creditors generally must hold a loan in portfolio to maintain the transaction's status as a qualified mortgage under § 1026.43(e)(5), subject to four exceptions. The proposed comment would have clarified that, unless one of these exceptions applies, a loan is no longer a qualified mortgage under § 1026.43(e)(5) 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(e)(1) unless the loan also met the requirements of another qualified mortgage definition. Proposed comment 43(e)(5)-6 would have clarified that § 1026.43(e)(5)(ii) applies not only to an initial sale, assignment, or other transfer by the originating creditor but to subsequent sales, assignments, and other transfers as well. The proposed comment would have given the following example: Assume Creditor A originates a qualified mortgage under § 1026.43(e)(5). Six months after consummation, Creditor A sells the qualified mortgage to Creditor B pursuant to § 1026.43(e)(5)(ii)(B) and the loan retains its qualified mortgage status because Creditor B complies with the limits on asset size and number of transactions. If Creditor B sells the qualified mortgage, it will lose its qualified mortgage status under § 1026.43(e)(5) unless the sale qualifies for one of the § 1026.43(e)(5)(ii) 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.

Proposed comment 43(e)(5)-7 would have clarified that, under § 1026.43(e)(5)(ii)(A), if a qualified mortgage under § 1026.43(e)(5) is sold, assigned, or otherwise transferred three years or more after consummation, the loan retains its status as a qualified mortgage under § 1026.43(e)(5) following the transfer. The proposed comment would have clarified that this is true even if the transferee is not itself eligible to originate qualified mortgages under § 1026.43(e)(5). The proposed comment would have clarified that, once three or more years after consummation have passed, the qualified mortgage will continue to be a qualified mortgage throughout its life, and a transferee, and any subsequent transferees, may invoke the presumption of compliance for qualified mortgages under § 1026.43(e)(1).

Proposed comment 43(e)(5)-8 would have clarified that, under § 1026.43(e)(5)(ii)(B), a qualified mortgage under § 1026.43(e)(5) may be sold, assigned, or otherwise transferred at any time to another creditor that meets the requirements of § 1026.43(e)(5)(v). The proposed comment would have noted that section § 1026.43(e)(5)(v) requires that a creditor, together with all affiliates during the preceding calendar year, originated 500 or fewer first-lien covered transactions and had total assets less than $2 billion (adjusted annually for inflation) at the end of the preceding calendar year. The proposed comment would have clarified that a qualified mortgage under § 1026.43(e)(5) that is 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.

Proposed comment 43(e)(5)-9 would have clarified that § 1026.43(e)(5)(ii)(C) facilitates sales that are deemed necessary by supervisory agencies to revive troubled creditors and resolve failed creditors. The proposed comment would have noted that this section provides that a qualified mortgage under § 1026.43(e)(5) retains its qualified mortgage status if it is sold, assigned, or otherwise transferred to: another person pursuant to a capital restoration plan or other action under 12 U.S.C. 1831o; the actions or instructions of any person acting as conservator, receiver or bankruptcy trustee; an order of a State or Federal government agency with jurisdiction to examine the creditor pursuant to State or Federal law; or an agreement between the creditor and such an agency. The proposed comment would have clarified that a qualified mortgage under § 1026.43(e)(5) 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. The proposed comment also would have clarified that § 1026.43(e)(5)(ii)(C) 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 government agency described in § 1026.43(e)(5)(ii)(C) mandating the sale of one or more qualified mortgages under § 1026.43(e)(5) held by the creditor, or one of the other circumstances listed in § 1026.43(e)(5)(ii)(C). As an example, the proposed comment would have explained that a qualified mortgage under § 1026.43(e)(5) 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, the mortgage would lose its status as a qualified mortgage following the sale unless it qualifies under another definition of qualified mortgage.

Proposed comment 43(e)(5)-10 would have clarified that a qualified mortgage under § 1026.43(e)(5) retains its qualified mortgage status if a creditor merges with or is acquired by another person regardless of whether the creditor or its successor is eligible to originate new qualified mortgages under § 1026.43(e)(5) after the merger or acquisition. However, the proposed comment also would have clarified that the creditor or its successor can originate new qualified mortgages under § 1026.43(e)(5) after the merger or acquisition only if the creditor or its successor complies with all of the requirements of § 1026.43(e)(5) at that time. The proposed comment would have provided the following example: Assume a creditor that originates 250 covered transactions each year and originates qualified mortgages under § 1026.43(e)(5) is acquired by a larger creditor that originates 10,000 covered transactions each year. Following the acquisition, the small creditor would no longer be able to originate § 1026.43(e)(5) qualified mortgages because, together with its affiliates, it would originate more than 500 covered transactions each year. However, the § 1026.43(e)(5) qualified mortgages originated by the small creditor before the acquisition would retain their qualified mortgage status.

Comments Received

A large number and broad range of commenters expressed support for proposed § 1026.43(e)(5). These commenters included national, State, and regional trade groups representing banks and credit unions, more than 90 small and mid-size creditors from more than two dozen States, one very large creditor, coalitions of State regulators, consumer advocacy organizations, a national trade group representing mortgage bankers, national trade groups representing homebuilders and real estate agents, a tribally designated housing entity, and representatives of the manufactured housing industry. These commenters generally agreed with the points made by the Bureau in its proposal.

A much smaller number of commenters objected to proposed § 1026.43(e)(5). These creditors included a consumer advocacy organization, a national trade group representing very large creditors, one very large creditor, a national trade group representing mortgage brokers, and several individual mortgage brokers. These commenters generally argued that the Bureau should not adopt special rules for small creditors because a consumer's ability to repay does not depend on the size of the creditor. These commenters also raised other arguments, such as that proposed § 1026.43(e)(5) would encourage regulatory arbitrage and charter shopping by creditors or that the Bureau's proposal to provide an additional qualified mortgage definition is evidence that the ability-to-repay and qualified mortgage provisions of the Dodd-Frank Act are fundamentally flawed and should be abandoned in favor of further study.

The Bureau solicited comments on a number of specific issues related to proposed § 1026.43(e)(5). First, the Bureau solicited comment on whether non-conforming mortgage credit is likely to be unavailable if the rule is not amended and whether amending the rule as proposed would ensure that such credit is made available in a responsible, affordable way. Commenters supporting proposed § 1026.43(e)(5) generally agreed with the Bureau's assessment that, without amendment, the ability-to-repay and qualified mortgage rules would significantly limit access to nonconforming credit and access to credit in rural and underserved areas. Many individual small creditors asserted that they would limit the number of residential mortgage loans they made or cease mortgage lending altogether if the rule was not amended and that this would severely limit access to credit in their communities. National and State trade groups representing creditors expressed similar views on behalf of their members. These commenters generally agreed that small creditors are uniquely able and have strong incentives to make accurate determinations of ability to repay, that the incentives to make these determinations accurately and conservatively are particularly strong with respect to portfolio loans, and that the combination of these factors would provide ample protection for consumers. Commenters opposing proposed § 1026.43(e)(5) did not refute the points raised by the Bureau in the proposal. These commenters did not offer evidence or substantive arguments that access to credit would be preserved without the proposed amendments, did not suggest meaningful alternative ways of preserving access to credit, and did not offer substantive arguments or evidence that credit made available pursuant to proposed § 1026.43(e)(5) likely would be irresponsible or unaffordable. One commenter argued that proposed § 1026.43(e)(5) would not preserve access to credit because it would not provide significant regulatory relief to small creditors and because it was limited to a small number of loans per small creditor and therefore would not benefit consumers.

Second, the Bureau solicited comment on the following issues relating to the criteria describing small creditors: Whether the Bureau should adopt criteria consistent with those used in § 1026.35(b) and in the § 1026.43(f) definition of qualified mortgages which applies to certain balloon loans made by small creditors operating predominantly in rural or underserved areas; whether the proposed $2 billion asset limit is appropriate and whether the limit should be higher or lower; and whether to include a limitation on the number of first-lien covered transactions extended by the creditor and its affiliates and, if so, whether the proposed 500-transaction limit is appropriate.

Most commenters urged the Bureau to expand the scope of proposed § 1026.43(e)(5) by adjusting the asset or originations limits or both.[157] Many commenters, including national and State trade groups representing banks and credit unions and many individual small creditors, asserted that 500 annual first-lien originations is more typical of a creditor with assets of $500 million than a creditor with assets of $2 billion. These commenters argued that the 500 annual first-lien originations limit is significantly more restrictive than the $2 billion asset limit and should therefore either be raised or be eliminated. Commenters suggested alternate limits such as 1,000 portfolio loans or between 2,000 and 5,000 total first-lien originations. Some commenters, including trade groups representing creditors and individual small and mid-size creditors, urged the Bureau to raise the $2 billion asset limit to $5 billion or $10 billion. These commenters argued that this change is necessary to facilitate access to nonconforming credit and access to credit in areas that are served only by mid-sized banks with assets greater than $2 billion.

Third, the Bureau solicited comment regarding the requirement that loans be held in portfolio generally, including whether the proposed exemptions were appropriate and whether other criteria, guidance, or exemptions should be included regarding the requirement to hold loans in portfolio, either in lieu of or in addition to those included in the proposal. Commenters generally did not object to the requirement that loans be held in portfolio as described in proposed § 1026.43(e)(5) and the accompanying comments. In addition, many commenters agreed with the Bureau that the requirement that loans be held in portfolio provides important protections for consumers because it aligns consumers' and creditors' interests regarding ability

[157] Several commenters, including representatives of creditors that finance manufactured housing and two creditors that provide low-documentation mortgage loans predominantly to Asian immigrants in California, argued that the Bureau should adopt additional qualified mortgage definitions that would include their mortgage loan products. The Bureau did not propose and did not solicit comment regarding such additional qualified mortgage definitions and is not adopting such definitions at this time.

to repay. One commenter, a consumer advocacy organization, argued against the proposed provision allowing loans to be transferred less than three years after origination because of a creditor's bankruptcy or failure. This commenter argued that bankruptcy or failure may be indicative of poor underwriting leading to high default rates and that consumers therefore should retain the right to make claims against the creditor in bankruptcy, conservatorship, or receivership.

Fourth, the Bureau solicited comment on the loan feature and underwriting requirements with which qualified mortgages under proposed § 1026.43(e)(5) would have to comply. The Bureau solicited comment on whether qualified mortgages under proposed § 1026.43(e)(5) should be exempt from additional provisions of § 1026.43(e)(2) or should be subject to any other loan feature or underwriting requirements, either in lieu of or in addition to those proposed. In particular, the Bureau solicited comment on whether these qualified mortgages should be exempt from the requirement to consider debt-to-income ratio calculated according to appendix Q and the prohibition on debt-to-income ratios in excess of 43 percent and whether other requirements related to debt-to-income ratio or residual income should be provided, either in lieu of or in addition to those proposed. Most commenters supported relaxing underwriting restrictions on portfolio loans made by small creditors generally and exempting these loans from both the requirement to consider debt-to-income ratio calculated according to appendix Q and the prohibition on debt-to-income ratios in excess of 43 percent specifically.[158] These commenters, including consumer advocacy organizations, national and State trade groups representing banks

[158] One commenter, a consumer advocacy organization, urged the Bureau to adopt a lower debt-to-income ratio limit, such as 41 percent, for low-income borrowers for all qualified mortgages. In contrast, other commenters urged the Bureau to raise or eliminate the debt-to-income ratio limit for all qualified mortgages secured by property in Puerto Rico and Hawaii. These commenters argued that the 43 percent debt-to-income ratio limit would limit access to mortgage credit in Puerto Rico and Hawaii because debt-to-income ratios in these areas often are more than 43 percent. The Bureau did not propose and did not solicit comment regarding changes to the debt-to-income ratio limit for other categories of qualified mortgages and is not reconsidering this issue at this time.

and credit unions, and many small creditors, agreed that small creditors are particularly able to make accurate determinations of ability to repay without a specific numeric limit and that the requirement to calculate debt-to-income ratio according to appendix Q would present a significant burden to many small creditors with little or no corresponding benefit to consumers. In addition, many small creditors and national and State trade groups representing creditors argued that all small creditors should be eligible to make balloon-payment qualified mortgages if the loan is held in portfolio.

Fifth, and last, the Bureau solicited comment on the following issue. Section 1026.43(e)(5) could provide different legal status to loans with identical terms based solely on the creditor's size and intention to hold the loan in portfolio. The Bureau stated its belief that the size of and relationship lending model employed by small creditors provide significant assurances that the mortgage credit they extend will be responsible and affordable. However, to the extent that consumers may have a choice of creditors, some of whom are not small, it was not clear that consumers shopping for mortgage loans would be aware that their choice of creditor could significantly affect their legal rights. The Bureau solicited comment on the extent and significance of this risk generally. Specifically, the Bureau solicited comment on whether consumers who obtain small creditor portfolio loans likely could have obtained credit from other sources and on the extent to which a consumer who obtains a portfolio loan from a small creditor would be disadvantaged by the inability to make an affirmative claim of noncompliance with the ability-to-repay rules or to assert noncompliance in a foreclosure action.

Most commenters, including national and State trade groups representing banks and credit unions, as well as many individual small creditors, stated that small creditors make portfolio loans almost exclusively to consumers who do not qualify for secondary market financing for reasons unrelated to ability to repay, including: comparable sales that are not sufficiently similar, too distant, or too old; irregular zoning, lack of zoning, or problems with land records; condominiums that do not comply with secondary market owner-occupancy requirements; loan-to-value ratio; self-employed and seasonally-employed consumers who cannot prove continuance to the satisfaction of the secondary market; consumers with a new job; and small dollar loans that fall below secondary market thresholds. These commenters noted that these issues may be particularly problematic in rural areas but that they are common in suburban and urban areas as well. These commenters stated that consumers who qualify for secondary market financing generally obtain secondary market loans that are not held in portfolio and would be unaffected by proposed § 1026.43(e)(5).

Two commenters, a national trade group representing very large creditors and a very large creditor, argued that consumers would be disadvantaged by proposed § 1026.43(e)(5) because the rule would apply even in geographic areas where there are other creditors and because consumers comparing loans from different creditors would have to compare different legal rights that are difficult to value.

The Final Rule

Section 1026.43(e)(5) and the related comments are adopted as proposed. For the reasons stated below, the Bureau believes that § 1026.43(e)(5) is necessary and appropriate to preserve access to responsible, affordable credit for some consumers, including consumers who do not qualify for conforming mortgage credit.

Access to affordable, responsible credit. The Bureau continues to believe that § 1026.43(e)(5) is necessary to preserve access to credit for some consumers, including consumers who do not qualify for conforming mortgage credit, and will ensure that this credit is provided in a responsible, affordable way.

As discussed above in part II.A and in the section-by-section analysis of § 1026.43(b)(4), the Bureau understands that small creditors are a significant source of nonconforming mortgage credit. The Bureau believes that many of these loans would not be made by larger creditors because the consumers or properties involved are not accurately assessed by the standardized underwriting criteria used by larger creditors or because larger creditors are unwilling to make loans that cannot be sold to the securitization markets. The Bureau therefore believes that access to mortgage credit for some consumers would be restricted if small creditors stopped making nonconforming loans or significantly reduced the number of nonconforming loans they make.

Such an impact could be particularly significant in rural areas, where small creditors are a significant source of credit. As discussed above in part II.A, small creditors are significantly more likely than larger creditors to operate offices in rural areas, and there are hundreds of counties nationwide where the only creditors are small creditors and hundreds more where larger creditors have only a limited presence.

The Bureau also continues to believe that small creditors are particularly well suited to originate responsible, affordable mortgage credit. As discussed above in part II.A, the small creditors often are better able to assess ability to repay because they are more likely to base underwriting decisions on local knowledge and qualitative data and less likely to rely on standardized underwriting criteria. Because many small creditors use a lending model based on maintaining ongoing relationships with their customers, they often have a more comprehensive understanding of their customer’s financial circumstances. Small creditors’ lending activities often are limited to a single community, allowing the creditor to have an in-depth understanding of the economic and other circumstances of that community. In addition, because small creditors often consider a smaller volume of applications for mortgage credit, small creditors may be more willing and able to consider the unique facts and circumstances attendant to each consumer and property, and senior personnel are more likely to be able to bring their judgment to bear regarding individual underwriting decisions.

Small creditors also have particularly strong incentives to make careful assessments of a consumer's ability to repay because small creditors bear the risk of default associated with loans held in portfolio and because each loan represents a proportionally greater risk to a small creditor than to a larger one. In addition, small creditors operating in limited geographical areas may face significant risk of harm to their reputations within their communities if they make loans that consumers cannot repay.

As many commenters reiterated, small creditors have repeatedly asserted that they will not lend outside the qualified mortgage safe harbor. The Bureau does not believe that small creditors face significant litigation risk from the ability-to-repay requirements. For the reasons stated above, the Bureau believes that small creditors as a group generally are better positioned to assess ability to repay than larger creditors, have particularly strong incentives to accurately assess ability to repay independent of the threat of ability-to-repay litigation, and historically have been very successful at accurately assessing ability to repay, as demonstrated by their comparatively low credit losses. In addition, the Bureau believes that because many small creditors use a lending model based on maintaining ongoing relationships with their customers, those customers may be more likely to pursue alternatives to litigation in the event that difficulties with a loan arise. The Bureau therefore believes that it is unlikely that small creditors will face significant liability for claims of noncompliance filed by their customers or will be significantly disadvantaged by recoupment and setoff claims in foreclosure actions.

However, the Bureau acknowledges that due to their size small creditors may find even a remote prospect of litigation risk to be so daunting that they may change their business models to avoid it. The Bureau also believes that the exit of small creditors from the residential mortgage market could create substantial short-term access to credit issues.

The Bureau therefore believes that, absent an amendment to the ability-to-repay and qualified mortgage rules, many small creditors will reduce or cease their mortgage lending activities, which would cause many consumers to face constraints on their access to credit that are entirely unrelated to their ability to repay. The Bureau believes that § 1026.43(e)(5) will preserve consumers' access to credit and, because of the characteristics of small creditors and portfolio lending described above, the credit provided generally will be responsible and affordable.

The Bureau is sensitive to concerns about the consistency of protections for all consumers and about maintaining a level playing field for market participants, but nevertheless believes that a differentiated approach is justified here. The commenters that suggested that consumers' interests are best served by subjecting all creditors to the same standards provided nothing that refutes the points raised in the Bureau's proposal regarding the low credit losses and unique business models of small creditors, their concerns about litigation risk and compliance burden, and the potential access to credit problems the Bureau believes will arise if the rule is not amended. The Bureau also disagrees that § 1026.43(e)(5) would not benefit consumers because it is limited to a small number of loans per creditor. Because there are thousands of small creditors as defined by § 1026.43(e)(5) in the United States, the Bureau believes that

§ 1026.43(e)(5) is likely to preserve access to affordable, responsible mortgage credit for hundreds of thousands of consumers annually.

Asset and originations limits. Section 1026.43(e)(5) includes portfolio loans made by creditors that have assets of $2 billion or less (adjusted annually for inflation) and, together with all affiliates, originate 500 or fewer first-lien mortgages each year. The Bureau proposed these thresholds to maintain consistency with the § 1026.43(f) qualified mortgage definition, which includes certain balloon loans made and held in portfolio by small creditors operating predominantly in rural or underserved areas, and with thresholds used in § 1026.35 as adopted by the Bureau's 2013 Escrows Final Rule. In the proposal, the Bureau emphasized the importance of maintaining consistent criteria, particularly between § 1026.43(e)(5) and (f), to avoid creating undesirable regulatory incentives (such as an incentive to make balloon loans where a creditor has the capability of making other mortgages that better protect consumers' interests) and to minimize compliance burdens by minimizing the number of metrics creditors must track to determine their eligibility for various regulatory provisions. The Bureau continues to believe that it is important to maintain consistency between these provisions.

Many commenters urged the Bureau to raise the limit above 500 first-lien originations for § 1026.43(e)(5), for instance by changing the types of loans counted or the numeric threshold. A national trade group representing small creditors and several other commenters argued that the originations limit in § 1026.43(e)(5) should be based on portfolio loans originated annually rather than all first-lien originations. These commenters argued that including loans sold to the secondary market in the origination threshold was not appropriate because the purpose of § 1026.43(e)(5) is to encourage portfolio lending and thereby preserve consumers' access to nonconforming credit.

On its face, the rationale advanced by these commenters argues against any limitation on the number of portfolio loans, as any limit would discourage portfolio lending in excess of that limit and all portfolio loans appear to carry with them a greater inherent incentive to exercise care in determining ability to repay than loans sold to the secondary market. However, one of the lessons learned in the recent financial crisis is that in the heat of a housing bubble, even portfolio lending standards can become too lax and standards that ensure responsible, affordable lending may be threatened.

Thus, the Bureau did not propose to provide qualified mortgage treatment to all portfolio loans, but rather only to portfolio loans made by small creditors on the theory that both the characteristics of the creditor—its small size, community-based focus, and commitment to relationship lending—and the inherent incentives associated with portfolio lending *together* would justify extending qualified mortgage status to a loan that would not meet the ordinary qualified mortgage criteria. Given this rationale, the Bureau does not believe it is appropriate to adopt an originations limit under which a creditor would be treated as a small, relationship-based creditor no matter how many loans it is selling to the secondary market.

Using publicly available HMDA data and call report data, the Bureau estimated the impact of adopting a limit based on portfolio loan originations instead of total first-lien originations. This change would add nearly one thousand creditors to the scope of § 1026.43(e)(5). These creditors appear to hold a significantly smaller percentage of the loans they originate in portfolio than creditors that would fall within § 1026.43(e)(5) as proposed, raising questions about the extent to which these creditors can be considered relationship lenders. This reinforces the point that the relationship lending model underlying the Bureau's rationale for § 1026.43(e)(5) cannot be defined by reference only to a subset of a creditor's originations, but rather based on the nature of its overall operations. The Bureau therefore continues to believe that an originations limit based on total first-lien originations is the most appropriate way to ensure that the new category of qualified mortgages is appropriately cabined.

In addition, many commenters recommended increasing the originations limit from 500 first-lien mortgages to between 2,000 and 5,000. The principal rationale offered by these commenters is that banks with assets over $500 million often originate more than 500 first-lien mortgages per year and that the limitation on originations is not consistent with (*i.e.*, is significantly more restrictive than) the $2 billion asset limit.

The Bureau intended and believes that both elements of the threshold play independent and important roles. The Bureau believes that an originations limit is the most accurate means of limiting § 1026.43(e)(5) to the class of small creditors the business model of which the Bureau believes will best assure that the qualified mortgage definition facilitates access only to responsible, affordable credit. However, the Bureau believes that an asset limit is nonetheless important to preclude a very large creditor with relatively modest mortgage operations from taking advantage of a provision designed for much smaller creditors with much different characteristics and incentives. Due to general scale, such a creditor would not have the same type of community focus and reputational and balance-sheet incentives to assess ability to repay with sufficient care as smaller, community-based creditors, and is generally better able from a systems perspective to handle compliance functions.

Based on estimates from publicly available HMDA and call report data, the Bureau understands that, under the proposed criteria, the likelihood of falling within the scope of § 1026.43(e)(5) decreases as a creditor's size increases. The proposed limits include approximately 95 percent of creditors with less than $500 million in assets, approximately 74 percent of creditors with assets between $500 million and $1 billion, and approximately 50 percent of creditors with assets between $1 billion and $2 billion. These percentages are entirely consistent with the Bureau's rationale for § 1026.43(e)(5), as described above. As the size of an institution increases, it is to be expected that the scale of its lending business will increase as well. As the scale of a creditor's lending business increases, the likelihood that the institution is engaged in relationship-based lending and employing qualitative or local knowledge in its underwriting decreases. The Bureau therefore continues to believe that the proposed limit of 500 total first-lien originations is consistent with the rationale underlying § 1026.43(e)(5) and appropriate to ensure that consumers have access only to responsible, affordable mortgage credit.

Finally, some commenters argued that the Bureau should increase the asset limit from $2 billion to $5 billion or $10 billion. The Bureau does not believe this change is necessary to preserve access to credit. The traditional definition of a community bank has long been regarded as an institution with less than $1 billion in assets.[159] The Bureau's estimates show that § 1026.43(e)(5) as proposed includes over 90 percent of institutions with assets less than $1 billion. In its recent Community Bank Study, the FDIC employed a more complex definition that excluded a small number of institutions with assets under $1 billion based primarily on the nature of their assets and added a modest number of banks with assets greater than $1 billion based on a multi-factor test including criteria such as the geographic scope of the institution's operations and focus on core banking activities.[160] The Bureau has concluded that the FDIC's definition is too complex for regulatory purposes and no commenters advocated that the Bureau adopt it. However, the Bureau notes that the larger banks added by the FDIC's more nuanced definition of community bank had average assets of $1.9 billion.

[159] *See, e.g., FDIC Community Banking Study*, p. 1-1.
[160] *FDIC Community Banking Study*, p. 1-1 – 1-5.

In addition, the Bureau notes that a creditor with assets between $1 billion and $2 billion has, on average, 16 branches, 252 employees, and operations in 5 counties. In contrast, a creditor with between $2 billion and $10 billion in assets has, on average, 34 branches, 532 employees, and operations in 12 counties. As the staff and geographic scope of an institution increases, it becomes less and less likely that a creditor will engage in relationship lending or use qualitative or local knowledge in its underwriting. In addition, as an institution adds staff and branches, it is more likely from a systems perspective to handle compliance functions. The Bureau therefore believes that the proposed $2 billion asset limit is consistent with the rationale underlying § 1026.43(e)(5) and appropriate to ensure that consumers have access only to affordable, responsible credit.

Portfolio requirements. The Bureau continues to believe that the discipline imposed when small creditors make loans that they will hold in their portfolio is important to protect consumers' interests and to prevent evasion. The Bureau proposed that qualified mortgages under § 1026.43(e)(5) must be held in portfolio for three years to retain their status as qualified mortgages, thus matching the statute of limitations for affirmative claims for violations of the ability-to-repay rules. If a small creditor holds a qualified mortgage in portfolio for three years, it retains all of the litigation risk for potential violations of the ability-to-repay rules except in the event of a subsequent foreclosure.

The Bureau is extending qualified mortgage status only to portfolio loans made by small creditors, rather than all portfolio loans, because, as discussed above, the Bureau believes that small creditors are a unique and important source of non-conforming mortgage credit and mortgage credit in rural areas for which there is no readily available replacement, that small creditors are likely to be particularly burdened by the litigation risk associated with the ability-to-repay requirements and are particularly likely to reduce or cease mortgage lending if subjected to these rules without accommodation, and that small creditors have both strong incentives and particular ability to make these loans in a way that ensures that consumers are able to repay that may not be present for larger creditors.

As the Bureau acknowledged in the proposal, limitations on the ability of a creditor to sell loans in its portfolio may limit the creditor's ability to manage its regulatory capital levels by adjusting the value of its assets, may affect the creditor's ability to manage interest rate risk by preventing sales of seasoned loans, and may present other safety and soundness concerns. The Bureau has consulted with prudential regulators on these issues and continues to believe the proposed exceptions address these concerns without sacrificing the consumer protection provided by the portfolio requirement.

One commenter, a consumer advocacy organization, argued that the Bureau should not adopt the proposed exception that would allow a qualified mortgage under § 1026.43(e)(5) to retain its qualified mortgage status if it is transferred less than three years after origination because of a bank failure. The commenter argued that the need for supervisory action strongly suggests that loans should not be entitled to the presumption of compliance associated with qualified mortgage status. The commenter further asserted that agencies charged with resolving failed creditors have sufficient authority to protect transferees from consumers' claims. The Bureau understands that creditors fail for many different reasons, many of which are entirely unrelated to underwriting practices for residential mortgage loans. The Bureau also continues to believe that this exception is necessary to ensure that resolutions are not impeded. The Bureau therefore declines to adopt the commenter's suggestion.

Underwriting requirements and debt-to-income ratio. Qualified mortgages under § 1026.43(e)(5) differ from qualified mortgages under the § 1026.43(e)(2) general definition in two key respects. First, as discussed above in the section-by-section analysis of § 1026.43(b)(4), qualified mortgages under § 1026.43(e)(5) are subject to a higher annual percentage rate threshold for the qualified mortgage safe harbor. Second, creditors are required to consider the consumer's debt-to-income ratio or residual income and to verify the underlying information generally in accordance with § 1026.43(c), but are not required to calculate the consumer's debt-to-income ratio according to appendix Q and there is no numeric limit on the consumers' debt-to-income ratio.

The Bureau continues to believe that consideration of debt-to-income ratio or residual income is fundamental to any determination of ability to repay. A consumer is able to repay a loan if he or she has sufficient funds to pay his or her other obligations and expenses and still make the payments required by the terms of the loan. Arithmetically comparing the funds to which a consumer has recourse with the amount of those funds the consumer has already committed to spend or is committing to spend in the future is necessary to determine whether sufficient funds exist.

However, for the same reasons that the Bureau declined to impose a specific 43-percent threshold for balloon-payment qualified mortgages under the balloon loan provision in § 1026.43(f), the Bureau does not believe it is necessary to impose a specific debt-to-income ratio or residual income threshold for this category of qualified mortgages. As discussed above, the Bureau believes that small creditors often are particularly able to make highly individualized determinations of ability to repay that take into consideration the unique characteristics and financial circumstances of a particular consumer. While the Bureau believes that many creditors can make mortgage loans with consumer debt-to-income ratios above 43 percent that consumers are able to repay, the Bureau also believes that portfolio loans made by small creditors are particularly likely to be made responsibly and to be affordable for the consumer even if such loans exceed the 43-percent threshold. The Bureau therefore believes that it is appropriate to presume compliance even above the 43-percent threshold for small creditors who meet the criteria set forth in § 1026.43(e)(5). The Bureau believes that the discipline imposed when small creditors make loans that they will hold in their portfolio is sufficient to protect consumers' interests in this regard. Because the Bureau is not adopting a specific limit on consumers' debt-to-income ratio, the Bureau does not believe it is necessary to require creditors to calculate debt-to-income ratio in accordance with a particular standard such as that set forth in appendix Q.

The Bureau does not believe it is appropriate to permit all small creditors to make balloon-payment qualified mortgages under § 1026.43(e)(5) as suggested by some commenters. The Bureau believes that Congress clearly indicated in the Dodd-Frank Act that only small creditors operating predominantly in rural or underserved areas should be eligible to originate balloon-payment qualified mortgages. However, as discussed below in the section-by-section analyses of § 1026.43(e)(6) and (f), the Bureau is providing a two-year transition period during which all small creditors may originate balloon-payment qualified mortgages. This transition period will allow the Bureau to study the existing definitions of rural and underserved to determine whether they adequately preserve consumers' access to responsible, affordable mortgage credit and will facilitate creditors' transition to alternatives to balloon-payment mortgages, such as adjustable-rate mortgages.

Valuation of legal rights by consumers. Finally, the Bureau is convinced that small creditor portfolio loans covered by § 1026.43(e)(5) are unlikely to be provided to consumers who qualify for secondary market financing or who can otherwise obtain mortgage credit. The Bureau therefore concludes that the risk that comparison shopping consumers will be unable to assess the value of the right to sue in the event of default or foreclosure is unlikely to be significant in practice. Also, as discussed above, the Bureau believes that small creditors' historically low credit losses demonstrate that the size and other characteristics of and relationship lending model employed by small creditors provide significant assurances that the mortgage credit they extend will be responsible and affordable. Because consumers are unlikely to receive loans from small creditors that result in default or foreclosure, it appears unlikely that consumers will be significantly disadvantaged by the inability to make an affirmative claim of noncompliance with the ability-to-repay rules or to assert noncompliance in a foreclosure action. The Bureau therefore believes that this issue is not sufficient to outweigh the significant benefit of § 1026.43(e)(5) in preserving access to credit.

Legal authority. Accordingly, the Bureau is exercising its authority under TILA sections 105(a), 129C(b)(2)(vi), and 129C(b)(3)(B)(i) to adopt § 1026.43(e)(5) as proposed for the reasons summarized below and discussed in more detail above. Under TILA section 105(a) the Bureau generally may prescribe regulations that provide for such adjustments and exceptions for all or any class of transactions that the Bureau judges are necessary and proper to effectuate the purposes of TILA, which include the purposes of TILA 129C, and facilitate compliance with these purposes, among other things. The Bureau believes that these amendments are necessary and proper to ensure that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay the loans. This provision is consistent with the findings of TILA section 129C by ensuring that consumers are able to obtain responsible affordable credit, which informs the Bureau's understanding of its purposes.

Furthermore, the Bureau revises the qualified mortgage criteria in the statute to adopt this new definition by finding that this provision is necessary and proper to ensure that responsible, affordable mortgage credit remains available to consumers in a manner consistent with the purposes of TILA section 129C, necessary and appropriate to effectuate the purposes of TILA section 129C and to facilitate compliance with TILA section129C. As described above, the Bureau believes that, unless § 1026.43(e)(5) is adopted, small creditors will be less likely to make residential mortgage loans. Because small creditors are a significant source of nonconforming mortgage credit nationally and mortgage credit generally in rural or underserved areas, this would significantly limit access to mortgage credit for some consumers. The Bureau also believes that the relationship lending model, qualitative local knowledge, and size of small creditors, combined with the intrinsic incentives of portfolio lending, provide strong assurances that these creditors typically will make reasonable and good faith determinations of consumers' ability to repay when originating loans pursuant to § 1026.43(e)(5). This provision is also necessary and proper to facilitate compliance with the purposes of TILA by easing the ability of small creditors to make qualified mortgages. The Bureau also believes that the provisions of § 1026.43(e)(5) relating to debt-to-income ratio or residual income are authorized by TILA section 129C(b)(2)(vi), which authorizes, but does not require, the Bureau to adopt guidelines or regulations relating to debt-to-income ratio or alternative measures of ability to pay regular expenses after payment of total monthly debt.

43(e)(6) Qualified Mortgage Defined—Temporary Balloon-Payment Qualified Mortgage Rules

Background

As discussed above, TILA section 129C(b) and the Bureau's rules thereunder, § 1026.43(e), provide that a creditor or assignee may presume that a loan has met the ability-to-repay requirements described in TILA section 129C(a)(1) through (4) and the Bureau's rules thereunder, § 1026.43(c), if a loan is a qualified mortgage. TILA section 129C(b)(2)(A)(ii) provides that qualified mortgages generally cannot include a balloon payment. Accordingly, § 1026.43(e)(2) of the Bureau's rules provides a general qualified mortgage definition that excludes loans with a balloon payment. In addition, § 1026.43(e)(4) provides a temporary qualified mortgage definition that also excludes balloon-payment loans.

However, TILA section 129C(b)(2)(E) permits the Bureau to provide by regulation an alternate qualified mortgage definition that includes certain balloon payment mortgages originated and held in portfolio by small creditors operating predominantly in rural or underserved areas. The Bureau exercised this authority in adopting § 1026.43(f). Section 1026.43(f) allows creditors with less than $2 billion in assets that originate, together with all affiliates, fewer than 500 first-lien mortgages annually to originate balloon-payment qualified mortgages if the creditor operates predominantly in rural or underserved areas and if certain other requirements are met. The Bureau adopted definitions of rural and underserved in § 1026.35(b)(2)(iv).

As discussed above in the section-by-section analysis of § 1026.43(e)(5), the Bureau proposed and is adopting a fourth category of qualified mortgage which includes loans originated and held in portfolio by small creditors that meet the same asset and originations criteria regardless of whether they operate predominantly in rural and underserved areas. Qualified mortgages in this category are subject to different, more relaxed requirements regarding debt-to-income ratio and are covered by the regulatory safe harbor at a higher annual percentage rate than other qualified mortgages. However, because TILA section 129C(b)(2)(A)(ii) specifies that qualified mortgages generally may not have a balloon payment, § 1026.43(e)(5) does not include mortgages with a balloon payment.

The Bureau's Proposal and Comments Received

Prohibition on balloon payments generally. As discussed above, in proposing the new category of qualified mortgage for certain small creditor portfolio loans under § 1026.43(e)(5), the Bureau solicited comment regarding the loan feature and underwriting requirements with which qualified mortgages under proposed § 1026.43(e)(5) would have to comply. Specifically, the Bureau solicited comment on whether qualified mortgages under proposed § 1026.43(e)(5) should be exempt from provisions of § 1026.43(e)(2) in addition to those related to debt-to-income ratio or should be subject to any other loan feature or underwriting requirements, either in lieu of or in addition to those proposed.

A large number of commenters, including national and State trade groups representing creditors and many individual small creditors, argued that § 1026.43(e)(5) would not have the intended effect of preserving access to nonconforming mortgage credit and mortgage credit in rural areas unless § 1026.43(e)(5) permitted small creditors to make balloon-payment mortgages within the qualified mortgage safe harbor regardless of whether they operate predominantly in rural or underserved areas.

These commenters argued that small creditors rely on balloon-payment provisions to manage interest rate risk for the overwhelming majority of their residential mortgage portfolio loans. One national trade group representing small creditors estimated that 75 percent of all residential mortgages in small creditors' portfolios have a balloon-payment feature. Many small creditors who reported information regarding their own portfolios reported that between 90 and 100 percent of their portfolio mortgage loans include a balloon-payment feature.

These commenters also stated that small creditors that rely on balloon-payment features generally do not have the capability at this time to originate and service adjustable-rate mortgages, also known as ARMs. Adjustable-rate mortgages would serve as an alternate way to manage interest rate risk and are permissible under § 1026.43(e)(5) as proposed and finalized. However, commenters expressed concerns that adjustable-rate mortgages are more difficult for small creditors to originate and service because of the systems and disclosures required.

Finally, these commenters reiterated that small creditors generally will be unwilling or unable to lend outside the qualified mortgage safe harbor because of the associated litigation risk. As such, argued these commenters, the prohibition on balloon-payments under § 1026.43(e)(5) would cause a significant reduction in consumers' access to nonconforming credit.

These commenters also asserted that small creditors have been originating balloon-payment loans for many years without significant harm to consumers and that balloon-payment loans made by small creditors generally have very low default rates that are a fraction of average default rates for mortgage loans generally. These commenters added that portfolio mortgage loans are a significant portion of assets and a significant revenue stream for most small creditors. Therefore, the commenters argued, the inability to make balloon-payment loans within the qualified mortgage safe harbor will cause serious financial harm to many small creditors, further reducing consumers' access to nonconforming and other mortgage credit.

Rollover balloons. The Bureau also solicited comment regarding consumers with balloon-payment loans originated before the January 10, 2014, effective date of the 2013 ATR

Final Rule for which the balloon payment will become due after the effective date. The Bureau noted that small creditors that use balloon-payment loans to manage interest rate risk generally refinance the remaining principal when the balloon payment becomes due. In other words, the small creditors who follow this practice generally use the balloon payment feature as an opportunity to adjust the loan's interest rate, not because they expect the consumer will repay the loan in full before the balloon payment becomes due.

In the proposal, the Bureau stated its belief that the balloon-payment qualified mortgage provision in § 1026.43(f) and the small creditor portfolio exemption in proposed § 1026.43(e)(5) would be adequate to facilitate refinancing of balloon-payment loans for which the balloon-payment becomes due after January 10, 2014. However, the Bureau solicited feedback regarding whether these provisions were adequate for this purpose or whether creditors would need additional time beyond the January 10, 2014, effective date or would require any additional accommodations, modifications, or exemptions.

Several commenters, including small creditors and creditor trade groups, specifically acknowledged the difficulties presented by balloon-payment loans originated before the effective date. These commenters stated the balloon-payment mortgages offered by small creditors generally have payments (other than the balloon) that amortize the loan over 30 years. These commenters stated that consumers most often take these loans not because they expect to repay the loan before the balloon payment becomes due but based on creditors' assurances that they will be able to refinance the loan, albeit at a different rate. In other words, these commenters confirmed that small creditors use balloons in a way that is functionally similar to a long-term adjustable-rate mortgage. These commenters asserted that small creditors generally are committed to refinancing these loans for their customers. They stated, however, that they will be unable or unwilling to do so after the effective date unless changes are made to permit them to originate new balloon-payment loans within the qualified mortgage safe harbor.

These commenters stated that, if the small creditors who originated these loans are unable or unwilling to refinance them, consumers will be forced to seek refinancing elsewhere. According to these commenters, consumers with balloon-payment loans from small creditors generally do not qualify for secondary market financing, and many of these consumers therefore will have difficulty finding other refinancing or restructuring options. The commenters asserted that in extreme circumstances some consumers who are unable to refinance or make the balloon payment might face foreclosure if they were unable to secure refinancing.

Commenters who raised this issue generally argued that the Bureau should exempt loans that refinance a balloon-payment loan originated before the effective date from the ability-to-repay and qualified mortgage rules or significantly broaden the ability of creditors to make balloon loans within the qualified mortgage safe harbor such that a greater portion of these refinancing loans would be covered.

The Final Rule

The Bureau is adopting new § 1026.43(e)(6), which provides a two-year transition period during which small creditors as defined by § 1026.43(e)(5) can originate balloon-payment qualified mortgages even if they do not operate predominantly in rural or underserved areas. The Bureau is adopting new § 1026.43(e)(6) because it believes that doing so is necessary to preserve access to responsible, affordable mortgage credit for some consumers. As discussed further below and in connection with § 1026.43(f), during the two-year period in which § 1026.43(e)(6) is in place, the Bureau intends to review whether the definitions of “rural” or “underserved” should be further adjusted for purposes of the qualified mortgage rule and to explore how it can best facilitate the transition of small creditors' who do not operate predominantly in rural or underserved areas from balloon-payment loans to adjustable-rate mortgages as Congress intended under the Dodd-Frank Act. At the end of the period, however, the Bureau expects that the statutory framework will take full effect such that balloon-payment loans are treated as qualified mortgages only where originated by small creditors operating predominantly in rural or underserved areas under § 1026.43(f).

New § 1026.43(e)(6) defines an additional category of qualified mortgages that, like § 1026.43(e)(5), includes loans originated and held in portfolio by creditors that:

- Have total assets that do not exceed $2 billion as of the end of the preceding calendar year (adjusted annually for inflation); and
- Together with all affiliates, extended 500 or fewer first-lien covered transactions during the preceding calendar year.

New § 1026.43(e)(6) is not limited to small creditors operating predominantly in rural or underserved areas. However, the new provision incorporates by reference all other requirements under the § 1026.43(f) balloon-payment qualified mortgage definition. The loan therefore cannot have:

- Payments that result in an increase of the principal balance;
- A term longer than 30 years; and
- Points and fees greater than 3 percent of the total loan amount (or, for smaller loans, a specified amount).

The creditor must consider and verify the consumer's current or reasonably expected income or assets (other than the dwelling and attached real property that secure the loan) and the consumer's current debt obligations, alimony, and child support. The creditor also must consider the consumer’s monthly debt-to-income ratio or residual income. As with § 1026.43(e)(5) and (f), there is no numeric limit on a consumer’s debt-to-income ratio and creditors are not required to calculate debt-to-income ratio according to appendix Q. In addition, the loan must provide for scheduled payments that are substantially equal and calculated using an amortization period that does not exceed 30 years, an interest rate that does not increase over the term of the loan, and a term of 5 years or longer.

A loan must not be subject at consummation to a commitment to be acquired by any person other than a person that also meets the above asset-size and number of transactions criteria. A loan loses its qualified mortgage status under § 1026.43(e)(6) if it is sold, assigned, or otherwise transferred, subject to exceptions for transfers that are made three or more years after consummation, to another qualifying institution, as required by a supervisory action, or pursuant to a merger or acquisition.

As with all qualified mortgages, a qualified mortgage under § 1026.43(e)(6) receives either a rebuttable or conclusive presumption of compliance with the ability-to repay requirements in § 1026.43(c), depending on the annual percentage rate. However, as described above in the section-by-section analysis of § 1026.43(b)(4), the Bureau is adopting an alternate definition of higher-priced covered transaction for first-lien covered transactions that are qualified mortgages under § 1026.43(e)(5) and (f). As also is discussed above in the section-by-section analysis of § 1026.43(b)(4), this alternate definition applies to qualified mortgages under § 1026.43(e)(6) as well. As such, § 1026.43(b)(4) provides that a first-lien covered transaction that is a qualified mortgage under proposed § 1026.43(e)(6) is a higher-priced covered transaction if the annual percentage rate exceeds APOR for a comparable transaction by 3.5 or more percentage points. This extends the qualified mortgage safe harbor described in § 1026.43(e)(1)(i) to first-lien qualified mortgages defined under proposed § 1026.43(e)(6) even if those loans have annual percentage rates between 1.5 and 3.5 percentage points higher than APOR. Such loans otherwise would be covered by the rebuttable presumption of compliance described in § 1026.43(e)(1)(ii).

As discussed below, § 1026.43(e)(6) is intended to provide a temporary transition period during which small creditors that do not operate predominantly in rural and underserved areas can originate balloon-payment qualified mortgages. Section 1026.43(e)(6) therefore applies only to loans consummated on or before January 10, 2016, two years after the effective date of the 2013 ATR Final Rule. Qualified mortgages originated under § 1026.43(e)(6) on or before January 10, 2016, will retain their qualified mortgage status after January 10, 2016, as long as all other requirements, such as the requirement to retain the loan in portfolio subject to certain exceptions, are met.

The Bureau believes § 1026.43(e)(6) appropriately balances consumer protection and access to credit issues. As discussed above in the section-by-section analyses of § 1026.43(b)(4) and (e)(5), the Bureau believes that small creditors are an important source of mortgage credit, including nonconforming mortgage credit, and that there would be a significant reduction in consumers' access to credit if small creditors were to substantially reduce the number of residential mortgage loans they make or cease mortgage lending altogether. The Bureau also understands that small creditors generally do not originate long-term fixed-rate portfolio loans because of the associated interest rate risk, that many small creditors do not offer ARMs because they do not have the compliance and other systems in place to originate and service them, and that many small creditors have expressed reluctance to offer balloon-payment mortgages outside the qualified mortgage safe harbor because of the associated litigation risk. The Bureau also understands that some consumers may find it more inconvenient, more costly, or more difficult to refinance their existing balloon-payment loans if small creditors are unable or unwilling to refinance these loans because these consumers would have to seek financing from other creditors. The Bureau also is sensitive to concerns that some consumers may be unable to find alternative financing and therefore could face foreclosure.

Commenters' preferred solution is for the Bureau to significantly and permanently broaden the ability of all small creditors to make balloon-payment mortgages that are either exempt from the ability-to-repay rules or within the qualified mortgage safe harbor. As discussed further below with regard to § 1026.43(f), the Bureau believes it is appropriate to use the two-year transition period to consider whether it can develop more accurate or precise definitions of rural and underserved. However, the Bureau believes that Congress made a deliberate policy choice in the Dodd-Frank Act not to extend qualified mortgage status to balloon-payment products outside of such areas. The Bureau believes that with appropriate transition time, and perhaps implementation support, small creditors can develop adjustable-rate mortgage products that will enable them to manage interest rate risk in a manner that poses less risk for consumers. Accordingly, the Bureau also will focus during the two-year transition period on facilitating small creditors' conversion to adjustable-rate mortgage products.

The Bureau understands that adjustable-rate mortgages offered today by many creditors would fall within that qualified mortgage safe harbor and incorporate interest rate adjustment features similar to those of the balloon-payment mortgages used by many small creditors. For example, the interest rate of a 5/5 ARM adjusts five years after consummation and every five years thereafter for the duration of the loan term, paralleling the interest rate adjustment terms of an amortizing 5-year balloon-payment mortgage that is expected to be refinanced until it is paid off. The Bureau also understands that there are differences between adjustable-rate and balloon-payment mortgages that may be significant for some creditors. Interest rate adjustments for adjustable-rate mortgages are tied to changes in an index rate, and commonly used index rates (*e.g.*, the London Interbank Offered Rate or "LIBOR") may not track small creditors' cost of funds. Interest rates for adjustable-rate mortgages generally are capped at a certain amount above the initial rate, and this cap makes managing interest rate risk more complex. In addition, creditors that do not currently originate ARMs are likely to incur costs for developing the capability to do so (such as by purchasing additional modules for existing lending platforms), and there are additional expenses associated with servicing adjustable-rate mortgages, as consumers must be notified before each interest rate adjustment and servicing systems must be equipped to adjust the interest rate and payment amount.

However, adjustable-rate mortgages also pose significantly less risk to consumers. The Bureau believes that balloon-payment mortgages are particularly risky for consumers because the consumer must rely on the creditors' nonbinding assurances that the loan will be refinanced before the balloon payment becomes due. Even a creditor with the best of intentions may find itself unable to refinance a loan when a balloon payment becomes due. Changes in the consumer's credit profile may affect the creditor's willingness to refinance or the price of the loan, and consumers may be unable to anticipate the new rate that will be offered and suddenly find that they are unable to afford it. Consumers with balloon-payment mortgages therefore face the periodic possibility of losing their property even if they perform their obligations under the terms of the loan. Adjustable-rate mortgages present less risk to consumers because they do not require refinancing and because interest rate adjustments are calibrated over the life of the loan and therefore are more predictable.

Publicly available data from reports filed with the National Credit Union Administration indicate that around 20 percent of small credit unions, including some with assets below $150 million, originate adjustable-rate mortgages and only 18 percent of small credit unions originate balloon-payment mortgages but not adjustable-rate mortgages. This suggests that small creditors can manage interest rate risk, lend safely and soundly, and afford the expense and compliance burden associated with originating adjustable-rate mortgages.

The Bureau believes that Congress made a clear policy choice in the Dodd-Frank Act that small creditors not operating predominantly in rural or underserved areas must ultimately conduct their residential mortgage business using adjustable-rate mortgages or other alternatives to balloon-payment mortgages. However, as discussed below in the section-by-section analysis of § 1026.43(f), the Bureau believes that further study of the existing definitions of rural and underserved is warranted. In addition, the Bureau acknowledges that many small creditors are not equipped to offer alternatives to balloon-payment mortgages today and are unlikely to be so equipped by the January 10, 2014, effective date. If small creditors are unable or unwilling to originate new loans as of that date, the Bureau believes there will be deleterious effects on access to nonconforming credit and possible harm to consumers with balloon-payment mortgages originated before the effective date that expect to refinance their loans with the same creditor when the balloon payment becomes due.

The Bureau therefore believes that, in order to preserve access to affordable, responsible credit, it is necessary and appropriate to provide small creditors, as defined in § 1026.43(e)(5), with a two-year transition period after the effective date during which they can continue to originate balloon loans. The Bureau believes that this two-year period will enable the Bureau to re-examine the definitions of rural or underserved to determine, among other things, whether these definitions accurately identify communities in which there are limitations on access to credit and whether it is possible to develop definitions that are more accurate or more precise. The Bureau may consider proposing changes to the definitions of rural or underserved based on the results of its inquiry. The two-year transition period also will facilitate small creditors' conversion to adjustable-rate mortgage products or other alternatives to balloon-payment loans.

Accordingly, the Bureau is exercising its authority under TILA sections 105(a), 129C(b)(2)(vi), and 129C(b)(3)(B)(i) to adopt § 1026.43(e)(6) for the reasons summarized below and discussed in more detail above. Under TILA section 105(a) the Bureau generally may prescribe regulations that provide for such adjustments and exceptions for all or any class of transactions that the Bureau judges are necessary and proper to effectuate the purposes of TILA, which include the purposes of TILA 129C, and facilitate compliance with these purposes, among other things. The Bureau believes that these amendments are necessary and proper to ensure that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay the loans. This provision is consistent with the findings of TILA section 129C by ensuring that consumers are able to obtain responsible affordable credit, which informs the Bureau's understanding of its purposes.

Furthermore, the Bureau revises the qualified mortgage criteria in the statute to adopt this new definition by finding that this provision is necessary and proper to ensure that responsible, affordable mortgage credit remains available to consumers in a manner consistent with the purposes of TILA section 129C, necessary and appropriate to effectuate the purposes of TILA section 129C and to facilitate compliance with TILA section129C. As described above, the Bureau believes that, unless § 1026.43(e)(6) is adopted, small creditors will be less likely to make residential mortgage loans. Because small creditors are a significant source of nonconforming mortgage credit nationally and mortgage credit generally in rural or underserved areas, this would significantly limit access to mortgage credit for some consumers. The Bureau also believes that the relationship lending model, qualitative local knowledge, and size of small creditors, combined with the intrinsic incentives of portfolio lending, provide strong assurances that these creditors typically will make reasonable and good faith determinations of consumers' ability to repay when originating loans pursuant to § 1026.43(e)(6). This provision is also necessary and proper to facilitate compliance with the purposes of TILA by easing the ability of small creditors to make qualified mortgages. The Bureau also believes that the provisions of § 1026.43(e)(6) relating to debt-to-income ratio or residual income are authorized by TILA section 129C(b)(2)(vi), which authorizes, but does not require, the Bureau to adopt guidelines or regulations relating to debt-to-income ratio or alternative measures of ability to pay regular expenses after payment of total monthly debt.

43(f) Balloon-Payment Qualified Mortgages Made by Certain Creditors

Section 1026.43(f) provides that certain balloon loans made and held in portfolio by certain small creditors operating predominantly in rural or underserved areas are qualified mortgages. The Bureau did not propose specific amendments to § 1026.43(f), but explained that if proposed § 1026.43(e)(5) were adopted with changes inconsistent with § 1026.43(f), the Bureau would consider and might adopt parallel amendments to § 1026.43(f) in order to keep these sections of the regulation consistent.

The Bureau solicited comment on the advantages and disadvantages of maintaining consistency between § 1026.43(e)(5) and (f). Commenters generally did not specifically discuss the importance of consistency, although most commenters advocating for changes to § 1026.43(e)(5) stated that conforming changes should be made to § 1026.43(f) as well.

However, many commenters raised concerns regarding the scope of the Bureau's definitions of rural and underserved under § 1026.43(f). Commenters including national and State trade groups representing creditors and dozens of small creditors argued that the Bureau's definitions of rural and underserved are too restrictive and do not adequately preserve consumers' access to credit. Commenters were particularly critical of the Bureau's definition of "rural," which they asserted excluded many communities that are considered rural under other legal or regulatory definitions or that are commonly viewed as rural because of their small, isolated, agricultural or undeveloped characteristics. Some of these commenters proposed that the Bureau adopt alternate definitions of "rural," such as those used by the U.S. Department of Agriculture's Rural Housing Loan Program or the Farm Credit System. Others suggested that all creditors or all small creditors should be eligible to make balloon-payment qualified mortgages if the loan is held in portfolio, or that a balloon-payment mortgage should be considered a qualified mortgage if the consumer and property have certain characteristics that suggest the loan would not be eligible for sale to the secondary market.

Other commenters raised concerns about the requirement that balloon-payment qualified mortgages have a loan term of five years or longer. These commenters asserted that many small creditors currently originate balloon-payment loans with shorter terms and would be unable to manage interest rate risk using balloon-payment loans with a five-year term.

One commenter, a consumer advocacy organization, argued that all qualified mortgages should be long-term, fixed-rate loans and that the § 1026.43(f) definition of balloon-payment qualified mortgages should be abandoned.

As discussed above in the section by section analysis of § 1026.43(e)(5), § 1026.43(e)(5) as adopted is consistent with existing § 1026.43(f). The Bureau did not propose and did not solicit comment regarding amendments § 1026.43(f) except with respect to preserving consistency with § 1026.43(e)(5), and the Bureau is not reconsidering the definitions of rural and underserved and the § 1026.43(f) restrictions on the terms of balloon-payment qualified mortgages at this time. The Bureau is therefore not adopting any changes to § 1026.43(f) in this rulemaking.

However, the Bureau is sensitive to concerns expressed by commenters that the existing definitions of rural and underserved may not include some communities in which there are limitations on access to credit related to the community's rural character or the small number of creditors operating in the community. For example, the Bureau is aware that there are drawbacks to a county-based system for defining "rural" and "undeserved," such as in western States where counties may cover extremely large areas. As discussed above in the section-by-section analysis of § 1026.43(e)(6), the Bureau is providing a two-year transition period during which small creditors can originate balloon payment qualified mortgages even if they do not operate predominantly in rural or underserved areas. In addition to providing time for small creditors to further develop their capacity to offer adjustable-rate mortgages, the Bureau expects to re-examine the definitions of rural or underserved during this time to determine, among other things, whether these definitions accurately identify communities in which there are limitations on access to credit and whether it is possible to develop definitions that are more accurate or more precise. The Bureau may consider proposing changes to the definitions of rural or underserved based on the results of its inquiry.

43(g) Prepayment Penalties

The Bureau is adopting conforming amendments to § 1026.43(g) to include references to § 1026.43(e)(5) and (6), as described in the section-by-section analyses of those sections, above.

VI. Effective Date

This final rule is effective on January 10, 2014. The rule applies to transactions for which the creditor received an application on or after that date. The Bureau received several comments requesting various delays in the effective date. For example, one commenter asked the Bureau to delay the effective date for all of § 1026.43 by six months to provide sufficient time to implement the processes, procedures, and systems changes needed to comply with the ability-to-repay requirements. The Bureau has considered these comments, but declines to delay the effective date. The Bureau acknowledges the challenges identified by commenters, but believes that an effective date of January 10, 2014 provides sufficient time to implement the required changes. Also, as discussed in the 2013 ATR Final Rule, the Bureau believes that this effective date will ensure that consumers receive the protections in these rules as soon as reasonably practicable, taking into account the timeframes established in section 1400(c) of the Dodd-Frank Act, the overlapping provisions of the other title XIV final rules, the Bureau's efforts at facilitating regulatory implementation, and the need to afford creditors, other affected entities, and other industry participants sufficient time to implement the more complex or resource-intensive new requirements.[161]

VII. Dodd-Frank Act Section 1022(b)(2) Analysis

In developing the final rule, the Bureau has considered potential benefits, costs, and impacts.[162] In addition, the Bureau has consulted, or offered to consult with, the prudential regulators, SEC, HUD, FHFA, the Federal Trade Commission, and the Department of the

[161] *See* 78 FR 6555 (Jan. 30, 2013).

[162] Specifically, section 1022(b)(2)(A) of the Dodd-Frank Act calls for the Bureau to consider the potential benefits and costs of a regulation to consumers and covered persons, including the potential reduction of access by consumers to consumer financial products or services; the impact on depository institutions and credit unions with $10 billion or less in total assets as described in section 1026 of the Dodd-Frank Act; and the impact on consumers in rural areas.

Treasury, including regarding consistency with any prudential, market, or systemic objectives administered by such agencies. The Bureau also held discussions with or solicited feedback from the United States Department of Agriculture, Rural Housing Service, the Federal Housing Administration, and the Department of Veterans Affairs regarding the potential impacts of the final rule on those entities' loan programs.

The Bureau is issuing this final rule to adopt certain exemptions, modifications, and clarifications to TILA's ability-to-repay rule. On January 10, 2013, the Bureau issued the 2013 ATR Final Rule to implement the ability-to-repay requirements of the Dodd-Frank Act that generally require a creditor to make a reasonable, good faith determination of a consumer's ability to repay a mortgage loan and other statutory provisions. *See* 78 FR 6407 (Jan. 30, 2013). At the same time, the Bureau issued the 2013 ATR Proposed Rule related to certain proposed exemptions, modifications, and clarifications to the ability-to-repay rule. *See* 78 FR 6621 (Jan. 30, 2013).

The final rule provides exceptions to the 2013 ATR Final Rule, which implements the statute's inclusion of loan originator compensation in points and fees. Specifically, in the final rule, payments by consumers to mortgage brokers need not be counted as loan originator compensation where such payments already have been included in points and fees as part of the finance charge. In addition, compensation paid by a mortgage broker to its employee loan originator need not be included in points and fees, nor does compensation paid by a creditor to its own loan originator employees. However, consistent with the statute and 2013 ATR Final Rule, compensation paid by a creditor to a mortgage broker continues to be included in points and fees in addition to any origination charges paid by a consumer to the creditor.

The final rule also provides certain exemptions from the ATR requirements. These include exemptions for extensions of credit made by certain types of creditors, in accordance with applicable conditions, including creditors designated by the U.S. Department of the Treasury as Community Development Financial Institutions; creditors designated by the U.S. Department of Housing and Urban Development as either a Community Housing Development Organization or a Downpayment Assistance Provider of Secondary Financing; and certain creditors designated as nonprofit organizations under section 501(c)(3) of the Internal Revenue Code. The final rule also exempts from the ability-to-repay requirements extensions of credit made pursuant to a program administered by a housing finance agency (HFA) and extensions of credit made pursuant to an Emergency Economic Stabilization Act program.

The final rule creates two new definitions for loans that can be qualified mortgages. The final rule creates a new category of qualified mortgages that includes, among other conditions, certain loans originated and held on portfolio by creditors that have total assets of less than $2 billion at the end of the previous calendar year and, together with all affiliates, originated 500 or fewer first-lien covered mortgages during the previous calendar year. In addition, the final rule creates a two-year transition period during which balloon loans originated and held on portfolio by small creditors (as defined above) who do not operate predominantly in rural or underserved areas can be qualified mortgages under defined conditions. Such loans would not be eligible for qualified mortgage status under section 1026.43(f) because under the statute, that provision is limited to creditors that operate predominantly in rural or underserved areas. The final rule also allows small creditors to charge a higher annual percentage rate of 3.5 percentage points above the Average Prime Offer Rate for first-lien qualified mortgages, and still benefit from a conclusive presumption of compliance (or safe harbor). This higher threshold applies to the new small creditor portfolio qualified mortgages just described, to first-lien balloon-payment qualified mortgages originated by small creditors operating predominantly in rural or underserved areas and, to balloon mortgages originated by other small creditors during the two-year transition period.

This analysis generally examines the benefits, costs, and impacts of the final rule against the baseline of the January 2013 ATR Rule.[163] For the analyses considered here, the Bureau believes that the baseline of the 2013 ATR Final Rule is the most appropriate and informative. Because the final rule includes amendments and clarifications to the January 2013 ATR Rule, a comparison to the January baseline focuses precisely on the impacts of such provisions. The analyses in this section rely on data that the Bureau have obtained, the record including comments received in the proposed rule, and the record established by the Board and Bureau during the development of the 2013 ATR Final Rule. However, the Bureau notes that for some analyses, there are limited data available with which to quantify the potential costs, benefits, and impacts of the proposal. Still, general economic principles together with the limited data that are available provide insight into the benefits, costs, and impacts and in these cases, the analysis provides a qualitative discussion of the benefits, costs, and impacts of the final rule.

Commenters on the proposed rule did not submit comments specifically addressing the analyses under Section 1022 contained in the Supplemental Information accompanying the proposal. However, several did address the overall benefits, costs and impacts of the proposal.[164] The comments are discussed throughout the section-by-section analyses above.

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[163] The Bureau has discretion in future rulemakings to choose the relevant provisions to discuss and to choose the most appropriate baseline for that particular rulemaking.

[164] In conducting the interagency consultation process under section 1022(b)(2)(B), the Bureau received communications for the public record regarding the proposed rule. The FDIC, HUD, and OCC wrote the Bureau regarding the proposed provisions on loan originator compensation and FHFA and HUD wrote the Bureau regarding the proposed exemptions from the ability-to-repay requirements. These comments are discussed in more detail in the section-by-section analyses above.

A. Potential Benefits and Costs to Consumers and Covered Persons

1. Points and Fees Calculation

In the final rule, payments by consumers to mortgage brokers need not be counted as loan originator compensation where such payments already have been included in points and fees as part of the finance charge. In addition, compensation paid by a mortgage broker to its employee loan originator need not be included in points and fees, nor does compensation paid by a creditor to its own loan originator employees. However, compensation paid by a creditor to a mortgage broker is included in points and fees in addition to any origination charges paid by a consumer to the creditor.

As noted above, the Bureau believes that the most appropriate baseline against which to consider these changes is the 2013 ATR Final Rule. Consistent with the literal language of the statute, the 2013 ATR Final Rule provided that loan originator compensation be treated as additive to other elements of points and fees and that compensation is added as it flows downstream to the loan originator. As discussed in the section-by-section analyses above, the Bureau is now invoking its exception and revision authorities to alter the statutory additive approach to exclude certain compensation.

At a general level, the exclusion (inclusion) of additional sources of compensation in the points and fees calculation decreases (increases) the total amount of points and fees. As explained in the 2013 ATR Final Rule, keeping all other provisions of a given loan fixed, calculations that exclude additional amounts of compensation will result in a greater number of loans being eligible as qualified mortgages. Conversely, calculations that include additional amounts of compensation are less likely to achieve qualified mortgage status. For loans that are not eligible to be qualified mortgages, the costs of origination may be slightly higher as a result of the slightly increased liability for the lender and any assignees and of possibly increased compliance costs related to the origination and documentation of the loan. If these costs are passed along, consumers' costs for these loans may also increase. However, these consumers will also have the added consumer protections that accompany loans made under the general ability-to-repay provisions. In some instances, such up-front points and fees could be folded into the interest rate in order to maintain loans' status as qualified mortgages, which in turn could move loans out of the safe harbor and into the rebuttable presumption. The 2013 ATR Final Rule discussed the impacts of the ability-to-repay/qualified mortgage regime on consumers in depth including the nature of the liability regime. To the extent that the impact of various provisions of this rule on consumers is essentially to expand or contract coverage of the ability-to-repay/qualified mortgage regime, the general discussion of the impacts from the January 2013 rule is informative for each of the various provisions.

The exclusion (inclusion) of additional loan originator compensation amounts in points and fees may similarly lead fewer (more) loans to exceed the points and fees triggers and rate triggers for high-cost mortgages under HOEPA. Based on the history of high-cost mortgage loans, the Bureau believes that loans exceeding the high-cost thresholds are less likely to be offered unless they can be restructured with lower up front points and fees. Consumers who are offered and accept loans above the high-cost mortgage threshold will have the added consumer protections that accompany high-cost mortgage loans; other consumers may still able to take out their loan by paying a higher interest rate and less up-front.[165] The January 2013 HOEPA rule discussed the impacts of the high-cost mortgage regime on consumers in depth including the nature of the liability regime. To the extent that the impact of various provisions of this rule on

[165] The ability to cover up-front costs in the interest rate depends on the characteristics of the borrower and the loan. The interest rate threshold for high-cost mortgages under HOEPA could also potentially limit this option.

consumers is essentially to expand or contract coverage of the high cost mortgage regime, the general discussion of the impacts from the January 2013 HOEPA rule is informative for each of the various provisions.

Measured against the 2013 ATR Final Rule baseline, the final rule excludes certain compensation from the points and fees calculation in both the wholesale and retail channels. In the wholesale channel, two types of compensation are excluded: payments by consumers to mortgage brokers where such payments are already included in points and fees as part of the finance charge and compensation paid by a mortgage broker to its employee loan originator. In the retail channel, compensation paid by a creditor to its own loan originator employees is also excluded. Because of these exclusions, more loans will satisfy the points and fees threshold for qualified mortgages and fewer loans will exceed the points and fees threshold for high-cost mortgages. As described above, for covered persons, the costs of supplying such loans should be slightly reduced; consumers with such loans should therefore benefit from greater access to credit and lower costs, but would have a more restricted ability to challenge violations of the ability-to-repay rules and would not benefit from the protections afforded to high-cost mortgages.

The magnitude of both of these effects – changes in the status of loans as qualified mortgages or high cost mortgages and the extent to which lenders may adjust pricing and compensation practices in response to such provisions – will determine the costs, benefits, and impacts on covered persons and consumers. As noted earlier, comprehensive and representative data that include points and fees as well as loan originator compensation is not readily available. The Bureau did receive some data, however, in response to its requests included in the proposed rule. In a communication that has been made part of the record, one industry trade group submitted data to the Bureau that contained loan-level information for three anonymous retail lenders. These data included information on points and fees and estimates of loan originator compensation. Based on the limited data in this submission, excluding compensation paid by retail lenders to their loan officers has a minor impact on the number of loans below the qualified mortgage points and fees or high-cost mortgage thresholds.[166] The Bureau is not able to determine precisely how representative these data are of the overall retail mortgage market, however. The Bureau therefore did not rely on these data, although the overall patterns in these data and the general magnitudes of any effects align with the Bureau's general understanding of the level of loan originator compensation and the level of up-front charges in the market. This general understanding informs the Bureau's analysis and leads the Bureau to believe that the economic impact of these outcomes should be small. On the whole, the final rule will slightly reduce costs related to supplying these loans as well as compliance costs for covered persons as compared to the 2013 ATR Final Rule. The Bureau believes that consumers will benefit from slightly increased access to credit and lower costs on the affected loans, but in return will not receive the protections afforded to loans originated under the general ability-to-repay standards or to high-cost mortgages.

This provision of the rule may also alter the competitive dynamics between the wholesale channel and the retail channel. As noted above, the Bureau recognizes that an additive approach makes it more difficult for creditors to impose up-front charges and still remain under the qualified mortgage points and fees limits and the high-cost mortgage threshold. For certain loans

[166] The precise magnitudes of the effects depend critically on whether third-party charges are provided by an affiliate of the loan originator. Assuming that affiliates are not involved in the transaction, the rule has almost no effect, with fewer than 0.5% of loans in this sample dropping below the relevant thresholds. Under the assumption that affiliates provided all settlement services, roughly 6% of loans that would exceed the limits are projected to no longer do so once loan originator compensation is excluded. However, this figure is very likely an overestimate: even for those creditors that use affiliates, it is rare that all settlement charges would be provided by affiliated third parties.

originated through the brokerage channel, the inclusion of compensation paid by the creditor to the brokerage firm in the points and fees calculation may have the effect of denying the loan qualified mortgage status while a loan ostensibly similar in terms of interest rate and up-front charges but that has no broker commission because it is offered through the retail channel might be a qualified mortgage. However, for loans in the brokerage channel, this impact could be mitigated by having the consumer pay the broker directly, by shifting other origination charges into the rate, and/or by shifting from a settlement services provider affiliated with the creditor to a non-affiliated provider.

The major alternative that the Bureau considered to address the competitive impact of the final rule was including in points and fees compensation from creditors to their loan originator employees in retail transactions (either under an additive or netting approach). This alternative, however, also could have altered the nature of competition between retail and the wholesale channels. On the one hand, if this alternative had been implemented, fewer loans made through the retail channel would have fallen within the regulatory points and fees thresholds.[167] On the other hand, the compliance burden on creditors originating retail transactions would have been significant, which could have given the wholesale channel a competitive advantage over the retail channel due to the cost of complying with this alternative. As noted above, the Bureau's general understanding of the market suggests that this alternative would not materially change which loans are qualified mortgages in the retail channel. However, the Bureau received numerous industry comments asserting that counting loan officer compensation in retail

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[167] The extent that payments from creditors to brokerage firms must cover overhead, which is not included in payments from creditor to their own employees, limits the degree to which this alternative could achieve a fully equal impact.

transactions would impose a significant burden on the retail channel.[168] Each creditor originating loans through the retail channel would have to devise internal policies and systems regarding which components of loan officers' compensation (and that of any other employees occasionally performing some of the loan officers' functions) to include under the rule and a method of tracking such compensation in real time for the purpose of determining whether a particular loan is eligible for the qualified mortgage status or is a high-cost mortgage. The Bureau believes that the labor and investments to develop such systems would be substantial. As described above, the Bureau was also concerned that this alternative would have provided little benefit to consumers, in part due to the anomalies in counting individual loan originator compensation that is specific to the retail transaction as of the time that the interest rate is set.

The other major alternative discussed in the proposed rule would have permitted creditors to net origination charges against loan originator compensation paid to brokers (and creditors' own loan originator employees) to calculate the amount of loan originator compensation that is included in points and fees. As noted, under such an approach (as compared to the final rule), fewer loans originated through the wholesale channel would exceed the qualified mortgage and high-cost points and fees thresholds. In the wholesale context, comprehensive data that includes points and fees as well as loan originator compensation is also not readily available. However, as discussed above, the Bureau was concerned that such an approach would reduce the benefits to consumers of the qualified mortgage status and high-cost mortgage protections by allowing higher combined loan originator compensation and up-front points and fees. Particularly in markets that are not fully competitive or in transactions involving less sophisticated consumers or consumers who are less likely to shop for competitive pricing, the

[168] The wholesale channel does not experience nearly the same burden due to this rule. Both the creditor to broker and the consumer to creditor fees are already routinely calculated by the industry.

Bureau was concerned that the netting approach would provide greater flexibility to structure loan originator compensation to provide incentives for mortgage brokers to deliver more costly loans. In addition, the Bureau was concerned that such an approach would have created strong incentives for creditors and mortgage brokers to structure loan originator compensation to be paid through the creditor to take advantage of the netting approach, which is not available where the consumer pays the mortgage broker directly.

Other combinations of the additive approach, the netting approach, and the approach of excluding all compensation in either channel are also possible; the impacts are derived as combinations of the ones discussed here.

2. Exemptions from Ability-to-Repay Requirements

As described in the Section 1022 Analysis of the 2013 ATR Final Rule, there are a number of situations where creditors may engage in lending with too little regard for the consumer's ability to repay. The 2013 Final ATR Rule is designed to minimize such activity by ensuring proper documentation and verification related to extensions of credit and by requiring consideration of a number of factors including the consumer's debt-to-income ratio and credit history. Creditors who fail to follow any of these requirements, or who extend credit without a "reasonable and good faith determination" of the consumer's ability to repay, are subject to liability.[169] However, as described above, the Bureau was concerned that the ability-to-repay requirements adopted in the 2013 ATR Final Rule would undermine or frustrate application of the uniquely tailored underwriting requirements employed by certain creditors and programs, and

[169] The liability regime extends beyond creditors. As amended by section 1413 of the Dodd-Frank Act, TILA provides that when a creditor, an assignee, other holder or their agent initiates a foreclosure action, a consumer may assert a violation of TILA section 129C(a) "as a matter of defense by recoupment or setoff." TILA section 130(k). There is no time limit on the use of this defense and the amount of recoupment or setoff is limited, with respect to the special statutory damages, to no more than three years of finance charges and fees. The impacts of the liability regime applicable to covered mortgages are discussed in more detail in the 1022 analysis for the 2013 ATR Final Rule.

would require a significant diversion of resources to compliance, thereby significantly reducing access to credit. The Bureau was also concerned that some of these creditors would not have the resources to implement and comply with the ability-to-repay requirements, and may have ceased or severely limited extending credit to low- to moderate-income consumers, which would result in the denial of responsible, affordable mortgage credit. The exemptions from the ability-to-repay requirements are designed to eliminate these requirements and thereby to limit creditors' costs and protect credit availability in carefully defined circumstances, namely loans or loan programs that serve certain consumers or communities and that typically assess repayment ability in ways that do not necessarily comport with the requirements of the Act and the 2013 ATR Final Rule.

As described earlier, mortgage lending by community-focused creditors, programs operated by housing finance agencies, nonprofit organizations, and housing stabilization programs, varies widely in the form of financing, the products offered, and the precise nature of underwriting. In particular, the Bureau understands that many of these creditors do not use documentation and verification procedures closely aligned with the requirements of the 2013 ATR Final Rule or consider all of the underwriting factors specified in the rule. The benefits of the final rule derive from eliminating the costs of imposing these requirements on these particular extensions of credits and assuring that credit remains available through these programs without regard to the rule's underwriting factors. Access to credit is a specific concern for the populations generally served by these lenders and programs.

As explained in the 2013 ATR Final Rule, in general, consumers and others could be harmed by this action as it removes particular consumer protections and could allow some deleterious lending to occur. However, in all of the cases discussed above, the Bureau believes that the community-focused mission of the creditor organizations and/or programs through which credit is extended, the close interaction between creditors and consumers in these instances, and other safeguards (including government monitoring of certain categories and the origination thresholds for the general nonprofit category) should mitigate any potential harms to consumers and costs from the rule.

Data regarding the exact scope of lending through these channels are limited, as are data regarding the performance of these loans. There are 51 HFAs and approximately 1,000 CDFIs, 62 percent of which are classified as Community Development (CD) Loan Funds, 22 percent as CD Credit Unions, while the rest are CD Banks, Thrifts, or CD Venture Capital Funds.[170] There are 233 501(c)(3) nonprofit agencies and nonprofit instrumentalities of government in the U.S. that are authorized to provide secondary financing,[171] 267 creditors certified by HUD as Community Housing Development Organizations (CHDOs) in connection with HUD's HOME Investment Partnership Program,[172] and 231 organizations certified as Downpayment Assistance through Secondary Financing Providers.[173] The Bureau is not aware and commenters did not provide a comprehensive list of these institutions. However, the Bureau believes that there may be substantial overlap among these institutions. A large number of creditors participate in the housing stabilization programs covered by the final rule.

Data regarding the number or volume of loans made by housing finance agencies and community-focused lending programs is limited. There is some data suggesting that HFA bonds funded approximately 67,000 loans in 2010 with a value of just over $8 billion.[174] Data

[170] *See* U.S. Dep't of the Treas., Community Development Financial Institutions Fund, http://www.cdfifund.gov/docs/certification/cdfi/CDFI List - 07-31-12.xls.
[171] *See* U.S. Dep't of Hous. and Urban Development: Nonprofits, https://entp.hud.gov/idapp/html/f17npdata.cfm.
[172] Includes 2011 data for institutions with CHDO reservations and CHDO loans without a rental tenure type. *See* U.S. Dep't of Hous. and Urban Development: HOME Participating Jurisdiction's Open Activities Reports, http://www.hud.gov/offices/cpd/affordablehousing/reports/open/.
[173] Includes data for institutions shown to offer secondary financing. *See* U.S. Dep't of Hous. and Urban Development: Nonprofits, https://entp.hud.gov/idapp/html/f17npdata.cfm.

regarding CDFIs indicate that these institutions funded just under $4 billion in loans; however, data on the type of housing supported is unavailable.[175] Lending at CHDOs totaled $64 million in 2011 with just under 500 loans.[176]

The Bureau had proposed an exemption to the ability-to-repay requirements for refinancing programs offered by the Department of Housing and Urban Development (HUD), the Department of Veterans Affairs (VA), or the U.S. Department of Agriculture (USDA). Similarly, the Bureau had proposed an exemption to the ability-to-repay requirements for certain GSE refinancing programs. However, as noted above, the Bureau has concluded after further deliberation that the proposed exemptions from the ability-to-repay requirements are unnecessary because, even absent an exemption from the ability-to-repay requirements, FHA, VA, and USDA loans, including refinancings, as well as GSE refinancings, are given qualified mortgage status under the Bureau's 2013 ATR Final Rule. Under the temporary category of qualified mortgages in § 1026.43(e)(4), the final rule already incorporates the refinancing programs' specific underwriting criteria and affords these loans a presumption (in some cases, conclusive) of compliance with the ability-to-repay requirements, so long as they meet certain product feature requirements and limitations on points and fees. The small difference between the proposed exemption and the 2013 ATR Final Rule temporary category for QMs involves loan features (*e.g.*, negative amortization and interest only features) and the cap on points and fees under § 1026.43(e)(2). Under the 2013 ATR Final Rule, loans with those features or above the points and fees threshold (that otherwise meet the conditions of the QM definition) cannot be originated

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[174] *See* National Council of State Housing Agencies, *State HFA Factbook* (2010), , http://www.ncsha.org/story/ncsha-releases-comprehensive-survey-hfa-program-activity.
[175] *See* U.S. Dep't of the Treas., Community Development Financial Institutions Fund: Awardees/Allocatees, http://www.cdfifund.gov/awardees/db/basicSearchResults.asp.
[176] *See* U.S. Dep't of Hous. and Urban Development: HOME Participating Jurisdiction's Open Activities Reports, http://www.hud.gov/offices/cpd/affordablehousing/reports/open.

as qualified mortgages and therefore must meet the ability-to-repay requirements, while under the proposed exemption they would have been exempted from those requirements as well. The Bureau believes that very few refinancings would be excluded on these grounds and therefore that these restrictions should not impose any additional meaningful costs on creditors or impede consumers' access to responsible, affordable mortgage credit.

Qualified mortgage refinancings that trigger the threshold for higher-priced mortgage loans are also another small area of difference: under the 2013 ATR Final Rule, these loans have a rebuttable presumption of compliance with the ability-to-repay requirements while under the exemption there would have been no such requirements. As described, costs for covered persons offering these loans could be slightly higher. However, as discussed above, in light of the history of refinancings, the Bureau believes that it is a meaningful benefit to consumers to preserve their ability to seek redress in the event of abuse.

3. Extension of Qualified Mortgage Status

The benefits to covered persons from extending qualified mortgage status to certain loans made by smaller creditors and held on portfolio also derive from maintaining access to credit and limiting potential increases in the costs of these loans. By granting creditors that qualify under the new qualified mortgage definition a conclusive or rebuttable presumption of compliance with the ability-to-repay provisions, the final rule limits the legal liability of these creditors and most expected litigation costs. The final rule may also provide greater flexibility with regard to certain documentation, verification, and underwriting practices in certain circumstances.[177] These cost reductions in turn could enhance the willingness of such creditors to make these loans

[177] For example, the final rule requires that small creditors assess either the debt-to-income ratio or the residual income of the borrower, but does not require that the consumer's DTI not exceed 43 percent as determined pursuant to appendix Q nor that the loan be eligible for purchase, guarantee, or insurance by the GSEs or by specified federal agencies.

or reduce the amount the creditors would otherwise charge for these loans.[178] Consumers, too, will benefit to the extent that the expanded qualified mortgage status makes creditors more willing to continue extending such credit and to do so at a lower price than they might charge for non-qualified mortgages under the new regulations. In return, however, consumers will have narrower grounds on which to challenge any violations of the ability-to-repay rules as discussed in more detail in the Section 1022 analysis of the 2013 Final ATR Rule.

Given the lower default and delinquency rates at these smaller community-focused institutions, the avoided costs related to liability and litigation are likely small. However, the lower default and delinquency rates at these institutions, the relationship lending that they engage in, and restrictions on reselling the loans on the secondary market for at least three years, together also suggest that the risk of consumer harm (and therefore the costs of this provisions) are also very small.[179] While the mathematical impacts of litigation costs/risks may be limited, the Bureau believes that the broader impacts on access to credit could be significant particularly in individual communities.

Based on data from 2011, roughly 9,200 institutions with approximately 450,000 loans on portfolio are likely to be affected by the extension of qualified mortgages for certain small creditors.[180] Based on the Bureau's estimates, on average, 16.7 percent of portfolio loans at

[178] To the extent that the cost advantage is material, this provision could give some smaller institutions a slight advantage over lenders not eligible to make qualified mortgages using this definition.

[179] The possibility that small creditors qualifying for this exemption can make certain mortgages as qualified mortgages, while their larger competitors can only make these loans subject to the ability-to-repay provisions, may allow them to offer these loans at lower rates. However, as discussed in the 2013 ATR Final Rule, any effects on pricing are likely to be small.

[180] The estimates in this analysis are based upon data and statistical analyses performed by the Bureau. To estimate counts and properties of mortgages for entities that do not report under HMDA, the Bureau has matched HMDA data to Call Report data and MCR data and has statistically projected estimated loan counts for those depository institutions that do not report these data either under HMDA or on the NCUA call report. The Bureau has projected originations of higher-priced mortgage loans for depositories that do not report HMDA in a similar fashion. These projections use Poisson regressions that estimate loan volumes as a function of an institution's total assets, employment, mortgage holdings, and geographic presence. Neither HMDA nor the Call Report data have loan level estimates of the DTI. To estimate these figures, the Bureau has matched the HMDA data to data on the HLP dataset

these institutions are estimated to have a DTI ratio above 43 percent. For the subset of these loans that also do not contain any of the prohibited features for the general definition for qualified mortgages (assuming other conditions are met), the final rule grants the creditor a conclusive or rebuttable presumption of compliance with the ability-to-repay requirements. The Bureau is unable to estimate the percentage of these loans that would not qualify for the temporary expansion of the qualified mortgage definition in the final rule under § 1026.43(e)(4). Similarly, the Bureau is unable to estimate the number of balloon mortgages originated by lenders not operating in rural areas that are eligible for qualified mortgage status under the final rule's temporary provision.

Similar tradeoffs are involved in the increase in the qualified mortgage threshold from 1.5 percentage points above the average prime offer rate (APOR) to 3.5 percentage points above APOR for first lien mortgages originated and held by small creditors and for the qualified balloon mortgages originated and held by small creditors predominantly operating in rural or underserved areas. For loans in this APR range, whether they meet the definition of qualified mortgage under the 2013 Final ATR Rule or under the new definitions provided in this final rule, the presumption of compliance with the ability-to-repay requirements would be strengthened. The Bureau estimates that roughly 8-10 percent of portfolio loans at these institutions are likely to be affected by this change. Strengthening the presumption of compliance for these loans will benefit consumers and/or covered persons to the extent doing so improves credit access or reduces costs. Strengthening the presumption will have a cost to consumers to the extent consumers who find themselves unable to afford their mortgage, and would otherwise be able to

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provided by the FHFA. This allows estimation of coefficients in a probit model to predict DTI using loan amount, income, and other variables. This model is then used to estimate DTI for loans in HMDA.

make out a claim and recover their losses, would be unable to do so under the expanded safe harbor.

B. Potential Specific Impacts of the Final Rule

1. Potential Impact on Consumer Access to Consumer Financial Products or Services

The Bureau does not anticipate that the final rule would reduce consumers' access to consumer financial products and services. Rather, as discussed above, the Bureau believes that the final rule would in fact enhance certain consumers' access to mortgage credit as compared to the 2013 ATR Final Rule. The Bureau believes that the exclusion of certain compensation from the calculation of points and fees allows more mortgages under the qualified mortgage and high-cost mortgage thresholds; the exemption from the ability-to-repay requirements should facilitate lending under various programs and by various creditors; and, the new and expanded qualified mortgage definitions should also expand responsible lending.

2. Depository Institutions and Credit Unions with $10 Billion or Less in Total Assets, As Described in Section 1026

The Bureau believes the final rule will have differential impacts on some depository institutions and credit unions with $10 billion or less in total assets as described in Section 1026. The depository institutions and credit unions that are CDFIs, and are therefore covered under the exemption from the ability-to-repay requirements, and the institutions covered by new definition of qualified mortgages and the higher-rate threshold for small creditor portfolio loans are all in this group and are therefore uniquely impacted by the rule as discussed above.

3. Impact of the Provisions on Consumers in Rural Areas

The final rule will have some differential impacts on consumers in rural areas. In these areas, a greater fraction of loans are made by smaller institutions and carried on portfolio and therefore the small creditor portfolio exemption would be likely to have greater impacts. The

Bureau understands that mortgage loans in these areas and by these institutions are less standardized and often cannot be sold into the secondary market. These differences may result in slightly higher interest rates on average for loans to rural consumers and more higher priced mortgage loans. By making it easier for loans held in portfolio by certain institutions to receive qualified mortgage status and by raising the rebuttable presumption threshold for those loans, the final rule will likely have a greater relative effect on rural consumers than on their non-rural counterparts: more loans will meet the definitions for qualified mortgages and within that group, more loans will have the safe harbor presumption of compliance with the ability-to-repay requirements. To the extent that these changes expand access to credit, rural consumers will benefit. While the relationship model of lending prevalent in this area makes both delinquency and litigation less likely overall, these changes will also limit some of the protections for these consumers as well.[181]

VIII. Regulatory Flexibility Act Analysis

A. Overview

The Regulatory Flexibility Act (RFA) generally requires an agency to conduct an initial regulatory flexibility analysis (IRFA) and a final regulatory flexibility analysis (FRFA) of any rule subject to notice-and-comment rulemaking requirements.[182] These analyses must "describe the impact of the proposed rule on small entities."[183] An IRFA or FRFA is not required if the

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[181] Relationship lending refers to underwriting decisions predicated on more tacit information and personal relationships, in particular, relative to more automated and formula-based forms of underwriting.

[182] 5 U.S.C. 601 *et. seq.*

[183] 5 U.S.C. 603(a); 5 U.S.C. 604(a). For purposes of assessing the impacts of the proposed rule on small entities, "small entities" is defined in the RFA to include small businesses, small not-for-profit organizations, and small government jurisdictions. 5 U.S.C. 601(6). A "small business" is determined by application of Small Business Administration regulations and reference to the North American Industry Classification System (NAICS) classifications and size standards. 5 U.S.C. 601(3). A "small organization" is any "not-for-profit enterprise which is independently owned and operated and is not dominant in its field." 5 U.S.C. 601(4). A "small governmental jurisdiction" is the government of a city, county, town, township, village, school district, or special district with a population of less than 50,000. 5 U.S.C. 601(5).

agency certifies that the rule will not have a significant economic impact on a substantial number of small entities.[184] The Bureau also is subject to certain additional procedures under the RFA involving the convening of a panel to consult with small business representatives prior to proposing a rule for which an IRFA is required.[185]

The final rule amends Regulation Z, which implements the Truth in Lending Act (TILA) and is related to a final rule published in the **Federal Register** in January 2013 (78 FR 6408) (2013 ATR Final Rule). That final rule implements certain amendments to TILA that were added by sections 1411, 1412, and 1414 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), which created new TILA section 129C. These changes were made in response to the recent foreclosure crisis to address certain lending practices (such as low- or no-documentation loans or underwriting mortgages without including any principal repayments in the underwriting determination) that led to consumers having mortgages they could not afford, thereby contributing to high default and foreclosure rates. Among other things, the Dodd-Frank Act requires creditors to make a reasonable, good faith determination of a consumer's ability to repay any consumer credit transaction secured by a dwelling (excluding an open-end credit plan, timeshare plan, reverse mortgage, or temporary loan) and establishes certain protections from liability under this provision for "qualified mortgages."

As discussed above, the Bureau believes that the 2013 ATR Final Rule should be modified to address potential adverse consequences on certain narrowly-defined categories of lending programs. Specifically, the final rule adopts certain amendments to the 2013 ATR Final Rule implementing these requirements, including exemptions for certain nonprofit and community-focused lending creditors and certain homeownership stabilization and foreclosure

[184] 5 U.S.C. 605(b).
[185] 5 U.S.C. 609.

prevention programs. The final rule also creates a new category of qualified mortgages, similar to the one for rural balloon-payment loans, for loans without balloon-payment features that are originated and held on portfolio by small creditors. The new category will not be limited to creditors that operate predominantly in rural or underserved areas, but will use the same general size thresholds and other criteria as the rural or underserved balloon-payment rules. In light of the fact that small creditors often have higher costs of funds than larger creditors, the final rule also increases the threshold separating safe harbor and rebuttable presumption qualified mortgages for balloon-payment qualified mortgages, the new small portfolio qualified mortgages, and balloon-payment qualified mortgages originated under the new temporary two-year balloon mortgage provision. Finally, the final rule provides additional clarifications and exclusions regarding the inclusion of loan originator compensation in the points and fees calculation for all categories of qualified mortgage.

In the proposal, the Bureau certified that the rule would not have a significant economic impact on a substantial number of small entities and therefore did not prepare an IRFA. Approximately 100 commenters argued that the Bureau should conduct a SBREFA panel to learn more about how the rule will impact the thousands of small business entities that originate mortgage loans. These commenters noted that while the Bureau stated that an initial regulatory flexibility analysis (IRFA) was not necessary under the Regulatory Flexibility Act (RFA) because the proposal would not have a significant economic impact on a substantial number of small entities, the Bureau's own methodology showed that the rule would apply to 9,373 small entities out of 14,194 total entities that originate mortgage loans. These commenters contended that the Bureau use its authority under the Dodd-Frank Act to delay the effective date of the 2013 ATR Final Rule and conduct further analysis of the mortgage loan origination market and how loan originators are currently assessing and determining consumers' ability to repay.[186]

While the Bureau acknowledges that the exemption applies to many small entities, this does not imply that it has a significant impact on a substantial number of small entities. Further, the commenters provided little reasoning and no data to support the claim that the rule would have such an effect. The Bureau believes that the final rule will not have a significant impact on a substantial number of small entities and therefore neither a SBREFA panel nor a FRFA is required.

The analysis below evaluates the potential economic impact of the final rule on small entities as defined by the RFA. The analysis generally examines the regulatory impact of the provisions of the final rule against the baseline of the 2013 ATR Final Rule published in January 2013, however some of the discussion includes consideration of alternative baselines. As a result of this analysis, the Bureau certifies that the final rule would not have a significant economic impact on a substantial number of small entities.

B. Number and Classes of Affected Entities

The final rule will apply to all creditors that extend closed-end credit secured by a dwelling, including real property attached to a dwelling, subject to certain exemptions. All small entities that extend these loans are potentially subject to at least some aspects of the final rule. This rule may impact small businesses, small nonprofit organizations, and small government jurisdictions. A "small business" is determined by application of SBA regulations and reference to the North American Industry Classification System (NAICS) classifications and size standards.[187] Under such standards, depository institutions with $175 million or less in assets are considered small; other financial businesses are considered small if such entities have average

[186] 78 FR 6663-6666.
[187] 5 U.S.C. 601(3). The current SBA size standards are located on the SBA's website at http://www.sba.gov/content/table-small-business-size-standards.

annual receipts (*i.e.*, annual revenues) that do not exceed $7 million. Thus, commercial banks, savings institutions, and credit unions with $175 million or less in assets are small businesses, while other creditors extending credit secured by real property or a dwelling are small businesses if average annual receipts do not exceed $7 million.

The Bureau can identify through data under the Home Mortgage Disclosure Act, Reports of Condition and Income (Call Reports), and data from the National Mortgage Licensing System (NMLS) the approximate numbers of small depository institutions that will be subject to the final rule. Origination data is available for entities that report in HMDA, NMLS or the credit union call reports; for other entities, the Bureau has estimated their origination activities using statistical projection methods.

The following table provides the Bureau's estimate of the number and types of entities to which the rule will apply:

Category	NAICS Code	Total Entities	Small Entities	Entities That Originate Any Mortgage Loans[b]	Small Entities that Originate Any Mortgage Loans
Commercial Banking	522110	6,505	3,601	6,307[a]	3,466[a]
Savings Institutions	522120	930	377	922[a]	373[a]
Credit Unions[c]	522130	7,240	6,296	4,178[a]	3,240[a]
Real Estate Credit[d e]	522292	2,787	2,294	2,787	2,294[a]
Total		17,462	12,568	14,194	9,373
Source: 2011 HMDA, Dec 31, 2011 Bank and Thrift Call Reports, Dec 31, 2011 NCUA Call Reports, Dec 31, 2011 NMLSR Mortgage Call Reports.					
[a] For HMDA reporters, loan counts from HMDA 2011. For institutions that are not HMDA reporters, loan counts projected based on Call Report data fields and counts for HMDA reporters. [b] Entities are characterized as originating loans if they make one or more loans.					
[c] Does not include cooperativas operating in Puerto Rico. The Bureau has limited data about these institutions or their mortgage activity.					
[d] NMLSR Mortgage Call Report (MCR) for 2011. All MCR reporters that originate at least one loan or that have positive loan amounts are considered to be engaged in real estate credit (instead of purely mortgage brokers). For institutions with missing revenue values, the probability that institution was a small entity is estimated based on the count and amount of originations and the count and amount of brokered loans.					
[e] Data do not distinguish nonprofit from for-profit organizations, but Real Estate Credit presumptively includes nonprofit organizations.					

It is difficult to determine the number of small nonprofits that would be subject to the regulation. Nonprofits do not generally file Call Reports or HMDA reports. As explained in part

II above, as of November 2012 there are 233 nonprofit agencies and nonprofit instrumentalities of government in the U.S. that are authorized by HUD to provide secondary financing,[188] 267 institutions designated as Community Housing Development Organizations that provided credit in 2011, and 231 institutions designated as Downpayment Assistance through Secondary Financing Providers. A comprehensive list of these institutions is not available; however the Bureau believes that there may be substantial overlap among these institutions and that most of these institutions would qualify as small entities.

Also, as of July 2012 there were 999 organizations designated by the Treasury Department as CDFIs, 356 of which are depository institutions or credit unions counted above. Among the remaining, some are nonprofits and most likely small.[189]

C. Clarification Regarding Loan Originator Compensation in the Points and Fees Calculation

As discussed in detail above, the Dodd-Frank Act requires creditors to include all compensation paid directly or indirectly by a consumer or creditor to a mortgage originator from any source, including a mortgage originator that is also the creditor in a table-funded transaction, in the calculation of points and fees. The statute does not express any limitation on this requirement, and thus, the Bureau adopted in the 2013 ATR Final Rule that loan originator compensation be treated as additive to up-front charges paid by the consumer and the other elements of points and fees and that compensation is added as it flows downstream to the loan originator.

The final rule provides that payments by consumers to mortgage brokers need not be counted as loan originator compensation where such payments already have been included in points and fees as part of the finance charge. The final rule also provides that compensation paid

[188] *See* U.S. Dep't of Hous. and Urban Development: Nonprofits, https://entp.hud.gov/idapp/html/f17npdata.cfm.
[189] *See* U.S. Dep't of the Treas., Community Development Financial Institutions Fund, http://www.cdfifund.gov/docs/certification/cdfi/CDFI List - 07-31-12.xls.

by a mortgage broker to its employee loan originator need not be included in points and fees. In the final rule, compensation paid by a creditor to a mortgage broker is included in points and fees in addition to any origination charges paid by a consumer to the creditor. Compensation paid by a creditor to its own loan originator employees need not be included in points and fees.

The statute requires loan originator compensation to be treated as additive to the other elements of points and fees and the 2013 ATR Final Rule adopted this approach. This places a burden on small creditors, since it makes it more likely that mortgage loans will not be eligible as qualified mortgages under the ability-to-repay rules or will be classified as high-cost mortgages for purposes of HOEPA. The Bureau's exercise of its exception and adjustment authority in the final rule, however, will reduce burden on small entities and facilitate compliance. Compared to the January 2013 baseline, where such compensation is included in the points and fees calculation, the final rule reduces burden on certain small entities: for retail originators, fewer loans will exceed the points and fees limits for qualified mortgages and high cost mortgages, and firms will face lowered compliance costs.[190]

D. Exemptions from the Ability-to-Repay Requirements

The provisions related to community-focused lending programs discussed above all provide exemptions from the ability-to-repay requirements. Measured against the baseline of the Bureau's 2013 ATR Final Rule, these provisions impose either no or insignificant additional burdens on small entities. More specifically, these provisions will reduce the burdens associated with implementation costs, additional underwriting costs, and compliance costs stemming from the ability-to-repay requirements.

Section 1026.43(a)(3)(iv) provides that an extension of credit made pursuant to a

[190] The Bureau notes that the ability-to-repay requirements as well as the rules applying to high-cost mortgages generally apply to creditors and not to other classes of small entities including mortgage brokers.

program administered by a housing finance agency, as defined by 24 CFR 266.5, is exempt from the requirements of § 1026.43(c) through (f). For any housing finance agencies and their partner creditors that meet the definition of "small entity," this provision will remove the burden of having to modify the underwriting practices associated with these programs to implement the ability-to-repay requirements. This provision will also remove the burden to small entities of having to develop and maintain policies and procedures to monitor compliance with the ability-to-repay requirements.

The final rule also exempts from the ability-to-repay requirements an extension of credit made by a creditor designated as a Community Development Financial Institution, a Downpayment Assistance through Secondary Financing Provider, or a Community Housing Development Organization (CHDO) if the CHDO meets certain additional criteria. This provision will remove the burden to small entities of having to implement the ability-to-repay requirements. This provision will also remove the burden to small entities of having to develop and maintain policies and procedures to monitor compliance with the ability-to-repay requirements. Regulatory burdens may be associated with obtaining and maintaining one of the designations required to qualify for the exemption. However, this decision is voluntary and the Bureau presumes that a small entity would not do so unless the burden reduction resulting from the exemption outweighed the additional burden imposed by obtaining and maintaining the designation. Thus, additional burdens would still be part of an overall burden reduction.

The final rule also exempts from the ability-to-repay requirements extensions of credit made by a creditor with a tax exemption ruling or determination letter from the Internal Revenue Service under section 501(c)(3) of the Internal Revenue Code of 1986 (26 U.S.C. 501(c)(3) provided that: during the calendar year preceding receipt of the consumer's application, the creditor extended credit secured by a dwelling no more than 200 times; during the calendar year preceding receipt of the consumer's application, the creditor extended credit secured by a dwelling only to consumers with income that did not exceed the low- and moderate-income household limits; the extension of credit is to a consumer with income that does not exceed the above limit; and, the creditor determines, in accordance with written procedures, that the consumer has a reasonable ability to repay the extension of credit.

For eligible entities, this provision will remove the burden of complying with the ability-to-repay requirements. This provision will also remove the burden to small entities of having to develop and maintain policies and procedures to monitor compliance with the ability-to-repay requirements in the 2013 ATR Final Rule. While eligible nonprofit creditors will need to maintain documentation of their own procedures regarding the determination of a consumer's ability to repay, the Bureau believes that such small nonprofits already have written policies and procedures. In any case, the decision to use the exemption is voluntary and entities are expected to use it only if reduces overall burden. Regulatory burdens may be associated with obtaining and maintaining the 501(c)(3) designation required to qualify for the exemption. However, this decision is voluntary and the Bureau presumes that a small entity would not do so unless the burden reduction resulting from the exemption outweighed the additional burden imposed by obtaining and maintaining the designation. Thus, additional burdens would still be part of an overall burden reduction.

The final rule provides that an extension of credit made pursuant to a program authorized by sections 101 and 109 of the Emergency Economic Stabilization Act of 2008 is exempt from the ability-to-repay requirements. This provision will remove the burden to participating small entities of having to modify the underwriting practices associated with these programs to implement the ability-to-repay requirements. This provision will also remove the burden to small entities of having to develop and maintain policies and procedures to monitor compliance with these ability-to-repay requirements.

E. Portfolio Loans Made by Small Creditors and Balloon-Payment Qualified Mortgages

As discussed above, the Bureau is finalizing certain amendments to the 2013 ATR Final Rule, including an additional definition of a qualified mortgage for certain loans made and held in portfolio by small creditors. The new category includes certain loans originated by small creditors that: (1) have total assets less than $2 billion at the end of the previous calendar year; and (2) together with all affiliates, originated 500 or fewer covered transactions, secured by first-liens during the previous calendar year. The $2 billion asset threshold in the definition will be adjusted annually based on the year-to-year change in the average of the Consumer Price Index for Urban Wage Earners and Clerical Workers, not seasonally adjusted. These loans must generally conform to the requirements under the general definition of a qualified mortgage in § 1026.43(e)(2), except that a loan with a consumer debt-to-income ratio higher than 43 percent could be a qualified mortgage if all other criteria are met. Small creditors are required to consider the consumer's debt-to-income ratio or residual income in underwriting the loans, but are not required to follow appendix Q or subject to any specific threshold.

This provision would reduce burden on small creditors by removing the 43 percent debt-to-income limitation for qualified mortgages, as well as providing more flexibility in the assessment of debt-to-income ratios. At the small creditors identified, 16.7 percent of mortgage loans on portfolio are estimated to have a debt to income ratios above 43 percent. For these loans, the final rule grants creditors a presumption of compliance with the ability-to-repay requirements; rough estimates indicate that three quarters of these loans will gain a conclusive presumption and the remaining loans will gain the rebuttable presumption. The final rule also temporarily allows small creditors that do not operate predominantly in rural or underserved areas to offer balloon-payment qualified mortgages, with the same presumptions of compliance, if they hold the loans in portfolio.

The Bureau also is allowing small creditors to charge a higher annual percentage rate for first-lien qualified mortgages in the new category and still benefit from a conclusive presumption of compliance or "safe harbor." In addition, the Bureau also is allowing small creditors operating predominantly in rural or underserved areas to offer first-lien balloon loans with a higher annual percentage rate and still benefit from a conclusive presumption of compliance with the ability-to-repay rules or "safe harbor." The increase in the threshold from the average prime offer rate (APOR) plus 1.5 percentage points to APOR plus 3.5 percentage points will reduce burden for the loans at these institutions between these rates, as these loans will now qualify for a conclusive, rather than a rebuttable presumption.

The regulatory requirement to make a reasonable and good faith determination based on verified and documented evidence that a consumer has a reasonable ability to repay may entail litigation risk for small creditors. It is difficult to estimate the reduction in potential future liability costs associated with the changes. However, the Bureau notes that lending practices at smaller institutions are often based on a more personal relationship based model and that historically, delinquency rates on mortgages at smaller institutions are lower than the average in the industry. The Bureau believes that small creditors have historically engaged in responsible mortgage underwriting that includes thorough and thoughtful determinations of consumers' ability to repay, at least in part because they bear the risk of default associated with loans held in their portfolios. The Bureau also believes that because small creditors' lending model is based on maintaining ongoing, mutually beneficial relationships with their customers, they therefore have a more comprehensive understanding of their customers' financial circumstances and are better able to assess ability to repay than larger creditors. As such, the expected litigation costs from the ability-to-repay provisions of the 2013 ATR Final Rule, and therefore the reduced burden from this final rule, should be small.

The Bureau acknowledges the possibility that this final rule may increase small creditor burden to the extent that creditors need to maintain records relating to eligibility for the exemption, but the Bureau believes that these costs are negligible, as creditor asset size and origination activity are data that all depository institutions and credit unions are likely to maintain for routine business or supervisory purposes. Thus, the Bureau believes that the burden reduction stemming from a reduction in liability costs would outweigh any potential recordkeeping costs, resulting in overall burden reduction. Small entities for which such cost reductions are outweighed by additional record keeping costs may choose not to utilize the exemption.

F. Conclusion

Each element of this final rule results in an economic burden reduction for these small entities. The exemptions for nonprofit creditors would lessen any economic impact resulting from the ability-to-repay requirements. The exemptions for homeownership stabilization and foreclosure prevention programs would also soften any economic impact on small entities extending credit pursuant to those programs. The new categories of qualified mortgage would make it easier for small entities to originate qualified mortgages. The Bureau's clarifications ensuring consumer-paid compensation to brokers is counted only once and the exclusion of retail loan officer and broker employee compensation will reduce burden on small entities and make it more likely that mortgage loans will be eligible for a presumption of compliance as qualified mortgages under the ability-to-repay rules and not be classified as high-cost mortgages for purposes of HOEPA. While all of these provisions may entail some additional recordkeeping costs, the Bureau believes that these costs are minimal and outweighed by the cost reductions resulting from the final rule. Small entities for which such cost reductions are outweighed by additional record keeping costs may choose not to utilize the exemptions.

Certification

Accordingly, the undersigned certifies that this proposal will not have a significant economic impact on a substantial number of small entities.

IX. Paperwork Reduction Act Analysis

Certain provisions of this final rule contain "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 (44 U.S.C. 3501 *et seq.*) (Paperwork Reduction Act or PRA). On January 30, 2013, the Bureau published notice of the proposed rule in the **Federal Register** (78 FR 6622). The Bureau received no PRA-related comments on the information collections in § 1026.43(c).

This final rule amends 12 CFR part 1026 (Regulation Z), which implements the Truth in Lending Act (TILA). Regulation Z currently contains collections of information approved by the Office of Management and Budget (OMB). The Bureau's OMB control number for Regulation Z is 3170–0015. The PRA (44 U.S.C. 3507(a), (a)(2) and (a)(3)) requires that a Federal agency may not conduct or sponsor a collection of information unless OMB approved the collection under the PRA and the OMB control number obtained is displayed. Further, notwithstanding any other provisions of law, no person is required to comply with, or is subject to any penalty for failure to comply with, a collection of information that does not display a currently valid OMB control number (44 U.S.C. 3512). The collection of information contained in this rule, and identified as such, has been submitted to OMB for review under section 3507(d) of the PRA.

A. Overview

As described below, the final rule amends the collections of information currently in Regulation Z to implement amendments to TILA made by the Dodd-Frank Act. This final rule is related to the Ability-to-Repay/Qualified Mortgage final rule (2013 ATR Final Rule) published in the **Federal Register** in January 2013 (78 FR 6408). The 2013 ATR Final Rule implements sections 1411, 1412, and 1414 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), which creates new TILA section 129C. Among other things, the Dodd-Frank Act requires creditors to make a reasonable, good faith determination, based on verified and documented information, that the consumer will have a reasonable ability to repay any consumer credit transaction secured by a dwelling (excluding an open-end credit plan, timeshare plan, reverse mortgage, or temporary loan), including any mortgage-related obligations (such as property taxes), and establishes certain protections from liability under this requirement for "qualified mortgages." TILA section 129C(a); 15 U.S.C. 1639c(a). The stated purpose of the Dodd-Frank Act ability-to-repay requirement is to assure that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay the loans and that are not understandable and not unfair, deceptive or abusive. TILA section 129B(a)(2); 15 U.S.C. 1639b(a)(2). Prior to the Dodd-Frank Act, existing Regulation Z provided ability-to-repay requirements for high-cost and higher-priced mortgage loans. The Dodd-Frank Act expanded the scope of the ability-to-repay requirement to cover all residential mortgage loans with its scope.

The 2013 ATR Final Rule establishes standards for complying with the ability-to-repay requirement, including defining "qualified mortgage." In addition to the ability-to-repay and qualified mortgage provisions, the 2013 ATR Final Rule implements the Dodd-Frank Act limits on prepayment penalties and lengthens the time creditors must retain records that evidence compliance with the ability-to-repay and prepayment penalty provisions.

This final rule adopts certain amendments to the 2013 ATR Final Rule implementing these ability-to-repay requirements, including exemptions for certain community-focused creditors, housing finance agencies, nonprofit organizations and housing stabilization programs; an additional definition of a qualified mortgage for certain loans made and held in portfolio by small creditors that have total assets less than $2 billion at the end of the previous calendar year and, together with all affiliates, originated 500 or fewer first-lien covered transactions during the previous calendar year. The final rule also temporarily allows small creditors that do not operate predominantly in rural or underserved areas to offer balloon-payment qualified mortgages if they hold the loans in portfolio. The Bureau also is allowing small creditors to charge a higher annual percentage rate for first-lien qualified mortgages in the new category and still benefit from a conclusive presumption of compliance or "safe harbor," and to allow small creditors operating predominantly in rural or underserved areas to offer first-lien balloon loans with a higher annual percentage rate and still benefit from a conclusive presumption of compliance with the ability-to-repay rules or "safe harbor."

The final rule also provides exceptions to the 2013 ATR Final Rule, which implements the statute's inclusion of loan originator compensation in points and fees. Specifically, in the final rule, payments by consumers to mortgage brokers need not be counted as loan originator compensation where such payments already have been included in points and fees as part of the finance charge. In addition, compensation paid by a mortgage broker to its employee loan originator need not be included in points and fees, nor does compensation paid by a creditor to its own loan originator employees. However, consistent with the statute and 2013 ATR Final Rule, compensation paid by a creditor to a mortgage broker continues to be included in points and fees in addition to any origination charges paid by a consumer to the creditor.

The information collection in the final rule is required to provide benefits for consumers and would be mandatory. *See* 15 U.S.C. 1601 *et seq.;* 12 U.S.C. 2601 *et seq.* Because the Bureau does not collect any information under the final rule, no issue of confidentiality arises. The likely respondents would be depository institutions (*i.e.*, commercial banks, savings institutions and credit unions) and non-depository institutions (*i.e.*, mortgage companies or other non-bank creditors) subject to Regulation Z.[191]

Under the final rule, the Bureau generally accounts for the paperwork burden associated with Regulation Z for the following respondents pursuant to its administrative enforcement authority: insured depository institutions with more than $10 billion in total assets and their depository institution affiliates; privately insured credit unions; and certain nondepository creditors. The Bureau and the FTC generally both have enforcement authority over non-depository institutions for Regulation Z. Accordingly, the Bureau has allocated to itself half of the estimated burden to non-depository institutions. Other Federal agencies are responsible for estimating and reporting to OMB the total paperwork burden for the institutions for which they have administrative enforcement authority. They may, but are not required to, use the Bureau's burden estimation methodology.

[191] For purposes of this PRA analysis, references to ''creditors'' or ''lenders'' shall be deemed to refer collectively to commercial banks, savings institutions, credit unions, and mortgage companies (*i.e.*, non-depository lenders), unless otherwise stated. Moreover, reference to ''respondents'' shall generally mean all categories of entities identified in the sentence to which this footnote is appended, except as otherwise stated or if the context indicates otherwise.

Using the Bureau's burden estimation methodology, there is no change to the total estimated burden under Regulation Z as a result of the final rule.

B. Information Collection Requirements

Ability-to-Repay Verification and Documentation Requirements

As discussed above, the 2013 ATR Final Rule published in January 2013 contains specific criteria that a creditor must consider in assessing a consumer's repayment ability while different verification requirements apply to qualified mortgages. As described in the relevant sections of the final rule, the Bureau does not believe that the verification and documentation requirements of the final rule result in additional ongoing costs for most covered persons. However, for some creditors, notably the community-focused lending programs, housing finance agencies, and not-for profit organizations exempted in the final rule, lending can vary widely, in the form of financing, the products offered and the precise nature of underwriting. These processes may not involve the more traditional products covered by the qualified mortgage definition nor do these creditors use documentation and verification procedures closely aligned with the requirements of the 2013 ATR Final Rule.

For these creditors, the final rule should eliminate any costs from imposing these requirements on these particular extensions of credits. The Bureau estimates one-time and ongoing costs to respondents of complying with the final rule as follows.

One-time costs. The Bureau estimates that covered persons will incur one-time costs associated with reviewing the relevant sections of the **Federal Register** and training relevant employees. In general, the Bureau estimates these costs to include, for each covered person, the costs for one attorney and one compliance officer to read and review the sections of the final rule that describe the verification and documentation requirements for loans, the exemptions from the ability-to-repay requirements, and the costs for each loan officer or other loan originator to receive training concerning the requirements. However, the Bureau believes that respondents will review the relevant sections of this final rule along with the 2013 ATR Final Rule to best understand any new regulatory requirements and their coverage. As such, there is no additional one-time burden attributed to the final rule.

Ongoing costs. The exemptions for the covered institutions should reduce any burden related to these provisions. However, in the 2013 ATR Final Rule, the Bureau did not attribute any paperwork burden to these provisions on the assumption that the verification and documentation requirements of the 2013 ATR Final Rule will not result in additional ongoing costs for most covered persons. As such, it would be inappropriate to credit any reduction in burden to the final rule.

C. Summary of Burden Hours

As noted, the Bureau does not believe the final rule results in any changes in the burdens under Regulation Z associated with information collections for Bureau respondents under the PRA.

D. Comments

The Consumer Financial Protection Bureau has a continuing interest in the public's opinions of our collections of information. At any time, comments regarding the burden estimate, or any other aspect of this collection of information, including suggestions for reducing the burden, may be sent to:

The Consumer Financial Protection Bureau (Attention: PRA Office), 1700 G Street NW, Washington, D.C., 20552, or by the internet to *CFPB_Public_PRA@cfpb.gov*.

List of Subjects in 12 CFR Part 1026

Advertising, Consumer protection, Mortgages, Reporting and recordkeeping requirements, Truth in Lending.

Authority and Issuance

For the reasons set forth in the preamble, the Bureau amends Regulation Z, 12 CFR part 1026, as amended by the final rule published on January 30, 2013 (78 FR 6408), as set forth below:

PART 1026—TRUTH IN LENDING (REGULATION Z)

1. The authority citation for part 1026 continues to read as follows:

AUTHORITY: 12 U.S.C. 2601, 2603-2605, 2607, 2609, 2617, 5511, 5512, 5532, 5581; 15 U.S.C. 1601 *et seq.*

Subpart E—Special Rules for Certain Home Mortgage Transactions

2. Section 1026.32 is amended by revising paragraphs (b)(1)(ii) and (b)(2)(ii) to read as follows:

§ 1026.32 Requirements for high-cost mortgages.

*   *   *   *   *

(b)   *   *   *

(1)   *   *   *

(ii) All compensation paid directly or indirectly by a consumer or creditor to a loan originator, as defined in § 1026.36(a)(1), that can be attributed to that transaction at the time the interest rate is set unless:

(A) That compensation is paid by a consumer to a mortgage broker, as defined in § 1026.36(a)(2), and already has been included in points and fees under paragraph (b)(1)(i) of this section;

(B) That compensation is paid by a mortgage broker, as defined in § 1026.36(a)(2), to a loan originator that is an employee of the mortgage broker; or

(C) That compensation is paid by a creditor to a loan originator that is an employee of the creditor.

*   *   *   *   *

(2)   *   *   *

(ii) All compensation paid directly or indirectly by a consumer or creditor to a loan originator, as defined in § 1026.36(a)(1), that can be attributed to that transaction at the time the interest rate is set unless:

(A) That compensation is paid by a consumer to a mortgage broker, as defined in § 1026.36(a)(2), and already has been included in points and fees under paragraph (b)(2)(i) of this section;

(B) That compensation is paid by a mortgage broker, as defined in § 1026.36(a)(2), to a loan originator that is an employee of the mortgage broker; or

(C) That compensation is paid by a creditor to a loan originator that is an employee of the creditor.

*   *   *   *   *

3. Section 1026.43 is amended by revising paragraphs (a)(3)(ii) and (iii), (b)(4), (e)(1), (e)(2), and (g)(1)(ii)(B), and adding new paragraphs (a)(3)(iv) through (vi), (e)(5) and (e)(6), to read as follows:

§ 1026.43 Minimum standards for transactions secured by a dwelling.

(a)   *   *   *

(3)   *   *   *

(ii) A temporary or “bridge” loan with a term of 12 months or less, such as a loan to finance the purchase of a new dwelling where the consumer plans to sell a current dwelling within 12 months or a loan to finance the initial construction of a dwelling;

(iii) A construction phase of 12 months or less of a construction-to-permanent loan;

(iv) An extension of credit made pursuant to a program administered by a Housing Finance Agency, as defined under 24 CFR 266.5;

(v) An extension of credit made by:

(A) A creditor designated as a Community Development Financial Institution, as defined under 12 CFR 1805.104(h);

(B) A creditor designated as a Downpayment Assistance through Secondary Financing Provider, pursuant to 24 CFR 200.194(a), operating in accordance with regulations prescribed by the U.S. Department of Housing and Urban Development applicable to such persons;

(C) A creditor designated as a Community Housing Development Organization provided that the creditor has entered into a commitment with a participating jurisdiction and is undertaking a project under the HOME program, pursuant to the provisions of 24 CFR 92.300(a), and as the terms community housing development organization, commitment, participating jurisdiction, and project are defined under 24 CFR 92.2; or

(D) A creditor with a tax exemption ruling or determination letter from the Internal Revenue Service under section 501(c)(3) of the Internal Revenue Code of 1986 (26 U.S.C. 501(c)(3); 26 CFR 1.501(c)(3)-1), provided that:

(*1*) During the calendar year preceding receipt of the consumer’s application, the creditor extended credit secured by a dwelling no more than 200 times;

(*2*) During the calendar year preceding receipt of the consumer’s application, the creditor extended credit secured by a dwelling only to consumers with income that did not exceed the low- and moderate-income household limit as established pursuant to section 102 of the Housing and Community Development Act of 1974 (42 U.S.C. 5302(a)(20)) and amended from time to time by the U.S. Department of Housing and Urban Development, pursuant to 24 CFR 570.3;

(*3*) The extension of credit is to a consumer with income that does not exceed the household limit specified in paragraph (a)(3)(v)(D)(*2*) of this section; and

(*4*) The creditor determines, in accordance with written procedures, that the consumer has a reasonable ability to repay the extension of credit.

(vi) An extension of credit made pursuant to a program authorized by sections 101 and 109 of the Emergency Economic Stabilization Act of 2008 (12 U.S.C. 5211; 5219);

(b) * * *

(4) *Higher-priced covered transaction* means a covered transaction with an annual percentage rate that exceeds the average prime offer rate for a comparable transaction as of the date the interest rate is set by 1.5 or more percentage points for a first-lien covered transaction, other than a qualified mortgage under paragraph (e)(5), (e)(6), or (f) of this section; by 3.5 or more percentage points for a first-lien covered transaction that is a qualified mortgage under paragraph (e)(5), (e)(6), or (f) of this section; or by 3.5 or more percentage points for a subordinate-lien covered transaction.

* * * * *

(e) *Qualified mortgages.* (1) *Safe harbor and presumption of compliance.* (i) *Safe harbor for loans that are not higher-priced covered transactions.* A creditor or assignee of a qualified mortgage, as defined in paragraphs (e)(2), (e)(4), (e)(5), (e)(6), or (f) of this section, that is not a higher-priced covered transaction, as defined in paragraph (b)(4) of this section, complies with the repayment ability requirements of paragraph (c) of this section.

(ii) *Presumption of compliance for higher-priced covered transactions.* (A) A creditor or assignee of a qualified mortgage, as defined in paragraph (e)(2), (e)(4), (e)(5), (e)(6), or (f) of this section, that is a higher-priced covered transaction, as defined in paragraph (b)(4) of this section, is presumed to comply with the repayment ability requirements of paragraph (c) of this section.

(B) To rebut the presumption of compliance described in paragraph (e)(1)(ii)(A) of this section, it must be proven that, despite meeting the prerequisites of paragraph (e)(2), (e)(4), (e)(5), (e)(6), or (f) of this section, the creditor did not make a reasonable and good faith determination of the consumer's repayment ability at the time of consummation, by showing that 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.

(2) *Qualified mortgage defined—general*. Except as provided in paragraph (e)(4), (e)(5), (e)(6), or (f) of this section, a qualified mortgage is a covered transaction:

*   *   *   *   *

(5) *Qualified mortgage defined—small creditor portfolio loans.* (i) Notwithstanding paragraph (e)(2) of this section, a qualified mortgage is a covered transaction:

(A) That satisfies the requirements of paragraph (e)(2) of this section other than the requirements of paragraph (e)(2)(vi) and without regard to the standards in appendix Q to this part;

(B) For which the creditor considers at or before consummation the consumer's monthly debt-to-income ratio or residual income and verifies the debt obligations and income used to determine that ratio in accordance with paragraph (c)(7) of this section, except that the calculation of the payment on the covered transaction for purposes of determining the consumer's total monthly debt obligations in paragraph (c)(7)(i)(A) shall be determined in accordance with paragraph (e)(2)(iv) of this section instead of paragraph (c)(5) of this section;

(C) That is not subject, at consummation, to a commitment to be acquired by another person, other than a person that satisfies the requirements of paragraph (e)(5)(i)(D) of this section; and

(D) For which the creditor satisfies the requirements stated in § 1026.35(b)(2)(iii)(B) and (C).

(ii) A qualified mortgage extended pursuant to paragraph (e)(5)(i) of this section immediately loses its status as a qualified mortgage under paragraph (e)(5)(i) if legal title to the qualified mortgage is sold, assigned, or otherwise transferred to another person except when:

(A) The qualified mortgage is sold, assigned, or otherwise transferred to another person three years or more after consummation of the qualified mortgage;

(B) The qualified mortgage is sold, assigned, or otherwise transferred to a creditor that satisfies the requirements of paragraph (e)(5)(i)(D) of this section;

(C) The qualified mortgage is sold, assigned, or otherwise transferred to another person pursuant to a capital restoration plan or other action under 12 U.S.C. 1831o, actions or instructions of any person acting as conservator, receiver, or bankruptcy trustee, an order of a

State or Federal government agency with jurisdiction to examine the creditor pursuant to State or Federal law, or an agreement between the creditor and such an agency; or

(D) The qualified mortgage is sold, assigned, or otherwise transferred pursuant to a merger of the creditor with another person or acquisition of the creditor by another person or of another person by the creditor.

(6) *Qualified mortgage defined—temporary balloon-payment qualified mortgage rules*. (i) Notwithstanding paragraph (e)(2) of this section, a qualified mortgage is a covered transaction:

(A) That satisfies the requirements of paragraph (f) of this section other than the requirements of paragraph (f)(1)(vi); and

(B) For which the creditor satisfies the requirements stated in § 1026.35(b)(2)(iii)(B) and (C).

(ii) The provisions of this paragraph (e)(6) apply only to covered transactions consummated on or before January 10, 2016.

* * * * *

(g) * * *

(1) * * *

(ii) * * *

(B) Is a qualified mortgage under paragraph (e)(2), (e)(4), (e)(5), (e)(6), or (f) of this section; and

* * * * *

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

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

i. Under *32(b) Definitions:*

a. Under *Paragraph 32(b)(1)(ii)*, paragraphs 1, 2, and 3 are revised, paragraph 4 is removed, and new paragraph 4 is added.

B. Under *Section 1026.43—Minimum Standards for Transactions Secured by a Dwelling*:

i. Under *43(a) Scope:*

a. *Paragraph 43(a)(3)(iv)* and paragraph 1 is added.

b. *Paragraph 43(a)(3)(v)(D)* and paragraph 1 are added.

c. *Paragraph 43(a)(3)(vi)* and paragraph 1 are added.

ii. Under *43(e) Qualified Mortgages:*

a. *Paragraph 43(e)(5)* and paragraphs 1 through 10 are added.

The revisions and additions read as follows:

Supplement I to Part 1026—Official Interpretations

*   *   *   *   *

Subpart E—Special Rules for Certain Home Mortgage Transactions

*   *   *   *   *

Section 1026.32—Requirements for High-Cost Mortgages

*   *   *   *   *

32(b) Definitions.

*   *   *   *   *

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

1. *Loan originator compensation—general*. Compensation paid by a consumer or creditor to a loan originator, other than an employee of the creditor, 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. Compensation paid to an employee of a creditor is not included in points and fees. 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.* Loan originator compensation is compensation that is paid by a consumer or creditor to a loan originator that 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.

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 compensation that can be attributed to that transaction at the time the creditor sets the interest rate for the transaction, even if that compensation is not paid until after consummation.

4. *Loan originator compensation—calculating loan originator compensation in connection with other charges or payments included in the finance charge or made to loan originators*. i. *Consumer payments to mortgage brokers.* As provided in § 1026.32(b)(1)(ii)(A), consumer payments to a mortgage broker already included in the points and fees calculation under § 1026.32(b)(1)(i) need not be counted again under § 1026.32(b)(1)(ii). For example,

assume a consumer pays a mortgage broker a $3,000 fee for a transaction. The $3,000 mortgage broker fee is included in the finance charge under § 1026.4(a)(3). Because the $3,000 mortgage broker fee is already included in points and fees under § 1026.32(b)(1)(i), it is not counted again under § 1026.32(b)(1)(ii).

ii. *Payments by a mortgage broker to its individual loan originator employee*. As provided in § 1026.32(b)(1)(ii)(B), compensation paid by a mortgage broker to its individual loan originator employee is not included in points and fees under § 1026.32(b)(1)(ii). For example, assume a consumer pays a $3,000 fee to a mortgage broker, and the mortgage broker pays a $1,500 commission to its individual loan originator employee for that transaction. The $3,000 mortgage broker fee is included in points and fees, but the $1,500 commission is not included in points and fees because it has already been included in points and fees as part of the $3,000 mortgage broker fee.

iii. *Creditor's origination fees—loan originator not employed by creditor*. Compensation paid by a consumer or creditor to a loan originator who is not employed by the creditor is included in the calculation of points and fees under § 1026.32(b)(1)(ii). Such compensation is included in points and fees in addition to any origination fees or charges paid by the consumer to the creditor that are included in points and fees under § 1026.32(b)(1)(i). For example, assume that a consumer pays to the creditor a $3,000 origination fee and that the creditor pays a mortgage broker $1,500 in compensation attributed to the transaction. Assume further that the consumer pays no other charges to the creditor that are included in points and fees under § 1026.32(b)(1)(i) and that the mortgage broker receives no other compensation that is included in points and fees under § 1026.32(b)(1)(ii). For purposes of calculating points and fees, the $3,000 origination fee is included in points and fees under § 1026.32(b)(1)(i) and the $1,500 in loan originator compensation is included in points and fees under § 1026.32(b)(1)(ii), equaling $4,500 in total points and fees, provided that no other points and fees are paid or compensation received.

*   *   *   *   *

Section 1026.43—Minimum Standards for Transactions Secured by a Dwelling

43(a) Scope.

*   *   *   *   *

Paragraph 43(a)(3)(iv).

1. *General.* The requirements of § 1026.43(c) through (f) do not apply to an extension of credit made pursuant to a program administered by a Housing Finance Agency, as defined under 24 CFR 266.5. Under the exemption, the requirements of § 1026.43(c) through (f) do not apply to extensions of credit made by housing finance agencies and extensions of credit made by intermediaries (*e.g.*, private creditors) pursuant to a program administered by a housing finance agency. For example, if a creditor is extending credit, including a subordinate-lien covered transaction, that will be made pursuant to a program administered by a housing finance agency, the creditor is exempt from the requirements of § 1026.43(c) through (f). Similarly, the creditor is exempt from the requirements of § 1026.43(c) through (f) regardless of whether the program administered by a housing finance agency is funded by Federal, State, or other sources.

Paragraph 43(a)(3)(v)(D).

1. *General*. An extension of credit is exempt from the requirements of § 1026.43(c) through (f) if the credit is extended by a creditor described in § 1026.43(a)(3)(v)(D), provided the conditions specified in that section are satisfied. The conditions specified in § 1026.43(a)(3)(v)(D)(*1*) and (*2*) are determined according to activity that occurred in the

calendar year preceding the calendar year in which the consumer's application was received. Section 1026.43(a)(3)(v)(D)(*2*) provides that, during the preceding calendar year, the creditor must have extended credit only to consumers with income that did not exceed the limit then in effect for low- and moderate-income households, as specified in regulations prescribed by the U.S. Department of Housing and Urban Development pursuant to 24 CFR 570.3. For example, a creditor has satisfied the requirement in § 1026.43(a)(3)(v)(D)(*2*) if the creditor extended credit only to consumers with incomes that did not exceed the limit in effect on the dates the creditor received each consumer's individual application. The condition specified in § 1026.43(a)(3)(v)(D)(*3*), which relates to the current extension of credit, provides that the extension of credit must be to a consumer with income that does not exceed the limit specified in § 1026.43(a)(3)(v)(D)(*2*) in effect on the date the creditor received the consumer's application. For example, assume that a creditor with a tax exemption ruling under section 501(c)(3) of the Internal Revenue Code of 1986 has satisfied the conditions identified in § 1026.43(a)(3)(v)(D)(*1*) and (*2*). If, on May 21, 2014, the creditor in this example extends credit secured by a dwelling to a consumer whose application reflected income in excess of the limit identified in § 1026.43(a)(3)(v)(D)(*2*) in effect on the date the creditor received that consumer's application, the creditor has not satisfied the condition in § 1026.43(a)(3)(v)(D)(*3*) and this extension of credit is not exempt from the requirements of § 1026.43(c) through (f).

Paragraph 43(a)(3)(vi).

1. *General.* The requirements of § 1026.43(c) through (f) do not apply to a mortgage loan modification made in connection with a program authorized by sections 101 and 109 of the Emergency Economic Stabilization Act of 2008. If a creditor is underwriting an extension of credit that is a refinancing, as defined by § 1026.20(a), that will be made pursuant to a program

authorized by sections 101 and 109 of the Emergency Economic Stabilization Act of 2008, the creditor also need not comply with § 1026.43(c) through (f). A creditor need not determine whether the mortgage loan modification is considered a refinancing under § 1026.20(a) for purposes of determining applicability of § 1026.43; if the transaction is made in connection with these programs, the requirements of § 1026.43(c) through (f) do not apply. In addition, if a creditor underwrites a new extension of credit, such as a subordinate-lien mortgage loan, that will be made pursuant to a program authorized by sections 101 and 109 of the Emergency Economic Stabilization Act of 2008, the creditor need not comply with the requirements of § 1026.43(c) through (f).

*   *   *   *   *

43(e) Qualified mortgages.

*   *   *   *   *

Paragraph 43(e)(5).

1. *Satisfaction of qualified mortgage requirements*. For a covered transaction to be a qualified mortgage under § 1026.43(e)(5), the mortgage must satisfy the requirements for a qualified mortgage under § 1026.43(e)(2), other than the requirements regarding debt-to-income ratio. For example, a qualified mortgage under § 1026.43(e)(5) may not have a loan term in excess of 30 years because longer terms are prohibited for qualified mortgages under § 1026.43(e)(2)(ii). Similarly, a qualified mortgage under § 1026.43(e)(5) may not result in a balloon payment because § 1026.43(e)(2)(i)(C) provides that qualified mortgages may not have balloon payments except as provided under § 1026.43(f). However, a covered transaction need not comply with § 1026.43(e)(2)(vi), which prohibits consumer monthly debt-to-income ratios in excess of 43 percent. A covered transaction therefore can be a qualified mortgage under

§ 1026.43(e)(5) even though the consumer's monthly debt-to-income ratio is greater than 43 percent.

2. *Debt-to-income ratio or residual income.* Section 1026.43(e)(5) does not prescribe a specific monthly debt-to-income ratio with which creditors must comply. Instead, creditors must consider a consumer's debt-to-income ratio or residual income calculated generally in accordance with § 1026.43(c)(7) and verify the information used to calculate the debt-to-income ratio or residual income in accordance with § 1026.43(c)(3) and (4). However, § 1026.43(c)(7) refers creditors to § 1026.43(c)(5) for instructions on calculating the payment on the covered transaction. Section 1026.43(c)(5) requires creditors to calculate the payment differently than § 1026.43(e)(2)(iv). For purposes of the qualified mortgage definition in § 1026.43(e)(5), creditors must base their calculation of the consumer's debt-to-income ratio or residual income on the payment on the covered transaction calculated according to § 1026.43(e)(2)(iv) instead of according to § 1026.43(c)(5). Creditors are not required to calculate the consumer's monthly debt-to-income ratio in accordance with appendix Q to this part as is required under the general definition of qualified mortgages by § 1026.43(e)(2)(vi).

3. *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 mortgage that will be acquired by a purchaser pursuant to a forward commitment does not satisfy the requirements of § 1026.43(e)(5), 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 forward commitment to another person that also meets the requirements of § 1026.43(e)(5)(i)(D)

is permitted. For example, assume a creditor that is eligible to make qualified mortgages under § 1026.43(e)(5) makes a mortgage. If that mortgage meets the purchase criteria of an investor with which the creditor has an agreement to sell loans after consummation, then the loan does not meet the definition of a qualified mortgage under § 1026.43(e)(5). However, if the investor meets the requirements of § 1026.43(e)(5)(i)(D), the mortgage will be a qualified mortgage if all other applicable criteria also are satisfied.

4. *Creditor qualifications.* To be eligible to make qualified mortgages under § 1026.43(e)(5), a creditor must satisfy the requirements stated in § 1026.35(b)(2)(iii)(B) and (C). Section 1026.35(b)(2)(iii)(B) requires that, during the preceding calendar year, the creditor and its affiliates together originated 500 or fewer first-lien covered transactions. Section 1026.35(b)(2)(iii)(C) requires that, as of the end of the preceding calendar year, the creditor had total assets of less than $2 billion, adjusted annually by the Bureau for inflation.

5. *Requirement to hold in portfolio*. Creditors generally must hold a loan in portfolio to maintain the transaction's status as a qualified mortgage under § 1026.43(e)(5), subject to four exceptions. Unless one of these exceptions applies, a loan is no longer a qualified mortgage under § 1026.43(e)(5) 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(e)(1) unless the loan also met the requirements of another qualified mortgage definition.

6. *Application to subsequent transferees*. The exceptions contained in § 1026.43(e)(5)(ii) 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(e)(5). Six months after consummation, Creditor A sells the qualified mortgage to Creditor B pursuant to § 1026.43(e)(5)(ii)(B) and the loan retains its qualified mortgage status because Creditor B complies with the limits on asset size and number of transactions. If Creditor B sells the qualified mortgage, it will lose its qualified mortgage status under § 1026.43(e)(5) unless the sale qualifies for one of the § 1026.43(e)(5)(ii) 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.

7. *Transfer three years after consummation*. Under § 1026.43(e)(5)(ii)(A), if a qualified mortgage under § 1026.43(e)(5) is sold, assigned, or otherwise transferred three years or more after consummation, the loan retains its status as a qualified mortgage under § 1026.43(e)(5) following the transfer. The transferee need not be eligible to originate qualified mortgages under § 1026.43(e)(5). The loan 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(e)(1).

8. *Transfer to another qualifying creditor*. Under § 1026.43(e)(5)(ii)(B), a qualified mortgage under § 1026.43(e)(5) may be sold, assigned, or otherwise transferred at any time to another creditor that meets the requirements of § 1026.43(e)(5)(v). That section requires that a creditor, during the preceding calendar year, together with all affiliates, 500 or fewer first-lien covered transactions and had total assets less than $2 billion (as adjusted for inflation) at the end of the preceding calendar year. A qualified mortgage under § 1026.43(e)(5) 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.

9. *Supervisory sales*. Section 1026.43(e)(5)(ii)(C) facilitates sales that are deemed

necessary by supervisory agencies to revive troubled creditors and resolve failed creditors. A qualified mortgage under § 1026.43(e)(5) retains its qualified mortgage status if it is sold, assigned, or otherwise transferred to another person pursuant to: a capital restoration plan or other action under 12 U.S.C. 1831o; the actions or instructions of any person acting as conservator, receiver or bankruptcy trustee; an order of a State or Federal government agency with jurisdiction to examine the creditor pursuant to State or Federal law; or an agreement between the creditor and such an agency. A qualified mortgage under § 1026.43(e)(5) 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(e)(5)(ii)(C) 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(e)(5)(ii)(C) directing the sale of one or more qualified mortgages under § 1026.43(e)(5) held by the creditor or one of the other circumstances listed in § 1026.43(e)(5)(ii)(C). For example, a qualified mortgage under § 1026.43(e)(5) 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.

10. *Mergers and acquisitions*. A qualified mortgage under § 1026.43(e)(5) retains its qualified mortgage status if a creditor merges with, is acquired by, or acquires another person regardless of whether the creditor or its successor is eligible to originate new qualified mortgages

under § 1026.43(e)(5) after the merger or acquisition. However, the creditor or its successor can originate new qualified mortgages under § 1026.43(e)(5) only if it complies with all of the requirements of § 1026.43(e)(5) after the merger or acquisition. For example, assume a creditor that originates 250 covered transactions each year and originates qualified mortgages under § 1026.43(e)(5) is acquired by a larger creditor that originates 10,000 covered transactions each year. Following the acquisition, the small creditor would no longer be able to originate § 1026.43(e)(5) qualified mortgages because, together with its affiliates, it would originate more than 500 covered transactions each year. However, the § 1026.43(e)(5) qualified mortgages originated by the small creditor before the acquisition would retain their qualified mortgage status.

[THIS SIGNATURE PAGE PERTAINS TO THE FINAL RULE TITLED "ABILITY-TO-REPAY AND QUALIFIED MORTGAGE STANDARDS UNDER THE TRUTH IN LENDING ACT (REGULATION Z)")]

Dated: May 29, 2013.

Richard Cordray

Richard Cordray,

Director, Bureau of Consumer Financial Protection.