revise these regulations to address electronic contributions expressly? If so, should the regulations take the same approach as those taken previously? If not, why not, and what approach should they take instead?

Recently, the Commission approved the use of text messaging to process contributions in a series of advisory opinions.[19] Should the Commission amend its regulations to address contributions made by text message? If so, should the regulations take the same approach as the advisory opinions? Should any revised regulations also address issues that were not addressed in the advisory opinions, such as how political committees should report the receipt of contributions made by text message? What related issues should the Commission address?

The Commission is also considering whether and, if so, how to revise the paper-oriented definitions of ''money'' and determinations of ''disbursement'' in its regulations. For example, the regulatory definition of ''contribution'' defines ''money'' as ''currency * * *, checks, money orders, or any other negotiable instruments payable on demand.'' 11 CFR 100.52(c); *see also* 11 CFR 100.111(d) (similarly defining ''money'' in the definition of ''expenditure''), 102.10 (requiring disbursements to be made by check or ''similar draft'' drawn on accounts established at the committee's campaign depository). In several advisory opinions, the Commission has interpreted the term ''similar draft'' to include electronic disbursements.[20] Should the Commission revise its regulations to provide expressly that contributions, expenditures, and disbursements include funds transferred electronically? Should any revised regulations take the same approach as the advisory opinions? If not, why not, and what approach should they take instead?

Finally, the Commission is considering whether to revise its regulations that expressly apply only to cash contributions so that they also expressly apply to certain electronic contributions. For example, cash contributions in excess of $100 are prohibited. 11 CFR 110.4. The Commission seeks comments on whether prepaid debit, credit, banking, and gift cards are functionally the same as cash. If so, should the regulation be revised to prohibit contributions in excess of $100 made by prepaid debit, credit, banking, and gift cards? If not, why not?

c. Rulemaking vs. *Other Guidance*

The Commission seeks comments on whether a rulemaking is the best way for it to address questions raised by the receipt of electronic contributions, and the making of electronic disbursements, by political committees. As noted above, the Commission to date has provided guidance on electronic transactions largely through advisory opinions, interpretive rules, and campaign guides. Are these the best ways for the Commission to provide guidance on the subject in light of rapidly evolving technologies, or would rules on the subject also be helpful? How should the Commission craft regulations in order to minimize the need for serial revisions in the face of new and emerging technologies? Given the speed at which technology has been advancing, the Commission welcomes comments suggesting general regulatory criteria or standards that are flexible and adaptable enough to apply to new or emerging technology or business arrangements.

3. Other Electronic Modernization Issues

The Commission welcomes comments, including any pertinent data, concerning any electronic modernization issues that are not addressed in this notice and that relate to the Commission's administration of the Act or Chapters 95 and 96 of Title 26.

Dated: April 25, 2013.

On behalf of the Commission.

Ellen L. Weintraub,

Chair, Federal Election Commission.

[FR Doc. 2013–10326 Filed 5–1–13; 8:45 am]

BILLING CODE 6715–01–P

pdf/candgui.pdf (describing when a credit card contribution is ''received'').

[19] *See* Advisory Opinion 2012–17 (Red Blue T LLC, ArmourMedia, Inc., and m-Qube, Inc.); Advisory Opinion 2012–26 (Cooper for Congress, ArmourMedia, Inc., and m-Qube, Inc.); Advisory Opinion 2012–28 (CTIA—The Wireless Association); Advisory Opinion 2012–30 (Revolution Messaging, LLC); Advisory Opinion 2012–31 (AT&T Inc.).

[20] *See, e.g.,* Advisory Opinion 1993–04 (Cox) (approving a ''computer driven billpayer service'' that included the disbursement of funds by electronic transfer); Advisory Opinion 1982–25 (Sigmund) (concluding that a wire transfer qualifies as a ''similar draft'').

BUREAU OF CONSUMER FINANCIAL PROTECTION

12 CFR Parts 1024 and 1026

[Docket No. CFPB–2013–0010]

RIN 3170–AA37

Amendments to the 2013 Mortgage Rules Under the Real Estate Settlement Procedure Act (Regulation X) and the Truth in Lending Act (Regulation Z)

AGENCY: Bureau of Consumer Financial Protection.

ACTION: Proposed rule with request for public comment.

SUMMARY: This rule proposes amendments to some of the final mortgage rules issued by the Bureau of Consumer Financial Protection (Bureau) in January of 2013. These amendments clarify or correct provisions on the relation to State law of Regulation X's servicing provisions; the small servicer exemption from certain servicing rules; the use of government-sponsored enterprise and Federal agency purchase, guarantee or insurance eligibility for determining qualified mortgage status; and the determination of debt and income for purposes of originating qualified mortgages.

DATES: Comments must be received on or before June 3, 2013.

ADDRESSES: You may submit comments, identified by Docket No. CFPB–2013–0010 or RIN 3170–AA37, by any of the following methods:

- *Electronic: http://www.regulations.gov.* Follow the instructions for submitting comments.
- *Mail/Hand Delivery/Courier:* Monica Jackson, Office of the Executive Secretary, Consumer Financial Protection Bureau, 1700 G Street NW., Washington, DC 20552.

Instructions: All submissions should include the agency name and docket number or Regulatory Information Number (RIN) for this rulemaking. Because paper mail in the Washington, DC area and at the Bureau is subject to delay, commenters are encouraged to submit comments electronically. In general, all comments received will be posted without change to *http://www.regulations.gov.* In addition, comments will be available for public inspection and copying at 1700 G Street NW., Washington, DC 20552, on official business days between the hours of 10 a.m. and 5 p.m. Eastern Time. You can make an appointment to inspect the documents by telephoning (202) 435–7275.

All comments, including attachments and other supporting materials, will become part of the public record and subject to public disclosure. Sensitive personal information, such as account numbers or social security numbers, should not be included. Comments will not be edited to remove any identifying or contact information.

FOR FURTHER INFORMATION CONTACT: Whitney Patross, Attorney; Joseph Devlin and Richard Arculin, Counsels; Marta Tanenhaus and R. Colgate Selden, Senior Counsels; Office of Regulations, at (202) 435–7700.

SUPPLEMENTARY INFORMATION:

I. Summary of Proposed Rule

In January 2013, the Bureau issued several final rules concerning mortgage markets in the United States, pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). Public Law 111–203, 124 Stat. 1376 (2010) (2013 Title XIV Final Rules). On January 10, 2013, the Bureau issued Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act (Regulation Z) (2013 ATR Final Rule).[1] On January 17, 2013, the Bureau issued Mortgage Servicing Rules Under the Real Estate Settlement Procedures Act (Regulation X) (2013 RESPA Servicing Final Rule) and Mortgage Servicing Rules Under the Truth in Lending Act (Regulation Z) (2013 TILA Servicing Final Rule) (together, 2013 Mortgage Servicing Final Rules).[2] This publication proposes several amendments to those rules. These amendments clarify or correct provisions on (1) The relation to State law of Regulation X's servicing provisions; (2) the small servicer exemption from certain of the new servicing rules; (3) the use of government-sponsored enterprise (GSE) and Federal agency purchase, guarantee or insurance eligibility for determining qualified mortgage (QM) status; and (4) the determination of debt and income for purposes of originating QMs. In addition to these four proposed revisions, which are discussed more fully below, the Bureau is also proposing certain technical corrections to the regulations with no substantive change intended.

First, the Bureau is proposing to amend the commentary to Regulation X to clarify that under the preemption provisions, that regulation does not occupy the field of regulation of the practices covered by RESPA or Regulation X, including with respect to mortgage servicers or mortgage servicing. The proposal would also redesignate § 1024.13, the Regulation X preemption provision, as § 1024.5(c).

Second, the Bureau is proposing to clarify the scope and application of an exemption for small servicers that is set forth in § 1026.41, the periodic statement provision, and incorporated by cross-reference in certain provisions of Regulation X. The proposal would clarify which mortgage loans to consider in determining small servicer status and the application of the small servicer exemption with regard to servicer/affiliate and master servicer/subservicer relationships. Further, the Bureau is proposing that three types of mortgage loan not be considered in determining small servicer status: mortgage loans voluntarily serviced for an unaffiliated entity without remuneration, reverse mortgages, and mortgage loans secured by a consumer's interest in timeshare plans. The Bureau is also proposing other minor changes involving the small servicer exemption.

Third, the Bureau is proposing to revise comment 43(e)(4)–4 to clarify what standards a creditor must meet when relying on a written guide or the automated underwriting system of one of the GSEs, U.S. Department of Housing and Urban Development (HUD), Veterans Administration (VA), U.S. Department of Agriculture (USDA), or Rural Housing Service (RHS) to determine qualified mortgage status under § 1026.43(e)(4). The proposed comment clarifies that a creditor is not required to satisfy certain mandates concerning loan delivery to the entities and other requirements that are wholly unrelated to assessing a consumer's ability to repay the loan. The proposed comment also specifies that a creditor relying on approval through an entity's automated underwriting system to establish qualified mortgage status must also meet the conditions on approval that are generated by that same system.

The Bureau further is proposing revisions to comment 43(e)(4)–4 to clarify that a loan meeting eligibility requirements provided in a written agreement between the creditor and one of the GSEs, HUD, VA, USDA, or RHS is also eligible for purchase or guarantee by the GSEs or insured or guaranteed by the agencies for the purposes of § 1026.43(e)(4). Thus, such loans could be qualified mortgages.

The Bureau is also proposing new comment 43(e)(4)–5, which provides that a repurchase or indemnification demand by the GSEs, HUD, VA, USDA, or RHS is not dispositive for ascertaining qualified mortgage status. The comment provides two examples to illustrate the application of this guidance.

Fourth, the Bureau is proposing changes to appendix Q of Regulation Z to facilitate compliance and ensure access to credit by assisting creditors in determining a consumer's debt-to-income ratio (DTI) for the purposes of § 1026.43(e)(2), the primary qualified mortgage provision. The Bureau is proposing changes to address compliance challenges raised by stakeholders, as well as technical and wording changes for clarification purposes.

II. Background

A. Title XIV Rulemakings Under the Dodd-Frank Act

In response to an unprecedented cycle of expansion and contraction in the mortgage market that sparked the most severe U.S. recession since the Great Depression, Congress passed the Dodd-Frank Act, which was signed into law on July 21, 2010. In the Dodd-Frank Act, Congress established the Bureau and, under sections 1061 and 1100A, generally consolidated the rulemaking authority for Federal consumer financial laws, including TILA and RESPA, in the Bureau.[3] At the same time, Congress significantly amended the statutory requirements governing mortgage practices with the intent to restrict the practices that contributed to and exacerbated the crisis. Under the statute, most of these new requirements would have taken effect automatically on January 21, 2013, if the Bureau had not issued implementing regulations by that date.[4] To avoid uncertainty and potential disruption in the national mortgage market at a time of economic vulnerability, the Bureau issued several final rules in a span of less than two weeks in January 2013 to implement these new statutory provisions and provide for an orderly transition.

On January 10, 2013, the Bureau issued the 2013 ATR Final Rule, Escrow Requirements Under the Truth in Lending Act (Regulation Z) (2013 Escrows Final Rule),[5] and High-Cost

[1] 78 FR 6407 (Jan. 30, 2013).

[2] 78 FR 10695 (Feb. 14, 2013) (Regulation X), 78 FR 10901 (Feb. 14, 2013) (Regulation Z).

[3] Sections 1011 and 1021 of the Dodd-Frank Act, in title X, the ''Consumer Financial Protection Act,'' Public Law 111–203, sections 1001–1100H, codified at 12 U.S.C. 5491, 5511. The Consumer Financial Protection Act is substantially codified at 12 U.S.C. 5481–5603. Section 1029 of the Dodd-Frank Act excludes from this transfer of authority, subject to certain exceptions, any rulemaking authority over a motor vehicle dealer that is predominantly engaged in the sale and servicing of motor vehicles, the leasing and servicing of motor vehicles, or both. 12 U.S.C. 5519.

[4] Dodd-Frank Act section 1400(c), 15 U.S.C. 1601 note.

[5] 78 FR 4726.

Mortgages and Homeownership Counseling Amendments to the Truth in Lending Act (Regulation Z) and Homeownership Counseling Amendments to the Real Estate Settlement Procedures Act (Regulation X) (2013 HOEPA Final Rule).[6] On January 17, 2013, the Bureau issued the 2013 Mortgage Servicing Final Rules. On January 18, 2013, the Bureau issued Appraisals for Higher-Priced Mortgage Loans (Regulation Z)[7] (issued jointly with other agencies) and Disclosure and Delivery Requirements for Copies of Appraisals and Other Written Valuations Under the Equal Credit Opportunity Act (Regulation B) (2013 Appraisals Final Rule).[8] On January 20, 2013, the Bureau issued Loan Originator Compensation Requirements Under the Truth in Lending Act (Regulation Z) (2013 Loan Originator Final Rule).[9] Most of these rules will become effective on January 10, 2014.

Concurrent with the 2013 ATR Final Rule, on January 10, 2013, the Bureau issued Proposed Amendments to the Ability-to-Repay Standards Under the Truth in Lending Act (Regulation Z) (2013 ATR Concurrent Proposal).[10] The 2013 ATR Concurrent Proposal would provide exemptions for certain nonprofit creditors and certain homeownership stabilization programs, an additional definition of a qualified mortgage for certain loans made and held in portfolio by small creditors, and specific rules for the inclusion of loan originator compensation in the points and fees calculation for QMs. The Bureau is currently in the process of considering comments received and finalizing this proposal.

B. Implementation Initiative for New Mortgage Rules

On February 13, 2013, the Bureau announced an initiative to support implementation of its new mortgage rules (Implementation Plan),[11] under which the Bureau would work with the mortgage industry to ensure that the new rules can be implemented accurately and expeditiously. The Implementation Plan included (1) Coordination with other agencies; (2) publication of plain-language guides to the new rules; (3) publication of additional corrections and clarifications of the new rules, as needed; (4) publication of readiness guides for the new rules; and (5) education of consumers on the new rules.

This proposal is the second issuance of additional corrections and clarifications of the new rules. The purpose of these updates is to address important questions raised by industry, consumer groups, or other agencies. Priority for this second set of updates has been given to issues that are important to a large number of stakeholders and that critically affect mortgage companies' implementation decisions. In June, the Bureau plans to issue additional proposed clarifications to the new mortgage rules, including the servicing rules touched on here and the 2013 Loan Originator Final Rule. We will also be issuing final versions of the recently published Escrows proposal and this issuance, after considering the comments we receive.[12]

III. Legal Authority

The Bureau is issuing this proposed rule pursuant to its authority under RESPA, TILA, and the Dodd-Frank Act. Section 1061 of the Dodd-Frank Act transferred to the Bureau the ''consumer financial protection functions'' previously vested in certain other Federal agencies, including the Federal Reserve Board (Board). The term ''consumer financial protection function'' is defined to include ''all authority to prescribe rules or issue orders or guidelines pursuant to any Federal consumer financial law, including performing appropriate functions to promulgate and review such rules, orders, and guidelines.''[13] Section 1061 of the Dodd-Frank Act also transferred to the Bureau all of HUD's consumer protections functions relating to RESPA.[14] Title X of the Dodd-Frank Act, including section 1061 of the Dodd-Frank Act, along with RESPA, TILA, and certain subtitles and provisions of title XIV of the Dodd-Frank Act, are Federal consumer financial laws.[15]

Section 19(a) of RESPA, 12 U.S.C. 2617(a), authorizes the Bureau to prescribe such rules and regulations, to make such interpretations, and to grant such reasonable exemptions for classes of transactions, as may be necessary to achieve the purposes of RESPA, which includes its consumer protection purposes. In addition, section 6(j)(3) of RESPA, 12 U.S.C. 2605(j)(3), authorizes the Bureau to establish any requirements necessary to carry out section 6 of RESPA and section 6(k)(1)(E) of RESPA, 12 U.S.C. 2605(k)(1)(E), authorizes the Bureau to prescribe regulations that are appropriate to carry out RESPA's consumer protection purposes. As identified in the 2013 RESPA Servicing Final Rule, the consumer protection purposes of RESPA include responding to borrower requests and complaints in a timely manner, maintaining and providing accurate information, helping borrowers avoid unwarranted or unnecessary costs and fees, and facilitating review for foreclosure avoidance options.

Section 105(a) of TILA, 15 U.S.C. 1604(a), authorizes the Bureau to prescribe regulations to carry out the purposes of TILA. Under 105(a) such regulations may contain such additional requirements, classifications, differentiations, or other provisions, and may provide for such adjustments and exceptions for all or any class of transactions, as in the judgment of the Bureau 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). 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, and abusive. Section 105(f) of TILA, 15 U.S.C. 1604(f), authorizes the

[6] 78 FR 6855.

[7] 78 FR 10367.

[8] 78 FR 7215.

[9] 78 FR 11279.

[10] 78 FR 6622.

[11] Consumer Financial Protection Bureau Lays Out Implementation Plan for New Mortgage Rules. Press Release. Feb. 13, 2013.

[12] The Bureau also has received some questions that it does not intend to address through further rulemaking because they are answered by the final rules as adopted. For example, the Bureau has been asked whether residual income considerations can have any impact on the status of a qualified mortgage, specifically, whether a creditor's failure to verify adequate residual income can be raised to refute the safe harbor for qualified mortgages that are not higher-priced covered transactions, under § 1026.43(e)(1)(i). The Bureau believes the rule is already clear that residual income is relevant only to rebutting the presumption of compliance for qualified mortgages that are higher-priced covered transactions, under § 1026.43(e)(1)(ii)(B), and therefore has no effect on the safe harbor status of qualified mortgages that are not higher-priced covered transactions.

[13] 12 U.S.C. 5581(a)(1).

[14] Public Law 111–203, 124 Stat. 1376, section 1061(b)(7); 12 U.S.C. 5581(b)(7).

[15] Dodd-Frank Act section 1002(14), 12 U.S.C. 5481(14) (defining ''Federal consumer financial law'' to include the ''enumerated consumer laws'' and the provisions of title X of the Dodd-Frank Act); Dodd-Frank Act section 1002(12), 12 U.S.C. 5481(12) (defining ''enumerated consumer laws'' to include TILA), Dodd-Frank section 1400(b), 15 U.S.C. 1601 note (defining ''enumerated consumer laws'' to certain subtitles and provisions of Title XIV).

Bureau to exempt from all or part of TILA any class of transactions if the Bureau determines that TILA coverage does not provide a meaningful benefit to consumers in the form of useful information or protection. Accordingly, the Bureau has authority to issue regulations pursuant to RESPA, TILA, title X, and the enumerated subtitles and provisions of title XIV.

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).]'' 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 authority to prescribe regulations to carry out the purposes of the qualified mortgage provisions, such as to ensure that responsible m affordable mortgage credit remains available to consumers in a manner consistent with the purposes of TILA section 128C. TILA section 129C(b)(3)(A), 15 U.S.C. 1639c(b)(3)(A).

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). Title X of the Dodd-Frank Act is a Federal consumer financial law. Accordingly, the Bureau is exercising its authority under the Dodd-Frank Act section 1022(b) to prescribe rules that carry out the purposes and objectives of RESPA, TILA, title X, and the enumerated subtitles and provisions of title XIV of the Dodd-Frank Act, and prevent evasion of those laws.

The Bureau is proposing to amend certain rules finalized in January, 2013 that implement a number of Dodd-Frank Act provisions. In particular, the Bureau is proposing to clarify or amend regulatory provisions and associated commentary adopted by the 2013 ATR Final Rule,[16] the 2013 TILA Servicing Final Rule,[17] and the 2013 RESPA Servicing Final Rule.[18] This proposed rule relies on the broad rulemaking and exception authorities specifically granted to the Bureau by RESPA, TILA, and title X of the Dodd-Frank Act.

IV. Section-by-Section Analysis

A. Regulation X

Subpart A—General Provisions

The Bureau is proposing a technical amendment to the heading for Subpart A of Regulation X from ''Subpart A—General'' to ''Subpart A—General Provisions'' to conform the heading in the text of the regulation to the heading set forth in the corresponding commentary.

Section 1024.5 Coverage of RESPA

The Bureau is proposing to redesignate § 1024.13 as § 1024.5(c). Section 1024.13, ''Relation to State laws,'' sets forth rules regarding the relationship of the requirements in RESPA and Regulation X to requirements established pursuant to State law. In the 2013 RESPA Servicing Final Rule, the Bureau divided Regulation X into subparts and § 1024.13 is located in new ''Subpart B—Mortgage Settlement and Escrow Accounts.'' The provisions of § 1024.13(a) are intended to apply with respect to all of Regulation X. Because § 1024.13 applies for all sections of Regulation X, the Bureau is redesignating § 1024.13 as § 1024.5(c), located within ''Subpart A—General Provisions.'' Further, the Bureau is proposing to remove and reserve § 1024.13.

The Bureau is further proposing to add commentary for proposed § 1024.5(c) to make clear that Regulation X does not create field preemption. Since the Bureau issued the 2013 RESPA Servicing Final Rule, it has received inquiries as to whether the Bureau's mortgage servicing rules result in preemption of the field of mortgage servicing regulation. The Bureau addressed this question in the preamble to the final rule, stating that ''the Final Servicing Rules generally do not have the effect of prohibiting State law from affording borrowers broader consumer protection relating to mortgage servicing than those conferred under the Final Servicing Rules.'' [19] The preamble further stated that, although ''in certain circumstances, the effect of specific requirements of the Final Servicing Rules is to preempt certain limited aspects of state law'' in general, ''the Bureau explicitly took into account existing standards (both State and Federal) and either built in flexibility or designed its rules to coexist with those standards.'' [20]

Because the Bureau has continued to receive questions on this issue, the Bureau believes it is appropriate to propose commentary to clarify the scope of proposed § 1024.5(c) and expressly address concerns about field preemption. Consistent with the preamble to the 2013 RESPA Servicing Final Rule, proposed comment 5(c)(1)-1 would state that State laws that are in conflict with the requirements of RESPA or Regulation X may be preempted by RESPA and Regulation X. Proposed comment 5(c)(1)-1 would state further that nothing in RESPA or Regulation X, including the provisions in subpart C with respect to mortgage servicers or mortgage servicing, should be construed to preempt the entire field of regulation of the covered practices. The Bureau believes that this proposed addition to the commentary would clarify that RESPA and Regulation X do not effectuate field preemption of States' regulation of mortgage servicers or mortgage servicing. The comment also makes clear that RESPA and Regulation X do not preempt State laws that give greater protection to consumers than they do.

The Bureau requests comment regarding the addition of the proposed commentary, including whether further clarification regarding the preemption effects of RESPA and Regulation X is necessary or appropriate.

B. Regulation Z

Section 1026.41 Periodic Statements for Residential Mortgage Loans

41(a) In General

41(a)(1) Scope

Section 1026.41(a)(1), which was established by the 2013 TILA Servicing Final Rule, sets forth the scope of mortgage loans subject to the periodic statement requirements. The mortgage loans covered by the rule are closed-end consumer credit transactions secured by

[16] 78 FR 6408 (January 30, 2013).

[17] 78 FR 10902 (February 14, 2013).

[18] 78 FR 10696 (February 14, 2013).

[19] 78 FR 10706.

[20] *Id.* (specifically identifying the National Mortgage Settlement and the California Homeowner Bill of Rights).

a dwelling, subject to certain exemptions set forth in § 1026.41(e). Section 1026.41(a)(1) further states that, for purposes of § 1026.41, ''[s]uch transactions are referred to as *mortgage loans.*''

The proposed revision would clarify the rule by replacing the indefinite reference ''such transactions'' in § 1026.41(a)(1) with a reiteration of the loans to which the rule applies, that is, closed-end consumer credit transactions secured by a dwelling. This revision clarifies which transactions are considered ''mortgage loans'' for purposes of § 1026.41.

The Bureau believes that this change also would reduce uncertainty about which loans to consider in determining a servicer's eligibility for one of the exemptions under § 1026.41(e), the small servicer exemption. Section 1026.41(e)(4)(ii) defines a small servicer as a servicer that services 5,000 or fewer mortgage loans, for all of which the servicer (or an affiliate) is the creditor or assignee.[21] The proposed text clarifies that, in general, a servicer determines whether it is a small servicer by considering the closed-end consumer credit transactions secured by a dwelling that it services. This includes coupon book loans, which are exempt from some of the requirements of the periodic statement rule. However, pursuant to proposed § 1026.41(e)(4)(iii), reverse mortgages and transactions secured by consumers' interests in timeshares, which are exempt from the periodic statement requirements, are excluded from consideration for purposes of determining small servicer status.

41(e) Exemptions

41(e)(4) Small Servicers

41(e)(4)(ii) Small Servicer Defined

For the reasons set forth in the 2013 Servicing Final Rules,[22] the Bureau determined that it was appropriate to exempt small servicers from certain mortgage servicing requirements. Specifically, small servicers, as defined by § 1026.41(e)(4), are exempt from the Regulation Z requirement to provide periodic statements for residential mortgage loans [23] and, in Regulation X, from (1) Certain requirements relating to obtaining force-placed insurance,[24] (2) the general servicing policies, procedures, and requirements,[25] and (3) certain requirements and restrictions relating to communicating with borrowers about, and evaluation of applications for, loss mitigation options.[26]

The Bureau is proposing to clarify the scope and application of the small servicer exemption. Determination of a servicer's status as a small servicer, and thus its eligibility for the small servicer exemption, is set forth in § 1026.41(e)(4). As set forth above, this standard is applicable by cross-reference to certain provisions of Regulation X. Regulation X applies to ''federally related mortgage loans,'' which excludes certain loans that are ''mortgage loans'' as defined by Regulation Z § 1026.41(a)(1). The proposed revision would clarify that, to qualify for the small servicer exemption applicable to either rule, the servicer must first qualify as a small servicer under § 1026.41(a)(1)—and that determination is based on closed-end consumer credit transactions secured by a dwelling. This Regulation Z standard applies regardless of whether or not the loans considered are subject to the requirements of Regulation X. The Bureau notes that, although some mortgage loans not subject to coverage under Regulation X count for purposes of determining eligibility as a small servicer, servicing such loans under Regulation X rules would not be required. Thus, a servicer that services 5,000 *federally related mortgage loans,* as defined by Regulation X, may service more than 5,000 *mortgage loans,* as defined by Regulation Z § 1026.41(a)(1). In this case, because the servicer's loans exceed the 5,000 mortgage loan limit, the servicer is not a small servicer and, thus, would not qualify for the small servicer exemption with regard to Regulation Z and Regulation X. However, the servicer would not have to comply with Regulation X requirements for those mortgage loans counted for purposes of determining small servicer eligibility but which are not federally related mortgage loans. Accordingly, by clarifying how a servicer determines whether it qualifies as a small servicer with regard to Regulation Z, this proposal also would clarify how a servicer determines whether it qualifies for the small servicer exemptions from the mortgage servicing requirements in Regulation X.

The Bureau is proposing to amend the commentary to § 1026.41(e)(4)(ii) to identify specifically which mortgage loans are considered for purposes of determining eligibility for the small servicer exemption. Specifically, the Bureau proposes to add comment 41(e)(4)(ii)–1 to clarify that, in general and pursuant to § 1026.41(a)(1), the mortgage loans considered in determining qualification for the small servicer exemption are closed-end consumer credit transactions secured by a dwelling. Proposed comment 41(e)(4)(ii)–1 highlights that, pursuant to § 1026.41(e)(4)(iii), certain closed-end consumer credit transactions secured by a dwelling are not considered in determining status as a small servicer, as discussed further below in connection with proposed § 1026.41(e)(4)(iii).

The Bureau requests comments and data regarding whether proposed comment 41(e)(4)(ii)–1 appropriately clarifies the scope of mortgage loans that must be considered for determining if a servicer qualifies as a small servicer. The Bureau specifically requests comment and data regarding whether any servicers service a significant number of closed-end consumer credit transactions secured by a dwelling, which are subject to Regulation Z, but service significantly fewer ''federally related mortgage loans,'' which are subject to Regulation X. For example, the Bureau requests comment and data regarding whether any servicers would not be considered a small servicer if the small servicer exemption is based on whether a servicer services 5,000 or fewer closed end consumer credit transactions secured by a dwelling, but would be a small servicer if the small servicer exemption is based on whether a servicer services 5,000 or fewer ''federally related mortgage loan[s],'' as that term is defined in 12 CFR 1024.2.[27]

The Bureau also is proposing to amend § 1026.41(e)(4)(ii)(A). Proposed § 1026.41(e)(4)(ii)(A) would clarify that, for purposes of determining small servicer status, a servicer considers the mortgage loans serviced by the servicer *together with any mortgage loans serviced by any affiliates.* Section 1026.41(e)(4)(iii) states that small servicer status is determined by counting ''the number of mortgage loans serviced by the servicer and any affiliates as of January 1 for the

[21] Housing Finance Agencies are deemed small servicers under § 1026.41(e)(4)(ii)(B) regardless of loan count and loan ownership status.

[22] *See, e.g.,* 78 FR 10718–10720.

[23] 12 CFR 1026.41(e).

[24] 12 CFR 1024.17(k)(5).

[25] 12 CFR 1024.30(b)(1).

[26] *Id.*

[27] One example of such a servicer would be a servicer that services 10,000 construction loans, which are not considered ''federally related mortgage loans'' pursuant to 12 CFR 1024.2, and 100 mortgage loans that are considered ''federally related mortgage loans'' pursuant to 12 CFR 1024.2. Such servicer would be considered to service 10,100 closed-end consumer credit transactions secured by a dwelling and would not qualify for the small servicer exemption. However, only the 100 federally related mortgage loans serviced by the servicer would be subject to the mortgage servicing requirements set forth in Regulation X pursuant to 12 CFR 1024.31.

remainder of the calendar year.'' To avoid any risk of inconsistency, the Bureau believes it is appropriate to amend § 1026.41(e)(4)(ii)(A) to conform the language to § 1026.41(e)(4)(iii) by adding the clause ''together with any affiliates'' such that a small servicer is a servicer that ''services, *together with any affiliates,* 5,000 or fewer mortgage loans, for all of which the servicer (or an affiliate) is the creditor or assignee.'' This change more fully conforms the language of § 1026.41(e)(4)(ii)(A) with the language of § 1026.41(e)(4)(iii) but does not change the meaning of the small servicer exemption.

The Bureau also is proposing to amend the comments to § 1026.41(e)(4)(ii)(A). Specifically, comment 41(e)(4)(ii)–1 would be redesignated as comment 41(e)(4)(ii)–2 and would be amended to clarify several elements set forth in the 2013 TILA Servicing Final Rule. First, it would clarify that there are two concurrent requirements for determining whether a servicer is a small servicer. Second, it would explain that the mortgage loans considered in making this determination are those serviced by the servicer as well as by its affiliates. Finally, it would clarify that the second requirement of the small servicer test, that a servicer must be either the ''creditor or assignee'' of the mortgage loans it services, means that the servicer must either currently own or have originated the mortgage loans. The comment also would provide examples to illustrate these points.

Proposed comment 41(e)(4)(ii)–1 would set forth the two requirements for determining if a servicer is a small servicer and would clarify that both requirements apply to the mortgage loans serviced by the servicer as well as by its affiliates. The comment would set forth both requirements: (1) A servicer, together with its affiliates, must service 5,000 or fewer mortgage loans, and (2) the servicer must only service mortgage loans for which the servicer (or an affiliate) is the creditor or assignee. Proposed comment 41(e)(4)(ii)–2 would further clarify that to be the ''creditor or assignee'' of a mortgage loan, the servicer (or an affiliate) must either currently own the mortgage loan or must have been the entity to which the mortgage loan was initially payable (that is, the originator of the mortgage loan). A servicer that only services such mortgage loans may qualify as a small servicer so long as the servicer also only services 5,000 or fewer mortgage loans. The Bureau believes that this clarification provides a helpful alternative way of expressing the requirement stated in the rule that the servicer or affiliate must also be the creditor or assignee of a mortgage loan.

Proposed comment 41(e)(4)(ii)–2 further would provide examples of specific circumstances demonstrating these requirements. The first example illustrates the loan count requirement of the small servicer test and the effect affiliation has on that requirement. Proposed comment 41(e)(4)(ii)–2.i states that if a servicer services 3,000 mortgage loans, but is affiliated (as defined at § 1026.32(b)(2)) [28] with another servicer that services 4,000 other mortgage loans, both servicers are considered to service 7,000 mortgage loans and neither servicer is considered a small servicer. The second example illustrates the ownership requirement of the small servicer test. Proposed comment 41(e)(4)(ii)–2.ii states that if a servicer services 3,100 mortgage loans, including 100 mortgage loans it neither owns nor originated but for which it owns the mortgage servicing rights, the servicer is not a small servicer. This is because the servicer services some mortgage loans for which the servicer (or an affiliate) is not the creditor or assignee, notwithstanding that the total number of mortgage loans serviced is fewer than 5,000.

Finally, the Bureau proposes to redesignate comment 41(e)(4)(ii)–2 as 41(e)(4)(ii)–3 and to revise the comment to provide further clarification regarding the application of the small servicer exemption in certain master servicer/subservicer relationships. Under the 2013 TILA Servicing Final Rule, comment 41(e)(4)(ii)–2 references Regulation X, 12 CFR 1024.31, for the definitions of ''master servicer'' and ''subservicer'' that apply to the rule. It also provides the example that, even though a master servicer meets the definition of a small servicer, a subservicer retained by that master servicer that does not meet the definition does not qualify for the small servicer exemption.

The proposed comment would clarify that a small servicer does not lose its small servicer status because it retains a subservicer, as that term is defined in 12 CFR 1024.31, to service any of its mortgage loans. The comment would also clarify that, for a subservicer, as that term is defined in 12 CFR 1024.31, to gain the benefit of the small servicer exemption, both the master servicer and the subservicer must be small servicers. The comment points out that, generally, a subservicer will not qualify as a small servicer because it does not own or did not originate the mortgage loans it subservices. However, a subservicer would qualify as a small servicer if it is an affiliate of a master servicer that qualifies as a small servicer.

Proposed comment 41(e)(4)(ii)–3 also removes the previous example described above in favor of three other examples that demonstrate the implication of a master servicer/subservicer relationship for purposes of qualifying for the small servicer exemption. In the first example, a credit union services 4,000 mortgage loans—all of which it originated or owns. The credit union retains a credit union service organization to subservice 1,000 of the mortgage loans and the credit union services the remaining 3,000 mortgage loans itself. The credit union has no affiliation relationship with the credit union service. The credit union is a small servicer and, thus, the small servicer exemption applies to the 3,000 mortgage loans the credit union services itself. The credit union service organization is not a small servicer because it services mortgage loans it does not own or did not originate. Accordingly, the credit union service organization does not gain the benefit of the small servicer exemption and, thus, must comply with any applicable mortgage servicing requirements for the 1,000 mortgage loans it subservices.

Proposed comment 41(e)(4)(ii)–3.ii posits the example of a bank holding company that, through a lender subsidiary, owns or originated 4,000 mortgage loans. All mortgage servicing rights for the 4,000 mortgage loans are owned by a wholly owned master servicer subsidiary. Servicing for the 4,000 mortgage loans is conducted by a wholly owned subservicer subsidiary. The bank holding company controls all of these subsidiaries and, thus, they are affiliates of the bank holding company pursuant § 1026.32(b)(2). Because the master servicer and subservicer service 5,000 or fewer mortgage loans and because the mortgage loans are owned or originated by an affiliate of each, the master servicer and the subservicer are each considered a small servicer and qualify for the small servicer exemption for all 4,000 mortgage loans.

Proposed comment 41(e)(4)(ii)–3.iii posits the example of a nonbank servicer that services 4,000 mortgage loans, all of which it originated or owns. The servicer retains a ''component servicer'' to assist it with servicing functions. The component servicer is

[28] The definition of ''affiliate'' for purposes of subpart E of Regulation Z, which includes § 1026.41, is set forth in § 1026.32(b)(2) and applies to all of subpart E, including the small servicer exemption. Affiliate, as defined in § 1026.32(b)(2), ''means any company that is controlled by, or is under common control with another company, as set forth in the Bank Holding Company Act of 1956 (12 USC 1841 *et seq.*).'' § 1026.32(b)(2).

not engaged in ''servicing'' as defined in 12 CFR 1024.2; that is, the component servicer does not receive any scheduled periodic payments from a borrower pursuant to the terms of any mortgage loan, including amounts for escrow accounts, and does not make the payments to the owner of the loan or other third parties of principal and interest and such other payments with respect to the amounts received from the borrower as may be required pursuant to the terms of the mortgage servicing loan documents or servicing contract. The component servicer is not a subservicer pursuant to 12 CFR 1024.31 because it is not engaged in servicing, as that term is defined in 12 CFR 1024.2. The nonbank servicer is a small servicer and the small servicer exemption applies to all 4,000 mortgage loans it services.

41(e)(4)(iii) Small Servicer Determination

Under the 2013 TILA Servicing Final Rule, § 1026.41(e)(4)(iii) sets forth certain criteria regarding how to determine if a servicer qualifies as a small servicer. Section 1026.41(e)(4)(iii) explains that the small servicer determination is based on the number of mortgage loans serviced by the servicer and any affiliates as of January 1 for the remainder of the calendar year. It also states that a servicer that ''crosses the threshold,'' and thus loses its small servicer status and its small servicer exemption, has six months after crossing the threshold or until the next January 1, whichever is later, to comply with any requirements from which the servicer is no longer exempt.

Proposed § 1026.41(e)(4)(iii) includes a number of revisions to § 1026.41(e)(4)(iii) as adopted by the 2013 TILA Servicing Final Rule. First, proposed § 1026.41(e)(4)(iii) would replace the reference to a servicer that ''crosses the threshold'' for determining if the servicer qualifies a small servicer with broader language indicating that a servicer that ''ceases to qualify'' as a small servicer will have six months or until the next January 1, whichever is later, to comply with any requirements for which a servicer is no longer exempt as a small servicer. The broader phrase ''ceases to qualify'' more accurately reflects the fact that there are two elements to determining if a servicer qualifies as a small servicer, as discussed above, either one of which could cause a servicer to lose exempt status.

Proposed § 1026.41(e)(4)(iii) thus would apply the transition period set out in the rule to situations in which a servicer no longer meets the loan count requirement as well as to situations in which the servicer no longer meets the requirement that the servicer is the creditor or assignee of all mortgage loans it services. Thus, if a servicer exceeds the 5,000 mortgage loan limit or begins to service mortgage loans it does not own or did not originate, it must comply with any requirements from which it is no longer exempt by either the following January 1 or six months after the change in operations that disqualifies it as a small servicer, whichever is later. For example, if on September 1 a servicer that previously qualified as a small servicer begins to service a mortgage loan that it does not own and did not originate, the servicer has until March 1 of the following year to comply with the requirements from which it was previously exempt as a small servicer.

The proposal also would add language to specify which mortgage loans should not be considered in determining small servicer status. Proposed § 1026.41(e)(4)(iii) would clarify that certain closed-end consumer credit transactions secured by a dwelling would not be considered for purposes of determining whether a servicer qualifies as a small servicer. Specifically, because such loans are exempt from § 1026.41, reverse mortgage transactions and mortgage loans secured by a consumer's interest in timeshare plans are not considered when determining if a servicer is a small servicer. (Because coupon book loans are exempt only from some requirements of § 1026.41, such loans are considered in determining whether a servicer is a small servicer.)

The Bureau also is proposing to exclude from consideration any mortgage loan voluntarily serviced by a small servicer for a creditor or assignee that is not an affiliate of the servicer and for which the servicer does not receive any compensation or fees (''charitably serviced'' mortgage loans). The Bureau has received feedback that certain servicers that would otherwise be considered small servicers, voluntarily service mortgage loans for unaffiliated non-profit entities for charitable purposes and do not receive compensation or fees from engaging in that servicing. If such charitably serviced mortgage loans are considered in connection with determining whether a servicer qualifies as a small servicer, a servicer engaging in this practice would not qualify for the small servicer exemption because the servicer would be servicing a mortgage loan it does not own or did not originate, notwithstanding that such servicer undertook to service those mortgage loans for charitable purposes.

The Bureau is concerned that including charitably serviced mortgage loans in determining status as a small servicer would cause servicers to refrain from charitable servicing rather than lose the benefits of a small servicer exemption. The Bureau believes such a result would not further the goal of consumer protection for the affected consumers and may instead negatively affect the availability and costs of credit for consumers whose mortgage loans would otherwise be serviced pursuant to such charitable arrangements. Further, the Bureau believes consumers more likely would receive superior service from an entity in the business of servicing that is willing to donate its services than from a non-profit entity that owns the mortgage servicing rights but is not experienced in the business of servicing. The Bureau believes that the benefits of excluding charitably serviced mortgage loans from small servicer determination outweigh the potential risks to consumers that exclusion may pose.

For the reasons set forth above, pursuant to the Bureau's exemption authority and authority to provide for adjustments and exceptions for any class of transactions as may be necessary or proper to effectuate the purposes of TILA, under TILA sections 105(a) and (f), the Bureau proposes that mortgage loans voluntarily serviced by a servicer for a creditor or assignee that is not an affiliate of the servicer and for which the servicer does not receive any compensation or fees are not considered in determining a servicer's qualification as a small servicer. As discussed, the Bureau believes that considering such loans in determining if a servicer is a small servicer would defeat the purposes of TILA by penalizing charitable servicers, thereby dissuading them from engaging in charitable servicing to the detriment of the consumers that otherwise would benefit from this activity. The Bureau requests comment regarding whether it is appropriate not to consider such mortgage loans when determining if a servicer qualifies for a small servicer exemption. The Bureau further requests comment on whether other mortgage loans serviced through similar limited arrangements should not be considered in determining whether a servicer is a small servicer. However, the Bureau emphasizes that, in this proposed rulemaking, it is neither reexamining nor seeking comment on the issue of exempting nonprofit entities engaged in mortgage servicing from the

requirements of the periodic statement or any other mortgage servicing rule.

Finally, the Bureau proposes to add comment 41(e)(4)(iii)–3. Proposed comment 41(e)(4)(iii)–3 would clarify that mortgage loans that are not considered for purposes of determining small servicer qualification pursuant to § 1026.41(e)(4)(iii), are not considered for determining either whether a servicer services, together with any affiliates, 5,000 or fewer mortgage loans or whether a servicer is servicing mortgage loans that it does not own or did not originate. Proposed comment 41(e)(4)(iii)–3 would further posit the example of a servicer that services 5,400 mortgage loans. Of these mortgage loans, the servicer owns or originated 4,800 mortgage loans, services 300 reverse mortgage transactions that it does not own or did not originate, and voluntarily services 300 mortgage loans that it does not own or did not originate for an unaffiliated non-profit organization for which the servicer does not receive any compensation or fees. Neither the reverse mortgage transactions nor the mortgage loans voluntarily serviced by the servicer are considered for purposes of determining if the servicer is a small servicer. Thus, because the only mortgage loans considered are the 4,800 other mortgage loans serviced by the servicer, and the servicer owns or originated each of those mortgage loans, the servicer is considered a small servicer and qualifies for the small servicer exemption with regard to all 5,400 mortgage loans it services. The comment also notes that reverse mortgages and transactions secured by a consumer's in timeshare plans, in addition to not being considered in determining small servicer qualification, also are *exempt* from the requirements of § 1026.41. In contrast, although charitably serviced mortgage loans, as defined by § 1026.41(e)(4)(iii), are likewise not considered in determining small servicer qualification, they are *not exempt* from the requirements of § 1026.41. Thus, a servicer that does *not* qualify as a small servicer would not be required to provide periodic statements for reverse mortgages and timeshare plans because they are exempt from the rule, but would be required to provide periodic statements for the mortgage loans it charitably services.

Legal authority. The Bureau is proposing to exclude charitably serviced mortgage loans and reverse mortgage transactions from consideration in determining a servicer's status as a small servicer for purposes of the small servicer exemption in § 1024.41(e)(4) pursuant to its authority to provide for adjustments and exceptions under TILA section 105(a) and (f).[29] With respect to charitably serviced mortgage loans, the Bureau believes, for the reasons described above, that declining to consider such mortgage loans for purposes of determining eligibility as a small servicer effectuates the purposes of, and facilitates compliance with TILA and Regulation Z. Further, consistent with TILA section 105(f) and in light of the factors in that provision, the Bureau believes that requiring servicers to consider mortgage loans they charitably service for purposes of determining eligibility as a small servicer would cause mortgage servicers to withdraw from such charitable relationships and will not provide a meaningful benefit to consumers in the form of useful information or protection. In addition, the Bureau is concerned regarding the extent to which any requirement to consider such loans will complicate, hinder, or make more expensive the credit process for such mortgage loan transactions, especially considering the status of the borrowers that typically secure mortgage loans that are charitably serviced. Ultimately, the Bureau believes the goal of consumer protection would be undermined if it considers for purposes of small servicer qualification, mortgage loans voluntarily serviced by a servicer for a creditor or assignee that is not an affiliate of the servicer and for which the servicer does not receive any compensation or fees.

The Bureau similarly believes that not considering reverse mortgage in determining whether a servicer is a small servicer effectuates the purposes of, and facilitates compliance with, TILA and Regulation Z. The Bureau believes this for the same reasons set forth in the 2013 TILA Servicing Final Rule[30] exempting reverse mortgages from the requirements of § 1024.41. As discussed in that Final Rule, the periodic statement requirements were designed for a traditional mortgage product such that information relevant and useful for consumers with reverse mortgages differs substantially from the information required on the periodic statement and, thus, would not provide a meaningful benefit to consumers of reverse mortgages. The Bureau believes that not considering reverse mortgages in determining whether a servicer is a small servicer is proper irrespective of the amount of the loan, the status of the consumer (including related financial arrangements, financial sophistication, and the importance to the consumer of the loan), or whether the loan is secured by the principal residence of the consumer.

Section 1026.43 Minimum Standards for Transactions Secured by a Dwelling

43(e) Qualified Mortgages

43(e)(4) Qualified Mortgage Defined—Special Rules

The 2013 ATR Final Rule generally 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 requirement for ''qualified mortgages.'' These provisions, in § 1026.43(c), (e)(2) and (4), and (f), implement the baseline requirement of TILA section 129C(a)(1) and the qualified mortgage provisions of TILA section 129C(b).

To determine the qualified mortgage status of a loan, creditors must analyze whether the loan meets one of the definitions of ''qualified mortgage'' in § 1026.43(e)(2), (e)(4), or (f). Section 1026.43(e)(4) provides a definition of qualified mortgage for loans that (1) meet the prohibitions on certain risky loan features (*e.g.,* negative amortization and interest only features); (2) do not exceed certain limitations on points and fees under § 1026.43(e)(2); and (3) either are eligible for purchase or guarantee by the GSEs, while under the conservatorship of the Federal Housing Finance Agency, or are eligible to be insured or guaranteed by HUD under the National Housing Act (12 U.S.C. 1707 *et seq.*), the VA, the USDA, or RHS.[31] HUD, VA, USDA, and RHS have authority under the Dodd-Frank Act to define qualified mortgage standards for their own loans. *See* TILA section 129C(b)(3)(B)(ii). Coverage under § 1026.43(e)(4) for such loans will

[29] TILA section 128(f) requires periodic statements for ''residential mortgage loans,'' which, pursuant to TILA section 103(cc)(5), excludes transactions secured by consumers' interests in timeshare plans. For this reason, exception authority is not required to exclude such loans from consideration in determining if a servicer is a small servicer.

[30] *See* 78 FR 10973.

[31] Eligibility standards for the GSEs and Federal agencies are available at: Fannie Mae, *Single Family Selling Guide, https://www.fanniemae.com/content/guide/sel111312.pdf;* Freddie Mac, *Single-Family Seller/Servicer Guide, http://www.freddiemac.com/sell/guide/;* HUD Handbook 4155.1, *http://www.hud.gov/offices/adm/hudclips/handbooks/hsgh/4155.1/41551HSGH.pdf;* Lenders Handbook—VA Pamphlet 26–7, *Web Automated Reference Material System (WARMS), http://www.benefits.va.gov/warms/pam26_7.asp; Underwriting Guidelines: USDA Rural Development Guaranteed Rural Housing Loan Program, http://www.rurdev.usda.gov/SupportDocuments/CA-SFH-GRHUnderwritingGuide.pdf.*

sunset once each agency promulgates its own qualified mortgage standards and such rules take effect. Coverage of GSE-eligible loans will sunset when conservatorship ends.

Even if the Federal agencies do not issue additional rules or conservatorship does not end, the temporary qualified mortgage definition in § 1026.43(e)(4) will expire seven years after the effective date of the rule.[32] Covered transactions that satisfy the requirements of § 1026.43(e)(4) that are consummated before the sunset of § 1026.43(e)(4) will retain their qualified mortgage status after the temporary definition expires. However, a loan consummated after the sunset of § 1026.43(e)(4) may be a qualified mortgage only if it satisfies the requirements of § 1026.43(e)(2) or (f), under the final rule.[33]

Eligibility Under GSE/Agency Guides and Automated Underwriting Systems

As adopted by the 2013 ATR Final Rule, comment 43(e)(4)–4 clarifies that, to satisfy § 1026.43(e)(4)(ii), a loan need not be actually purchased or guaranteed by a GSE or insured or guaranteed by HUD, VA, USDA, or RHS. Rather, § 1026.43(e)(4)(ii) requires only that the loan be eligible for such purchase, guarantee, or insurance. For example, the comment provides that, for purposes of § 1026.43(e)(4), a creditor is not required to sell a loan to the GSEs for that loan to be a qualified mortgage. Rather, the loan must be eligible for purchase or guarantee by the GSEs. To determine eligibility, a creditor may rely on an underwriting recommendation provided by one of the GSEs' or agencies' automated underwriting systems (AUSs) or their written guides. Accordingly, with regard to the GSEs, the comment states that a covered transaction is eligible for purchase or guarantee by Fannie Mae or Freddie Mac (and therefore a qualified mortgage under § 1026.43(e)(4)) if: (i) the loan conforms to the standards set forth in the Fannie Mae Single-Family Selling Guide or the Freddie Mac Single-Family Seller/Servicer Guide; or (ii) the loan receives an ''Approve/Eligible'' recommendation from Desktop Underwriter (DU); or an ''Accept and Eligible to Purchase'' recommendation from Loan Prospector (LP).

The Bureau is proposing to revise comment 43(e)(4)–4 in a number of ways as discussed here and below. First, the proposal would clarify that a creditor is not required to comply with all GSE or agency requirements to show qualified mortgage status. Specifically, the proposed revision specifies that the creditor need not comply with certain requirements that are wholly unrelated to a consumer's ability to repay, including activities related to selling, securitizing, or delivering consummated loans and any requirement the creditor is required to perform after the consummated loan is sold, guaranteed, or endorsed for insurance (in the case of agency loans) such as document custody, quality control, and servicing. These requirements are spelled out in the most depth in the GSE and agency written guides, but may also be referenced in automated underwriting system conditions and written agreements with individual creditors, as discussed further below.

The Bureau believes that the proposed comment will clarify the intended scope of the temporary category of qualified mortgage created in § 1026.43(e)(4) and facilitate compliance with the provisions of Regulation Z adopted in the 2013 ATR Final Rule. As the Bureau explained in the preamble to the final rule, the Bureau established § 1026.43(e)(4) as a temporary transition measure designed to ensure access to responsible, affordable credit for consumers with debt-to-income ratios that exceed the 43% threshold that the Bureau adopted as a bright-line standard in the permanent general definition of qualified mortgage under § 1026.43(e)(2) while creditors adapted to the new ATR rules and other changes in economic and regulatory conditions. The Bureau believed that using widely recognized, federally related underwriting standards to define qualified mortgages during this interim period would both facilitate compliance and ensure responsible lending practices. The temporary provision therefore bases qualified mortgage status on *eligibility* for purchase, insurance, or guarantee, but does not require actual sale, guarantee, or insurance endorsement. Furthermore, the temporary provision requires that a qualified mortgage must be eligible at consummation.

However, the Bureau recognizes that the GSEs and agencies impose a wide variety of requirements relating not only to underwriting of potentially eligible loans, but also to the mechanics of sale, guarantee, or insurance and post-consummation activities. Because underwriting is a complex process that involves assessment of the consumer's ability to repay the loan as well as other credit risk factors, the Bureau continues to believe that it is appropriate to base qualified mortgage status under § 1026.43(e)(4) on the GSEs' and agencies' general standards concerning borrower, product, and mortgage eligibility and underwriting. While some of these underwriting requirements may be more closely related to assessing a consumer's ability to repay than others, the Bureau believes that attempting to disaggregate them would be an extraordinarily complex task that would defeat the purposes of the temporary definition in adopting widely recognized standards to facilitate compliance and access to responsible credit. Where groups of requirements are wholly unrelated to underwriting (*i.e.,* wholly unrelated to assessing ability to repay and other risk-related factors), however, the Bureau believes that it is appropriate to specify that such requirements do not affect qualified mortgage status.

The Bureau believes that the items specified in the comment meet this test and provide greater clarity to the temporary definition of qualified mortgage. Because TILA requires assessment of a consumer's ability to repay a loan as of the time of consummation, the Bureau believes that GSE and agency requirements relating to post-consummation activity should not be relevant to qualified mortgage status. And because the temporary definition does not require actual purchase, guarantee, or insurance, the Bureau believes that it would not be appropriate to base qualified mortgage status on elements of the guides relating to the mechanics of actual delivery, purchase, guarantee, and endorsement. The Bureau recognizes that most requirements wholly unrelated to underwriting involve post-consummation activity, however, pre-consummation GSE and agency requirements could also be wholly unrelated to underwriting. For example, the status of a creditor's approval or eligibility to do business with a GSE is not relevant for ascertaining qualified mortgage status. The Bureau invites comment on this proposed clarification generally and on whether other GSE or

[32] The rule's effective date is January 10, 2014, thus the § 1026.43(e)(4) qualified mortgage definition expires at the latest on January 10, 2021.

[33] The Bureau issued a concurrent proposed rule after January 10, 2013 when the 2013 ATR Final Rule was issued. The proposed Amendments to the Ability to Repay Standards under the Truth in Lending Act amend the 2013 ATR Final Rule by providing exemptions for certain nonprofit creditors and certain homeownership stabilization programs and an additional definition of a qualified mortgage for certain loans made and held in portfolio by small creditors. The Bureau also seeks feedback in the proposal on whether additional clarification is needed regarding the inclusion of loan originator compensation in the points and fees calculation. The concurrent proposal is available at: *http://files.consumerfinance.gov/f/201301_cfpb_concurrent-proposal_ability-to-repay.pdf.*

agency requirements should be excluded.

The Bureau is also proposing to revise comment 43(e)(4)–4 to clarify eligibility as determined by an automated underwriting system of a GSE, or one of the agencies. Thus, the AUSs and the written guides of the GSEs as well as the agencies can be used for eligibility purposes. The proposed language would explain that to rely upon an AUS recommendation to demonstrate qualified mortgage status a creditor must have (1) accurately input the loan information into the automated system, and (2) satisfied any accompanying requirements or conditions to the AUS approval that would otherwise invalidate the recommendation, unless the conditions concern activities related to selling, securitizing, or delivering consummated loans or post-consummation requirements as discussed above. The comment as adopted in the 2013 ATR Final Rule assumed that any recommendation used for compliance would be valid, and these clarifications merely list two criteria that should be monitored to ensure that validity. In particular, because the AUSs generate a list of conditions that must be met in support of the approval designation, the Bureau believes that those conditions must be satisfied to show eligibility for purchase, guarantee, or insurance. The Bureau seeks comment on these revisions as well and is also proposing technical edits to comment 43(e)(4)–4 for clarity and accuracy.

Effect of Written Contract Variances

The Bureau also is proposing to revise comment 43(e)(4)–4 in a third way to clarify further that a loan meeting eligibility requirements provided in a written agreement between the creditor and a GSE or agency that permits variation from the standards of the written guides and/or AUSs in effect at the time of consummation is also eligible for purchase or guarantee by the GSEs or insurance or guarantee by the agencies for the purposes of § 1026.43(e)(4). Thus, such loans would be qualified mortgages. The Bureau recognizes that these agreements between creditors and the GSEs or agencies effectively constitute modification of, or substitutes for, the general manuals or AUSs with regard to these creditors. In many cases, the agreements allow the creditors to use other automated underwriting systems rather than the GSE or agency systems, subject to certain conditions or limitations on which loans the GSE or agency will accept as eligible for purchase, guarantee, or insurance. The Bureau believes that it is therefore appropriate for the purposes of § 1026.43(e)(4) to consider the agreements to be equivalent to the standard written guides for purposes of the specific creditor to which the agreement applies. Many of these agreements are necessary to accommodate local and regional market variations and other considerations that do not substantially relate to ATR-related underwriting criteria and therefore are generally consistent with the consumer protection and other purposes of the rule. However, the Bureau does not believe that it would be appropriate to allow one creditor to rely on the terms specified in another creditor's written agreement with a GSE or agency to establish qualified mortgage status, as the written agreements are individually negotiated and monitored. The Bureau seeks comment on this proposed clarification generally and on whether other variations on standard guides and eligibility criteria should be considered.

Repurchase and Indemnification Demands

The Bureau is also proposing new comment 43(e)(4)–5 to provide additional clarification on how repurchase and indemnification demands by the GSEs and agencies may affect the qualified mortgage status of a loan. The proposed comment does not amend the meaning of the current rule but clarifies how a determination of the qualified mortgage status of a loan should be understood in relation to claims that the loan was not eligible for purchase or insurance and therefore not a qualified mortgage. The Bureau understands that facts upon which eligibility status was determined at or before consummation could later be found to be incorrect. Often, a repurchase or indemnification demand by a GSE or an agency involves such issues. However, the mere occurrence of a GSE or agency demand that a creditor repurchase a loan or indemnify the agency for an insurance claim does not necessarily mean that the loan is not a qualified mortgage.

Proposed comment 43(e)(4)–5 specifically provides that a repurchase or indemnification demand by the GSEs, HUD, VA, USDA, or RHS is not dispositive in ascertaining qualified mortgage status. Much as qualified mortgage status under the general definition in § 1026.43(e)(2) may typically turn on whether the consumer's debt-to-income ratio at the time of consummation was equal to or less than 43%, qualified mortgage status under § 1026.43(e)(4) may typically turn on whether the loan was eligible for purchase, guarantee, or insurance at the time of consummation. Thus, for example, a demand for repurchase or indemnification based on post-consummation GSE or agency requirements would therefore not be relevant to qualified mortgage status. Rather, only reasons for a repurchase or indemnification demand that specifically apply to the qualified mortgage status of the loan under § 1026.43(e)(4) would be relevant, as discussed above in connection with proposed comment 43(e)(4)–4. Moreover, the mere fact that a demand has been made, or even resolved, as between a creditor and GSE or agency is not dispositive with regard to eligibility for purposes of § 1026.43(e)(4), as those parties are involved in an ongoing business relationship rather than an adjudicatory process. However, evidence of whether a particular loan satisfied the § 1026.43(e)(4) eligibility criteria at consummation may be brought to light in the course of dealings over a particular demand, depending on the facts and circumstances. Such evidence—like any evidence discovered after consummation that relates to the facts as of the time of consummation—may be relevant in assessing whether a particular loan is a qualified mortgage.

To clarify this point further, proposed comment 43(e)(4)–5 also includes two examples of relevant evidence discovered after consummation. In the first example, assume eligibility to purchase a loan was based in part on the consumer's employment income of $50,000 per year. The creditor uses the income figure in obtaining an approve/eligible recommendation from DU. A quality control review, however, later determines that the documentation provided and verified by the creditor to comply with Fannie Mae requirements did not support the reported income of $50,000 per year. As a result, Fannie Mae demands that the creditor repurchase the loan. Assume that the quality control review is accurate, and that DU would not have issued an approve/eligible recommendation if it had been provided the accurate income figure. The Bureau believes that, given the facts and circumstances of this example, the DU determination at the time of consummation was invalid because it was based on inaccurate information provided by the creditor; therefore, the loan was never a qualified mortgage.

For the second example, assume a creditor delivered a loan, that the creditor determined was a qualified mortgage at the time of consummation,

to Fannie Mae for inclusion in a particular To-Be-Announced Mortgage Backed Security (MBS) pool of loans. The data submitted by the creditor at the time of loan delivery indicated that the various loan terms met the product type, weighted-average coupon (WAC), weighted-average maturity (WAM), and other MBS pooling criteria, and MBS issuance disclosures to investors reflect this loan data. However, after delivery and MBS issuance, a quality control review determines that the loan violates the pooling criteria. The loan still meets eligibility requirements for other Fannie Mae products and loan terms. Fannie Mae, however, requires the creditor to repurchase the loan due to the violation of MBS pooling requirements. Assume that the quality control review determination is accurate. The reason the creditor repurchases this loan is not relevant to the loan's qualified mortgage status. The loan still meets other Fannie Mae eligibility requirements and therefore remains a qualified mortgage based on these facts and circumstances.

The Bureau invites comment on proposed comment 43(e)(4)–5 in general. The Bureau also solicits comment on whether additional examples or other particular situations should be provided or whether alternatives for eligibility other than relationship to ability-to-repay standards should be adopted that would determine the qualified mortgage status of a loan.

Section 1026.43(e)(4) was adopted pursuant to the Bureau's exception and adjustment authority under TILA section 105(a) and its authority to revise, add to, or subtract from criteria that define a qualified mortgage under TILA section 129C(b)(3)(B)(i). The Bureau proposes these revisions to comment 43(e)(4)–4 and proposes new comment 43(e)(4)–5 to provide additional clarity to § 1026.43(e)(4) pursuant to that authority.

Appendix Q to Part 1026—Standards for Determining Monthly Debt and Income

Section 1026.43(e)(2) defines ''qualified mortgages'' as loans that satisfy all of the qualified mortgage criteria required by the statute (including underwriting to the maximum interest rate during the first five years of the loan and consideration and verification of the consumer's income or assets), for which the creditor considers and verifies the consumer's current debt obligations, alimony, and child support, and that have a total (*i.e.,* back-end) monthly DTI of no greater than 43 percent, following the standards for ''debt'' and ''income'' set forth in appendix Q to the rule. The Bureau adopted the 43 percent DTI requirement and other modifications to the statutory criteria pursuant to its authorities under TILA section 129C and 105(a).[34]

The Bureau also adopted and incorporated into the rule appendix Q, which contains detailed requirements for determining ''debt'' and ''income'' for the purposes of the DTI calculation based on the definitions of those terms set forth in HUD Handbook 4155.1, *Mortgage Credit Analysis for Mortgage Insurance on One-to-Four-Unit Mortgage Loans.* The standards in the Handbook are used by creditors originating FHA-insured residential mortgages to determine and verify a consumer's total monthly debt and monthly income. For the purposes of appendix Q, the Bureau largely codified the Handbook, but modified various portions of it to remove standards and references unique to the FHA underwriting process, such as references to the TOTAL Scorecard Instructions and certain borrower qualification procedures.

As discussed in the preamble to the 2013 ATR Final Rule, the Bureau believes that, to the extent possible, using existing FHA underwriting guidelines as the foundation for determining ''debt'' and ''income'' for DTI purposes provides creditors with well-established standards for determining whether a loan is a qualified mortgage under § 1026.43(e)(2). The Bureau also believes that this approach is consistent with the proposed approach to defining debt and income in the 2011 Proposed Qualified Residential Mortgage Rule (QRM), thus facilitating compliance. However, the Bureau stated it would continue to consult with the Federal agencies responsible for the QRM rulemaking on possible changes to FHA guidelines that may occur over time, which could affect the definition of debt and income in both rules.

Since publication of the 2013 ATR Final Rule, the Bureau has received numerous inquiries from industry regarding provisions of the appendix that they believe were intended to function as flexible underwriting standards used by the FHA for insurance underwriting purposes, but now have been codified as bright-line requirements for determining debt and income. For example, some provisions of the appendix as adopted would require creditors to assess a consumer's qualifications for employment, predict whether a consumer's income will continue for up to three years, or assess economic conditions that may affect future income for self-employed consumers. Stakeholders have raised concerns that these provisions may be properly suited for the purposes of a holistic and qualitative underwriting analysis—such as a determination of insurance eligibility where the FHA has discretion to grant waivers or variances based on a given set of facts or offer informal guidance—but are not well-suited to function as regulatory requirements that are not subject to discretionary variance or waiver on an individual basis. Stakeholders also pointed out that many of these provisions (such as requirements to evaluate a consumer's qualification for his or her job) provide little clarity or guidance for creditors to follow to comply with them—again a consequence of their original purpose to function as discretionary ''guidelines'' and not bright-line requirements. Similarly, stakeholders have expressed concerns that the broad nature of these provisions could undermine the presumption of compliance available to creditors who make qualified mortgages and expose them to significant litigation risk.

As discussed below, the Bureau adopted these provisions of appendix Q largely for consistency with existing underwriting standards used by FHA, but in light of the concerns raised by stakeholders agrees that certain provisions as adopted are not properly suited to function as regulations. The Bureau intended appendix Q to serve as a reliable mechanism for creditors to evaluate income and debts for the purpose of determining DTI and in turn the qualified mortgage status of a loan. It did not intend for appendix Q to function as a general and flexible underwriting policy for assessing risk (as it is used by FHA in the context of insurance), and recognizes that the Bureau will not have the same level of discretion regarding the application of appendix Q. Thus, in light of these inquiries, the Bureau proposes the following revisions to appendix Q to facilitate compliance when determining DTI and to further the purposes of the ATR Rule.

In addition, the Bureau proposes other revisions to clarify the application of appendix Q, as well as general technical and wording changes throughout appendix Q for consistency and clarification, including technical changes to conform to the specific

[34] The Bureau notes that the specific 43 percent debt-to-income requirement applies only to qualified mortgages under § 1026.43(e)(2). The specific debt-to-income ratio requirement does not apply to loans that meet the qualified mortgage definitions in § 1026.43(e)(4) or (f), or that are not qualified mortgages and instead comply with the general ability-to-repay standard.

purpose that appendix Q serves in the 2013 ATR Final Rule, as opposed to the function that the HUD Handbook serves for FHA underwriting.

I. CONSUMER ELIGIBILITY

A. Section I.A. Stability of Income

The Bureau proposes revising the criteria in appendix Q for determining whether a consumer's income is ''stable'' for the purposes of DTI. Appendix Q as adopted requires in section I.A.3 that creditors evaluate the ''probability of continued employment'' by analyzing, among other things, (i) The consumer's past employment record; (ii) the consumer's qualification for the position; (iii) the consumer's previous training and education; and (iv) the employer's confirmation of continued employment. Stakeholders have raised concerns that, beyond analysis of a consumer's past employment record and current employment status, each of these requirements is incompatible with appendix Q's purpose of providing clear rules for determining debt and income, and is likely to result in compliance difficulty and significant exposure to litigation risk for creditors attempting to avoid such risk by originating qualified mortgages and thereby taking advantage of the presumption of compliance. For instance, stakeholders have informed the Bureau that many employers are likely to be unwilling for various reasons (including but not limited to economic uncertainty) to confirm that a consumer's employment will continue into the future, and similarly creditors may be unqualified to evaluate a consumer's education, training, and job qualifications. The Bureau believes that requirements for a creditor to evaluate a consumer's training, education, and qualifications for his or her position are not well-suited to function as regulations designed to enable creditors to determine debts and income and in turn calculate a DTI ratio, and may increase exposure to litigation risk. In the context of codified regulations as opposed to guidelines subject to waiver, variance, or other guidance, it is not entirely clear what creditors would need to do in order to comply with them, or how those determinations would affect a consumer's income for the purpose of calculating DTI. In turn this could increase the risk of litigation to creditors attempting to operate in qualified mortgage space.

The Bureau believes that requiring creditors to obtain an employer's confirmation of the consumer's continued employment will not function properly as a regulatory requirement because employers likely will be unwilling to provide any confirmation of employment continuing beyond current, ongoing employment. Without the benefit of waiver or variance, such a requirement could serve to disqualify any such consumer's employment income from being included in the DTI calculation—which would frustrate access to credit.

For these reasons, the Bureau proposes to amend appendix Q in section I.A.3 to remove the requirements that creditors determine the ''probability of continued employment'' by considering a consumer's ''qualifications for the position'' and ''previous training and education.'' Instead, the Bureau is proposing to amend the provision to require creditors to examine past and current employment. The Bureau is also proposing to remove the requirement that creditors obtain ''the employer's confirmation of continued employment'' and instead require only that the creditor examine a confirmation of current, ongoing employment.

The Bureau believes that a confirmation of current, ongoing employment status is adequate to verify employment for purposes of determining income and is proposing to amend appendix Q accordingly. In addition, the Bureau is adding for clarification purposes a proposed note that states creditors may assume that employment is ongoing if a consumer's employer verifies current employment and does not indicate that employment has been, or is set to be terminated. The proposed note would make clear that creditors should not rely upon a verification of current employment that includes an affirmative statement that the employment is likely to cease, such as a statement that indicates the employee has given (or been given) notice of employment suspension or termination. The Bureau also is proposing other technical changes to section I.A for clarification purposes; no substantive change is intended by these amendments.

B. Section I.B. Salary, Wage and Other Forms of Income

The ''General Policy on Consumer Income Analysis'' in section I.B.1.a of appendix Q as adopted states that creditors must analyze the income for each consumer who will be obligated for the mortgage debt to determine whether his/her income level can be reasonably expected to continue ''through at least the first three years of the mortgage loan.'' Similarly, sections I.B.2 and I.B.3 of appendix Q as adopted require that creditors determine whether overtime and bonus income ''will likely continue'' and that they ''establish and document an earnings trend for overtime and bonus income.'' With respect to these provisions, the Bureau received inquiries from industry stakeholders similar to those discussed above, noting that these provisions codify general, forward-looking standards that are better suited for the purposes of a holistic and qualitative underwriting analysis (such as the FHA guidelines for determining insurance eligibility) and may not function properly as regulations. And, because the Bureau may not have the same flexibility to waive or grant variances on an individual basis regarding the application of appendix Q that the FHA has with respect to its underwriting requirements, these provisions will undermine the purpose of appendix Q to serve as a reliable mechanism for evaluating income and debts for the purpose of determining the qualified mortgage status of a loan, and also increase the risk of litigation.

The Bureau believes that the intended purpose of appendix Q will not be served by requiring creditors to predict a consumer's employment status up to three years after application. As noted above, the Bureau largely adopted these provisions from the existing FHA underwriting guidelines for the purposes of consistency with existing standards used by industry to evaluate debts and income. However, the Bureau believes that these requirements are unlikely to function properly as regulatory requirements and may frustrate appendix Q's purpose of providing clear and reliable standards for determining debts and income for purposes of the 2013 ATR Final Rule. The Bureau also believes that the broad nature of these provisions could increase the risk of litigation to creditors attempting to take advantage of the qualified mortgage presumption of compliance. For these reasons, the Bureau is proposing amendments to section I.B.1 of appendix Q to explain and clarify the criteria for calculating a consumer's employment income and to determine whether a consumer's income is continuing for the purposes of the DTI calculation. The Bureau also is proposing to amend section I.B.1.a to require creditors to evaluate only whether a consumer's income level would not be reasonably expected to continue based on the documentation provided, with no three-year requirement. The Bureau believes that creditors should be required to analyze recent and current employment, along with any evidence in the applicant's

documentation indicating whether employment is likely to continue. The Bureau is proposing to add a note would make clear that creditors should not assume that a consumer's wage or salary income can be reasonably expected to continue if the verification of current employment includes an affirmative statement that the employment is likely to cease, such as a statement that indicates the employee has given (or been given) notice of employment suspension or termination. However, if the consumer's application and the employment confirmation indicate that the consumer is currently employed and provide no such indication that employment will cease, the Bureau believes the creditor should be able to use that consumer's income without an obligation to predict whether or not that consumer will be employed on some future date.

For similar reasons, the Bureau also is proposing changes to sections 1.B.2 and 1.B.3, regarding bonus and overtime income. The Bureau is proposing to eliminate the requirement in section I.B.2.a that creditors determine whether such income ''will continue.'' Instead, creditors must focus on evaluating the consumer's documented bonus and overtime income history for the past two years and any submitted documentation indicating whether the income likely will cease. The Bureau recognizes that bonus and overtime income may vary from year to year and generally may be less reliable than salary. However, in certain occupations, overtime and bonus income may be an integral and reliable component of the consumer's income. The Bureau believes that creditors must confirm that bonus and overtime income is not anomalous. Even so, the Bureau believes the requirement to analyze the consumer's two-year overtime bonus and overtime history and to verify that the submitted documentation does not indicate bonus or overtime income will cease adequately addresses this concern while satisfying the purposes of the qualified mortgage provision.

The Bureau further is proposing clarifications to the provisions in section I.B.11 of appendix Q as adopted explaining how to account for Social Security income. Section I.B.11 as adopted requires that Social Security income either be verified by the Social Security Administration or through Federal tax returns. While the provision as adopted references Federal tax returns, the Bureau believes that a Social Security benefit verification letter may more easily provide proof of the receipt of Social Security benefits and their continuance. Thus, the Bureau is proposing to amend section I.B.11 to remove the option of using Federal tax returns and instead require creditors to obtain a benefit verification letter issued by the Social Security Administration. The Bureau also proposes to clarify in section I.B.11 that a creditor shall assume a benefit is ongoing and will not expire within three years absent evidence of expiration. The Bureau believes this would provide a more workable and accurate standard for verification of Social Security income.

C. Section I.D. General Information on Self-Employed Consumers and Income Analysis

As adopted, section I.D of appendix Q permits income from self-employed consumers to be considered income for the purposes of the DTI calculation if certain criteria are met, including various documentation requirements and analysis of the financial strength of the consumer's business. Among the documentation requirements in section I.D.4 is the requirement to provide a ''business credit report for corporations and 'S' corporations.'' The analysis of the financial strength of the business in section I.D.6 requires that the creditor carefully analyze the ''source of the business's income'' and the ''general economic outlook of similar businesses in the area.'' Like other provisions of appendix Q discussed above, the Bureau has received inquiries from stakeholders concerning these requirements and also noted compliance difficulties and increased risk of litigation that may arise from them. Specifically, industry has raised concerns that business credit reports can be expensive and difficult to obtain, and a requirement to assess economic conditions for geographic areas both costly and difficult, as well as imprecise—which is contrary to the purpose of appendix Q to provide reliable and uniform standards for assessing income. Furthermore, the broad and fact-specific nature of this requirement could also increase litigation risk by undermining the qualified mortgage presumption of compliance.

The Bureau proposes to make several amendments to these income stability requirements for self-employed consumers. The first amendment eliminates the requirement in current section I.D.4 that self-employed consumers provide a business credit report for corporations and ''S'' corporations. The Bureau recognizes that business credit reports for many smaller businesses can be difficult or very expensive to obtain. The Bureau believes that these reports may provide some valuable information for the purposes of an underwriting analysis, but are less suited to function as a requirement to determining income for self-employed consumers.

The second proposed amendment eliminates two requirements under the requirement to analyze a business's financial strength in section I.D.6. Current section I.D.6 requires creditors (i) to evaluate the sources of the business's income and (ii) to evaluate the general economic outlook for similar businesses in the area. The Bureau believes that both of these requirements demand that the creditor engage in complex analysis without providing clarity concerning what types of evaluations are satisfactory for the purpose of complying with the rule. As discussed above, such a provision is better-suited to function as part of an underwriting analysis subject to waiver, variance, and guidance rather than a regulatory rule—and as adopted could increase the risk of litigation risk to creditors. Accordingly, the proposal would eliminate these requirements.

The Bureau's proposal also makes technical revisions to section I.D. to accommodate removal of these requirements.

II. NON-EMPLOYMENT RELATED CONSUMER INCOME

A. Section II.B. Investment and Trust Income

Section II.B.2 of appendix Q as adopted permits trust income to be considered income for the purposes of the DTI calculation ''if guaranteed, constant payments will continue for at least the first three years of the mortgage term.'' Current appendix Q then provides a list of required documentation consumers must provide but does not otherwise specify the universe creditors must review to make and support the three-year determination.

For clarification purposes, the Bureau proposes to delineate more clearly the breadth of the analysis for trust income by specifying that the analysis is limited to the documents appendix Q requires. Specifically, the proposal revises ''if guaranteed, constant payments will continue for at least the first three years of the mortgage term'' by adding ''as evidenced by trust income documentation.'' Under the current requirements in section II.B.2, there is no specific cut-off for the amount of diligence required or information that must be collected to satisfy the requirement. The Bureau believes that the amendment will facilitate compliance and help ensure access to

credit by making the standard clear and easy to apply.

For notes receivable income to be considered income, section II.B.3.a of appendix Q as adopted requires that the consumer provide a copy of the note and documentary evidence that payments have been consistently made over the prior 12 months. If the consumer is not the original payee on the note, however, section II.B.3.b requires the creditor to establish that the consumer is ''now a holder in due course, and able to enforce the note.'' The Bureau proposes to eliminate the requirement that the consumer be a holder in due course, which may require further investigation than is necessary to establish that the income is effective for the purposes of the rule. The proposal would amend appendix Q to require only that the consumer is able to enforce the note.

B. Section II.D. Rental Income

As adopted, appendix Q allows creditors to consider certain rental income payable to the consumer taking out the loan for the purposes of the DTI calculation in section II.D. Section II.D.3.a states that it is not acceptable to consider income from roommates in a single-family property occupied as the consumer's primary residence as ''income'' for the purposes of determining the consumer's DTI, but that it is acceptable to consider rental income payable to the consumer from boarders related by blood, marriage, or law. The Bureau adopted this provision of appendix Q for consistency with existing FHA standards used by industry.

Since publication of the Final Rule, the Bureau has become aware of concerns that may arise from requirements that boarders be related to the homeowner in order for rental income payable to the consumer to be considered ''income'' for DTI purposes. The Bureau does not believe that the relation requirement is useful in determining whether or not the rental income should be used in determining DTI. The Bureau accordingly proposes to eliminate the requirement that boarders be related by blood, marriage, or law from section II.D.3.a.

The Bureau adopted Appendix Q under its TILA section 105(a) and its authority under TILA section 129C(b)(2)(vi) to establish guidelines or regulations relating to ratios of total monthly debt to monthly income for the purposes of defining qualified mortgages and, more broadly, its authority under 129C(b)(3) to prescribe rules to implement the qualified mortgage and revise, add to or subtract form the qualified mortgage criteria. The Bureau invites comment on these proposed changes to appendix Q. The Bureau also seeks comment on other potential amendments that may better facilitate compliance while furthering the purposes of the qualified mortgage provision and the 2013 ATR Final Rule.

V. Section 1022(b)(2) of the Dodd-Frank Act

A. Overview

The Bureau is considering the potential benefits, costs, and impacts of the proposed rule.[35] The Bureau requests comment on the preliminary analysis presented below as well as submissions of additional data that could inform the Bureau's analysis of the benefits, costs, and impacts of the proposed rule. The Bureau has consulted, or offered to consult with, the prudential regulators, SEC, HUD, VA, USDA, FHFA, the Federal Trade Commission, and the Department of the Treasury, including regarding consistency with any prudential, market, or systemic objectives administered by such agencies.

As noted above, this rule proposes amendments to some of the final mortgage rules issued by the Bureau in January of 2013. These amendments clarify or correct provisions on (1) The small servicer exemption from the new servicing rules; (2) the use of GSE and federal agency purchase, guarantee, or insurance eligibility for determining qualified mortgage status; (3) the determination of debt and income for purposes of originating qualified mortgages; and (4) the relation to State law of Regulation X's servicing provisions.

B. Potential Benefits and Costs to Consumers and Covered Persons

The Bureau believes that, compared to the baseline established by the final rules issued in January 2013,[36] the primary benefit of most of the provisions of the proposed rule to both consumers and covered persons is an increase in clarity and precision of the regulations and an accompanying reduction in compliance costs. More specifically, the provisions that would clarify: (1) The definition of qualified mortgage under the test that they be eligible for purchase or guarantee by the GSEs or insured or guaranteed by the agencies for the purposes of the provisions adopted by the 2013 ATR Final Rule; (2) the proposed new comment which provides that a repurchase or indemnification demand by the GSEs, FHA, VA, USDA, or RHS is not determinative of qualified mortgage status; (3) the proposed changes to appendix Q of Regulation Z assisting creditors in determining a consumer's debt-to-income ratio (DTI); and, (4) the proposed amendment to Regulation X to clarify that the preemption provisions in Regulation X do not preempt the field of regulation of the practices covered by RESPA and Regulation X all should add clarity to the rule and thus lower costs of compliance. The Bureau believes that each of these changes simply conform the rules to the policies intended by the final rules issued in January. Accordingly, the discussion of benefits, costs, or impacts discussed in part VII of each of the January rules considered each of the proposed provisions.

One of the proposed changes may slightly alter whether particular persons are covered by a relevant exemption. Specifically, the proposal would modify the text of the Regulation Z servicing rule to clarify scope and application of the small servicer exemption, to clarify the application of the small servicer exemption with regard to servicer/affiliate and master servicer/subservicer relationships, and to exclude mortgage loans voluntarily serviced for an unaffiliated entity without remuneration, reverse mortgage transactions, and mortgage loans secured by consumers' interest in timeshare plans from being considered when determining whether a servicer qualifies as a small servicer. In total, these changes are expected to grant the small servicer exemption to a larger number of firms: These entities should benefit from lower costs while their customers may lose some of the protections embedded in the relevant rules. The nature and magnitude of these protections and their potential costs are described in part VII of both of the 2013 Mortgage Servicing Final Rules.

The proposed rule is not expected to have a differential impact on depository

[35] Section 1022(b)(2)(A) of the Dodd-Frank Act, 12 U.S.C. 5521(b)(2), directs the Bureau, when prescribing a rule under the Federal consumer financial laws, to consider the potential benefits and costs of regulation to consumers and covered persons, including the potential reduction of access by consumers to consumer financial products or services; the impact on insured 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. Section 1022(b)(2)(B) of the Dodd-Frank Act directs the Bureau to consult with appropriate prudential regulators or other Federal agencies regarding consistency with prudential, market, or systemic objectives that those agencies administer.

[36] The Bureau has discretion in any rulemaking to choose an appropriate scope of analysis with respect to potential benefits and costs and an appropriate baseline.

institutions and credit unions with $10 billion or less in total assets as described in section 1026 or on consumers in rural areas. Given the small changes for the proposed rule, the Bureau does not believe that the proposed rule would meaningfully reduce consumers' access to consumer products and services.

VI. Regulatory Flexibility Act Analysis

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.[37] These analyses must ''describe the impact of the proposed rule on small entities.'' [38] An IRFA or FRFA is not required if the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities,[39] or if the agency considers a series of closely related rules as one rule for purposes of complying with the IRFA or FRFA requirements.[40] 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.[41]

This rulemaking is part of a series of rules that have revised and expanded the regulatory requirements for entities that originate or service mortgage loans. In January 2013, the Bureau adopted the 2013 ATR Final Rule and the 2013 Mortgage Servicing Final Rules, along with other related rules mentioned above. Part VIII of the supplementary information to each of these rules set forth the Bureau's analyses and determinations under the RFA with respect to those rules. *See* 78 FR 10861 (Regulation X), 78 FR 10994 (Regulation Z—servicing), 78 FR 6575 (Regulation Z—ATR). The Bureau also notes that any lack of clarity, along with the resulting potential confusion or compliance burden, was inadvertent; as such, its Regulatory Flexibility analyses considered the impact of the provisions at issue in this rule as if no such lack of clarity existed. Because these rules qualify as ''a series of closely related rules,'' for purposes of the RFA, the Bureau relies on those analyses and determines that it has met or exceeded the IRFA requirement.

In the alternative, the Bureau also concludes that the proposed rule would not have a significant impact on a substantial number of small entities. As noted, the proposal generally clarifies the existing rule. These changes would not have a material impact on small entities. In the instance of the small servicer exemption, the rule likely reduces burden for the affected firms. Therefore, the Bureau affirms that the proposal would not have a significant impact on a substantial number of small entities.

VII. Paperwork Reduction Act

This proposed rule would amend 12 CFR part 1026 (Regulation Z), which implements the Truth in Lending Act (TILA), and 12 CFR part 1024 (Regulation X), which implements the Real Estate Settlement Procedures Act (RESPA). Regulations Z and X currently contain collections of information approved by OMB. The Bureau's OMB control number for Regulation Z is 3170–0015 and for Regulation X is 3170–0016. However, the Bureau has determined that this proposed rule would not materially alter these collections of information or impose any new recordkeeping, reporting, or disclosure requirements on the public that would constitute collections of information requiring approval under the Paperwork Reduction Act, 44 U.S.C. 3501 *et seq.* Comments on this determination may be submitted to the Bureau as instructed in the **ADDRESSES** section of this notice and to the attention of the Paperwork Reduction Act Officer.

List of Subjects

12 CFR Part 1024

Condominiums, Consumer protection, Housing, Mortgage servicing, Mortgages, Recordkeeping requirements, Reporting.

12 CFR Part 1026

Advertising, Consumer protection, Credit, Credit unions, Mortgages, National banks, Reporting and recordkeeping requirements, Savings associations, Truth in lending.

Authority and Issuance

For the reasons set forth in the preamble, the Bureau proposes to further amend Regulation X, 12 CFR part 1024, as amended by the final rule published on February 14, 2013, 78 FR 10695, and further amend Regulation Z, 12 CFR part 1026, as amended by the final rules published on January 30, 2013, 78 FR 6407, and February 14, 2013, 78 FR 10901, as set forth below:

PART 1024—REAL ESTATE SETTLEMENT PROCEDURES ACT (REGULATION X)

■ 1. The authority citation for part 1024 continues to read as follows:

Authority: 12 U.S.C. 2603–2605, 2607, 2609, 2617, 5512, 5532, 5581.

■ 2. In subpart A, the heading is revised to read as follows:

Subpart A—General Provisions

■ 3. Section 1024.5 is amended by adding paragraph (c) to read as follows:

§ 1024.5 Coverage of RESPA.

* * * * *

(c) *Relation to State laws.* (1) State laws that are inconsistent with RESPA or this part are preempted to the extent of the inconsistency. However, RESPA and these regulations do not annul, alter, affect, or exempt any person subject to their provisions from complying with the laws of any State with respect to settlement practices, except to the extent of the inconsistency.

(2) Upon request by any person, the Bureau is authorized to determine if inconsistencies with State law exist; in doing so, the Bureau shall consult with appropriate Federal agencies.

(i) The Bureau may not determine that a State law or regulation is inconsistent with any provision of RESPA or this part, if the Bureau determines that such law or regulation gives greater protection to the consumer.

(ii) In determining whether provisions of State law or regulations concerning affiliated business arrangements are inconsistent with RESPA or this part, the Bureau may not construe those provisions that impose more stringent limitations on affiliated business arrangements as inconsistent with RESPA so long as they give more protection to consumers and/or competition.

(3) Any person may request the Bureau to determine whether an inconsistency exists by submitting to the address established by the Bureau to request an official interpretation, a copy of the State law in question, any other

[37] 5 U.S.C. 601 *et seq.*

[38] 5 U.S.C. 603(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).

[39] 5 U.S.C. 605(b).

[40] 5 U.S.C. 605(c).

[41] 5 U.S.C. 609.

law or judicial or administrative opinion that implements, interprets or applies the relevant provision, and an explanation of the possible inconsistency. A determination by the Bureau that an inconsistency with State law exists will be made by publication of a notice in the **Federal Register**. ''Law'' as used in this section includes regulations and any enactment which has the force and effect of law and is issued by a State or any political subdivision of a State.

(4) A specific preemption of conflicting State laws regarding notices and disclosures of mortgage servicing transfers is set forth in § 1024.33(d).

Subpart B—Mortgage Settlement and Escrow Accounts

■ 4. Section 1024.13 is removed and reserved.

■ 5. In Supplement I to Part 1024, Subpart A is added to read as follows:

Supplement I to Part 1024—Official Bureau Interpretations

* * * * *

Subpart A—General Provisions

Section 1024.5 Coverage of RESPA

5(c) Relation to State laws.

Paragraph 5(c)(1).

1. State laws that are in conflict with the requirements of RESPA or Regulation X may be preempted by RESPA or Regulation X. State laws that give greater protection to consumers do not conflict with and are not preempted by RESPA or Regulation X. In addition, nothing in RESPA or Regulation X should be construed to preempt the entire field of regulation of the practices covered by RESPA or Regulation X, including the regulations in Subpart C with respect to mortgage servicers or mortgage servicing.

* * * * *

PART 1026—TRUTH IN LENDING (REGULATION Z)

■ 6. The authority citation for part 1026 is revised 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

■ 7. Section 1026.41 is amended by revising paragraphs (a)(1), (e)(4)(ii), and (e)(4)(iii) to read as follows:

§ 1026.41 Periodic statements for residential mortgage loans.

(a) *In general.* (1) *Scope.* This section applies to a closed-end consumer credit transaction secured by a dwelling, unless an exemption in paragraph (e) of this section applies. A closed-end consumer credit transaction secured by a dwelling is referred to as a *mortgage loan* for purposes of this section.

* * * * *

(e) * * *

(4) * * *

(ii) *Small servicer defined.* A small servicer is a servicer that either:

(A) Services, together with any affiliates, 5,000 or fewer mortgage loans, for all of which the servicer (or an affiliate) is the creditor or assignee; or

(B) Is a Housing Finance Agency, as defined in 24 CFR 266.5.

(iii) *Small servicer determination.* In determining whether a servicer is a small servicer, the servicer is evaluated based on the mortgage loans serviced by the servicer and any affiliates as of January 1 for the remainder of the calendar year. A servicer that ceases to qualify as a small servicer will have six months from the time it ceases to qualify or until the next January 1, whichever is later, to comply with any requirements from which the servicer is no longer exempt as a small servicer. The following mortgage loans are not considered in determining whether a servicer qualifies as a small servicer:

(A) Mortgage loans voluntarily serviced by the servicer for a creditor or assignee that is not an affiliate of the servicer and for which the servicer does not receive any compensation or fees.

(B) Reverse mortgage transactions.

(C) Mortgage loans secured by consumers' interests in timeshare plans.

* * * * *

■ 8. Appendix Q to Part 1026-Standards for Determining Monthly Debt and Income is revised to read as follows:

Appendix Q to Part 1026—Standards for Determining Monthly Debt and Income

Section 1026.43(e)(2)(vi) provides that, to satisfy the requirements for a qualified mortgage under § 1026.43(e)(2), the ratio of the consumer's total monthly debt payments to total monthly income at the time of consummation cannot exceed 43 percent. Section 1026.43(e)(2)(vi)(A) requires the creditor to calculate the ratio of the consumer's total monthly debt payments to total monthly income using the following standards, with additional requirements for calculating debt and income appearing in § 1026.43(e)(2)(vi)(B).

I. Consumer Employment Related Income

A. Stability of Income.

1. *Effective Income.* Income may not be used in calculating the consumer's debt-to-income ratio if it comes from any source that cannot be verified, is not stable, or will not continue.

2. *Verifying Employment History.*

a. The creditor must verify the consumer's employment for the most recent two full years, and the creditor must require the consumer to:

i. Explain any gaps in employment that span one or more months, and

ii. Indicate if he/she was in school or the military for the recent two full years, providing evidence supporting this claim, such as college transcripts, or discharge papers.

b. Allowances can be made for seasonal employment, typical for the building trades and agriculture, if documented by the creditor.

Note: A consumer with a 25 percent or greater ownership interest in a business is considered self-employed and will be evaluated as a self-employed consumer.

3. *Analyzing a Consumer's Employment Record.*

a. When analyzing a consumer's employment, creditors must examine:

i. The consumer's past employment record; and

ii. The employer's confirmation of current, ongoing employment status.

Note: Creditors may assume that employment is ongoing if a consumer's employer verifies current employment and does not indicate that employment has been, or is set to be terminated. Creditors should not rely upon a verification of current employment that includes an affirmative statement that the employment is likely to cease, such as a statement that indicates the employee has given (or been given) notice of employment suspension or termination.

b. Creditors may favorably consider the stability of a consumer's income if he/she changes jobs frequently within the same line of work, but continues to advance in income or benefits. In this analysis, income stability takes precedence over job stability.

4. *Consumers Returning to Work After an Extended Absence.* A consumer's income may be considered effective and stable when recently returning to work after an extended absence if he/she:

a. Is employed in the current job for six months or longer; and

b. Can document a two year work history prior to an absence from employment using:

i. Traditional employment verifications; and/or

ii. Copies of IRS Form W–2s or pay stubs.

Note: An acceptable employment situation includes individuals who took several years off from employment to raise children, then returned to the workforce.

c. Important: Situations not meeting the criteria listed above may not be used in qualifying. Extended absence is defined as six months.

B. Salary, Wage and Other Forms of Income.

1. *General Policy on Consumer Income Analysis.*

a. The income of each consumer who will be obligated for the mortgage debt and whose income is being relied upon in determining ability to repay must be analyzed to determine whether his/her income level can be reasonably expected to continue.

b. In most cases, a consumer's income is limited to salaries or wages. Income from other sources can be considered as effective, when properly verified and documented by the creditor.

Notes:

i. Effective income for consumers planning to retire during the first three-year period must include the amount of:

a. Documented retirement benefits;

b. Social Security payments; or

c. Other payments expected to be received in retirement.

ii. Creditors must not ask the consumer about possible, future maternity leave.

iii. Creditors may assume that salary or wage income from employment verified in accordance with section I.A.3 above can be reasonably expected to continue if a consumer's employer verifies current employment and income and does not indicate that employment has been, or is set to be terminated. Creditors should not assume that income can be reasonably expected to continue if a verification of current employment that includes an affirmative statement that the employment is likely to cease, such as a statement that indicates the employee has given (or been given) notice of employment suspension or termination.

2. *Overtime and Bonus Income.*

a. Overtime and bonus income can be used to qualify the consumer if he/she has received this income for the past two years, and documentation submitted for the loan does not indicate this income will likely cease. If, for example, the employment verification states that the overtime and bonus income is unlikely to continue, it may not be used in qualifying.

b. The creditor must develop an average of bonus or overtime income for the past two years. Periods of overtime and bonus income less than two years may be acceptable, provided the creditor can justify and document in writing the reason for using the income for qualifying purposes.

3. *Establishing an Overtime and Bonus Income Earning Trend.*

a. The creditor must establish and document an earnings trend for overtime and bonus income. If either type of income shows a continual decline, the creditor must document in writing a sound rationalization for including the income when qualifying the consumer.

b. A period of more than two years must be used in calculating the average overtime and bonus income if the income varies significantly from year to year.

4. *Qualifying Part-Time Income.*

a. Part-time and seasonal income can be used to qualify the consumer if the creditor documents that the consumer has worked the part-time job uninterrupted for the past two years, and plans to continue. Many low and moderate income families rely on part-time and seasonal income for day to day needs, and creditors should not restrict consideration of such income when qualifying the income of these consumers.

b. Part-time income received for less than two years may be included as effective income, provided that the creditor justifies and documents that the income is likely to continue.

c. Part-time income not meeting the qualifying requirements may not be used in qualifying.

Note: For qualifying purposes, ''part-time'' income refers to employment taken to supplement the consumer's income from regular employment; part-time employment is not a primary job and it is worked less than 40 hours.

5. *Income from Seasonal Employment.*

a. Seasonal income is considered uninterrupted, and may be used to qualify the consumer, if the creditor documents that the consumer:

i. Has worked the same job for the past two years, and

ii. Expects to be rehired the next season.

b. Seasonal employment includes, but is not limited to:

i. Umpiring baseball games in the summer; or

ii. Working at a department store during the holiday shopping season.

6. *Primary Employment Less Than 40 Hour Work Week.*

a. When a consumer's primary employment is less than a typical 40-hour work week, the creditor should evaluate the stability of that income as regular, on-going primary employment.

b. Example: A registered nurse may have worked 24 hours per week for the last year. Although this job is less than the 40-hour work week, it is the consumer's primary employment, and should be considered effective income.

7. *Commission Income.*

a. Commission income must be averaged over the previous two years. To qualify commission income, the consumer must provide:

i. Copies of signed tax returns for the last two years; and

ii. The most recent pay stub.

b. Consumers whose commission income was received for more than one year, but less than two years may be considered favorably if the underwriter can:

i. Document the likelihood that the income will continue, and

ii. Soundly rationalize accepting the commission income.

Notes:

i. Unreimbursed business expenses must be subtracted from gross income.

ii. A commissioned consumer is one who receives more than 25 percent of his/her annual income from commissions.

iii. A tax transcript obtained directly from the IRS may be used in lieu of signed tax returns.

8. *Qualifying Commission Income Earned for Less Than One Year.*

a. Commission income earned for less than one year is not considered effective income. Exceptions may be made for situations in which the consumer's compensation was changed from salary to commission within a similar position with the same employer.

b. A consumer's income may also qualify when the portion of earnings not attributed to commissions would be sufficient to qualify the consumer for the mortgage.

9. *Employer Differential Payments.* If the employer subsidizes a consumer's mortgage payment through direct payments, the amount of the payments:

a. Is considered gross income, and

b. Cannot be used to offset the mortgage payment directly, even if the employer pays the servicing creditor directly.

10. *Retirement Income.* Retirement income must be verified from the former employer, or from Federal tax returns. If any retirement income, such as employer pensions or 401(k)'s, will cease within the first full three years of the mortgage loan, such income may not be used in qualifying.

11. *Social Security Income.* Social Security income must be verified by a Social Security Administration benefit verification letter (sometimes called a ''proof of income letter,'' ''budget letter,'' ''benefits letter,'' or ''proof of award letter''). If any benefits expire within the first full three years of the loan, the income source may not be used in qualifying.

Notes:

i. If the Social Security Administration benefit verification letter does not indicate a defined expiration date within three years of loan origination, the creditor shall consider the income effective and likely to continue. Pending or current re-evaluation of medical eligibility for benefit payments is not considered an indication that the benefit payments are not likely to continue.

ii. Some portion of Social Security income may be ''grossed up'' if deemed nontaxable by the IRS.

12. *Automobile Allowances and Expense Account Payments.*

a. Only the amount by which the consumer's automobile allowance or expense account payments exceed actual expenditures may be considered income.

b. To establish the amount to add to gross income, the consumer must provide the following:

i. IRS Form 2106, Employee Business Expenses, for the previous two years; and

ii. Employer verification that the payments will continue.

c. If the consumer uses the standard per-mile rate in calculating automobile expenses, as opposed to the actual cost method, the portion that the IRS considers depreciation may be added back to income.

d. Expenses that must be treated as recurring debt include:

i. The consumer's monthly car payment; and

ii. Any loss resulting from the calculation of the difference between the actual expenditures and the expense account allowance.

C. Consumers Employed by a Family Owned Business.

1. *Income Documentation Requirement.*

In addition to normal employment verification, a consumer employed by a family owned business is required to provide evidence that he/she is not an owner of the business, which may include:

a. Copies of signed personal tax returns, or

b. A signed copy of the corporate tax return showing ownership percentage.

Note: A tax transcript obtained directly from the IRS may be used in lieu of signed tax returns.

D. General Information on Self-Employed Consumers and Income Analysis.

1. *Definition: Self-Employed Consumer.* A consumer with a 25 percent or greater ownership interest in a business is considered self-employed.

2. *Types of Business Structures.* There are four basic types of business structures. They include:

a. Sole proprietorships;

b. Corporations;

c. Limited liability or ''S'' corporations; and

d. Partnerships.

3. *Minimum Length of Self Employment.*

a. Income from self-employment is considered stable, and effective, if the consumer has been self-employed for two or more years.

b. Due to the high probability of failure during the first few years of a business, the requirements described in the table below are necessary for consumers who have been self-employed for less than two years.

If the period of self-employment is:	Then:
Between one and two years	For the individual's income to be effective, the individual must have at least two years of documented previous successful employment in the line of work in which the individual is self-employed, or in a related occupation. Note: A combination of one year of employment and formal education or training in the line of work the individual is self-employed or in a related occupation is also acceptable.
Less than one year	The income from the consumer may not be considered effective income.

4. *General Documentation Requirements for Self-Employed Consumers.* Self-employed consumers must provide the following documentation:

a. Signed, dated individual tax returns, with all applicable tax schedules for the most recent two years;

b. For a corporation, ''S'' corporation, or partnership, signed copies of Federal business income tax returns for the last two years, with all applicable tax schedules; and

c. Year to date profit and loss (P&L) statement and balance sheet.

5. *Establishing a Self-Employed Consumer's Earnings Trend.*

a. When qualifying income, the creditor must establish the consumer's earnings trend from the previous two years using the consumer's tax returns.

b. If a consumer:

i. Provides quarterly tax returns, the income analysis may include income through the period covered by the tax filings, or

ii. Is not subject to quarterly tax returns, or does not file them, then the income shown on the P&L statement may be included in the analysis, provided the income stream based on the P&L is consistent with the previous years' earnings.

c. If the P&L statements submitted for the current year show an income stream considerably greater than what is supported by the previous year's tax returns, the creditor must base the income analysis solely on the income verified through the tax returns.

d. If the consumer's earnings trend for the previous two years is downward and the most recent tax return or P&L is less than the prior year's tax return, the consumer's most recent year's tax return or P&L must be used to calculate his/her income.

6. *Analyzing the Business's Financial Strength.*

The creditor must consider the business's financial strength by examining annual earnings. Annual earnings that are stable or increasing are acceptable, while businesses that show a significant decline in income over the analysis period are not acceptable.

E. Income Analysis: Individual Tax Returns (IRS Form 1040).

1. *General Policy on Adjusting Income Based on a Review of IRS Form 1040.* The amount shown on a consumer's IRS Form 1040 as adjusted gross income must either be increased or decreased based on the creditor's analysis of the individual tax return and any related tax schedules.

2. *Guidelines for Analyzing IRS Form 1040.* The table below contains guidelines for analyzing IRS Form 1040:

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IRS Form 1040 heading	Description
Wages, Salaries and Tips	An amount shown under this heading may indicate that the individual: • Is a salaried employee of a corporation, or • Has other sources of income. This section may also indicate that the spouse is employed, in which case the spouse's income must be subtracted from the consumer's adjusted gross income.
Business Income and Loss (from Schedule C)	Sole proprietorship income calculated on Schedule C is business income. Depreciation or depletion may be added back to the adjusted gross income.
Rents, Royalties, Partnerships (from Schedule E)	Any income received from rental properties or royalties may be used as income, after adding back any depreciation shown on Schedule E.
Capital Gain and Losses (from Schedule D)	Capital gains or losses generally occur only one time, and should not be considered when determining effective income. However, if the individual has a constant turnover of assets resulting in gains or losses, the capital gain or loss must be considered when determining the income. Three years' tax returns are required to evaluate an earning trend. If the trend: • Results in a gain, it may be added as effective income, or • Consistently shows a loss, it must be deducted from the total income. Creditor must document anticipated continuation of income through verified assets. *Example:* A creditor can consider the capital gains for an individual who purchases old houses, remodels them, and sells them for profit.
Interest and Dividend Income (from Schedule B)	This taxable/tax-exempt income may be added back to the adjusted gross income only if it: • Has been received for the past two years; and • Is expected to continue. If the interest-bearing asset will be liquidated as a source of the cash investment, the creditor must appropriately adjust the amount.
Farm Income or Loss (from Schedule F)	Any depreciation shown on Schedule F may be added back to the adjusted gross income.
IRA Distributions, Pensions, Annuities, and Social Security Benefits	The non-taxable portion of these items may be added back to the adjusted gross income, if the income is expected to continue for the first three years of the mortgage.
Adjustments to Income	Adjustments to income may be added back to the adjusted gross income if they are: • IRA and Keogh retirement deductions; • Penalties on early withdrawal of savings; • Health insurance deductions; and • Alimony payments.
Employee Business Expenses	Employee business expenses are actual cash expenses that must be deducted from the adjusted gross income.

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F. Income Analysis: Corporate Tax Returns (IRS Form 1120).

1. *Description: Corporation.* A corporation is a State-chartered business owned by its stockholders.

2. *Need To Obtain Consumer Percentage of Ownership Information.*

a. Corporate compensation to the officers, generally in proportion to the percentage of ownership, is shown on the:

i. Corporate tax return IRS Form 1120; and

ii. Individual tax returns.

b. When a consumer's percentage of ownership does not appear on the tax returns, the creditor must obtain the information from the corporation's accountant, along with evidence that the consumer has the right to any compensation.

3. *Analyzing Corporate Tax Returns.*

a. In order to determine a consumer's self-employed income from a corporation the adjusted business income must:

i. Be determined; and

ii. Multiplied by the consumer's percentage of ownership in the business.

b. The table below describes the items found on IRS Form 1120 for which an adjustment must be made in order to determine adjusted business income.

Adjustment item	Description of adjustment
Depreciation and Depletion	Add the corporation's depreciation and depletion back to the after-tax income.
Taxable Income	Taxable income is the corporation's net income before Federal taxes. Reduce taxable income by the tax liability.
Fiscal Year vs. Calendar Year	If the corporation operates on a fiscal year that is different from the calendar year, an adjustment must be made to relate corporate income to the individual tax return.
Cash Withdrawals	The consumer's withdrawal of cash from the corporation may have a severe negative impact on the corporation's ability to continue operating.

G. Income Analysis: ''S'' Corporation Tax Returns (IRS Form 1120S).

1. *Description: ''S'' Corporation.*

a. An ''S'' corporation is generally a small, start-up business, with gains and losses passed to stockholders in proportion to each stockholder's percentage of business ownership.

b. Income for owners of ''S'' corporations comes from IRS Form W–2 wages, and is taxed at the individual rate. The IRS Form 1120S, Compensation of Officers line item is transferred to the consumer's individual IRS Form 1040.

2. *Analyzing ''S'' Corporation Tax Returns.*

a. ''S'' corporation depreciation and depletion may be added back to income in proportion to the consumer's share of the corporation's income.

b. In addition, the income must also be reduced proportionately by the total obligations payable by the corporation in less than one year.

c. Important: The consumer's withdrawal of cash from the corporation may have a severe negative impact on the corporation's ability to continue operating, and must be considered in the income analysis.

H. Income Analysis: Partnership Tax Returns (IRS Form 1065).

1. *Description: Partnership.*

a. A partnership is formed when two or more individuals form a business, and share in profits, losses, and responsibility for running the company.

b. Each partner pays taxes on his/her proportionate share of the partnership's net income.

2. *Analyzing Partnership Tax Returns.*

a. Both general and limited partnerships report income on IRS Form 1065, and the partners' share of income is carried over to Schedule E of IRS Form 1040.

b. The creditor must review IRS Form 1065 to assess the viability of the business. Both depreciation and depletion may be added back to the income in proportion to the consumer's share of income.

c. Income must also be reduced proportionately by the total obligations payable by the partnership in less than one year.

d. Important: Cash withdrawals from the partnership may have a severe negative impact on the partnership's ability to continue operating, and must be considered in the income analysis.

II. Non-Employment Related Consumer Income

A. Alimony, Child Support, and Maintenance Income Criteria. Alimony, child support, or maintenance income may be considered effective, if:

1. Payments are likely to be received consistently for the first three years of the mortgage;

2. The consumer provides the required documentation, which includes a copy of the:

i. Final divorce decree;

ii. Legal separation agreement;

iii. Court order; or

iv. Voluntary payment agreement; and

3. The consumer can provide acceptable evidence that payments have been received during the last 12 months, such as:

i. Cancelled checks;

ii. Deposit slips;

iii. Tax returns; or

iv. Court records.

Notes:

i. Periods less than 12 months may be acceptable, provided the creditor can adequately document the payer's ability and willingness to make timely payments.

ii. Child support may be ''grossed up'' under the same provisions as non-taxable income sources.

B. Investment and Trust Income.

1. *Analyzing Interest and Dividends.*

a. Interest and dividend income may be used as long as tax returns or account statements support a two-year receipt history. This income must be averaged over the two years.

b. Subtract any funds that are derived from these sources, and are required for the cash investment, before calculating the projected interest or dividend income.

2. *Trust Income.*

a. Income from trusts may be used if guaranteed, constant payments will continue for at least the first three years of the mortgage term as evidenced by trust income documentation.

b. Required trust income documentation includes a copy of the Trust Agreement or other trustee statement, confirming the:

i. Amount of the trust;

ii. Frequency of distribution; and

iii. Duration of payments.

c. Trust account funds may be used for the required cash investment if the consumer provides adequate documentation that the withdrawal of funds will not negatively affect income. The consumer may use funds from the trust account for the required cash investment, but the trust income used to determine repayment ability cannot be affected negatively by its use.

3. *Notes Receivable Income.*

a. In order to include notes receivable income, the consumer must provide:

i. A copy of the note to establish the amount and length of payment, and

ii. Evidence that these payments have been consistently received for the last 12 months through deposit slips, cancelled checks, or tax returns.

b. If the consumer is not the original payee on the note, the creditor must establish that the consumer is able to enforce the note.

4. *Eligible Investment Properties.*

Follow the steps in the table below to calculate an investment property's income or loss if the property to be subject to a mortgage is an eligible investment property.

1	Subtract the monthly payment (PITI) from the monthly net rental income of the subject property. Note: Calculate the monthly net rental by taking the gross rents, and subtracting the 25 percent reduction for vacancies and repairs.
2	Does the calculation in Step 1 yield a positive number? • If *yes,* add the number to the consumer's monthly gross income. • If *no,* and the calculation yields a negative number, consider it a recurring monthly obligation.

C. Military, Government Agency, and Assistance Program Income.

1. *Military Income.*

a. Military personnel not only receive base pay, but often times are entitled to additional forms of pay, such as:

i. Income from variable housing allowances;

ii. Clothing allowances;

iii. Flight or hazard pay;

iv. Rations; and

v. Proficiency pay.

b. These types of additional pay are acceptable when analyzing a consumer's income as long as the probability of such pay to continue is verified in writing.

Note: The tax-exempt nature of some of the above payments should also be considered.

2. *VA Benefits.*

a. Direct compensation for service-related disabilities from the Department of Veterans Affairs (VA) is acceptable, provided the creditor receives documentation from the VA.

b. Education benefits used to offset education expenses are not acceptable.

3. *Government Assistance Programs.*

a. Income received from government assistance programs is acceptable as long as the paying agency provides documentation indicating that the income is expected to continue for at least three years.

b. If the income from government assistance programs will not be received for at least three years, it may not be used in qualifying.

c. Unemployment income must be documented for two years, and there must be reasonable assurance that this income will continue. This requirement may apply to seasonal employment.

Note: Social Security income is acceptable as provided in section I.B.11.

4. *Mortgage Credit Certificates.*

a. If a government entity subsidizes the mortgage payments either through direct payments or tax rebates, these payments may be considered as acceptable income.

b. Either type of subsidy may be added to gross income, or used directly to offset the mortgage payment, before calculating the qualifying ratios.

5. *Homeownership Subsidies.*

a. A monthly subsidy may be treated as income, if a consumer is receiving subsidies under the housing choice voucher home ownership option from a public housing agency (PHA). Although continuation of the homeownership voucher subsidy beyond the first year is subject to Congressional appropriation, for the purposes of underwriting, the subsidy will be assumed to continue for at least three years.

b. If the consumer is receiving the subsidy directly, the amount received is treated as income. The amount received may also be treated as nontaxable income and be ''grossed up'' by 25 percent, which means that the amount of the subsidy, plus 25 percent of that subsidy may be added to the consumer's income from employment and/or other sources.

c. Creditors may treat this subsidy as an ''offset'' to the monthly mortgage payment (that is, reduce the monthly mortgage payment by the amount of the home ownership assistance payment before dividing by the monthly income to determine the payment-to-income and debt-to-income ratios). The subsidy payment must not pass through the consumer's hands.

d. The assistance payment must be:

i. Paid directly to the servicing creditor; or

ii. Placed in an account that only the servicing creditor may access.

Note: Assistance payments made directly to the consumer must be treated as income.

D. Rental Income.

1. *Analyzing the Stability of Rental Income.*

a. Rent received for properties owned by the consumer is acceptable as long as the creditor can document the stability of the rental income through:

i. A current lease;

ii. An agreement to lease; or

iii. A rental history over the previous 24 months that is free of unexplained gaps greater than three months (such gaps could be explained by student, seasonal, or military renters, or property rehabilitation).

b. A separate schedule of real estate is not required for rental properties as long as all properties are documented on the Uniform Residential Loan Application.

Note: The underwriting analysis may not consider rental income from any property being vacated by the consumer, except under the circumstances described below.

2. *Rental Income From Consumer Occupied Property.*

a. The rent for multiple unit property where the consumer resides in one or more units and charges rent to tenants of other units may be used for qualifying purposes.

b. Projected rent for the tenant-occupied units only may:

i. Be considered gross income, only after deducting vacancy and maintenance factors, and

ii. Not be used as a direct offset to the mortgage payment.

3. *Income from Roommates in a Single Family Property.*

a. Income from roommates in a single family property occupied as the consumer's primary residence is not acceptable. Rental income from boarders however, is acceptable.

b. The rental income may be considered effective, if shown on the consumer's tax return. If not on the tax return, rental income paid by the boarder may not be used in qualifying.

4. *Documentation Required To Verify Rental Income.* Analysis of the following required documentation is necessary to verify all consumer rental income:

a. IRS Form 1040 Schedule E; and

b. Current leases/rental agreements.

5. *Analyzing IRS Form 1040 Schedule E.*

a. The IRS Form 1040 Schedule E is required to verify all rental income. Depreciation shown on Schedule E may be added back to the net income or loss.

b. Positive rental income is considered gross income for qualifying purposes, while negative income must be treated as a recurring liability.

c. The creditor must confirm that the consumer still owns each property listed, by comparing Schedule E with the real estate owned section of the Uniform Residential Loan Application (URLA).

6. *Using Current Leases To Analyze Rental Income.*

a. The consumer can provide a current signed lease or other rental agreement for a property that was acquired since the last income tax filing, and is not shown on Schedule E.

b. In order to calculate the rental income:

i. Reduce the gross rental amount by 25 percent for vacancies and maintenance;

ii. Subtract PITI and any homeowners association dues; and

iii. Apply the resulting amount to income, if positive, or recurring debts, if negative.

7. *Exclusion of Rental Income From Property Being Vacated by the Consumer.* Underwriters may not consider any rental income from a consumer's principal residence that is being vacated in favor of another principal residence, except under the conditions described below:

Notes:

i. This policy assures that a consumer either has sufficient income to make both mortgage payments without any rental income, or has an equity position not likely to result in defaulting on the mortgage on the property being vacated.

ii. This applies solely to a principal residence being vacated in favor of another principal residence. It does not apply to existing rental properties disclosed on the loan application and confirmed by tax returns (Schedule E of form IRS 1040).

8. *Policy Exceptions Regarding the Exclusion of Rental Income From a Principal Residence Being Vacated by a Consumer.*

When a consumer vacates a principal residence in favor of another principal residence, the rental income, reduced by the appropriate vacancy factor, may be considered in the underwriting analysis under the circumstances listed in the table below.

Exception	Description
Relocations	The consumer is relocating with a new employer, or being transferred by the current employer to an area not within reasonable and locally-recognized commuting distance. A properly executed lease agreement (that is, a lease signed by the consumer and the lessee) of at least one year's duration after the loan is closed is required. Note: Underwriters should also obtain evidence of the security deposit and/or evidence the first month's rent was paid to the homeowner.
Sufficient Equity in Vacated Property	The consumer has a loan-to-value ratio of 75 percent or less, as determined either by: • A current (no more than six months old) residential appraisal, or • Comparing the unpaid principal balance to the original sales price of the property. Note: The appraisal, in addition to using forms Fannie Mae1004/Freddie Mac 70, may be an exterior-only appraisal using form Fannie Mae/Freddie Mac 2055, and for condominium units, form Fannie Mae 1075/Freddie Mac 466.

E. Non-Taxable and Projected Income.

1. *Types of Non-Taxable Income.*

Certain types of regular income may not be subject to Federal tax. Such types of non-taxable income include:

a. Some portion of Social Security, some Federal government employee retirement income, Railroad Retirement Benefits, and some State government retirement income;

b. Certain types of disability and public assistance payments;

c. Child support;

d. Military allowances; and

e. Other income that is documented as being exempt from Federal income taxes.

2. *Adding Non-Taxable Income to a Consumer's Gross Income.*

a. The amount of continuing tax savings attributed to regular income not subject to Federal taxes may be added to the consumer's gross income.

b. The percentage of non-taxable income that may be added cannot exceed the appropriate tax rate for the income amount. Additional allowances for dependents are not acceptable.

c. The creditor:

i. Must document and support the amount of income grossed up for any non-taxable income source, and

ii. Should use the tax rate used to calculate the consumer's last year's income tax.

Note: If the consumer is not required to file a Federal tax return, the tax rate to use is 25 percent.

3. *Analyzing Projected Income.*

a. Projected or hypothetical income is not acceptable for qualifying purposes. However, exceptions are permitted for income from the following sources:

i. Cost-of-living adjustments;

ii. Performance raises; and

iii. Bonuses.

b. For the above exceptions to apply, the income must be:

i. Verified in writing by the employer; and

ii. Scheduled to begin within 60 days of loan closing.

4. *Projected Income for New Job.*

a. Projected income is acceptable for qualifying purposes for a consumer scheduled to start a new job within 60 days of loan closing if there is a guaranteed, non-revocable contract for employment.

b. The creditor must verify that the consumer will have sufficient income or cash reserves to support the mortgage payment and any other obligations between loan closing and the start of employment. Examples of this type of scenario are teachers whose contracts begin with the new school year, or physicians beginning a residency after the loan closes.

c. The income does not qualify if the loan closes more than 60 days before the consumer starts the new job.

III. Consumer Liabilities: Recurring Obligations

1. *Types of Recurring Obligation.* Recurring obligations include:

a. All installment loans;

b. Revolving charge accounts;

c. Real estate loans;

d. Alimony;

e. Child support; and

f. Other continuing obligations.

2. *Debt to Income Ratio Computation for Recurring Obligations.*

a. The creditor must include the following when computing the debt to income ratios for recurring obligations:

i. Monthly housing expense; and

ii. Additional recurring charges extending ten months or more, such as

a. Payments on installment accounts;

b. Child support or separate maintenance payments;

c. Revolving accounts; and

d. Alimony.

b. Debts lasting less than ten months must be included if the amount of the debt affects the consumer's ability to pay the mortgage during the months immediately after loan closing, especially if the consumer will have limited or no cash assets after loan closing.

Note: Monthly payments on revolving or open-ended accounts, regardless of the balance, are counted as a liability for qualifying purposes even if the account appears likely to be paid off within 10 months or less.

3. *Revolving Account Monthly Payment Calculation.* If the credit report shows any revolving accounts with an outstanding balance but no specific minimum monthly payment, the payment must be calculated as the greater of:

a. 5 percent of the balance; or

b. $10.

Note: If the actual monthly payment is documented from the creditor or the creditor obtains a copy of the current statement reflecting the monthly payment, that amount may be used for qualifying purposes.

4. *Reduction of Alimony Payment for Qualifying Ratio Calculation.* Since there are tax consequences of alimony payments, the creditor may choose to treat the monthly alimony obligation as a reduction from the consumer's gross income when calculating the ratio, rather than treating it as a monthly obligation.

IV. Consumer Liabilities: Contingent Liability

1. *Definition: Contingent Liability.* A contingent liability exists when an individual is held responsible for payment of a debt if another party, jointly or severally obligated, defaults on the payment.

2. *Application of Contingent Liability Policies.* The contingent liability policies described in this topic apply unless the consumer can provide conclusive evidence from the debt holder that there is no possibility that the debt holder will pursue debt collection against him/her should the other party default.

3. *Contingent Liability on Mortgage Assumptions.* Contingent liability must be considered when the consumer remains obligated on an outstanding FHA-insured, VA-guaranteed, or conventional mortgage secured by property that:

a. Has been sold or traded within the last 12 months without a release of liability, or

b. Is to be sold on assumption without a release of liability being obtained.

4. *Exemption From Contingent Liability Policy on Mortgage Assumptions.* When a mortgage is assumed, contingent liabilities need not be considered if the:

a. Originating creditor of the mortgage being underwritten obtains, from the servicer of the assumed loan, a payment history showing that the mortgage has been current during the previous 12 months, or

b. Value of the property, as established by an appraisal or the sales price on the HUD–1 Settlement Statement from the sale of the property, results in a loan-to-value (LTV) ratio of 75 percent or less.

5. *Contingent Liability on Cosigned Obligations.*

a. Contingent liability applies, and the debt must be included in the underwriting analysis, if an individual applying for a mortgage is a cosigner/co-obligor on:

i. A car loan;

ii. A student loan;

iii. A mortgage; or

iv. Any other obligation.

b. If the creditor obtains documented proof that the primary obligor has been making regular payments during the previous 12 months, and does not have a history of delinquent payments on the loan during that time, the payment does not have to be included in the consumer's monthly obligations.

V. Consumer Liabilities: Projected Obligations and Obligations Not Considered Debt

1. *Projected Obligations.*

a. Debt payments, such as a student loan or balloon-payment note scheduled to begin or come due within 12 months of the mortgage loan closing, must be included by the creditor as anticipated monthly obligations during the underwriting analysis.

b. Debt payments do not have to be classified as projected obligations if the consumer provides written evidence that the debt will be deferred to a period outside the 12-month timeframe.

c. Balloon-payment notes that come due within one year of loan closing must be considered in the underwriting analysis.

2. *Obligations Not Considered Debt.* Obligations not considered debt, and therefore not subtracted from gross income, include:

a. Federal, State, and local taxes;

b. Federal Insurance Contributions Act (FICA) or other retirement contributions, such as 401(k) accounts (including repayment of debt secured by these funds):

c. Commuting costs;

d. Union dues;

e. Open accounts with zero balances;

f. Automatic deductions to savings accounts;

g. Child care; and

h. Voluntary deductions.

■ 9. In Supplement I to Part 1026—Official Interpretations:

A. Under *Section 1026.41—Periodic Statements for Residential Mortgage Loans:*

i. Under *41(e)(4) Small servicers:*

a. Under *41(e)(4)(ii) Small servicer defined,* paragraphs 1 and 2 are revised and paragraph 3 is added.

b. Under *Paragraph 41(e)(4)(iii) Small servicer determination,* paragraph 3 is added.

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

i. Under *43(e)(4) Qualified mortgage defined-special rules,* paragraph 4 is revised and paragraph 5 is 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 1026.41—Periodic Statements for Residential Mortgage Loans

* * * * *

41(e)(4)(ii) Small servicer defined.

1. *Mortgage loans considered.* Pursuant to § 1026.41(a)(1), the mortgage loans considered in determining status as small servicer are closed-end consumer credit transactions secured by a dwelling, subject to the exclusions in § 1026.41(e)(4)(iii).

2. *Requirements to be a small servicer.* Pursuant to § 1026.41(e)(4)(ii)(A), to qualify as a small servicer, a servicer must service, together with any affiliates, 5,000 or fewer mortgage loans, for all of which the servicer (or an affiliate) is the creditor or assignee. There are two elements to this requirement. First, a servicer, together with any affiliates, must service 5,000 or fewer mortgage loans. Second, a servicer must service only mortgage loans for which the servicer (or an affiliate) is the creditor or assignee. To be the creditor or assignee of a mortgage loan, the servicer (or an affiliate) must either currently own the mortgage loan or must have been the entity to which the mortgage loan obligation was initially payable (that is, the originator of the mortgage loan). A servicer is not a small servicer if it services any mortgage loans for which the servicer or an affiliate is not the creditor or assignee (that is, for which the servicer or an affiliate is not the owner or was not the originator). The following two examples demonstrate circumstances in which a servicer would not qualify as a small servicer because it did not meet both requirements for determining a servicer's status as a small servicer:

i. A servicer services 3,000 mortgage loans, all of which it or an affiliate owns or originated. An affiliate of the servicer services 4,000 other mortgage loans, all of which it or an affiliate owns or originated. Because the number of mortgage loans serviced by a servicer is determined by counting the mortgage loans serviced by a servicer together with any affiliates, both of these servicers are considered to be servicing 7,000 mortgage loans and neither servicer is a small servicer.

ii. A servicer services 3,100 mortgage loans—3,000 mortgage loans it owns or originated and 100 mortgage loans it neither owns nor originated, but for which it owns the mortgage servicing rights. The servicer is not a small servicer because it services mortgage loans for which the servicer (or an affiliate) is not the creditor or assignee, notwithstanding that the servicer services fewer than 5,000 mortgage loans.

3. *Master servicing and subservicing.* A servicer that qualifies as a small servicer does not lose its small servicer status if it retains a subservicer, as that term is defined in 12 CFR 1024.31, to service any of its mortgage loans. A subservicer can gain the benefit of the small servicer exemption only if (1) the master servicer, as that term is defined in 12 CFR 1024.31, is a small servicer and (2) the subservicer is a small servicer. A subservicer generally will not qualify as a small servicer because it does not own or did not originate the mortgage loans it subservices—unless it is an affiliate of a master servicer that qualifies as a small servicer. The following

examples demonstrate the application of the small servicer exemption for different forms of servicing relationships:

i. A credit union services 4,000 mortgage loans, all of which it originated or owns. The credit union retains a credit union service organization, that is not an affiliate, to subservice 1,000 of the mortgage loans. The credit union is a small servicer and, thus, can gain the benefit of the small servicer exemption for the 3,000 mortgage loans the credit union services itself. The credit union service organization is not a small servicer because it services mortgage loans it does not own or did not originate. Accordingly, the credit union service organization does not gain the benefit of the small servicer exemption and, thus, must comply with any applicable mortgage servicing requirements for the 1,000 mortgage loans it subservices.

ii. A bank holding company, through a lender subsidiary, owns or originated 4,000 mortgage loans. All mortgage servicing rights for the 4,000 mortgage loans are owned by a wholly owned master servicer subsidiary. Servicing for the 4,000 mortgage loans is conducted by a wholly owned subservicer subsidiary. The bank holding company controls all of these subsidiaries and, thus, they are affiliates of the bank holding company pursuant 12 CFR 1026.32(b)(2). Because the master servicer and subservicer service 5,000 or fewer mortgage loans, and because all the mortgage loans are owned or originated by an affiliate, the master servicer and the subservicer both qualify for the small servicer exemption for all 4,000 mortgage loans.

iii. A nonbank servicer services 4,000 mortgage loans, all of which it originated or owns. The servicer retains a ''component servicer'' to assist it with servicing functions. The component servicer is not engaged in ''servicing'' as defined in 12 CFR 1024.2; that is, the component servicer does not receive any scheduled periodic payments from a borrower pursuant to the terms of any mortgage loan, including amounts for escrow accounts, and does not make the payments to the owner of the loan or other third parties of principal and interest and such other payments with respect to the amounts received from the borrower as may be required pursuant to the terms of the mortgage servicing loan documents or servicing contract. The component servicer is not a subservicer pursuant to 12 CFR 1024.31 because it is not engaged in servicing, as that term is defined in 12 CFR 1024.2. The nonbank servicer is a small servicer and, thus, can gain the benefit of the small servicer exemption with regard to all 4,000 mortgage loans it services.

41(e)(4)(iii) Small servicer determination.

* * * * *

3. *Mortgage loans not considered in determining whether a servicer is a small servicer.* Mortgage loans that are not considered for purposes of determining whether a servicer is a small servicer pursuant to § 1026.41(e)(4)(iii), are not considered either for determining whether a servicer, together with any affiliates, services 5,000 or fewer mortgage loans or whether a servicer is servicing only mortgage loans that it owns or originated. For example, assume a servicer services 5,400 mortgage loans. Of these mortgage loans, the servicer owns or originated 4,800 mortgage loans, services 300 reverse mortgage transactions that it does not own or did not originate, and voluntarily services 300 mortgage loans that it does not own or did not originate for an unaffiliated non-profit organization for which the servicer does not receive any compensation or fees. Neither the reverse mortgage transactions nor the mortgage loans voluntarily serviced by the servicer are considered in determining whether a servicer is a small servicer. Thus, because the only mortgage loans considered are the 4,800 other mortgage loans serviced by the servicer, and the servicer owns or originated each of those mortgage loans, the servicer is considered a small servicer and qualifies for the small servicer exemption with regard to all 5,400 mortgage loans it services. Note that reverse mortgages and mortgage loans secured by consumers' interests in timeshare plans, in addition to not being considered in determining small servicer qualification, also are exempt from the requirements of the § 1026.41. In contrast, although charitably serviced mortgage loans, as defined by § 1026.41(e)(4)(iii), are likewise not considered in determining small servicer qualification, they are not exempt from the requirements of § 1026.41. Thus, a servicer that does *not* qualify as a small servicer would not have to provide periodic statements for reverse mortgages and timeshare plans because they are exempt from the rule, but would have to provide periodic statements for mortgage loans it charitably services.

* * * * *

Section 1026.43—Minimum Standards for Transactions Secured by a Dwelling

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

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4. *Eligible for purchase, guarantee, or insurance.* To satisfy § 1026.43(e)(4)(ii), a loan need not be actually purchased or guaranteed by Fannie Mae or Freddie Mac or insured or guaranteed by one of the Agencies (the U.S. Department of Housing and Urban Development (HUD), U.S. Department of Veterans Affairs (VA), U.S. Department of Agriculture (USDA), or Rural Housing Service (RHS)). Rather, § 1026.43(e)(4)(ii) requires only that the creditor determine that the loan is eligible (*i.e.,* meets the criteria) for such purchase, guarantee, or insurance at consummation. For example, for purposes of § 1026.43(e)(4), a creditor is not required to sell a loan to Fannie Mae or Freddie Mac (or any limited-life regulatory entity succeeding the charter of either) for that loan to be a qualified mortgage; however, the loan must be eligible for purchase or guarantee by Fannie Mae or Freddie Mac (or any limited-life regulatory entity succeeding the charter of either), including satisfying any requirements regarding consideration and verification of a consumer's income or assets, credit history, and debt-to-income ratio or residual income. To determine eligibility for purchase or guarantee, a creditor may rely on a valid underwriting recommendation provided by a GSE or Agency automated underwriting systems (AUS); compliance with the standards in the GSE or Agency written guide in effect at the time; or a written agreement between the creditor and a GSE or Agency that permits variation from the standards of the written guides and/or variation from the AUSs, in effect at the time. However, the creditor need not satisfy standards that are wholly unrelated to assessing a consumer's ability to repay that the creditor is required to perform such as requirements related to selling, securitizing, or delivering already consummated loans and any requirement that the creditor must perform after the consummated loan is sold, guaranteed, or endorsed for insurance such as document custody, quality control, or servicing. Accordingly, a covered transaction is eligible for purchase or guarantee by Fannie Mae or Freddie Mac, for example, if:

i. The loan conforms to the relevant standards set forth in the Fannie Mae Single-Family Selling Guide or the Freddie Mac Single-Family Seller/Servicer Guide in effect at the time, or to standards set forth in a written agreement between the creditor and Fannie Mae or Freddie Mac that permits variation from the standards of those guides; or

ii. The creditor inputs information accurately into the Fannie Mae or Freddie Mac AUS or another AUS pursuant to a written agreement between the creditor and Fannie Mae or Freddie Mac that permits variation from the GSE AUS; the loan receives one of the recommendations specified below in paragraphs A or B from the corresponding GSE AUS or an equivalent recommendation pursuant to another AUS as authorized in the written agreement; and the creditor satisfies any requirements and conditions specified by the relevant AUS, the non-satisfaction of which would invalidate that recommendation:

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

B. A risk class of ''Accept'' and purchase eligibility of ''Freddie Mac Eligible'' from Loan Prospector (LP).

5. *Repurchase and indemnification demands.* A repurchase or indemnification demand by Fannie Mae, Freddie Mac, HUD, VA, USDA, or RHS is not dispositive of qualified mortgage status. Qualified mortgage status under § 1026.43(e)(4) depends on whether a loan is eligible to be purchased, guaranteed, or insured at the time of consummation, provided that other requirements under § 1026.43(e)(4) are satisfied. Some repurchase or indemnification demands are not related to eligibility criteria at consummation. *See* comment 43(e)(4)-4. Further, even where a repurchase or indemnification demand relates to whether the loan satisfied relevant eligibility requirements as of the time of consummation, the mere fact that a demand has been made, or even resolved, between a creditor and GSE or agency is not dispositive for purposes of § 1026.43(e)(4). However, evidence of whether a particular loan satisfied the § 1026.43(e)(4) eligibility criteria at consummation may be brought to light in the course of dealings over a particular demand, depending on the facts and

circumstances. Accordingly, each loan should be evaluated by the creditor based on the facts and circumstances relating to the eligibility of that loan at the time of consummation. For example:

i. Assume eligibility to purchase a loan was based in part on the consumer's employment income of $50,000 per year. The creditor uses the income figure in obtaining an approve/eligible recommendation from DU. A quality control review, however, later determines that the documentation provided and verified by the creditor to comply with Fannie Mae requirements did not support the reported income of $50,000 per year. As a result, Fannie Mae demands that the creditor repurchase the loan. Assume that the quality control review is accurate, and that DU would not have issued an approve/eligible recommendation if it had been provided the accurate income figure. The DU determination at the time of consummation was invalid because it was based on inaccurate information provided by the creditor; therefore, the loan was never a qualified mortgage.

ii. Assume that a creditor delivered a loan, which the creditor determined was a qualified mortgage at the time of consummation under § 1026.43(e)(4), to Fannie Mae for inclusion in a particular To-Be-Announced Mortgage Backed Security (MBS) pool of loans. The data submitted by the creditor at the time of loan delivery indicated that the various loan terms met the product type, weighted-average coupon (WAC), weighted-average maturity (WAM), and other MBS pooling criteria, and MBS issuance disclosures to investors reflected this loan data. However, after delivery and MBS issuance, a quality control review determines that the loan violates the pooling criteria. The loan still meets eligibility requirements for Fannie Mae products and loan terms. Fannie Mae, however, requires the creditor to repurchase the loan due to the violation of MBS pooling requirements. Assume that the quality control review determination is accurate. The reason the creditor repurchases this loan is wholly unrelated to assessing a consumer's ability to repay under § 1026.43(e)(4). The loan still meets Fannie Mae eligibility requirements and therefore remains a qualified mortgage based on these facts and circumstances.

* * * * *

Dated: April 19, 2013.

Richard Cordray,

Director, Bureau of Consumer Financial Protection.

[FR Doc. 2013–09750 Filed 5–1–13; 8:45 am]

BILLING CODE 4810–AM–P

DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

14 CFR Part 39

[Docket No. FAA–2013–0361; Directorate Identifier 2013–NM–026–AD]

RIN 2120–AA64

Airworthiness Directives; The Boeing Company Airplanes

AGENCY: Federal Aviation Administration (FAA), DOT.

ACTION: Notice of proposed rulemaking (NPRM).

SUMMARY: We propose to adopt a new airworthiness directive (AD) for all The Boeing Company Model 727 series airplanes. This proposed AD was prompted by a report of cracking in the left-side chord of the fin closure rib on the vertical stabilizer. This proposed AD would require repetitive inspections of the left and right side chords of the fin closure rib for cracking and corrosion, and related investigative and corrective actions if necessary. We are proposing this AD to detect and correct cracking and corrosion in the left and right side chords of the fin closure rib, which could lead to widespread cracking in the chords that might weaken the fin closure rib structure and result in loss of airplane control due to lack of horizontal stabilizer support.

DATES: We must receive comments on this proposed AD by June 17, 2013.

ADDRESSES: You may send comments, using the procedures found in 14 CFR 11.43 and 11.45, by any of the following methods:

- *Federal eRulemaking Portal:* Go to *http://www.regulations.gov*. Follow the instructions for submitting comments.
- *Fax:* 202–493–2251.
- *Mail:* U.S. Department of Transportation, Docket Operations, M–30, West Building Ground Floor, Room W12–140, 1200 New Jersey Avenue SE., Washington, DC 20590.
- *Hand Delivery:* Deliver to Mail address above between 9 a.m. and 5 p.m., Monday through Friday, except Federal holidays.

For Boeing service information identified in this proposed AD, contact Boeing Commercial Airplanes, Attention: Data & Services Management, P.O. Box 3707, MC 2H–65, Seattle, WA 98124–2207; telephone 206–544–5000, extension 1; fax 206–766–5680; Internet *https://www.myboeingfleet.com.* You may review copies of the referenced service information at the FAA, Transport Airplane Directorate, 1601 Lind Avenue SW., Renton, Washington. For information on the availability of this material at the FAA, call 425–227–1221.

Examining the AD Docket

You may examine the AD docket on the Internet at *http://www.regulations.gov*; or in person at the Docket Management Facility between 9 a.m. and 5 p.m., Monday through Friday, except Federal holidays. The AD docket contains this proposed AD, the regulatory evaluation, any comments received, and other information. The street address for the Docket Office (phone: 800–647–5527) is in the **ADDRESSES** section. Comments will be available in the AD docket shortly after receipt.

FOR FURTHER INFORMATION CONTACT: Berhane Alazar, Aerospace Engineer, Airframe Branch, ANM–120S, FAA, Seattle Aircraft Certification Office, 1601 Lind Avenue SW., Renton, Washington 98057–3356; phone: 425–917–6577; fax: 425–917–6590; email: *berhane.alazar@faa.gov.*

SUPPLEMENTARY INFORMATION:

Comments Invited

We invite you to send any written relevant data, views, or arguments about this proposal. Send your comments to an address listed under the **ADDRESSES** section. Include ''Docket No. FAA–2013–0361; Directorate Identifier 2013–NM–026–AD'' at the beginning of your comments. We specifically invite comments on the overall regulatory, economic, environmental, and energy aspects of this proposed AD. We will consider all comments received by the closing date and may amend this proposed AD because of those comments.

We will post all comments we receive, without change, to *http://www.regulations.gov*, including any personal information you provide. We will also post a report summarizing each substantive verbal contact we receive about this proposed AD.

Discussion

During a routine maintenance inspection an operator reported finding a crack on the left-side chord of the fin closure rib. The crack measured 2.4 inches long and ran along the length of the chord. Cracking on the left-side chord of the fin closure rib is the result of intergranual stress corrosion caused by the material properties of 2024–T351 extrusion from which the closure rib chord is made. This material becomes vulnerable after the surface finishes begin to break down as a result of normal in-service aging. We are