AUTHENTICATED
U.S. GOVERNMENT
INFORMATION
GPO

FEDERAL REGISTER

Vol. 78 Wednesday,
No. 20 January 30, 2013

Part III

Bureau of Consumer Financial Protection

12 CFR Part 1026
Ability To Repay Standards Under the Truth in Lending Act (Regulation Z); Proposed Rule

BUREAU OF CONSUMER FINANCIAL PROTECTION

12 CFR Part 1026

[Docket No. CFPB–2013–0002]

RIN 3170–AA34

Ability To Repay Standards Under the Truth in Lending Act (Regulation Z)

AGENCY: Bureau of Consumer Financial Protection.

ACTION: Proposed rule with request for public comment.

SUMMARY: The Bureau of Consumer Financial Protection (Bureau) is proposing to amend Regulation Z, which implements the Truth in Lending Act (TILA). This proposal is related to a final rule published elsewhere in today's **Federal Register**. That final rule implements sections 1411, 1412, and 1414 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), which creates new TILA section 129C. Among other things, the Dodd-Frank Act requires creditors to make a reasonable, good faith determination 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.'' The Bureau is proposing certain amendments to the final rule implementing these requirements, including 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 is also seeking feedback on whether additional clarification is needed regarding the inclusion of loan originator compensation in the points and fees calculation.

DATES: Comments must be received on or before February 25, 2013, except that comments on the Paperwork Reduction Act analysis in part VIII of this **Federal Register** notice must be received on or before March 1, 2013.

ADDRESSES: You may submit comments, identified by Docket No. CFPB–2013–0002 or RIN 3170–AA34, 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: Jennifer B. Kozma, Eamonn K. Moran, or Priscilla Walton-Fein, Counsels; Thomas J. Kearney or Mark Morelli, Senior Counsels; or Stephen Shin, Managing Counsel, Office of Regulations, at (202) 435–7700.

SUPPLEMENTARY INFORMATION:

I. Summary of Proposed Rule

As discussed in detail under part II below, sections 1411, 1412, and 1414 of the Dodd-Frank Act created new TILA section 129C, which establishes, among other things, new ability-to-repay requirements. The Bureau is adopting final rules implementing these ability-to-repay requirements in a rule published elsewhere in today's **Federal Register** (the Bureau's 2013 ATR Final Rule). The Bureau believes that several exemptions and modifications to the ability-to-repay requirements may be appropriate. The Bureau is also proposing two alternative comments intended to clarify the calculation of points and fees in a transaction involving loan originator compensation. Accordingly, the Bureau solicits feedback regarding these exemptions and modifications.

A. Proposed Exemption for Credit Extended Pursuant to a Community-Focused Lending Program

The Bureau is proposing to exempt an extension of credit made pursuant to a program administered by a housing finance agency (HFA) from the ability-to-repay requirements. The Bureau believes that this exemption may be necessary to preserve access to credit for low- to moderate-income (LMI) consumers. The Bureau is concerned that the ability-to-repay requirements may undermine the underwriting requirements of these programs. For example, the ability-to-repay provisions may require consideration of underwriting factors that are not required under HFA programs, such as the consumer's credit history. The Bureau is also concerned that the ability-to-repay requirements may affect the ability of HFAs to offer extensions of credit customized to meet the needs of LMI consumers while promoting long-term housing stability. Furthermore, the Bureau is concerned that the costs of implementing and complying with the ability-to-repay requirements would result in a severe curtailment of the credit offered under these programs. The proposed exemption related to HFAs is discussed in more detail below in the section-by-section analysis of § 1026.43(a)(3)(iv).

The Bureau is also proposing to exempt an extension of credit made by certain types of nonprofit creditors from the ability-to-repay requirements. Creditors designated by the U.S. Department of the Treasury as Community Development Financial Institutions and creditors designated by the U.S. Department of Housing and Urban Development as either a Community Housing Development Organization or a Downpayment Assistance Provider of Secondary Financing are included in this proposed exemption. The proposal also exempts creditors designated as nonprofit organizations under section 501(c)(3) of the Internal Revenue Code, provided that the extension of credit is to a consumer with income that does not exceed the qualifying limit for moderate income families as established pursuant to section 8 of the United States Housing Act of 1937, that during the calendar year preceding receipt of the consumer's application the creditor extended credit no more than 100 times, and only to consumers with income that did not exceed the above qualifying limit, and that the creditor determines, in accordance with written procedures, that the consumer has a reasonable ability to repay the extension of credit. The Bureau is concerned that nonprofit creditors may not have the resources to implement and comply with the ability-to-repay requirements, and may be forced to cease or severely limit extending credit to LMI consumers,

which would result in the denial of responsible, affordable mortgage credit. However, to prevent circumvention of TILA, the Bureau believes that this exemption should be limited to the nonprofit creditors identified above. The proposed exemption related to these nonprofit creditors is discussed in more detail below in the section-by-section analysis of § 1026.43(a)(3)(v).

B. Proposed Exemption for Credit Extended Pursuant to a Homeownership Stabilization and Foreclosure Prevention Program, Federal Agency Refinancing Program, or GSE Refinancing Program

The Bureau is proposing to exempt an extension of credit made pursuant to an Emergency Economic Stabilization Act (EESA) program, such as extensions of credit made pursuant to a State Hardest Hit Fund (HHF) program, from the ability-to-repay requirements. The Bureau believes that this exemption may be necessary to preserve access to credit. The Bureau is concerned that requiring credit extended pursuant to these programs to comply with the ability-to-repay provisions may unnecessarily interfere with these programs' unique underwriting requirements, which would make it more difficult for many consumers to qualify for assistance and increase the cost of credit for those who do, thereby impacting the availability of credit for these at-risk consumers. Further, the Bureau is concerned that creditors may elect not to participate in these programs, rather than investing resources complying with the requirements of both homeownership stabilization programs and the ability-to-repay requirements, which would frustrate efforts to ameliorate the effects of the financial crisis and disrupt the financial market for consumers at risk of foreclosure or default, thereby harming those in need of the assistance provided under these programs. The proposed exemption related to these emergency programs is discussed in more detail below in the section-by-section analysis of § 1026.43(a)(3)(vi).

The Bureau is proposing to exempt from the ability-to-repay requirements a refinancing that is eligible to be insured, guaranteed, or made pursuant to a program administered by the Federal Housing Administration, U.S. Department of Veterans Affairs, or the U.S. Department of Agriculture. The proposed exemption is available only until the Federal agency administering the program under which the extension of credit is eligible to be insured, guaranteed, or made prescribes rules pursuant to section 129C(a)(5) or 129C(b)(3)(B)(ii) of TILA. The Bureau believes that this exemption is necessary to preserve access to credit. The Federal agencies described above have not yet prescribed rules related to the ability-to-repay requirements for refinances, pursuant to TILA section 129C(a)(5), or the definition of qualified mortgage, pursuant to TILA section 129C(b)(3)(B)(ii). The Bureau is concerned that the ability-to-repay provisions would unnecessarily interfere with requirements of these Federal agency refinance programs, which would make it more difficult for many consumers to qualify for these programs and increase the cost of credit for those who do, thereby constraining the availability of responsible, affordable credit for consumers. The proposed exemption related to these Federal agencies is discussed in more detail below in the section-by-section analysis of § 1026.43(a)(3)(vii).

The Bureau is proposing to exempt an extension of credit that is a refinancing that is eligible to be purchased or guaranteed by the Federal National Mortgage Association (Fannie Mae) or the Federal Home Loan Mortgage Corporation (Freddie Mac) (collectively, the GSEs) from the ability-to-repay requirements. This proposed exemption only applies if:

- The refinancing is made pursuant to an eligible targeted refinancing program, as defined under regulations promulgated by the Federal Housing Finance Agency;
- Such entities are operating under the conservatorship or receivership of the Federal Housing Finance Agency on the date the refinancing is consummated;
- The existing obligation satisfied and replaced by the refinancing is owned by Fannie Mae or Freddie Mac;
- The existing obligation satisfied and replaced by the refinancing was not consummated on or after January 10, 2014; and
- The refinancing is not consummated on or after January 10, 2021.

The Bureau is concerned that the ability-to-repay requirements may add unnecessary additional costs and may cause needless delays for distressed consumers whose current mortgage obligations are owned by Fannie Mae or Freddie Mac and who seek refinancings pursuant to these eligible targeted refinancing programs. The proposed exemption related to these GSE refinancing programs is discussed in more detail below in the section-by-section analysis of § 1026.43(a)(3)(viii).

C. Loans Held in Portfolio by Small Creditors

The 2013 ATR Final Rule defines three categories of qualified mortgages. Qualified mortgages are provided either a conclusive or rebuttable presumption of compliance with the requirement that creditors make a reasonable, good faith determination of a consumer's ability to repay before originating a mortgage loan. The Bureau is proposing to define a new, fourth category of qualified mortgages.

The proposed new category would include certain loans originated by small creditors [1] that:

- Have total assets of $2 billion or less at the end of the previous calendar year; and
- Together with all affiliates, originated 500 or fewer first-lien covered transactions during the previous calendar year.

The proposed new category would include only loans held in portfolio by these creditors. Therefore, if a creditor agreed prior to consummation to sell a loan, that loan would not be a qualified mortgage under the proposed definition. Such loans often are described as being subject to a ''forward commitment.'' The rule would provide an exception that would allow forward commitments to sell to a creditor that also meets the limits on asset size and number of first-lien covered transactions. To prevent evasion, a loan in the proposed new category would lose its status as a qualified mortgage if it is held in portfolio for less than three years after consummation, with certain exceptions.

The loan also would have to conform to all of the requirements under the general definition of a qualified mortgage except the 43 percent limit on monthly debt-to-income ratio. In other words, the loan could not have:

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

When underwriting the loan the creditor would have to:

- Consider and verify the consumer's income and assets; and
- Base the underwriting on a monthly payment calculated using the maximum interest rate that may apply during the

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

first five years of the loan and that is fully amortizing.

The creditor also would have to consider the consumer's debt-to-income ratio or residual income and verify the underlying information. In contrast, the general definition of a qualified mortgage requires creditors to calculate debt-to-income ratio according to the instructions in appendix Q to the rule and prohibits debt-to-income ratios above 43 percent. In other words, under the proposed additional definition, a creditor would not have to use the instructions in appendix Q to calculate debt-to-income ratio, and a loan with a consumer debt-to-income ratio higher than 43 percent could be a qualified mortgage if all other criteria are met.

The Bureau also is proposing to allow small creditors to charge a higher annual percentage rate for first-lien qualified mortgages in the proposed new category and still benefit from a conclusive presumption of compliance or ''safe harbor.'' Qualified mortgages can have different levels of protection from liability depending on their annual percentage rate. Under the existing rules, first-lien qualified mortgages with an annual percentage rate less than or equal to the average prime offer rate plus 1.5 percentage points and subordinate-lien qualified mortgages with an annual percentage rate less than or equal to the average prime offer rate plus 3.5 percentage points are within the safe harbor. A qualified mortgage with an annual percentage rate above those thresholds is presumed to comply with the ability-to-repay rules, but a consumer could rebut that presumption under certain circumstances. A qualified mortgage in the proposed new category would be conclusively presumed to comply if the annual percentage rate is equal to or less than the average prime offer rate plus 3.5 percentage points for both first-lien and subordinate-lien loans.

The Bureau is proposing these changes because it believes they may be necessary to preserve access to responsible, affordable mortgage credit for some consumers. Small creditors are a significant source of loans that, for various reasons, do not qualify for government guarantee and insurance programs and cannot be sold for securitization. Larger creditors often are unwilling to make these loans because they involve consumers or properties with unique features that make them difficult to assess using larger creditors' underwriting standards or because larger creditors are unwilling to hold the loans in portfolio. Small creditors often are willing and able to consider these consumers and properties individually and to hold the loans on their balance sheets. Small creditors also may be the predominant source of credit in many rural areas where large creditors do not operate.

Small creditors may be particularly well suited to make mortgage loans that are responsible and affordable because their small size, relationship-based lending model, and ties to their communities enable them to make more accurate assessments of consumers' ability to repay than larger creditors. Small creditors also have strong incentives to carefully consider whether a consumer will be able to repay a portfolio loan at least in part because the small creditor retains the risk of default.

Small creditors often charge higher interest rates and fees for legitimate business reasons. For example, small creditors often pay more for the funds they lend and may charge more to compensate for the interest rate and other risks associated with holding a loan in portfolio.

Many small creditors have expressed concerns about the litigation risk associated with the requirement to make a reasonable and good faith determination of consumers' ability to pay based on verified and documented information. Indeed, small creditors assert that they will not continue to make mortgage loans unless they are protected from liability for violations of the ability-to-repay rules by a conclusive presumption of compliance or ''safe harbor.'' The Bureau therefore believes that creating a new category of qualified mortgages that would include small creditor portfolio loans and raising the annual percentage rate threshold for the safe harbor to accommodate small creditors' higher costs may be necessary to preserve some consumers' access to mortgage credit and also would ensure that the mortgage credit is provided in a responsible, affordable way.

The Bureau is soliciting comment on both the proposed approach to small creditor portfolio loans generally and on the specific criteria proposed. The proposed amendments related to small creditor portfolio loans are discussed in more detail below in the section-by-section analysis of § 1026.43(b)(4) and (e)(5).

D. Higher-Priced Covered Transaction Threshold for Balloon-Payment Qualified Mortgages

The Bureau also is proposing to allow small creditors operating predominantly in rural or underserved areas to offer first-lien balloon loans with a higher annual percentage rate and still benefit from a conclusive presumption of compliance with the ability-to-repay rules or ''safe harbor.'' The Bureau believes this change may be necessary to preserve access to responsible, affordable mortgage credit in rural and underserved areas.

Consumers in rural and underserved areas may be able to obtain a mortgage loan only from small creditors because larger creditors often do not lend in those areas. Small creditors operating predominantly in rural and underserved areas assert that they cannot offer mortgage loans unless they are allowed to make balloon loans that are protected from liability for violations of the ability-to-repay rules by a safe harbor.

The Bureau's current rule provides that certain balloon loans made by small creditors operating predominantly in rural or underserved areas are qualified mortgages. However, qualified mortgages can have different levels of protection from liability depending on their annual percentage rate. Under the existing rules, first-lien qualified mortgages with an annual percentage rate less than or equal to the average prime offer rate plus 1.5 percentage points and subordinate-lien qualified mortgages with an annual percentage rate less than or equal to the average prime offer rate plus 3.5 percentage points are within the safe harbor. Qualified mortgages with annual percentage rates above these thresholds are presumed to comply with the ability-to-repay rules, but a consumer can rebut that presumption under certain circumstances.

Small creditors often charge higher interest rates and fees for legitimate business reasons, such as to cover their higher costs and to compensate for interest rate and other risks associated with holding a loan in portfolio. Therefore, the Bureau is concerned that many balloon-payment qualified mortgages will have annual percentage rates that are too high to qualify for the safe harbor. Because small creditors operating in rural and underserved areas insist that they are unwilling to make mortgage loans outside of the safe harbor because of litigation risk, this could limit access to credit for some consumers.

The Bureau is soliciting comment on adjusting the annual percentage rate threshold for balloon-payment qualified mortgages generally and on the specific threshold proposed. The proposed amendment is discussed in more detail below in the section-by-section analysis of § 1026.43(b)(4).

II. Background

For over 20 years, consumer advocates, legislators, and regulators have raised concerns about creditors originating mortgage loans without regard to the consumer's ability to repay the loan. Beginning in about 2006, these concerns were heightened as mortgage delinquencies and foreclosure rates increased dramatically, caused in part by the gradual deterioration in underwriting standards. *See* 73 FR 44524 (Jul. 30, 2008). The following is presented as background information, including a brief summary of the legislative and regulatory responses to this issue, which culminated in the enactment of the Dodd-Frank Act on July 21, 2010, the Board of Governors of the Federal Reserve System's (the Board) issuance of a proposed rule on May 11, 2011 to implement certain amendments to TILA made by the Dodd-Frank Act, the Bureau's issuance of the final rule to implement sections 1411, 1412, and 1414 of the Dodd-Frank Act, and this proposal to provide certain exemptions from and amendments to the ability-to-repay requirements. For additional detailed background regarding the issues addressed in this proposal, see the discussion in part II of the Bureau's final rule, published elsewhere in today's **Federal Register**.

A. TILA and Regulation Z

In 1968, Congress enacted TILA, 15 U.S.C. 1601 *et seq.,* based on findings that economic stability would be enhanced and competition among consumer credit providers would be strengthened by the informed use of credit resulting from consumers' awareness of the cost of credit. One of the purposes of TILA is to promote the informed use of consumer credit by requiring disclosures about its costs and terms. *See* 15 U.S.C. 1601(a). TILA requires additional disclosures for loans secured by consumers' homes and permits consumers to rescind certain transactions secured by their principal dwellings. *See* 15 U.S.C. 1635, 1637a. Section 105(a) of TILA directs the Bureau (formerly the Board) [2] to prescribe regulations to carry out TILA's purposes, and specifically authorizes the Bureau, among other things, to issue regulations that contain such additional requirements, classifications, differentiations, or other provisions, or that provide for such adjustments and exceptions for all or any class of transactions, that in the Bureau's judgment are necessary or proper to effectuate the purposes of TILA, facilitate compliance with TILA, or prevent circumvention or evasion therewith. *See* 15 U.S.C. 1604(a). TILA is implemented by the Bureau's Regulation Z, 12 CFR part 1026. Commentary provided in the Official Interpretations supplement to Regulation Z interprets the requirements of the regulation and provides guidance to creditors in applying the rules to specific transactions. *See* 12 CFR part 1026, Supp. I.

B. Ability-to-Repay Requirements Prior to the Dodd-Frank Act

In response to evidence of abusive practices in the home-equity lending market, Congress amended TILA by enacting the Home Ownership and Equity Protection Act (HOEPA) in 1994. Public Law 103–325, 108 Stat. 2160. HOEPA created special substantive protections for ''high-cost mortgage loans,'' [3] including prohibiting a creditor from engaging in a pattern or practice of extending a high-cost mortgage to a consumer based on the consumer's collateral without regard to the consumer's repayment ability, including the consumer's current and expected income, current obligations, and employment. TILA section 129(h); 15 U.S.C. 1639(h). In addition to the disclosures and limitations specified in the statute, TILA section 129, as added by HOEPA, expanded the Board's rulemaking authority by authorizing the Board to prohibit acts or practices the Board found to be unfair and deceptive in connection with mortgage loans.[4]

In 1995, the Board implemented the HOEPA amendments at §§ 226.31, 226.32, and 226.33 of Regulation Z. *See* 60 FR 15463 (Mar. 24, 1995). In particular, § 226.32(e)(1) implemented TILA section 129(h) to prohibit a creditor from extending a high-cost mortgage based on the consumer's collateral if, considering the consumer's current and expected income, current obligations, and employment status, the consumer would be unable to make the scheduled payments. In 2001, the Board amended these regulations to expand HOEPA's protections to more loans by revising the annual percentage rate (APR) threshold and the points and fees definition. *See* 66 FR 65604 (Dec. 20, 2001). In addition, the ability-to-repay provisions in the regulation were revised to provide for a presumption of a violation of the rule if the creditor engages in a pattern or practice of making high-cost mortgages without verifying and documenting the consumer's repayment ability.

After the Board finalized the 2001 HOEPA rules, new consumer protection issues arose in the mortgage market. During a series of national hearings held by the Board in 2006 and 2007, consumer advocates and government officials expressed a number of concerns and urged the Board to use HOEPA to prohibit or restrict certain underwriting practices, such as ''stated income'' or ''low documentation'' loans, and certain product features, such as prepayment penalties. *See* 73 FR 44527 (Jul. 30, 2008). In response to these hearings, in July of 2008, the Board adopted final rules adding new protections under HOEPA. *See* 73 FR 44522 (Jul. 30, 2008) (the Board's 2008 HOEPA Final Rule). The Board's 2008 HOEPA Final Rule defined a new class of ''higher-priced mortgage loans'' (HPMLs) [5] with APRs that are lower than those prescribed for HOEPA loans but that nevertheless exceed the average prime offer rate by prescribed amounts. This new category of loans was designed to include subprime credit. Among other things, the Board's 2008 HOEPA Final Rule revised the ability-to-repay requirements for high-cost mortgages

[2] General rulemaking authority for TILA transferred to the Bureau in July 2011, other than for certain motor vehicle dealers in accordance with Dodd-Frank Act section 1029, 12 U.S.C. 5519. Pursuant to that transferred rulemaking authority, the Bureau issued its own Regulation Z, 12 CFR part 1026, which substantially parallels the Board's Regulation Z, 12 CFR part 226. *See* 76 FR 79767 (Dec. 22, 2011).

[3] HOEPA defines a class of ''high-cost mortgages,'' which are generally consumer credit transactions secured by the consumers' principal dwellings (originally excluding home-purchase loans and open-end lines of credit, although the Dodd-Frank Act amended HOEPA to cover such transactions) with annual percentage rates or total points and fees exceeding prescribed thresholds. Mortgages covered by the HOEPA amendments have been referred to as ''HOEPA loans,'' ''section 32 loans,'' ''high-cost mortgages,'' or ''high-cost mortgage loans.'' The Dodd-Frank Act now refers to these loans as ''high-cost mortgages.'' *See* Dodd-Frank Act section 1431; TILA section 103(aa). For simplicity and consistency, this proposed rule uses the term ''high-cost mortgages'' to refer to mortgage loans covered by the HOEPA provisions.

[4] Originally 15 U.S.C. 1639(*l*)(2)(A), subsequently recodified by the Dodd-Frank Act as 15 U.S.C. 1639(p)(2)(A).

[5] Under the Board's 2008 HOEPA Final Rule, a higher-priced mortgage loan is a consumer credit transaction secured by the consumer's principal dwelling with an APR that exceeds the average prime offer rate (APOR) for a comparable transaction, as of the date the interest rate is set, by 1.5 or more percentage points for loans secured by a first lien on the dwelling, or by 3.5 or more percentage points for loans secured by a subordinate lien on the dwelling. The definition of a ''higher-priced mortgage loan'' includes practically all ''high-cost mortgages'' because the latter transactions are determined by higher loan pricing threshold tests. *See* 12 CFR 226.35(a)(1), since codified in parallel by the Bureau at 12 CFR 1026.35(a)(1).

and extended these requirements to higher-priced mortgage loans.[6]

Significantly, the Board's 2008 HOEPA Final Rule prohibited individual high-cost mortgage loans or higher-priced mortgage loans from being extended based on the collateral without regard to repayment ability, rather than simply prohibiting a pattern or practice of making extensions based on the collateral without regard to ability to repay.[7] The Board exercised its authority under TILA section 129(*l*)(2)[8] to revise HOEPA's restrictions based on a conclusion that the revisions were necessary to prevent unfair and deceptive acts or practices in connection with mortgage loans. *See* 73 FR 44545 (July 30, 2008). In particular, the Board concluded that a prohibition on making individual loans without regard for repayment ability was necessary to ensure a remedy for consumers who are given unaffordable loans and to deter irresponsible lending, which injures individual consumers. The Board determined that imposing the burden to prove ''pattern or practice'' on an individual consumer would leave many consumers with a lesser remedy, such as those provided under some State laws, or without any remedy, for loans made without regard to repayment ability. The Board further determined that removing this burden would not only improve remedies for individual consumers, it would also increase deterrence of irresponsible lending.

C. The Dodd-Frank Act

In 2007, Congress held hearings focused on the extent to which lending practices contributed to rising subprime foreclosure rates. Consumer advocates testified that certain lending terms or practices contributed to the foreclosures, including a failure to consider the consumer's ability to repay, low- or no-documentation loans, hybrid adjustable-rate mortgages, and prepayment penalties. Industry representatives, on the other hand, testified that adopting substantive restrictions on subprime loan terms would risk reducing access to credit for some consumers. In response to these hearings, the House of Representatives passed the Mortgage Reform and Anti-Predatory Lending Act, both in 2007 and again in 2009. H.R. 3915, 110th Cong. (2007); H.R. 1728, 111th Cong. (2009). Both bills would have amended TILA to provide consumer protections for mortgages, including ability-to-repay requirements, but neither bill was passed by the Senate. Instead, both houses shifted their focus to enacting comprehensive financial reform legislation, and the Senate passed its own version of ability-to-repay requirements as part of that effort, called the Restoring American Financial Stability Act of 2010. S. 3217, 111th Cong. (2010).

After several months of additional debate and negotiations, the Dodd-Frank Act was signed into law on July 21, 2010. Public Law 111–203, 124 Stat. 1376 (2010). In the Dodd-Frank Act, Congress established the Bureau and, under sections 1061 and 1100A, consolidated the rulemaking authority for many consumer financial protection statutes, including the two primary Federal consumer protection statutes governing mortgage credit, TILA and the Real Estate Settlement Procedures Act (RESPA), in the Bureau.[9] Congress also provided the Bureau with supervision authority for certain consumer financial protection statutes over certain entities, including insured depository institutions with total assets over $10 billion and their affiliates, and all mortgage-related non-depository financial service providers.[10]

At the same time, Congress significantly amended the statutory requirements governing mortgage practices with the intent to restrict the practices that contributed to the crisis. Title XIV of the Dodd-Frank Act, titled the Mortgage Reform and Anti-Predatory Lending Act, contains several new regulations designed to prevent the mortgage lending practices that harmed consumers and contributed to the financial crisis.[11] Sections 1411, 1412, and 1414 of the Dodd-Frank Act created new TILA section 129C, which establishes, among other things, new ability-to-repay requirements and new limits on prepayment penalties. Section 1402 of the Dodd-Frank Act states that Congress created new TILA section 129C upon a finding that ''economic stabilization would be enhanced by the protection, limitation, and regulation of the terms of residential mortgage credit and the practices related to such credit, while ensuring that responsible, affordable mortgage credit remains available to consumers.'' TILA section 129B(a)(1), 15 U.S.C. 1639b(a)(1). Section 1402 of the Dodd-Frank Act further states that the purpose of TILA section 129C is to ''assure that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay the loans.'' TILA section 129B(a)(2), 15 U.S.C. 1639b(a)(2).

Specifically, TILA section 129C:

- Expands coverage of the ability-to-repay requirements to any consumer credit transaction secured by a dwelling, except an open-end credit plan, credit secured by an interest in a timeshare plan, reverse mortgage, or temporary loan.
- Prohibits a creditor from making a mortgage loan unless the creditor makes a reasonable and good faith determination, based on verified and documented information, that the consumer has a reasonable ability to repay the loan according to its terms, and all applicable taxes, insurance, and assessments.
- Provides a presumption of compliance with the ability-to-repay requirements if the mortgage loan is a ''qualified mortgage,'' which does not contain certain risky features and limits points and fees on the loan.

The statutory ability-to-repay standards reflect Congress's belief that certain lending practices (such as low- or no-documentation loans) and terms (such as hybrid adjustable-rate mortgages and loans with negative amortization) led to consumers having mortgages they could not afford, resulting in high default and foreclosure rates. Accordingly, new TILA section 129C prohibits a creditor from making a residential mortgage loan unless the creditor makes a reasonable and good faith determination, based on verified and documented information, that the consumer has a reasonable ability to repay the loan according to its terms.

[6] Originally adopted as 12 CFR 226.34(a)(4), 226.35(b)(2), since recodified as 12 CFR 1026.34(a)(4), 1026.35(b)(1).

[7] Specifically, the rule prohibits a creditor from extending a higher-priced mortgage loan based on the collateral and without regard to the consumer's repayment ability, and prohibits a creditor from relying on income or assets to assess repayment ability unless the creditor verifies such amounts using third party documents that provide reasonably reliable evidence of the consumer's income and assets. For further information, see the Bureau's 2012 HOEPA Proposal, 77 FR 49090 (Aug. 15, 2012).

[8] Subsequently renumbered by the Dodd-Frank Act as TILA section 129(p)(2).

[9] 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.

[10] Sections 1024 through 1026 of the Dodd-Frank Act, codified at 12 U.S.C. 5514 through 5516.

[11] Although S. Rpt. No. 111–176 contains general legislative history concerning the Dodd-Frank Act and the Senate ability-to-repay provisions, it does not address the House Mortgage Reform and Anti-Predatory Lending Act. Separate legislative history for the predecessor House bills is available in H. Rpt. No. 110–441 for H.R. 3915 (2007), and H. Rpt. No. 111–194 for H.R. 1728 (2009).

To provide more certainty to creditors while protecting consumers from unaffordable loans, the Dodd-Frank Act provides a presumption of compliance with the ability-to-repay requirements for certain ''qualified mortgages.'' Qualified mortgages are prohibited from containing certain features that Congress considered to increase risks to consumers and must comply with certain limits on points and fees. The Act states that a creditor or assignee may presume that a loan has met the repayment ability requirement if the loan is a qualified mortgage, but does not address whether the presumption is conclusive or, if it can be rebutted, on what grounds it may be challenged.

The Dodd-Frank Act creates special remedies for violations of TILA section 129C. As amended by section 1416 of the Dodd-Frank Act, TILA section 130(a) provides that a consumer who brings a timely action against a creditor for a violation of TILA section 129C(a) (the ability-to-repay requirements) may be able to recover special statutory damages equal to the sum of all finance charges and fees paid by the consumer, unless the creditor demonstrates that the failure to comply is not material. 15 U.S.C. 1640(a). This recovery is in addition to actual damages; statutory damages in an individual action or class action, up to a prescribed threshold; and court costs and attorney fees that would be available for violations of other TILA provisions. In addition, the statute of limitations for an action for a violation of TILA section 129C is three years from the date of the occurrence of the violation (as compared to one year for most other TILA violations). TILA section 130(e), 15 U.S.C. 1640(e). Moreover, as amended by section 1413 of the Dodd-Frank Act, TILA section 130(k) provides that when a creditor or an assignee initiates a foreclosure action, a consumer may assert a violation of TILA section 129C(a) ''as a matter of defense by recoupment or setoff.'' 15 U.S.C. 1640(k). There is no time limit on the use of this defense, nor is there any requirement that the violation be apparent to the assignee on the face of the documents obtained from the creditor. However, the amount of special statutory damages that may be recovered in recoupment or setoff is limited to no more than three years of finance charges and fees.

In addition to the foregoing ability-to-repay provisions, the Dodd-Frank Act established other new standards concerning a wide range of mortgage lending practices, including compensation of mortgage loan originators,[12] Federal mortgage loan disclosures [13] and mortgage loan servicing.[14] Those and other Dodd-Frank Act provisions are the subjects of other rulemakings by the Bureau. For additional information on these rulemakings, see part III of the Bureau's 2013 ATR Final Rule.

D. The Board's Proposed and the Bureau's Final Rules

In 2011, the Board published for public comment a proposed rule amending Regulation Z to implement the foregoing ability-to-repay amendments to TILA made by the Dodd-Frank Act. *See* 76 FR 27390 (May 11, 2011) (Board's 2011 ATR Proposal or Board's proposal). Consistent with the Dodd-Frank Act, the Board's proposal applied the ability-to-repay requirements to any consumer credit transaction secured by a dwelling (including vacation homes and home equity loans), except an open-end credit plan, extension of credit secured by a consumer's interest in a timeshare plan, reverse mortgage, or temporary loan with a term of 12 months or less.

The Board's proposal provided four options for complying with the ability-to-repay requirement. First, the proposal would have allowed a creditor to meet the general ability-to-repay standard by originating a mortgage loan for which the creditor considered and verified eight underwriting factors in determining repayment ability, and the mortgage payment calculation is based on the fully indexed rate.[15] Second, the proposal would have allowed a creditor to meet the general ability-to-repay standard by refinancing a ''non-standard mortgage'' into a ''standard mortgage.'' [16] Under this option, the proposal would not have required the creditor to verify the consumer's income or assets. Third, the proposal would have allowed a creditor to meet the general ability-to-repay standard by originating a ''qualified mortgage,'' which provides special protection from liability for creditors. Because the Board determined that it was unclear whether that protection is intended to be a safe harbor or a rebuttable presumption of compliance with the repayment ability requirement, the Board proposed two alternative definitions of a ''qualified mortgage.'' [17] Finally, the proposal would have allowed a small creditor operating predominantly in rural or underserved areas to originate a balloon-payment qualified mortgage if the loan term is five years or more, and the payment calculation is based on the scheduled periodic payments, excluding the balloon payment.[18] The Board's proposal also would have implemented the Dodd-Frank Act's limits on prepayment penalties, lengthened the time creditors must retain evidence of compliance with the ability-to-repay and prepayment penalty provisions, and prohibited evasion of the rule by structuring a closed-end extension of credit as an open-end plan.

As discussed above, the Bureau inherited rulemaking authority under TILA from the Board in July 2011, including the authority to finalize the Board's 2011 ATR Proposal. *See* sections 1061 and 1100A of the Dodd-Frank Act. The Bureau's 2013 ATR Final Rule implemented the ability-to-repay requirements. Consistent with TILA section 129C, the Bureau's 2013 ATR Final Rule adopted § 1026.43(a), which applies the ability-to-repay requirements to any consumer credit transaction secured by a dwelling, except an open-end credit plan,

[12] Sections 1402 through 1405 of the Dodd-Frank Act, codified at 15 U.S.C. 1639b.

[13] Section 1032(f) of the Dodd-Frank Act, codified at 12 U.S.C. 5532(f).

[14] Sections 1418, 1420, 1463, and 1464 of the Dodd-Frank Act, codified at 12 U.S.C. 2605; 15 U.S.C. 1638, 1638a, 1639f, and 1639g.

[15] The eight proposed factors were: (1) Current or reasonably expected income or assets; (2) current employment status; (3) the monthly payment on the mortgage; (4) the monthly payment on any simultaneous loan; (5) the monthly payment for mortgage-related obligations; (6) current debt obligations; (7) the monthly debt-to-income ratio, or residual income; and (8) credit history.

[16] The alternative is based on a Dodd-Frank Act provision that is meant to provide flexibility for certain refinancings, which are no- or low-documentation transactions designed to move consumers out of risky mortgage loans and into more stable mortgage loan products, what the proposal defined as mortgage loans that, among other things, do not contain negative amortization, interest-only payments, or balloon payments, and have limited points and fees.

[17] The Board's proposed first alternative would have operated as a legal safe harbor and defined a ''qualified mortgage'' as a mortgage for which: (a) The loan does not contain negative amortization, interest-only payments, or balloon payments, or a loan term exceeding 30 years; (b) the total points and fees do not exceed 3 percent of the total loan amount; (c) the consumer's income or assets are verified and documented; and (d) the underwriting of the mortgage is based on the maximum interest rate in the first five years, uses a payment schedule that fully amortizes the loan over the loan term, and takes into account any mortgage-related obligations. The Board's proposed second alternative would have provided a rebuttable presumption of compliance and defined a ''qualified mortgage'' as including the criteria listed above in the first alternative as well as the following additional underwriting requirements from the ability-to-repay standard: the consumer's employment status, the monthly payment for any simultaneous loan, the consumer's current debt obligations, the total debt-to-income ratio or residual income, and the consumer's credit history.

[18] As the Board's proposal noted, this standard is evidently meant to accommodate community banks that originate balloon loans to hedge against interest rate risk.

timeshare plan, reverse mortgage, or temporary loan.

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

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

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

Section 1026.43(e) specifies requirements for originating ''qualified mortgages,'' as well as standards for when the presumption of compliance with ability-to-repay requirements can be rebutted. Section 1026.43(e)(1)(i) provides a safe harbor under the ability-to-repay requirements for loans that satisfy the definition of a qualified mortgage and are not higher-priced covered transactions (*i.e.,* the APR does not exceed the Average Prime Offer Rate (APOR) [19] plus 1.5 percentage points for first-lien loans or 3.5 percentage points for subordinate-lien loans). Section 1026.43(e)(1)(ii) provides a rebuttable presumption for qualified mortgage loans that are higher-priced covered transactions (*i.e.,* the APR exceeds APOR plus 1.5 percent for first lien or 3.5 percent for subordinate lien). Section 1026.43 also provides three options for creditors to originate a qualified mortgage:

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

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

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

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

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

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

Section 1026.43(f)(1)(vi) limits eligibility to creditors that originated 500 or fewer covered transactions in the preceding calendar year and that have assets of no more than $2 billion (to be adjusted annually). In addition, to originate a balloon-payment qualified mortgage more than 50 percent of a creditor's total first-lien covered transactions must have been secured by properties in counties that are ''rural'' or ''underserved,'' as designated by the Bureau. A county is ''rural'' if, during a calendar year, it is located in neither a metropolitan statistical area nor a micropolitan statistical area adjacent to a metropolitan statistical area, as those terms are defined by the U.S. Office of Management and Budget. A county is ''underserved'' if no more than two creditors extend covered transactions five or more times in that county during a calendar year. Also, during the preceding and current calendar years, the creditor must not have sold or assigned legal title to any balloon-payment qualified mortgage originated pursuant to this provision. Balloon loans by such creditors are eligible for qualified mortgage status if they meet the statutory limitations on product features and points and fees, and if the creditor follows certain other requirements that are part of the general ability-to-repay standard.

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

III. The Mortgage Loan Market Overview

For a complete discussion of the mortgage market, the financial crisis that precipitated the Dodd-Frank Act, and more recent efforts at stabilization, see part II of the Bureau's 2013 ATR Final Rule. The mortgage market is the single largest market for consumer financial products and services in the United States. In 2008 this market collapsed, greatly diminishing the wealth of millions of American consumers and sending the economy into a severe recession. A primary cause of the collapse was the steady deterioration of credit standards in mortgage lending. Evidence demonstrates that many mortgage loans were made solely against collateral and without consideration of ability to repay, particularly in the markets for ''subprime'' and ''Alt-A'' products, which more than doubled from $400 billion in originations in 2003 to $830 billion in originations in 2006.[20] Subprime products were sold primarily to consumers with poor or no credit history, while Alt-A loans were sold primarily to consumers who provided little or no documentation of income or other evidence of repayment ability.[21]

Because subprime and Alt-A loans involved additional risk, they were typically more expensive to consumers than ''prime'' mortgage loans, although many of them had very low introductory interest rates. While housing prices continued to increase, it was relatively easy for consumers to refinance their existing loans into more affordable products to avoid interest rate resets and other adjustments. When housing prices began to decline in 2005, however, refinancing became more difficult and delinquency rates on subprime and Alt-A products increased dramatically.[22] By the summer of 2006, 1.5 percent of loans less than a year old were in default, and this figure peaked at 2.5 percent in late 2007.[23] As the economy worsened, the rates of serious delinquency (90 or more days past due or in foreclosure) for the subprime and Alt-A products began a steep increase from approximately 10 percent in 2006, to 20 percent in 2007, to over 40 percent in 2010.[24]

Although the mortgage market is recovering, consumers today continue to feel the effects of the financial crisis.

A. Community-Focused Lending Programs

While governmental and nonprofit programs have always been an important source of assistance for low- to moderate-income (LMI) consumers, these programs have taken on even greater significance in light of current tight mortgage credit standards and Federal initiatives to stabilize the housing market. There are a variety of programs designed to assist LMI consumers with access to homeownership. These programs are generally offered through a nonprofit entity, local government, or a housing finance agency (HFA). These programs play a significant role in the housing sector of the economy.

Types of Financial Assistance Available

Community-focused lending programs typically provide LMI consumers with assistance ranging from housing counseling services to full mortgage loan financing. Some programs offer financial assistance through land trust programs, in which the consumer leases the real property and takes ownership of only the improvements. Many organizations provide ''downpayment assistance'' in connection with mortgage loan financing. This can be a gift, grant, or loan to the consumer to assist with the consumer's down payment, or to pay for some of the closing costs. These programs often rely on subsidies from Federal government funds (such as through the HUD HOME program), local government funds, foundations, or employer funding.[25]

Some programs offer first-lien mortgage loans designed to meet the needs of LMI consumers. These first-lien mortgage loans may have a discounted interest rate, limited origination fees, or permit high loan-to-value ratios. Many programs offer subordinate financing. Subordinate-financing options may be simple, such as a relatively inexpensive subordinate-lien loan to pay for closing costs. Other methods of subordinate financing may be complex. For example, one HFA program offers a 30-year, fixed-rate, subordinate-lien mortgage loan through partner creditors, with interest-only payments for the first 11 years of the loan's term, and which also provides the LMI consumer with an interest subsidy, resulting in a graduated monthly payment between the fifth and eleventh

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

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

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

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

[24] *FCIC Report* at 217.

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

year of the loan; an additional 30-year deferred, 0 percent subordinate-lien mortgage loan is extended by the HFA equal to the amount of the subsidy.[26] Some of the loans offered by these programs, whether first-lien or subordinate-financing, are structured as hybrid grant products that commonly will be forgiven.

Housing Finance Agencies

For over 50 years, HFAs have provided LMI consumers with opportunities for affordable homeownership.[27] HFAs are quasi-governmental entities, chartered by either a State or a municipality, that engage in diverse housing financing activities for the promotion of affordable housing. Some HFAs are chartered to promote affordable housing goals across an entire state, while others' jurisdiction extends to only particular cities or counties.[28] These agencies are generally funded through tax-exempt bonds.[29] HFAs issue these tax-exempt bonds, also known as Mortgage Revenue Bonds, and use the proceeds of the bond sale to finance affordable mortgage loans to LMI consumers. As of June, 2012, the 51 State HFAs (SHFAs) had $107 billion in outstanding tax-free municipal debt available. These Mortgage Revenue Bonds funded approximately 100,000 first-time homeowners per year. HFAs may also receive funding through Federal programs, such as HUD's HOME Investment Partnerships Program, which is the largest Federal block grant for affordable housing.[30]

HFAs employ several methods of promoting affordable homeownership. These agencies may partner with local governments to develop and implement long-term community-development strategies. For example, HFAs may provide tax credits to companies that build or rehabilitate affordable housing.[31] These agencies may also administer affordable housing trust funds or other State programs to facilitate the affordable housing development.[32] Many HFAs also provide education or training courses to first-time or LMI consumers.

HFAs also provide financial assistance directly to consumers. Typically, HFAs offer the first-lien mortgage loan, subordinate financing, and downpayment assistance programs described above. HFAs may also establish pooled loss reserves to self-insure mortgage loans originated pursuant to the program, thereby permitting LMI consumers to avoid private mortgage insurance. In 2010, HFAs provided about $10 billion in affordable financing.[33] In 2010, 89 percent of SHFAs provided down payment assistance loan or grant assistance and 57 percent of SHFAs provided assistance in conjunction with FHA or USDA programs.[34] However, HFAs generally do not provide direct financing to LMI consumers. HFAs partner with creditors, such as local banks, that extend credit pursuant to the HFA's program guidelines.

Private Organizations

While entities such as HFAs develop and finance affordable housing programs, these mortgage loans are generally extended by private organizations. These organizations often are structured as nonprofit 501(c)(3) organizations. Under Internal Revenue Code section 501(c)(3), the designation is for nonprofit, tax-exempt, charitable organizations not operated for the benefit of private interests.[35] Under Federal tax law, 501(c)(3) organizations are restricted from lobbying activities, while 501(c)(4) organizations, which must exist to promote social welfare, may engage in political campaigning and lobbying.[36] Most organizations that provide support to LMI consumers are structured as 501(c)(3) organizations. However, some organizations are structured as nonprofit 501(c)(4) organizations.

Various Federal programs establish eligibility requirements and provide ongoing monitoring of specific types of creditors that receive Federal grants and other support. For example, Community Development Financial Institutions (CDFIs) are approved by the U.S. Department of the Treasury (Treasury Department) to receive monetary awards from the Treasury Department's CDFI Fund, which was established to promote capital development and growth in underserved communities. Promoting homeownership and providing safe lending alternatives are among the Fund's main goals. The Treasury Department created the CDFI designation to identify and support small-scale creditors that are committed to community-focused lending, but have difficulty raising the capital needed to provide affordable housing services.[37] CDFIs may operate on a for-profit or nonprofit basis, provided the CDFI has a primary mission of promoting community development.[38] These programs are also subject to other eligibility requirements.[39] As of July 2012 there were 999 such organizations in the U.S., 62 percent of which are classified as Community Development (CD) Loan Funds, 22 percent as CD Credit Unions, while the rest are CD Banks, Thrifts, or CD Venture Capital Funds.[40]

The U.S. Department of Housing and Urban Development (HUD) may designate nonprofits engaging in affordable housing activities as Downpayment Assistance through Secondary Financing Providers (DAPs).[41] HUD established this designation as part of an effort to promote nonprofit involvement in affordable housing programs.[42] HUD-

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

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

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

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

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

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

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

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

[34] *Id.* at 21–22, 35–36.

[35] *See http://www.irs.gov/Charities-&-Non-Profits/Charitable-Organizations/Exemption-Requirements—Section-501(c)(3)-Organizations.*

[36] *See http://www.irs.gov/Charities-&-Non-Profits/Other-Non-Profits/Social-Welfare-Organizations.*

[37] *See* 68 FR 5704 (Feb. 4, 2003).

[38] *See* 12 CFR 1805.201(b).

[39] *Id.* Treasury Department eligibility requirements for CDFIs stipulate that an approved organization must: Be a legal entity at the time of certification application; have a primary mission of promoting community development; be a financing entity; primarily serve one or more target markets; provide development services in conjunction with its financing activities; maintain accountability to its defined target market; and be a non-government entity and not be under control of any government entity (Tribal governments excluded).

[40] *See http://www.cdfifund.gov/docs/certification/cdfi/CDFI List—07–31–12.xls.*

[41] *See* 24 CFR 200.194.

[42] ''Nonprofit organizations are important participants in HUD's efforts to further affordable housing opportunities for low- and moderate-income persons through the FHA single family programs. FHA's single family regulations recognize a special role for nonprofit organizations in conjunction with the * * * provision of secondary financing.'' *See* 67 FR 39238 (June 6, 2002).

approved nonprofits may participate in FHA single-family programs that allow them to purchase homes at a discount, finance FHA-insured mortgages with the same terms and conditions as owner-occupants, or be able to finance secondary loans for consumers obtaining FHA-insured mortgages. A DAP must be approved by HUD if it is a nonprofit or nonprofit instrumentality of government that provides downpayment assistance as a lien in conjunction with an FHA first mortgage; government entity DAPs and gift programs do not require approval.[43] As of November 2012 HUD lists 233 nonprofit agencies and nonprofit instrumentalities of government in the U.S. that are authorized to provide secondary financing.[44] HUD performs field reviews and requires annual reports of participating nonprofit agencies. Additionally, HUD's quality control plan requires periodic review for deficient policies and procedures and corrective actions. These approval and subsequent review procedures are intended to ensure that DAPs operate in compliance with HUD requirements and remain financially viable.[45] However, HUD recognizes that these nonprofits have limited resources and gives consideration to DAP viability when crafting regulations.[46]

Creditors may also be certified by HUD as Community Housing Development Organizations (CHDOs) in connection with HUD's HOME Investment Partnership Program, which provides grants to fund a wide range of activities that promote affordable homeownership.[47] HUD Participating Jurisdictions confer CHDO certification only on community-focused nonprofits that are both dedicated to furthering a community's affordable housing goals and capable of complying with the requirements of the HOME Program.[48] Creditors designated as CHDOs are eligible to receive special CHDO set-aside funds from HUD's HOME program to fund local homebuyer assistance programs.[49] Applicants seeking CHDO status must meet rigorous requirements. For example, a CHDO must be designated as a nonprofit under section 501(c)(3) or (c)(4) of the Internal Revenue Code, adhere to strict standards of financial accountability, have among its purposes the provision of decent and affordable housing for LMI consumers, maintain accountability to the community, and have a proven record of capably and effectively serving low-income communities.[50] After the CHDO designation is obtained, CHDO creditors must operate under the supervision of a Participating Jurisdiction and in accordance with the requirements of the HUD HOME Program.[51] HUD conducts annual performance reviews to determine whether funds have been used in accordance with program requirements.[52] While HUD continues to support affordable housing programs involving CHDOs, current market conditions have affected CHDO viability.[53]

Nonprofit creditors may engage in community-focused lending without obtaining one of the designations described above. Such nonprofits often rely on HFA or Federal programs for funding, lending guidelines, and other support. However, some nonprofits offer credit to LMI consumers independent of these State or Federal programs. For example, nonprofits may make mortgage loans in connection with a GSE affordable housing program. The Federal Home Loan Bank (FHLB) System, Fannie Mae (FNMA), and Freddie Mac (FHLMC) offer several programs to support affordable housing by facilitating mortgage financing for LMI consumers. For example, the FHLB Affordable Housing Program provides grants to member banks to fund programs that assist with closing costs or down payments, buy down principal amounts or interest rates, refinance an existing loan, or assist with rehabilitation or construction costs.[54] Fannie Mae and Freddie Mac also offer two programs focused on community-focused lending.[55]

Other options exist for nonprofits seeking to develop and fund community-focused lending programs. For example, a nonprofit may originate mortgage loans to LMI consumers and subsequently sell the loans to a bank, credit union, or other investor as part of a Community Reinvestment Act partnership program.[56] Other nonprofits may operate a limited affordable housing assistance fund, funded entirely by private donations, under which LMI consumers may obtain subordinate financing. Nonprofits such as these often rely on the underwriting performed by the creditor for the first-lien mortgage loan, which is often a bank or credit union, to process, underwrite, and approve the LMI consumer's application. In addition, some nonprofits are self-supporting and offer full financing to LMI consumers. These nonprofits often establish lending programs with unique guidelines, such as requirements that LMI consumers devote a minimum number of hours towards the construction of affordable housing.

[43] *See http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/sfh/np/sfhdap01.*

[44] *See https://entp.hud.gov/idapp/html/f17npdata.cfm.*

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

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

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

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

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

[50] *See* 24 CFR 92.2.

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

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

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

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

[55] FNMA offers first-lien mortgage loans through the My Community Mortgage program and subordinate-lien loans through the Community Seconds program. FHLMC offers both first- and subordinate-lien mortgage loans through the Home Possible program.

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

B. Homeownership Stabilization and Foreclosure Prevention Programs

During the early stages of the financial crisis the mortgage market significantly tightened mortgage loan underwriting requirements in response to uncertainty over the magnitude of potential losses due to delinquencies, defaults, and foreclosures.[57] This restriction in credit availability coincided with increasing unemployment, falling home values, and the onset of subprime ARM resets. As a result, many subprime ARM consumers could not afford their mortgage payments and were not able to obtain refinancings. This led to increases in delinquencies and foreclosures, which prompted further tightening of underwriting standards. Other subprime ARM consumers were able to remain current, but were not able to refinance because of a decrease in their loan-to-value ratio or an increase in their debt-to-income ratio.[58] However, these consumers devoted most of their disposable income to mortgage payments, thereby lowering overall consumer demand and further weakening the national economy.[59]

Policymakers became concerned that the losses incurred from foreclosures on subprime mortgage loans would destabilize the entire mortgage market.[60] There was a particular concern that the uncertainty surrounding exposure to these losses would lead to a fear-induced downward economic spiral.[61] As the crisis worsened, industry stakeholders attempted to stop this self-reinforcing cycle through a series of measures intended to stabilize homeownership and prevent foreclosure. Beginning in late 2008, the Federal government, Federal agencies, and GSEs implemented programs designed to facilitate refinancings and loan modifications.

The Troubled Asset Relief Program. The U.S. government enacted and implemented several programs intended to promote economic recovery by stabilizing homeownership and preventing foreclosure. The Emergency Economic Stabilization Act of 2008,[62] as amended by the American Recovery and Reinvestment Act of 2009,[63] authorizes the Treasury Department to ''use loan guarantees and credit enhancements to facilitate loan modifications to prevent avoidable foreclosures.'' [64] Pursuant to this authority, the Treasury Department established the Troubled Asset Relief Program (TARP), under which two programs were created to provide financial assistance directly to homeowners in danger of losing their homes: the Making Home Affordable (MHA) program and the Hardest Hit Fund (HHF) program. The MHA program is operated by the Treasury Department and seeks to provide Federally directed assistance to consumers who are at risk of default, foreclosure, or were otherwise harmed by the financial crisis.[65] The HHF program provides funds to certain SHFAs in States where the Treasury Department has determined that locally-directed stabilization programs are required.[66]

MHA began with the introduction of the Home Affordable Modification Program (HAMP) in March 2009.[67] HAMP, which is intended to assist employed homeowners by replacing the consumer's current mortgage loan with a more affordable mortgage loan, was immediately successful; nearly 500,000 trial modifications were begun during the first six months of the program.[68] MHA offerings expanded with the creation of the Second Lien Modification Program in August 2009 and the Home Affordable Foreclosure Alternatives Program in November 2009.[69] The Treasury Department subsequently modified these programs several times in response to the changing needs of distressed consumers and the mortgage market.[70]

MHA programs are currently scheduled to expire on December 31, 2013, although there is continuing debate about whether to extend them.[71] As of December 2012, ten programs have been established under MHA. The Treasury Department operates five MHA programs.[72] The remaining five MHA programs are operated in conjunction with FHA, VA, or USDA programs.[73] Many consumers facing default or foreclosure have received assistance under these programs. For example, from the beginning of the HAMP program to October 2012, over 1.1 million permanent HAMP modifications have been completed, saving distressed consumers an estimated $16.2 billion.[74]

In March 2010 the Treasury Department established the HHF program to enable the States most affected by the financial crisis to develop innovative assistance programs.[75] Nineteen programs have been established under the HHF fund, which is currently scheduled to expire on December 31, 2017. These programs

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

[58] ''[W]ith house prices becoming flat or declining in many parts of the country during 2007, it has become increasingly difficult for many subprime ARM borrowers to refinance. While many such borrowers remain current on their loans or are still able to refinance at market rates or into FHA products, an increasing number have either fallen behind on their existing payments or face the prospect of falling behind when rates reset and they are unable to refinance.'' *Accelerating Loan Modifications, Improving Foreclosure Prevention and Enhancing Enforcement,* 110th Cong. (Dec. 6, 2007) (testimony of John C. Dugan, Comptroller, Office of the Comptroller of the Currency).

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

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

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

[62] 12 U.S.C. 5201 *et. seq.;* Pub. L. 110–343 (Oct. 3, 2008).

[63] *See* Sec. 7002 of Public Law 111–5 (January 6, 2009).

[64] 12 U.S.C. 5219(a)(1).

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

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

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

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

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

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

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

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

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

[74] *See* October 2012 Making Home Affordable Report.

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

provide assistance to homeowners in the District of Columbia and the 18 states most affected by the economic crisis.[76] The HHF provides funds directly to HFAs in these States, which are used to create foreclosure-avoidance programs. As of November 2012, $1.7 billion has been allocated to support the 57 programs established to assist distressed consumers in these localities.[77] In California alone, nearly 17,000 consumers have received over $166 million in assistance since the beginning of the program.[78]

As with the MHA programs discussed above, these HHF programs have evolved over time. The Treasury Department originally encouraged SHFAs to establish programs for mortgage modifications, principal forbearance, short sales, principal reduction for consumers with high loan-to-value ratios, unemployment assistance, and second-lien mortgage loan reduction or modification.[79] No SHFAs were able to establish all of these programs in the early stages of the HHF. However, through 2011 and 2012 State HHF programs were significantly modified and expanded.[80] The 19 SHFAs continue to modify these programs to develop more effective and efficient methods of providing assistance to at-risk consumers. For example, in September 2012 the Nevada HHF program was amended for the tenth time.[81]

Federal agency programs. In response to the financial crisis, the FHA, the VA, and the USDA expanded existing programs and implemented new programs intended to facilitate refinancings for consumers at risk of delinquency or default. Some of these programs operate in conjunction with the Treasury Department's MHA program, while others are run solely by the particular Federal agency. In 2008 Congress expanded access to refinancings under the VA's Interest Rate Reduction Refinancing Loan program by raising the maximum loan-to-value ratio to 100 percent and increasing the maximum loan amount of loans eligible to be guaranteed under the program.[82] In February 2009 HUD increased the maximum loan amount for FHA-insured mortgages.[83] This change expanded access to refinancings available under the FHA's Streamline Refinance Program.[84] Several months later, the FHA created the Short Refinance Option program to assist consumers with non-FHA mortgage loans.[85] This program, which operates in conjunction with TARP, permits underwater consumers to refinance if the current creditor agrees to write down 10 percent of the outstanding principal balance. Similarly, in August 2010 the Rural Housing Service of the USDA (RHS) adopted rules intended to facilitate loan modifications for consumers struggling to make payments on USDA Guaranteed Loans.[86] The USDA subsequently created the Single Family Housing Guaranteed Rural Refinance Pilot Program, which was intended to refinance USDA borrowers into more stable and affordable mortgage loans.[87]

These efforts have enabled many consumers to receive refinancings under these programs. In 2011, the FHA accounted for 5.6 percent of the mortgage refinance market, with originations totaling $59 billion.[88] However, the number of consumers receiving assistance under these programs varies. For example, between April 2009 and December 2011, the FHA started 5.6 million mortgage loan modifications.[89] During a similar time period, nearly 997,000 FHA Streamline Refinances were consummated.[90] In contrast, between February 2010 and September 2012, only 1,772 mortgage loans were refinanced under the Short Refinance Option program.[91] Efforts continue to develop and enhance these programs to assist distressed homeowners while improving the performance of existing mortgage loans owned, insured, or guaranteed by these agencies.

HARP and other GSE refinancing programs. After the GSEs were placed into conservatorship in late 2008, the Federal Housing Finance Agency (FHFA) took immediate steps to reduce GSE losses by mitigating foreclosures.[92] In November 2008 FHFA and the GSEs, in coordination with the Treasury Department and other stakeholders, announced the Streamlined Modification Program, which was intended to help delinquent consumers avoid foreclosure by affordably restructuring mortgage payments.[93] This program was the precursor to the Home Affordable Refinance Program (HARP) that was announced in March 2009.[94] The HARP program was originally set to expire in June 2010 and limited to consumers with a loan-to-value ratio that did not exceed 105 percent. However, HARP was modified over time to account for the deteriorating mortgage market. In July 2010 the maximum loan-to-value ratio was increased from 105 percent to 125 percent.[95] Nine months

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

[77] *See* Troubled Asset Relief Program (TARP) Monthly Report to Congress—November 2012.

[78] *See* Keep Your Home California 2012 Fourth Quarterly Report.

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

[80] From 2011–2012, the program agreements between the 19 SHFAs and the Treasury Department were modified 55 times. *See http://www.treasury.gov/initiatives/financial-stability/TARP-Programs/housing/hhf/Pages/Archival-information.aspx.*

[81] *See* Tenth Amendment to Commitment to Purchase Financial Instrument and HFA Participation Agreement, available at *http://www.treasury.gov/initiatives/financial-stability/TARP-Programs/housing/Pages/Program-Documents.aspx.*

[82] *See* Sec. 504 of the Veterans' Benefits Improvement Act of 2008, Public Law 110–389 (Oct. 10, 2008).

[83] *See* HUD Mortgagee Letter 2009–07. Section 1202(b) of the American Recovery and Reinvestment Act of 2009, Pub. L. 111–5 (January 6, 2009), authorized the Secretary of Housing and Urban Development to increase the loan limit.

[84] The FHA Streamline Refinance Program contains reduced underwriting requirements for consumers with FHA mortgage loans seeking to refinance into a new FHA mortgage loan with a reduced interest rate. The FHA has offered streamline refinances for over thirty years. *See* HUD Mortgagee Letter 1982–23.

[85] *See* HUD Mortgagee Letter 2010–23.

[86] *See* 75 FR 52429 (Aug. 26, 2010).

[87] *See* Rural Dev. Admin. Notice No. 4615 (1980–D) (Feb. 1, 2012).

[88] This number represents FHA's market share by dollar volume. By number of originations, the FHA controlled 6.5 percent of the refinance market, with 312,385 refinances originated. *See* FHA-Insured Single-Family Mortgage Originations and Market Share Report 2012—Q2, available at *http://portal.hud.gov/hudportal/documents/huddoc?id=fhamktq2_2012.pdf.*

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

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

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

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

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

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

[95] *See* Press Release, FHFA, *FHFA Authorized Fannie Mae and Freddie Mac to Expand Home*

Continued

later FHFA extended the HARP expiration date by one year, to June 30, 2011.[96]

Many of the nearly five million eligible consumers were expected to receive refinancings under HARP.[97] However, by mid-2011 fewer than one million consumers had received HARP refinances. Fannie Mae, Freddie Mac, and FHFA responded by significantly altering the HARP program.[98] Perhaps most significantly, the maximum loan-to-value ratio was removed, facilitating refinances for all underwater consumers who otherwise fit HARP's criteria. These changes were immediately successful. More HARP refinances were completed during the first six months of 2012 than in all of 2011.[99] These changes were especially effective in assisting consumers with high loan-to-value ratios. In September 2012, consumers with loan-to-value ratios in excess of 125 percent received 26 percent of all HARP refinances.[100]

The GSEs have implemented other streamline refinance programs intended to facilitate the refinancing of existing GSE consumers into more affordable mortgage loans. These programs are available for consumers who are not eligible for a refinancing under HARP. For example, a consumer with a loan-to-value ratio of less than 80 percent is eligible for a streamline refinancing through Fannie Mae's Refi Plus program or Freddie Mac's Relief Refinance program. These programs comprise a significant share of GSE refinancing activity. From January through September 2012, 45 percent of GSE streamline refinances were non-HARP refinances.[101] FHFA and the GSEs remain committed to continue modifying these programs to enhance access to refinancing credit for distressed consumers.[102]

C. The Mortgage Loan Market for Small Portfolio Creditors

Securitization fundamentally altered mortgage lending practices. Traditionally, underwriting standards were determined at the branch or local bank level. These practices heavily emphasized the relationship between the bank and the consumer.[103] Starting in the mid-1990s, much of the mortgage market began to move toward standardized underwriting practices based on quantifiable and verifiable data points, such as a consumer's credit score.[104] The shift toward standardized, electronic underwriting lowered costs for creditors and consumers, thereby increasing access to mortgage credit. Standardized loan-level data made it easier to analyze individual loans for compliance with underwriting requirements, which facilitated the expansion of private mortgage securitizations. This shift from portfolio-focused to securitization-focused mortgage lending also altered the traditional risk calculations undertaken by creditors, as creditors no longer retained the risks associated with poorly underwritten loans.[105] Additionally, in another departure from the traditional mortgage lending model, these creditors increasingly relied on the fees earned by originating and selling mortgage loans, as opposed to the interest revenue derived from the loan itself.

Small community creditor access to the secondary mortgage market was limited. Many small creditors originated ''non-conforming'' loans which could not be purchased by the GSEs. Also, many community creditors chose to retain the relationship model of underwriting, rather than fully adopting standardized data models popular with larger banks. Retaining these traditional business methods had important consequences during the subprime crisis. While large lending institutions generally depended on the secondary market for liquidity, small community banks and credit unions generally remained reliant on interest income derived from mortgage loans held in portfolio. As a result, community creditors were less affected by the contraction in the secondary mortgage market during the financial crisis.[106] For example, the percentage of mortgage-backed securities in relation to the total assets of credit unions actually declined by more than 1.5 percent as subprime lending expanded.[107]

The magnitude of portfolio lending within this market remains an important influence on the underwriting practices of community banks and credit unions. These institutions generally rely on long-term relationships with a small group of consumers. Therefore, the reputation of these community banks and credit unions is largely dependent on serving their community in ways that cause no harm. Furthermore, by retaining mortgage loans in portfolio community creditors also retain the risk of delinquency or default on those loans. Thus, community creditors have an added incentive to engage in thorough underwriting to protect their balance sheet as well as their reputation. To minimize portfolio performance risk, small community creditors have developed underwriting standards that are different than those employed by larger institutions. Small creditors generally engage in ''relationship banking,'' in which underwriting decisions rely on qualitative information gained from personal relationships between creditors and consumers.[108] This qualitative information, often referred to as ''soft'' information, focuses on subjective factors such as consumer character and reliability, which ''may be difficult to quantify, verify, and communicate

Affordable Refinance Program to 125 Percent Loan-to-Value (July 1, 2009), available at: *http://www.fhfa.gov/webfiles/13495/125_LTV_release_and_fact_sheet_7_01_09%5B1%5D.pdf.*

[96] *See* Press Release, FHFA, *FHFA Extends Refinance Program By One Year* (March 1, 2010), available at: *http://www.fhfa.gov/webfiles/15466/HARPEXTENDED3110%5B1%5D.pdf.*

[97] *See* Treasury Department Press Release *supra* note 94.

[98] *See* Press Release, FHFA, *FHFA, Fannie Mae and Freddie Mac Announce HARP Changes to Reach More Borrowers* (Oct. 24, 2011), available at: *http://www.fhfa.gov/webfiles/22721/HARP_release_102411_Final.pdf.*

[99] *See* Federal Housing Finance Agency Refinance Report (June 2012).

[100] *See* Federal Housing Finance Agency Refinance Report (September 2012).

[101] *Id.*

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

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

[104] *See FCIC Report* at 72.

[105] *See FCIC Report* at 89.

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

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

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

through the normal transmission channels of a banking organisation.'' [109] Evidence suggests that underwriting based on such ''soft'' information yields loan portfolios that perform better than those underwritten according to ''hard'' information, such as credit score and consumer income levels.[110] For example, one recent study found that delinquency and default rates were significantly lower for consumers receiving mortgage loans from institutions relying on soft information for underwriting decisions.[111] This is consistent with market-wide data demonstrating that mortgage loan delinquency and charge-off rates are significantly lower at smaller banks than larger ones.[112] Current data also suggests that that these relationship-based lending practices lead to more accurate underwriting decisions during cycles of both lending expansion and contraction.[113]

Although the number of community banks has declined in recent years, these institutions remain an important source of nonconforming credit in areas commonly considered ''rural'' or ''underserved.'' In 2011, community banks held over 50 percent of all deposits in micropolitan areas and over 70 percent of all deposits held in rural areas.[114] Similarly, in 2011, there were more than 600 counties where community banks operated offices but where no noncommunity bank offices were present, and more than 600 additional counties where community banks operated offices but where fewer than three noncommunity bank offices were present.[115] These counties have a combined population of more than 16 million people and include both rural and metropolitan areas.[116] It is important to note that the cost of credit offered by these community institutions is generally higher than the cost of similar products offered by larger institutions. One reason for this increased expense stems from the nature of relationship-based underwriting decisions. Such qualitative evaluations of creditworthiness tend to take more time, and therefore are more expensive, than underwriting decisions based on standardized points of data.[117] Also, the cost of funds for community banks tends to be higher than the cost for larger institutions.[118]

IV. Legal Authority

The Bureau is issuing this proposed rule pursuant to its authority under TILA and the Dodd-Frank Act. *See* 15 U.S.C. 1604(a), 12 U.S.C. 5511(a) and (b), 5512(b)(1) and (2). On July 21, 2011, 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 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.'' [119] TILA is defined as a Federal consumer financial law.[120] Accordingly, the Bureau has authority to issue regulations pursuant to TILA.

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

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

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

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

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

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

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

[113] ''In two retail loan categories—residential real estate loans and loans to individuals—community banks consistently reported lower average loss rates from 1991 through 2011, the period for which these data are available.'' *FDIC Community Banking Study,* p. 4–6.

[114] *FDIC Community Banking Study,* p. 3–6.

[115] *FDIC Community Banking Study,* p. 3–5.

[116] *Id.*

[117] *FCIC Report* at 72.

[118] *FDIC Community Banking Study,* p. 4–5.

[119] 12 U.S.C. 5581(a)(1).

[120] 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).

TILA also provides the Bureau with authority to prescribe regulations that revise, add to, or subtract from the criteria that define a qualified mortgage upon a finding that such regulations are necessary or proper to ensure that responsible, affordable mortgage credit remains available to consumers in a manner consistent with the purposes of the ability-to-repay requirements; or are necessary and appropriate to effectuate the purposes of the ability-to-repay requirements, to prevent circumvention or evasion thereof, or to facilitate compliance with TILA sections 129B and 129C. TILA section 129C(b)(3)(B)(i), 15 U.S.C. 1639c(b)(3)(B)(i). In addition, TILA section 129C(b)(3)(A) provides the Bureau with authority to prescribe regulations to carry out the purposes of the qualified mortgage provisions, namely, to ensure that responsible, affordable mortgage credit remains available to consumers in a manner consistent with the purposes of TILA section 129C. TILA section 129C(b)(3)(A), 15 U.S.C. 1939c(b)(3)(A). As discussed in the section-by-section analysis below, the Bureau is issuing certain provisions of this rule pursuant to its authority under TILA section 129C(b)(3)(B)(i).

With respect to the qualified mortgage provisions, the Dodd-Frank Act contains several specific grants of regulatory authority. First, for purposes of defining ''qualified mortgage,'' TILA section 129C(b)(2)(A)(vi) provides the Bureau with authority to establish guidelines or regulations relating to monthly debt-to-income ratios or alternative measures of ability to pay. Second, TILA section 129C(b)(2)(D) provides that the Bureau shall prescribe rules adjusting the qualified mortgage points and fees limits described above to permit creditors that extend smaller loans to meet the requirements of the qualified mortgage provisions. 15 U.S.C. 1639c(b)(2)(D)(ii). In prescribing such rules, the Bureau must consider their potential impact on rural areas and other areas where home values are lower. *Id.* Third, TILA section 129C(b)(2)(E) provides the Bureau with authority to include in the definition of ''qualified mortgage'' loans with balloon payment features, if those loans meet certain underwriting criteria and are originated by creditors that operate predominantly in rural or underserved areas, have total annual residential mortgage originations that do not exceed a limit set by the Bureau, and meet any asset size threshold and any other criteria as the Bureau may establish, consistent with the purposes of TILA. 15 U.S.C. 1639c(b)(2)(E). As discussed in the section-by-section analysis below, the Bureau is issuing certain provisions of this rule pursuant to its authority under TILA sections 129C(a)(6)(D), (b)(2)(A)(vi), (b)(2)(D), and (b)(2)(E).

B. Other Rulemaking and Exception Authorities

This proposed rule also relies on the rulemaking and exception authorities specifically granted to the Bureau by TILA and the Dodd-Frank Act, including the authorities discussed below.[121]

TILA

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

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

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

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

[121] As discussed in the introductory material to part IV above, prior to the Dodd-Frank Act, rulemaking authority over TILA was vested in the Board. The Dodd-Frank Act transferred rulemaking authority for TILA to the Bureau, effective July 21, 2011. *See* Dodd-Frank Act sections 1061, 1098, and 1100A. Thus, the Bureau proposes these amendments pursuant to its authorities in section 1061 of the Dodd-Frank Act.

mortgage credit remains available to consumers, strengthening competition among financial institutions, and promoting economic stabilization.

TILA section 105(f). Section 105(f) of TILA, 15 U.S.C. 1604(f), authorizes the Bureau to exempt from all or part of TILA 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. In exercising this authority, the Bureau must consider the factors identified in section 105(f) of TILA and publish its rationale at the time it proposes an exemption for public comment. Specifically, the Bureau must consider:

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

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

(c) The status of the borrower, including—

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

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

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

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

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

As discussed in the section-by-section analysis below, the Bureau is proposing to exempt certain transactions from the requirements of TILA pursuant to its authority under TILA section 105(f). In developing this proposal under TILA section 105(f), the Bureau has considered the relevant factors and determined that the proposed exemptions may be appropriate.

The Dodd-Frank Act

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

V. Section-by-Section Analysis

Section 1026.32 Requirements for High-Cost Mortgages

32(b) Definitions

32(b)(1)

32(b)(1)(ii)

Background

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

Those rulemakings also adopted the Dodd-Frank Act's amendments to TILA concerning the exclusion of certain bona fide third-party charges and up to two bona fide discount points from the points and fees calculation for both qualified mortgages and high-cost mortgages. With respect to bona fide discount points in particular, TILA sections 129C(b)(2)(C)(ii)(I) and 103(dd)(1) provide for the exclusion of up to and including two bona fide discount points from points and fees for qualified mortgages and high-cost mortgages, respectively, but only if the interest rate for the transaction before the discount does not exceed by more than one percentage point the average prime offer rate, as defined in § 1026.35(a)(2). Similarly, TILA sections 129C(b)(2)(C)(ii)(II) and 103(dd)(2) provide for the exclusion of up to and including one bona fide discount point from points and fees, but only if the interest rate for the transaction before the discount does not exceed the average prime offer rate by more than two percentage points.[122] The Bureau's 2013 ATR and HOEPA Final Rules implemented the bona fide discount point exclusions from points and fees in § 1026.32(b)(1)(i)(E) and (F) (closed-end credit) and (b)(2)(i)(E) and (F) (open-end credit), respectively.

TILA section 129C(b)(2)(C) defines ''points and fees'' for qualified mortgages and high-cost mortgages to have the same meaning, as set forth in TILA section 103(aa)(4) (renumbered as section 103(bb)(4)).[123] Points and fees for the high-cost mortgage threshold are defined in § 1026.32(b)(1) (closed-end credit) and (2) (open-end credit), and § 1026.43(b)(9) provides that, for a qualified mortgage, ''points and fees'' has the same meaning as in § 1026.32(b)(1).

Section 1431 of the Dodd-Frank Act amended TILA to require that ''all compensation paid *directly or indirectly* by a consumer *or creditor* to a mortgage originator from any source, including a mortgage originator that is also the creditor in a table-funded transaction,'' be included in points and fees. TILA section 103(bb)(4)(B) (emphases added). Prior to the amendment, HOEPA had provided that only compensation paid by a consumer to a mortgage broker at or before closing should count toward the points and fees threshold. Under amended TILA section 103(bb)(4)(B), however, compensation paid to anyone that qualifies as a ''mortgage originator'' is to be included in points and fees.[124]

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

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

[124] ''Mortgage originator'' is generally defined to include ''any person who, for direct or indirect compensation or gain, or in the expectation of direct or indirect compensation or gain—(i) takes a

Continued

Thus, in addition to compensation paid to mortgage brokerage firms, points and fees also includes compensation paid to other mortgage originators, including employees of a creditor (*i.e.,* loan officers) or of a brokerage firm (*i.e.,* individual brokers). In addition, the Dodd-Frank Act removed the phrase ''payable at or before closing'' from the high-cost mortgage points and fees test and did not apply the ''payable at or before closing'' limitation to the points and fees cap for qualified mortgages. *See* TILA sections 103(bb)(1)(A)(ii) and 129C(b)(2)(A)(vii) and (C).

The Bureau's 2013 ATR Final Rule amended § 1026.32(b)(1) to implement revisions to the definition of ''points and fees'' under section 1431 of the Dodd-Frank Act, both for the purposes of HOEPA and qualified mortgages. Among other things, the Dodd-Frank Act added loan originator compensation to the definition of ''points and fees'' that had previously applied to high-cost mortgages under HOEPA. Section 1431 of the Dodd-Frank Act also amended TILA to provide that open-end credit plans (*i.e.,* HELOCs) are covered by HOEPA. The Bureau's 2013 HOEPA Final Rule thus separately amended § 1026.32(b)(2) to provide for the inclusion of loan originator compensation in points and fees for HELOCs, to the same extent as such compensation is required to be counted for closed-end credit transactions. Under § 1026.32(b)(1)(ii) (for closed-end credit) and § 1026.32(b)(2)(ii) (for open-end credit), all compensation paid directly or indirectly by a consumer or creditor to a loan originator, as defined in § 1026.36(a)(1), that can be attributed to that transaction at the time the interest rate is set, is required to be included in points and fees. The commentary to § 1026.32(b)(1)(ii) as adopted in the 2013 ATR Final Rule provides details for applying this requirement for closed-end credit transactions (*e.g.,* by clarifying when compensation must be known to be counted). The commentary to § 1026.32(b)(2)(ii) as adopted in the 2013 HOEPA Final Rule cross-references the commentary adopted in § 1026.32(b)(1)(ii) for interpretive guidance.

Discussion

In response to the Board's 2011 ATR Proposal and the Bureau's 2012 HOEPA Proposal, the Bureau received feedback regarding the inclusion of loan originator compensation in the qualified mortgage and high-cost mortgage points and fees calculation. In the context of both rulemakings, several industry commenters argued that including loan originator compensation in points and fees would result in ''double-counting'' because creditors often compensate loan originators with funds collected from consumers at consummation. The commenters argued that money collected in up-front charges to consumers should not be counted a second time toward the points and fees thresholds if it is passed on to a loan originator. In outreach, consumer advocates urged the Bureau not to assume that up-front consumer payments to creditors are applied to loan originator compensation, particularly in the wholesale channel where consumers can pay mortgage brokers directly.

The Bureau's 2013 ATR and HOEPA Final Rules implemented as written the statutory provision including loan originator compensation in points and fees. As the Bureau noted, the underlying statutory provisions as amended by the Dodd-Frank Act do not express any limitation on the requirement to count loan originator compensation toward the points and fees test. Rather, the literal language of TILA section 103(bb)(4) as amended by the Dodd-Frank Act defines points and fees to include all items included in the finance charge (except interest rate), all compensation paid directly or indirectly by a consumer or creditor to a loan originator, ''and'' various other enumerated items. Both the use of ''and'' and the reference to ''all'' compensation paid ''directly or indirectly'' and ''from any source'' suggest that compensation should be counted as it flows downstream from one party to another so that it is counted each time that it reaches a loan originator, whatever the previous source.

The Bureau believes the statute would be read to require that loan originator compensation be treated as additive to the other elements of points and fees. The Bureau did not believe that an automatic literal reading of the statute in all cases would be in the best interest of either consumers or industry, but it did not believe that it yet had sufficient information with which to choose definitively between the additive approach provided for in the statutory language and other potential methods of accounting for payments in all circumstances, given multiple practical and complex policy considerations involved. Accordingly, the Bureau decided to finalize the rule without a qualifying interpretation on this issue and to include in this proposal several comments to clarify interpretation of the statute as it applies to particular payment streams between particular parties. The Bureau is also seeking comment on whether additional guidance regarding treatment of loan originator compensation under the points and fees thresholds would be useful to facilitate compliance, as described further below.

In approaching the interpretive issue, the Bureau is cognizant of the broader purposes of the statute. As discussed in the 2013 ATR Final Rule, the Dodd-Frank Act contains a number of provisions that focus on loan originator compensation and regulation, in apparent response to concerns that industry compensation practices contributed to the mortgage market crisis by creating strong incentives for brokers and retail loan officers to steer consumers into higher-priced loans. Specifically, loan originators were often paid a commission by creditors that increased with the interest rate on a transaction. These commissions were funded by creditors through the increased revenue received by the creditor as a result of the higher rate paid by the consumer and were closely tied to the price the creditor expected to receive for the loan on the secondary market as a result of that higher rate.[125] In addition, many mortgage brokers charged consumers up-front fees to cover some of their costs at the same time that they accepted backend payments from creditors out of the rate. This may have contributed to consumer confusion about where the brokers' loyalties lay.

Although other provisions of the Dodd-Frank Act prohibit specific compensation practices that created particularly strong incentives for loan originators to ''upcharge'' consumers on a loan-by-loan basis and particular confusion about loan originators' loyalties, the Bureau believes that the inclusion of loan originator compensation in points and fees has

residential mortgage loan application; (ii) assists a consumer in obtaining or applying to obtain a residential mortgage loan; or (iii) offers or negotiates terms of a residential mortgage loan.'' TILA section 103(cc)(2)(A). The statute excludes certain persons from the definition, including a person who performs purely administrative or clerical tasks; an employee of a retailer of manufactured homes who does not take a residential mortgage application or offer or negotiate terms of a residential mortgage loan; and, subject to certain conditions, real estate brokers, sellers who finance three or fewer properties in a 12-month period, and servicers. TILA section 103(cc)(2)(C) through (F).

[125] For more detailed discussions, see the Bureau's 2012 proposed rule regarding loan originator compensation at 77 FR 55272, 55276, 55290 (Sept. 7, 2012) (2012 Loan Originator Proposal) and the final rule issued by the Board in 2010 at 75 FR 58509, 5815–16, 58519–20 (Sept. 24, 2010) (2010 Loan Originator Final Rule).

distinct purposes. In addition to discouraging more generalized rent-seeking and excessive loan originator compensation, the Bureau believes that Congress may have been focused on particular risks to consumers. Thus, with respect to qualified mortgages, including loan originator compensation in points and fees helps to ensure that, in cases in which high up-front compensation might otherwise cause the creditor and/or loan originator to be less concerned about long-term sustainability, the creditor is not able to invoke a presumption of compliance if challenged to demonstrate that it made a reasonable and good faith determination of the consumer's ability to repay the loan. Similarly in HOEPA, the threshold triggers additional consumer protections, such as enhanced disclosures and housing counseling, for the loans with the highest up-front pricing.

The Bureau believes that a strict additive rule that would automatically require that loan originator compensation be counted against the points and fees thresholds even if it is already counted against the thresholds for another reason under the statute would not serve the broader purposes of the statute. For instance, the Bureau does not believe that it is necessary or appropriate to count the same payment between a consumer and a mortgage broker firm twice, simply because it is both part of the finance charge and loan originator compensation. Similarly, the Bureau does not believe that where a payment from either a consumer or a creditor to a mortgage broker is counted toward points and fees, it is necessary or appropriate to count separately funds that the broker then passes on to its individual employees. In each case, any costs and risks to the consumer from high loan originator compensation are adequately captured by counting the funds a single time against the points and fees cap; thus, the Bureau does not believe the purposes of the statute would be served by counting some or all of the funds a second time, and is concerned that doing so could have negative impacts on the price and availability of credit.

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

The potential downstream effects of different accounting methods are significant. Under the additive approach where no offsetting of consumer payments against creditor-paid loan originator compensation is allowed, some loans might be precluded from being qualified mortgages given the other charges that are included in points and fees, such as fees paid to affiliates for settlement services. In other cases, creditors whose combined loan originator compensation and up-front charges would otherwise exceed the points and fees limits would have strong incentives to cap their up-front charges for other overhead expenses under the threshold and instead recover those expenses by increasing interest rates to generate higher gains on sale. This would adversely affect consumers who prefer a lower interest rate and higher up-front costs and, at the margins, could result in some consumers being unable to qualify for credit. Additionally, to the extent creditors responded to a ''no offsetting'' rule by increasing interest rates, this could increase the number of qualified mortgages that receive a rebuttable rather than conclusive presumption of compliance.

One alternative would be to allow all consumer payments to offset creditor-paid loan originator compensation. However, a ''full offsetting'' approach would allow creditors to offset much higher levels of up-front points and fees against expenses paid through rate before the heightened consumer protections required by the Dodd-Frank Act would apply. For example, a consumer could pay 3 percentage points in originating charges and be charged an interest rate sufficient to generate a 3 percent loan originator commission, and the loan could still fall within the 3 percent cap for qualified mortgages even though the up-front payments may be so high as to cause the creditor to be undemanding in underwriting the loan. The consumer could be charged 5 percent in originating charges and an interest rate sufficient to generate a five percentage loan originator commission and still stay under the HOEPA points and fees trigger, thereby denying consumers the special protections afforded to loans with high up-front costs. In markets that are less competitive, this would create an opportunity for creditors or brokerage firms to take advantage of their market power to harm consumers. Particularly under HOEPA, this may raise tensions with Congress's apparent intent. Other alternatives might use a hybrid approach depending on the type of expense, type of loan, or other factors, but would involve more compliance complexity.

In light of these complexities, the Bureau has proposed three comments (one with two alternative versions) to specify accounting methods where loan originator compensation could otherwise be counted twice under the statutory scheme. As discussed below, the Bureau believes that, consistent with TILA section 105(a), these comments would facilitate compliance by clarifying the requirements of § 1026.32(b)(1)(ii). The Bureau is proposing comment 32(b)(1)(ii)–5.i to provide that a payment from a consumer to a mortgage broker need not be counted toward points and fees twice because it is both part of the finance charge under § 1026.32(b)(1)(i) and loan originator compensation under § 1026.32(b)(1)(ii). Similarly, proposed comment 32(b)(1)(ii)–5.ii would clarify that § 1026.32(b)(1)(ii) does not require a creditor to include payments by a mortgage broker to its individual loan originator employee in the calculation of points and fees. For example, assume a consumer pays a $3,000 fee to a mortgage broker, and the mortgage broker pays a $1,500 commission to its individual loan originator employee for that transaction. The $3,000 mortgage broker fee is included in points and fees, but the $1,500 commission is not included in points and fees because it has already been included in points and fees as part of the $3,000 mortgage broker fee. As discussed above, the Bureau believes that this clarification may ensure that any costs to the consumer from loan originator compensation are adequately captured by counting the funds a single time

against the points and fees cap. The Bureau seeks comment regarding these proposed comments.

Finally, the Bureau is seeking comment on two alternative versions of proposed comment 32(b)(1)(ii)–5.iii. The first would explicitly preclude offsetting, in accordance with the statute's additive language, by specifying that § 1026.32(b)(1)(ii) requires a creditor to include compensation paid by a consumer or creditor to a loan originator in the calculation of points and fees in addition to any fees or charges paid by the consumer to the creditor. This proposed comment also contains an illustrative example which applies to both retail and wholesale transactions. For example, assume that a consumer pays to the creditor a $3,000 origination fee and that the creditor pays to its loan officer employee $1,500 in compensation attributed to the transaction. Assume further that the consumer pays no other charges to the creditor that are included in points and fees under § 1026.32(b)(1)(i) and the loan officer receives no other compensation that is included in points and fees under § 1026.32(b)(1)(ii). For purposes of calculating points and fees, the $3,000 origination fee is included in points and fees under § 1026.32(b)(1)(i) and the $1,500 in loan officer compensation is included in points and fees under § 1026.32(b)(1)(ii), equaling $4,500 in total points and fees, provided that no other points and fees are paid or compensation received.

The second alternative would allow all consumer payments of up-front fees and points to offset creditor payments to the loan originator. Specifically, it would provide that § 1026.32(b)(1)(ii) requires a creditor to reduce the amount of loan originator compensation included in the points and fees calculation under § 1026.32(b)(1)(ii) by any amount paid by the consumer to the creditor and included in the points and fees calculation under § 1026.32(b)(1)(i). This proposed comment also contains an illustrative example which applies to both retail and wholesale transactions. For example, assume that a consumer pays to the creditor a $3,000 origination fee and that the creditor pays to the loan originator $1,500 in compensation attributed to the transaction. Assume further that the consumer pays no other charges to the creditor that are included in points and fees under § 1026.32(b)(1)(i) and the loan originator receives no other compensation that is included in points and fees under § 1026.32(b)(1)(ii). For purposes of calculating points and fees, the $3,000 origination fee is included in points and fees under § 1026.32(b)(1)(i), but the $1,500 in loan originator compensation need not be included in points and fees. If, however, the consumer pays to the creditor a $1,000 origination fee and the creditor pays to the loan originator $1,500 in compensation, then the $1,000 origination fee is included in points and fees under § 1026.32(b)(1)(i), and $500 of the loan originator compensation is included in points and fees under § 1026.32(b)(1)(ii), equaling $1,500 in total points and fees, provided that no other points and fees are paid or compensation received. This example illustrates the requirements of § 1026.32(b)(1)(ii) for both retail and wholesale transactions.

The Bureau solicits feedback regarding all aspects of both alternatives. In addition, the Bureau specifically requests feedback regarding whether there are differences in various types of loans, consumers, loan origination channels, or market segments which would justify applying different interpretations regarding offsetting to such categories. For example, are the risks to consumers from applying either the first or the second interpretation greater in the subprime market (*i.e.,* with respect to higher-priced mortgages) than in the prime market? If so, should the Bureau use its authority under TILA to adopt different interpretations or regulatory approaches for these different markets or in adopting either approach in general? The Bureau also seeks feedback as to whether, if it were to adopt the first alternative in some or all instances, the creditor should be permitted to reduce the loan originator compensation by the full amount of points and fees included in finance charges or whether the reduction should be limited to that portion of points and fees denominated as general origination charges, rather than specific fees that are passed through to affiliates.

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

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

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

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

35(b) Escrow Accounts

35(b)(2) Exemptions

Section 1026.35(b)(2)(iii) provides that an escrow account need not be established in connection with a mortgage if the creditor operates predominantly in rural or underserved areas, originates 500 or fewer first-lien mortgages per year, and has total assets less than $2 billion (adjusted annually for inflation). As discussed below in the section-by-section analysis of § 1026.43(e)(5), the Bureau believes that it may be important to preserve consistency among § 1026.35(b)(2) and § 1026.43(e)(5) and (f). The Bureau is not proposing specific amendments to § 1026.35(b)(2) because § 1026.43(e)(5) as proposed is consistent with existing § 1026.35(b)(2). However, if § 1026.43(e)(5) is adopted with significant changes, the Bureau will consider and may adopt parallel amendments to § 1026.35(b)(2) and § 1026.43(f) in its final rule.

The Bureau solicits comment on the advantages and disadvantages of maintaining consistency between § 1026.35(b)(2) and § 1026.43(e)(5) and (f) generally and on whether the Bureau should make conforming changes to § 1026.35(b)(2) if necessary to maintain consistency with specific provisions of § 1026.43(e)(5).

Section 1026.43 Minimum Standards for Transactions Secured by a Dwelling

43(a) Scope

43(a)(3)

Applicability of the Ability-to-Repay Requirements

Section 129C(a)(1) of TILA, as added by section 1411 of the Dodd-Frank Act, states that, in accordance with regulations prescribed by the Bureau, no creditor may make a residential mortgage loan unless the creditor makes a reasonable and good faith determination based on verified and documented information that, at the time the loan is consummated, the consumer has a reasonable ability to repay the loan, according to its terms, and all applicable taxes, insurance (including mortgage guarantee insurance), and assessments. TILA section 129C(a)(6)(E) provides certain special rules to govern determinations of consumers' ability to repay where a ''hybrid'' loan is being refinanced by the same creditor into a ''standard'' product in anticipation of a significant risk of default after a reset in rates. The statute otherwise applies the same general ability-to-repay standards to all residential mortgage loans.

Section 1401 of the Dodd-Frank Act adds new TILA section 103(cc)(5), which defines ''residential mortgage loan'' to mean, with some exceptions, any consumer credit transaction secured by a mortgage, deed of trust, or other equivalent consensual security interest on ''a dwelling or on residential real property that includes a dwelling.'' TILA section 103(v) defines ''dwelling'' to mean a residential structure or mobile home which contains one- to four-family housing units, or individual units of condominiums or cooperatives. Thus, a ''residential mortgage loan'' generally includes all mortgage loans, except mortgage loans secured by a structure with more than four residential units. However, TILA section 103(cc)(5) specifically excludes from the term ''residential mortgage loan'' an open-end credit plan or an extension of credit secured by an interest in a timeshare plan, for purposes of the ability-to-repay requirements under TILA section 129C as well as provisions concerning prepayment penalties and other restrictions. In addition, TILA section 129C(a)(8) exempts reverse mortgages and temporary or ''bridge'' loans with a term of 12 months or less from the ability-to-repay requirements.[126] Thus, taken together, the ability-to-repay requirements of TILA section 129C(a) apply to all closed-end mortgage loans secured by a one- to four-unit dwelling, except loans secured by a consumer's interest in a timeshare plan, reverse mortgages, or temporary or ''bridge'' loans with a term of 12 months or less.

The Board's 2011 ATR Proposal included language to implement these statutory exemptions and solicited comment on whether any additional exemptions were appropriate and consistent with the authority under TILA section 129C(b)(3)(B)(i) to modify the provisions related to the definition of qualified mortgage.[127] However, the Board did not propose any specific additional exemptions. The Bureau's 2013 ATR Final Rule adopted § 1026.43 to implement the provisions of section 129C of TILA concerning consideration of consumers' ability to repay, limitations on prepayment penalties, and anti-evasion restrictions. The final rule's provisions on scope are substantially similar to the statute, with modifications to conform to the usage of Regulation Z. Section 1026.43(a) provides that § 1026.43 applies to any consumer credit transaction that is secured by a dwelling, as defined in § 1026.2(a)(19), other than: (1) A home equity line of credit subject to § 1026.40; or (2) a mortgage transaction secured by a consumer's interest in a timeshare plan, as defined in 11 U.S.C. 101(53(D)). Further, § 1026.43(a)(3)(i) and (ii) provides that a reverse mortgage subject to § 1026.33, or a temporary or ''bridge'' loan with a term of 12 months or less, such as a loan to finance the purchase of a new dwelling where the consumer plans to sell a current dwelling within 12 months or a loan to finance the initial construction of a dwelling, are exempt from the ability-to-repay requirements in § 1026.43(c) through (f).[128] Section 1026.43(a)(3)(iii) contains a related exemption for the construction phase of a construction-to-permanent loan.

Concerns Raised in Response to the Board's 2011 ATR Proposal

In the response to the Board's requests for feedback, many commenters requested exemptions from, or modifications to, the ability-to-repay requirements. Several commenters identified two categories of credit that are of particular concern to the Bureau: community-focused lending programs and programs intended to stabilize homeownership and prevent foreclosure.

Community-focused lending programs. One industry commenter requested that credit extended pursuant to a community-focused lending program be excluded from the ability-to-repay requirements. This commenter explained that creditors participating in these programs do so to benefit the community as a whole and knowingly assume any additional risks inherent in such lending. Another industry commenter requested broad flexibility for community-focused lending programs, noting that mortgage loans financed by State housing finance agencies (SHFAs) had lower long-term delinquency and foreclosure rates than mortgage loans financed by non-SHFA creditors. Other commenters requested a variety of accommodations for community-focused lending programs,

[126] In addition, section 129C(i) of TILA also exempts credit secured by a consumer's interest in a timeshare from the ability-to-repay requirements.

[127] *See* 76 FR 27390, 27448, 27456.

[128] Section 1026.43(c) contains the ability-to-repay requirements, § 1026.43(d) contains special ability-to-repay requirements for certain types of refinancings, § 1026.43(e) contains the qualified mortgage provisions, and § 1026.43(f) sets forth the provisions regarding balloon payment qualified mortgage loans made by certain creditors. Reverse mortgage loans and temporary or ''bridge'' loans with a term of 12 months or less remain subject to the prepayment penalty provisions in § 1026.43(g) and the anti-evasion provisions in § 1026.43(h).

ranging from a request to provide loans originated by SHFAs with qualified mortgage status to a request that the Bureau explicitly adopt the underwriting standards of SHFAs in the ability-to-repay standards. Both industry and consumer advocate commenters argued that community-focused lending programs provide low- to moderate-income (LMI) consumers with responsible and affordable mortgage credit.

Homeownership stabilization and foreclosure prevention programs. Many commenters requested that the Bureau accommodate programs designed to stabilize homeownership or mitigate the risks of foreclosure in the 2013 ATR Final Rule. One industry commenter argued that programs developed in response to the financial crisis, such as the Home Affordable Refinance Program, should be exempt from the ability-to-repay requirements. This commenter noted that a complete exemption was necessary because many of these programs' requirements conflicted with the proposed ability-to-repay requirements. Additional analysis conducted by the Bureau confirmed arguments made by commenters that programs such as these contain complex and comprehensive underwriting requirements.

The Bureau's proposal. This feedback prompted the Bureau to analyze the effects of the ability-to-repay requirements on community-focused lending programs and homeownership stabilization and foreclosure prevention programs. As explained further below, the Bureau believes that several narrowly tailored exemptions from the ability-to-repay requirements may be warranted. Specifically, the Bureau is concerned that the ability-to-repay requirements could have significant unintended consequences on certain community-focused lending programs designed to assist LMI consumers to access mortgage credit and certain housing stabilization and foreclosure assistance programs designed to assist consumers who have been harmed by the aftermath of the financial crisis. Because these programs already have carefully calibrated underwriting standards and are generally subject to significant government monitoring, the Bureau is concerned that overlaying an additional set of underwriting requirements and private liabilities could divert resources and reduce the effectiveness and availability of such programs. Accordingly, to preserve access to credit and promote stabilization of the housing market, the Bureau is therefore proposing to exempt loans made by certain community-focused creditors and under certain housing stabilization programs from the ability-to-repay requirements, rather than simply designating these extensions of credit as qualified mortgages. However, given the unique underwriting characteristics of these extensions of credit and the importance of ensuring access to mortgage credit for consumers seeking assistance under these programs, the Bureau believes it is important to seek additional public comment in crafting these exemptions.

As detailed below the proposed exemptions are narrowly targeted to apply only to certain types of creditors and extensions of credit. For example, the exemptions proposed below do not apply to credit extended in connection with a proprietary community-lending or foreclosure prevention program. The Bureau recognizes that such proprietary programs are a critical component of efforts to support housing affordability and homeownership stabilization. However, the Bureau believes that creditors offering these proprietary programs have the resources and flexibility to incorporate the ability-to-repay requirements into the programs' existing underwriting requirements. In contrast, the Bureau believes that, for certain extensions of credit, creditors do not have the resources or flexibility to implement the ability-to-repay requirements. The exemptions proposed below are intended to address these narrow circumstances to prevent consumers from being harmed by unintended consequences caused by application of the ability-to-repay requirements.

As detailed below under each specific proposed provision, the Bureau seeks comment on every aspect of this approach. In particular, the Bureau seeks comment on the premise that the ability-to-repay requirements could impose significant implementation and compliance burdens on the designated creditors and programs even if credit extended by the designated creditors or under the designated programs were granted some protection from liability as qualified mortgages. The Bureau also seeks comment on whether the creditors and programs identified have sufficiently rigorous underwriting standards and monitoring processes to protect the interests of consumers in the absence of TILA's ability-to-repay requirements. The Bureau solicits feedback specifically regarding the particular requirements of these creditors and these programs, how these requirements account for a consumer's ability to repay, and whether these requirements duplicate or render unnecessary the ability-to-repay provisions of § 1026.43(c) through (f). The Bureau also requests data related to the delinquency, default, and foreclosure rates of consumers participating in these programs. Finally, the Bureau requests feedback regarding whether such an exemption could harm consumers, such as by denying consumers the ability to pursue claims arising under violations of § 1026.43(c) through (f) against creditors extending credit in connection with these programs. Should the Bureau determine that a full exemption is not warranted, the Bureau seeks detailed comment on what modifications to the general ability-to-repay standards are warranted, or whether qualified mortgage status should be granted instead and, if so, under what conditions. The Bureau also solicits feedback on any alternative approaches that would preserve the availability of credit under HFA programs while ensuring that consumers receive mortgage loans that reasonably reflect consumers' ability to repay. Finally, the Bureau seeks comment on whether any exemptions or qualified mortgage status should be extended to additional programs or creditors, and, if so, under what conditions.

43(a)(3)(iv)

As discussed above, neither TILA nor Regulation Z provide an exemption to the ability-to-repay requirements for credit extended pursuant to a program administered by a housing finance agency (HFA). HFAs are supported by taxpayers, often through tax-exempt bonds but occasionally through direct government funding, and conduct diverse housing finance activities. For example, an HFA may extend credit directly to LMI consumers, insure or purchase mortgage loans originated by private creditors in accordance with the requirements of an HFA program, or provide other assistance to LMI consumers, such as mortgage loan payment subsidies or assistance with the up-front costs of a mortgage loan. HFAs are quasi-governmental, nonprofit, entities, chartered by either a State or a municipality, that promote affordable housing and community development. To achieve these goals, HFA underwriting requirements are tailored to the credit characteristics of LMI consumers. Credit offered in connection with these programs is similarly customized to the meet the unique needs of these consumers while ensuring the ongoing financial stability of the HFA. As HFAs extend credit to promote long-term housing stability, rather than for profit, HFAs generally extend credit after performing a

complex and lengthy analysis of a consumer's ability to repay which, given the unique underwriting characteristics of LMI consumers, often gives significant weight to nontraditional underwriting elements, extenuating circumstances, and other subjective factors that are indicative of responsible homeownership.

The Bureau is concerned that the ability-to-repay requirements may undermine the underwriting requirements of these programs. For example, the ability-to-repay provisions may require consideration of underwriting factors that are not required under HFA programs, such as the consumer's credit history. The Bureau is also concerned that the ability-to-repay requirements may affect the ability of HFAs to offer extensions of credit customized to meet the needs of LMI consumers while promoting long-term housing stability. For example, the Bureau is aware of several HFA programs offering mortgage loans that defer the repayment of principal until the consumer sells the home or refinances the mortgage, unless the consumer maintains the home as the consumer's principal residence for 30 years, in which case the deferred principal balance is forgiven. This mortgage loan would not be eligible for qualified mortgage status under § 1026.43(e) because it provides for deferred repayment of principal. Thus, a creditor extending such a mortgage loan is required to comply with the ability-to-repay requirements of § 1026.43(c).

Based on these considerations, the Bureau believes that it may be appropriate to exempt credit extended pursuant to an HFA program from the ability-to-repay requirements. In addition to the issues addressed above, the Bureau is especially concerned that the costs of implementing and complying with the requirements of § 1026.43(c) through (f) would endanger the viability and effectiveness of these programs. Nonprofit, taxpayer-supported HFAs may not have sufficient resources to implement and comply with the ability-to-repay requirements. Some HFAs may respond to the burden by severely curtailing the credit offered under these programs. Others may divert resources from lending to compliance, which may also result in the denial of mortgage credit to low- to moderate-income consumers. Private creditors offering credit in connection with HFA programs may determine that complying with both the ability-to-repay requirements and the specialized HFA program requirements is too burdensome, which also may result in the denial of mortgage credit to LMI consumers. These private creditors may also determine that the potential liability risk involved with applying the ability-to-repay requirements to the unique characteristics of HFA consumers is too great, thereby reducing the availability of mortgage credit. Further, these programs may employ underwriting requirements that are uniquely tailored to meet the needs of low- to moderate-income consumers, such that applying the more generalized statutory ability-to-repay requirements would be unnecessarily burdensome and provide no net benefit to consumers. Accordingly, the Bureau is proposing § 1026.43(a)(3)(iv), which provides that an extension of credit made pursuant to a program administered by a housing finance agency, as defined under 24 CFR 266.5, is exempt from § 1026.43(c) through (f).

Section 1026.43(a)(3)(iv) is proposed pursuant to the Bureau's authority under section 105(a) and (f) of TILA. Pursuant to section 105(a) of TILA, the Bureau believes that this exemption is necessary and proper to effectuate the purposes of TILA. This exemption would ensure that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay. The Bureau believes that mortgage loans originated in connection with programs administered by State housing finance agencies sufficiently account for a consumer's ability to repay, and the exemption ensures that consumers are able to receive assistance under these programs. Furthermore, without the exemption the Bureau believes that consumers in this demographic would be denied access to the responsible, affordable credit offered under these programs, which is contrary to the purposes of TILA.

The Bureau has considered the factors in TILA section 105(f) and believes that, for the reasons discussed above, an exemption is appropriate under that provision. Specifically, the Bureau believes that the proposed exemption is appropriate for all affected consumers, regardless of their other financial arrangements and financial sophistication and the importance of the loan to them. Similarly, the Bureau believes that the proposed exemption is appropriate for all affected loans, regardless of the amount of the loan and whether the loan is secured by the principal residence of the consumer. Furthermore, the Bureau believes that, on balance, the proposed exemption will simplify the credit process without undermining the goal of consumer protection or denying important benefits to consumers. Based on these considerations and the analysis discussed elsewhere in this proposal, the Bureau believes that the proposed exemptions are appropriate. The Bureau recognizes that its exemption and exception authorities apply to a class of transactions, and proposes to apply these authorities to the loans covered under the proposal of the entities proposed for potential exemption.

43(a)(v)

As discussed above, neither TILA nor Regulation Z provide an exemption to the ability-to-repay requirements for nonprofit creditors. Feedback provided in response to solicitations for comment in the Board's 2011 ATR Proposal alerted the Bureau to the possibility that many charitable organizations that provide credit to low- to moderate-income consumers would be negatively affected by the requirements of § 1026.43(c) through (f). The Bureau is concerned that the ability-to-repay requirements may result in consumers being denied access to the affordable mortgage credit offered by many of these charitable organizations. The costs of implementing and complying with the requirements of § 1026.43(c) through (f) may be significantly more burdensome on creditors that are charitable organizations than other creditors. These nonprofit creditors may not have the resources to implement and comply with the ability-to-repay requirements, and may cease or severely limit extending credit to low- to moderate-income consumers, which would result in the denial of responsible, affordable mortgage credit.

Credit Extended by CDFIs, CHDOs, and DAPs

The Bureau has identified several types of creditors that focus on extending credit to these consumers. Nonprofit creditors seeking designation as a Community Development Financial Institutions (CDFIs) by the Treasury Department must undergo a thorough screening process to obtain this designation and then must engage in community-focused lending to maintain the designation. Creditors designated as Downpayment Assistance through Secondary Financing Providers (DAPs) or Community Housing Development Organizations (CHDOs) must meet similar requirements imposed by the U.S. Department of Housing and Urban Development (HUD). The Bureau is concerned that the ability-to-repay requirements will negatively affect these creditors, while providing little additional protection to consumers.

Accordingly, the Bureau proposes § 1026.43(a)(3)(v), which provides that an extension of credit made by one of the four types of creditors specified in proposed § 1026.43(a)(3)(v)(A) through (D) is exempt from § 1026.43(c) through (f). Proposed § 1026.43(a)(3)(v)(A) exempts an extension of credit made by a creditor designated as a Community Development Financial Institution, as defined under 12 CFR 1805.104(h). Proposed § 1026.43(a)(3)(v)(B) exempts an extension of credit made by a creditor designated as a Downpayment Assistance Provider operating in accordance with regulations prescribed by the U.S. Department of Housing and Urban Development applicable to such persons. Proposed § 1026.43(a)(3)(v)(C) exempts an extension of credit made by a creditor designated as a Community Housing Development Organization, as defined under 24 CFR 92.2, operating in accordance with regulations prescribed by the U.S. Department of Housing and Urban Development applicable to such persons. Research conducted by the Bureau suggests that these organizations only extend credit after determining that an applicant has the ability to repay the loan, as part of these organizations' broader purpose of extending credit to promote community development. Furthermore, the Bureau believes that the requirements imposed in connection with obtaining and maintaining the designations identified in proposed § 1026.43(a)(3)(v)(A) through (C) may be sufficient to ensure that such creditors provide consumers with responsible and affordable credit, and that unscrupulous or irresponsible creditors would not be able to use these designations to evade the requirements of TILA, extend credit without regard to the consumer's ability to repay, or otherwise harm consumers. However, the Bureau requests feedback regarding this exemption and the analysis that supports it.

Credit Extended by Other Nonprofits

The Bureau believes that charitable organizations other than those addressed above also may be negatively affected by the ability-to-repay requirements, which may impair the availability of mortgage credit for low- to moderate-income consumers. However, the Bureau is concerned that an exemption for all charitable organizations would allow irresponsible creditors to harm consumers. For example, IRS regulations regarding nonprofit status do not incorporate consumer financial protection regulations, such as the ability-to-repay requirements. Thus, a creditor could operate in accordance with applicable IRS regulations while extending credit without regard to a consumer's ability to repay, therefore causing the harm that the ability-to-repay requirements are intended to prevent. The Bureau is also concerned that an exemption for all charitable organizations would allow unscrupulous creditors to intentionally circumvent TILA's ability-to-repay requirements and harm consumers. For example, IRS regulations require nonprofit organizations to file annual financial reports by the 15th day of the 5th month after the end of the organization's fiscal year.[129] Thus, an unscrupulous creditor could operate a for-profit lending operation, in violation of IRS requirements, and extend credit without determining a consumer's ability to repay for 17 months before filing the required financial report, which would lead to the loss of the creditor's nonprofit designation. Therefore, the Bureau believes that an exemption for charitable organizations may be appropriate, if the exemption is limited to those charitable organizations that focus on low- to moderate-income consumers and will be disproportionately affected by the costs associated with the ability-to-repay requirements. These nonprofit creditors may not have the resources to implement and comply with the ability-to-repay requirements, and may cease or severely limit extending credit to LMI consumers, which would result in the denial of mortgage credit. Accordingly, proposed § 1026.43(a)(3)(v)(D) exempts an extension of credit made by a creditor with a tax exemption ruling or determination letter from the Internal Revenue Service under section 501(c)(3) of the Internal Revenue Code of 1986 (26 CFR 1.501(c)(3)–1), provided that certain other limitations apply.

Specifically, the exemption is available only if the creditor extended credit secured by a dwelling no more than 100 times in the calendar year preceding receipt of the consumer's application. The Bureau believes that this limit of 100 transactions per year may be appropriate because nonprofit creditors that extend credit secured by a dwelling fewer than 100 times a year do not have the resources to implement and monitor compliance with the ability-to-repay requirements. In addition, small creditors such as these may devote more time to determining whether a consumer has the ability to repay a mortgage loan than a creditor that extends credit more than 100 times a year. However, the Bureau solicits feedback on whether this condition is appropriate, on the costs of implementing and complying with the ability-to-repay requirements that will be incurred by creditors that extend credit secured by a dwelling more than 100 times a year, the extent to which this proposed condition would affect access to responsible, affordable credit, and whether the limit of 100 transactions per year should be increased or decreased.

The exemption in proposed § 1026.43(a)(3)(v)(D) is further conditioned on the creditor, in the calendar year preceding receipt of the consumer's application, extending credit secured by a dwelling only to consumers with income that did not exceed the qualifying limit for moderate-income families, as established pursuant to section 8 of the United States Housing Act of 1937 and amended from time to time by the U.S. Department of Housing and Urban Development. Also, the proposed exemption is available only if the extension of credit is to a consumer with income that does not exceed this qualifying limit.

The Bureau solicits feedback on whether this exemption, and the conditions under which the exemption applies, are appropriate. The Bureau also specifically requests comment regarding the costs that nonprofit creditors will incur in connection with the ability-to-repay requirements, the extent to which these additional costs will affect the ability of nonprofit creditors to extend credit to low- to moderate-income consumers, and whether consumers could be harmed by providing an exemption to the ability-to-repay requirements to the creditors described above.

The proposed exemption under § 1026.43(a)(3)(v)(D) is limited to creditors designated as nonprofits under the Internal Revenue Code of 1986, and is not available for creditors operating on a for-profit basis. The Bureau believes that this distinction may be appropriate and necessary. It may be appropriate because of the difference in lending practices between nonprofit and other creditors. For-profit creditors price and extend credit based on several considerations, including the assumption that certain consumers will default and must be foreclosed upon. In contrast, the nonprofit creditors identified in § 1026.43(a)(3)(v)(D) appear to elevate long-term community stability over the creditor's economic considerations. Thus, these nonprofits appear to have a stronger incentive to determine that an LMI consumer has the ability to repay a mortgage loan than for-profit creditors. Furthermore, this distinction may be necessary to preserve

[129] 26 CFR 1.6033–6(f).

access to responsible and affordable credit. This proposed exemption is premised on the belief that the additional costs imposed by the ability-to-repay requirements will force certain nonprofit creditors to cease extending credit, or substantially limit credit activities, thereby harming low- to moderate-income consumers. By definition, for-profit creditors derive more revenue from mortgage lending activity than nonprofit creditors, and therefore presumably have the resources to comply with the ability-to-repay requirements. Thus, expanding the proposed exemption to apply to for-profit creditors may not be necessary to preserve access to responsible, affordable credit. However, the Bureau solicits comment regarding this analysis.

This proposed exemption applies to creditors designated as nonprofits under section 501(c)(3), but not 501(c)(4), of the Internal Revenue Code of 1986. The Bureau recognizes that these creditors also may be affected by the ability-to-repay requirements. However, the Bureau believes that this distinction may be appropriate. As explained above, the Bureau's proposed exemption is premised on the belief that the additional costs imposed by the ability-to-repay requirements will force certain nonprofit creditors to cease extending credit, or substantially limit credit activities, thereby harming low- to moderate-income consumers.

IRS regulations permit 501(c)(4) nonprofits to engage in lobbying and certain political activities. Nonprofit creditors with the resources to engage in lobbying or other political activities are presumably more likely to have the resources to comply with the ability-to-repay requirements. Furthermore, tax-exempt status under section 501(c)(3) requires a rigorous application to the government and a formal determination by the Internal Revenue Service that an organization is ''exclusively'' charitable.[130] Tax-exempt status under other provisions of section 501(c), by contrast, can be merely self-proclaimed, without any formal determination by the government.[131] The heightened scrutiny placed on wholly charitable organizations by the IRS would help ensure that scrupulous and responsible creditors that seek to provide responsible and affordable credit qualify for the exemption.

However, the Bureau solicits comment regarding whether the proposed exemption should be extended to creditors designated as nonprofits under section 501(c)(4) of the Internal Revenue Code of 1986. In addition, the Bureau requests financial reports and mortgage lending activity data supporting the argument that the marginal cost of implementing and complying with the ability-to-repay requirements would cause 501(c)(4) nonprofit creditors to cease, or severely limit, extending credit to low- to moderate-income consumers.

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

Legal Authority

Section 1026.43(a)(3)(v) is proposed pursuant to the Bureau's authority under section 105(a) and (f) of TILA. Pursuant to section 105(a) of TILA, the Bureau believes that this exemption is necessary and proper to effectuate the purposes of TILA. By ensuring the viability of the low- to moderate-income mortgage market, this exemption would ensure that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay. Without the exemption the Bureau believes that low- to moderate-income consumers would be denied access to the responsible and affordable credit offered by these creditors, which is contrary to the purposes of TILA. This exemption is consistent with the goals of TILA section 129C by ensuring that consumers are able to obtain responsible, affordable credit from the nonprofit creditors discussed above.

The Bureau has considered the factors in TILA section 105(f) and believes that, for the reasons discussed above, an exemption is appropriate under that provision. Specifically, the Bureau believes that the proposed exemption is appropriate for all affected consumers, regardless of their other financial arrangements and financial sophistication and the importance of the loan to them. Similarly, the Bureau believes that the proposed exemption is appropriate for all affected loans, regardless of the amount of the loan and whether the loan is secured by the principal residence of the consumer. Furthermore, the Bureau believes that, on balance, the proposed exemption will simplify the credit process without undermining the goal of consumer protection or denying important benefits to consumers. Based on these considerations and the analysis discussed elsewhere in this proposal, the Bureau believes that the proposed exemptions are appropriate. The Bureau recognizes that its exemption and exception authorities apply to a class of transactions, and proposes to apply these authorities to the loans covered under the proposal of the entities proposed for potential exemption.

43(a)(3)(vi)

Background

Several commenters requested that the Bureau modify the ability-to-repay requirements to accommodate extensions of credit made pursuant to a

[130] 26 U.S.C. 501(c)(3), 508(a); 26 CFR 1.508–1.

[131] *Id. See, e.g.,* U.S. Gov't Accountability Office, GAO–07–563, *Thousands of Organizations Exempt from Federal Income Tax Owe Nearly $1 Billion in Payroll and Other Taxes* (2007) 5–6.

homeownership stabilization or foreclosure prevention program from the ability-to-repay requirements. The Bureau is concerned that the ability-to-repay requirements are not sufficiently flexible, or may be unduly burdensome, with respect to extensions of credit made pursuant to these programs, which are intended to assist consumers at risk of default, foreclosure, or who were otherwise harmed by the financial crisis. Generally, consumers are able to obtain new extensions of credit, refinancings of existing mortgage loans, or loan modification agreements in connection with these programs. As a threshold matter, determining the applicability of these programs to the ability-to-repay requirements implicates the refinancing provisions under § 1026.20 of Regulation Z as well as the payment shock refinancing provisions under TILA section 129C(a)(6)(E), as implemented by § 1026.43(d).

Refinancings generally. Regulation Z contains several provisions regarding when a transaction is considered a ''refinancing,'' and therefore subject to the requirements of TILA. Section 1026.20(a) currently provides that ''a refinancing occurs when an existing obligation that was subject to this subpart is satisfied and replaced by a new obligation undertaken by the same consumer. A refinancing is a new transaction requiring new disclosures to the consumer.'' Comment 20(a)–1, which clarifies this general definition, provides that a refinancing is a new transaction requiring a complete new set of disclosures. Whether a refinancing has occurred is determined by reference to whether the original obligation has been satisfied or extinguished and replaced by a new obligation, based on the parties' contract and applicable law. Comment 20(a)–1 further explains that the refinancing may involve the consolidation of several existing obligations, disbursement of new money to the consumer or on the consumer's behalf, or the rescheduling of payments under an existing obligation. In any form, the new obligation must completely replace the prior one. However, changes in the terms of an existing obligation, such as the deferral of individual installments, will not constitute a refinancing unless accomplished by the cancellation of that obligation and the substitution of a new obligation. Furthermore, a substitution of agreements that meets the refinancing definition will require new disclosures, even if the substitution does not substantially alter the prior credit terms. Comment 20(a)–5 explains that § 1026.20(a) applies only to refinancings undertaken by the original creditor or a holder or servicer of the original obligation. A ''refinancing'' by any other person is a new transaction under the regulation, not a refinancing under § 1026.20(a).

There are five types of transactions, identified in § 1026.20(a)(1) through (5), that are not considered refinances, three of which are relevant for purposes of these proposed exemptions. First, § 1026.20(a)(1) provides that a renewal of a single payment obligation with no change in the original terms shall not be treated as a refinancing. Comment 20(a)(1)–1 clarifies that this exception applies both to obligations with a single payment of principal and interest and to obligations with periodic payments of interest and a final payment of principal. In determining whether a new obligation replacing an old one is a renewal of the original terms or a refinancing, the creditor may consider it a renewal even if: (1) Accrued unpaid interest is added to the principal balance; (2) changes are made in the terms of renewal resulting from the factors listed in § 1026.17(c)(3);[132] and (3) the principal at renewal is reduced by a curtailment of the obligation.

Second, § 1026.20(a)(2) provides that a reduction in the APR with a corresponding change in the payment schedule shall not be considered a refinancing. Comment 20(a)(2)–1 explains that ''a reduction in the annual percentage rate with a corresponding change in the payment schedule is not a refinancing. If the annual percentage rate is subsequently increased (even though it remains below its original level) and the increase is effected in such a way that the old obligation is satisfied and replaced, new disclosures must then be made.'' Comment 20(a)(2)–2 further clarifies that a corresponding change in the payment schedule to implement a lower APR would be a shortening of the maturity, or a reduction in the payment amount or the number of payments of an obligation. Additionally, the exemption in § 1026.20(a)(2) does not apply if the maturity is lengthened, or if the payment amount or number of payments is increased beyond that remaining on the existing transaction.

Third, § 1026.20(a)(4) provides that a change in the payment schedule or a change in collateral requirements as a result of the consumer's default or delinquency, unless the rate is increased, or the new amount financed exceeds the unpaid balance plus earned finance charge and premiums for continuation of insurance of the types described in § 1026.4(d) shall not be considered a refinancing. Comment 20(a)(4)–1, which refers to the agreements described in § 1026.20(a)(4) as ''workout agreements,'' explains that a workout agreement is not a refinancing unless the APR is increased or additional credit is advanced beyond amounts already accrued plus insurance premiums.

TILA section 129C(a)(6)(E). As discussed further in the Bureau's 2013 ATR Final Rule, two provisions of section 1411 of the Dodd-Frank Act address refinancing of existing mortgage loans under the ability-to-repay requirements. As amended by the Dodd-Frank Act, TILA section 129C(a)(5) provides that Federal agencies may create an exemption from the income and verification requirements for certain streamlined refinancings of loans made, guaranteed, or insured by various federal agencies. 15 U.S.C. 1639(a)(5). In addition, TILA section 129C(a)(6)(E) provides special ability-to-repay requirements to encourage applications to refinance existing ''hybrid loans'' into ''standard loans'' with the same creditor, where the consumer has not been delinquent on any payments on the existing loan and the monthly payments would be reduced under the refinanced loan. 15 U.S.C. 1639c(a)(6)(E). The statute allows creditors to give special weight to the mortgagor's good standing and to whether the refinancing would prevent a likely default after the interest rate on the existing loan resets, as well as other potentially favorable treatment to the consumer. However, it does not expressly exempt applications for such ''payment shock refinancings'' from TILA's general ability-to-repay requirements.

The Bureau implemented TILA section 129C(a)(6)(E) in § 1026.43(d). Although the Bureau used its authority to interpret and implement TILA to modify the payment shock refinancing provisions, § 1026.43(d) still applies to only a narrow category of refinancings. Specifically, § 1026.43(d) applies only if:

- The refinancing is conducted in response to an application to refinance a non-standard mortgage into a standard mortgage;
- The creditor for the standard mortgage is the current holder of the existing non-standard mortgage or the

[132] Section 1026.17(c)(3) provides that the creditor may disregard the effects of the following in making calculations and disclosures: (i) That payments must be collected in whole cents; (ii) that dates of scheduled payments and advances may be changed because the scheduled date is not a business day; (iii) that months have different numbers of days; and (iv) the occurrence of leap year.

servicer acting on behalf of the current holder;

- The creditor receives the consumer's written application for the standard mortgage before the non-standard mortgage is recast;
- The creditor considers whether the standard mortgage likely will prevent a default by the consumer on the non-standard mortgage once the loan is recast;
- The creditor determines that the monthly payment for the standard mortgage is materially lower than the monthly payment for the non-standard mortgage, as calculated under § 1026.43(d)(5);
- The consumer has made no more than one payment more than 30 days late on the non-standard mortgage during the 12 months immediately preceding the application for refinancing;
- The consumer has made no payments more than 30 days late during the six months immediately preceding the creditor's receipt of the consumer's written application for the standard mortgage; and
- If the non-standard mortgage was consummated on or after January 10, 2014, the non-standard mortgage was made in accordance with § 1026.43(c) or (e), as applicable.

With the exception of the last requirement, which the Bureau added using discretionary authority to prevent potential evasion of the statutory scheme, all of these requirements are based on statutory text. The definition of ''standard mortgage'' also constrains application of the provision; while it does not require that the non-standard loan be replaced by a qualified mortgage, it does incorporate some of the product feature protections from the qualified mortgage framework.[133] Thus, while § 1026.43(d) may facilitate refinancings for some consumers at risk of default, § 1026.43(d) would not apply to many extensions of credit made in connection with homeownership stabilization or foreclosure prevention programs. These extensions of credit remain subject to the ability-to-repay requirements.

Concerns raised in response to the Board's 2011 ATR Proposal. In response to the Board's request for feedback, many commenters requested that the Bureau accommodate programs designed to stabilize homeownership or mitigate the risks of foreclosure in the 2013 ATR Final Rule. One industry commenter argued that programs developed in response to the financial crisis, such as the Home Affordable Refinance Program, should be exempt from the ability-to-repay requirements. This commenter noted that a complete exemption was necessary because many of these programs' requirements conflicted with the proposed ability-to-repay requirements.

Discussion

Prompted by the feedback provided, the Bureau has conducted a thorough review of homeownership stabilization programs under sections 101 and 109 of the Emergency Economic Stabilization Act of 2008 (12 U.S.C. 5211, 5219) (EESA), such as the Making Home Affordable program administered by the Treasury Department. Based on this analysis, the Bureau believes it may be appropriate to exempt any extension of credit under these programs from the ability-to-repay requirements.

At the outset the Bureau notes that some of the activities conducted under these EESA programs (as well as a wide variety of proprietary loan modification programs by private creditors) would not trigger ability-to-repay requirements because such transactions involve modifications of existing loans by the holder or servicer of the original loan obligation rather than a new extension of credit through a refinancing. As discussed above, Regulation Z distinguishes between refinancing of an existing credit obligation by a creditor that is not the holder or servicer of the existing obligation, which trigger generally TILA's requirements, and refinancings by the existing holder or servicer, which trigger TILA's requirements under certain circumstances. Specifically, with regard to activities by the holder or servicer of the existing obligation, § 1026.20(a) and related commentary state that a refinancing that triggers TILA disclosures only occurs where there is a new extension of credit that entirely replaces an existing obligation with a new obligation undertaken by the same consumer. As discussed above, the regulation and commentary distinguish lesser modifications that do not completely extinguish the original obligation and further provide various exceptions stating that certain activities by the holder or servicer of the original obligation do not constitute refinancings that trigger disclosure requirements even if the activities involve replacement of the original obligation. The list of such exceptions includes certain credit renewals (including those with principal reductions), reductions in APR with corresponding changes in the payment schedule, and certain ''workout agreements'' in response to a consumer's default or delinquency.

Although many activities conducted under these EESA programs do not implicate TILA, the Bureau is concerned that the ability-to-repay requirements may deter creditors from participating in these programs. The Bureau is concerned that where refinancings and other new extensions of credit are involved, application of the ability-to-repay requirements and liabilities in addition to existing EESA program requirements could significantly chill creditor participation. The requirements of these programs appear to be comprehensive and tailored to the specific needs of consumers who are at risk of default or foreclosure. The Bureau also is concerned that requiring credit extended pursuant to these programs to comply with the ability-to-repay provisions may unnecessarily interfere with these unique underwriting requirements, which would make it more difficult for many consumers to qualify for assistance and increase the cost of credit for those who do, thereby impacting the availability of credit for these at-risk consumers. Further, participation in the programs is entirely voluntary, and already involves substantial compliance burdens in order to satisfy Federal requirements. If those burdens are exacerbated by the addition of the ability-to-repay requirements, the Bureau is concerned that creditors may elect not to participate in these programs, rather than investing resources complying with the requirements of both homeownership stabilization programs and the ability-to-repay provisions. A response such as this would frustrate efforts to ameliorate the effects of the financial crisis and disrupt the financial market for consumers at risk of foreclosure or default, thereby harming those in need of the assistance provided under these programs.

Due to these factors, the Bureau has considered whether it would be practical to address potential chilling effects with only a narrow exemption from or modification to the ability-to-repay requirements. An exemption from

[133] Specifically, § 1026.43(d)(1)(ii) also defines ''standard mortgage'' as an extension of credit subject to the ability-to-repay requirements: (1) that provides for regular periodic payments that do not cause the principal balance to increase, allow the consumer to defer repayment of principal, or result in a balloon payment, as defined in § 1026.18(s)(5)(i); (2) for which the total points and fees payable in connection with the transaction do not exceed the amounts specified for qualified mortgages in § 1026.43(e)(3); (3) for which the term does not exceed 40 years; (4) for which the interest rate is fixed for at least the first five years after the date on which the first regular periodic payment will be due; and (5) for which the proceeds from the loan are used solely to pay off the outstanding principal balance on the non-standard mortgage, or to pay closing or settlement charges required to be disclosed under the Real Estate Settlement Procedures Act, 12 U.S.C. 2601 *et seq.*

only the requirement to consider the consumer's debt-to-income ratio under § 1026.43(c)(2)(7), or a modification to the refinancing provisions in § 1026.43(d), for instance, may address only partially the inconsistencies between the requirements of these programs and the ability-to-repay requirements. Also, if redundancies or inconsistencies such as these exist, the ability-to-repay requirements may not provide additional, meaningful protection to consumers.

Accordingly, proposed § 1026.43(a)(3)(vi) provides that an extension of credit made pursuant to a program authorized by sections 101 and 109 of the Emergency Economic Stabilization Act of 2008 (12 U.S.C. 5211; 5219) is exempt from § 1026.43(c) through (f). Although this proposed exemption may help consumers who are at risk of default or foreclosure and are likely to need responsible and affordable credit, the Bureau wishes to obtain additional information regarding whether consumers seeking assistance under these Federal programs may need the protection afforded by the ability-to-repay requirements. Therefore, in addition to soliciting general feedback regarding whether this proposed exemption is appropriate, the Bureau solicits feedback regarding whether applicability of the ability-to-repay requirements would constrict the availability of credit offered under these programs, whether consumers have suffered financial loss or other harm by creditors participating in these programs, and the extent to which the requirements of these Federal programs account for a consumer's ability to repay.

Proposed comment 43(a)(3)(vi)–1 explains that creditors need not determine whether an activity under EESA constitutes a loan modification or workout, a refinancing that is subject to new disclosures under § 1026.20(a), or an independent extension of new credit that would trigger TILA requirements in any event. Under any of these scenarios, § 1026.43(c) through (f) would not apply. In this respect, the exemption proposed under § 1026.43(a)(3)(vi) is broader than the proposed exemptions for other housing stabilization programs. Creditors participating in the other housing stabilization programs identified in proposed § 1026.43(a)(3)(vii) and (viii) would not be subject to ability-to-repay requirements when providing loan modifications and workouts, and would be exempt when conducting refinancings under § 1026.20(a) as the holder or servicer of the original obligation. However, independent refinancings as third-party creditors would be subject to ability-to-repay requirements under the narrower exemptions provided for housing stabilization programs offered by the Federal Housing Administration, Department of Veterans Affairs, Department of Agriculture, or Fannie Mae or Freddie Mac while they are under conservatorship.

Section 1026.43(a)(3)(vi) is proposed pursuant to the Bureau's authority under section 105(a) and (f) of TILA. Pursuant to section 105(a) of TILA, the Bureau finds that this exemption is necessary and proper to effectuate the purposes of TILA. This exemption would ensure that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay. In the Bureau's judgment extensions of credit made pursuant to a program authorized by sections 101 and 109 of the Emergency Economic Stabilization Act of 2008 sufficiently account for a consumer's ability to repay, and the exemption ensures that consumers are able to receive assistance under these programs. Furthermore, without the exemption the Bureau believes that consumers at risk of default or foreclosure would be denied access to the responsible, affordable credit offered under these programs, which is contrary to the purposes of TILA.

The Bureau has considered the factors in TILA section 105(f) and believes that, for the reasons discussed above, an exemption is appropriate under that provision. Specifically, the Bureau believes that the proposed exemption is appropriate for all affected consumers, regardless of their other financial arrangements and financial sophistication and the importance of the loan to them. Similarly, the Bureau believes that the proposed exemption is appropriate for all affected loans, regardless of the amount of the loan and whether the loan is secured by the principal residence of the consumer. Furthermore, the Bureau believes that, on balance, the proposed exemption will simplify the credit process without undermining the goal of consumer protection or denying important benefits to consumers. Based on these considerations and the analysis discussed elsewhere in this proposal, the Bureau believes that the proposed exemptions are appropriate. The Bureau recognizes that its exemption and exception authorities apply to a class of transactions, and proposes to apply these authorities to the loans covered under the proposal of the entities proposed for potential exemption.

43(a)(3)(vii)

As discussed under § 1026.43(a)(3)(vi) above, a transaction is subject to the ability-to-repay requirements if, pursuant to the definition of refinancing under § 1026.20(a), the existing obligation is satisfied and replaced by the new obligation, provided that the transaction is not otherwise exempt under § 1026.20(a)(1) through (5).

Section 129C(a)(5) of TILA, as added by section 1411 of the Dodd-Frank Act, provides that the Department of Housing and Urban Development, the Department of Veterans Affairs, the Department of Agriculture, and the Rural Housing Service may modify certain ability-to-repay requirements, with respect to certain loans made, guaranteed, or insured by such agencies. These agencies may exempt refinancings from the income verification requirements in TILA section 129C(a)(4) provided that the conditions identified in TILA section 129C(a)(5)(A) through (G) are met. Specifically, the consumer must not be 30 days or more past due on the prior existing residential mortgage loan, the refinancing may not increase the principal balance outstanding on the prior existing residential mortgage loan, except to the extent of fees and charges allowed by the department or agency making, guaranteeing, or insuring the refinancing, and the total points and fees (as defined in TILA section 103(aa)(4), other than bona fide third party charges not retained by the mortgage originator, creditor, or an affiliate of either) payable in connection with the refinancing do not exceed 3 percent of the total new loan amount. Further, the interest rate on the refinancing must be lower than the interest rate of the original loan, unless the consumer is replacing an adjustable-rate loan with a fixed-rate loan, under guidelines that the department or agency shall establish for loans they make, guarantee, or issue. The refinancing must also be subject to a payment schedule that will fully amortize the refinancing and does not result in a balloon payment, as defined in TILA section 129C(b)(2)(A)(ii), in accordance with the regulations prescribed by the department or agency making, guaranteeing, or insuring the refinancing. The final condition provides that both the residential mortgage loan being replaced and the new refinancing must satisfy all requirements of the department or agency making, guaranteeing, or insuring the refinancing.

The Board solicited feedback in its 2011 ATR Proposal regarding the impact

of certain proposed provisions related to refinancings. The Board requested comment regarding whether exemptions from the ability-to-repay requirements, other than those proposed, were appropriate.[134] The Board specifically solicited comment on whether there were any appropriate exemptions consistent with the Board's authority in TILA section 129C(b)(3)(B)(i).[135] Several commenters argued that the ability-to-repay requirements adopted by the Bureau should account for the requirements of Federal agency programs. Some commenters stated that Federal agency loans, such as loans made under a program administered by the U.S. Department of Housing and Urban Development, should be exempt from several of the ability-to-repay requirements.

The Federal agencies described above have not yet prescribed rules related to the ability-to-repay requirements for refinances, pursuant to TILA section 129C(a)(5), or the definition of qualified mortgage, pursuant to TILA section 129C(b)(3)(B)(ii). An exemption to the ability-to-repay requirements may be necessary until these Federal agencies have prescribed such rules. Without such an exemption, the Bureau is concerned that the ability-to-repay provisions would unnecessarily interfere with requirements of these Federal agency refinance programs, which would make it more difficult for many consumers to qualify for these programs and increase the cost of credit for those who do, thereby constraining the availability of responsible, affordable credit for consumers.

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

As explained above, TILA section 129C(a)(5) permits the Department of Housing and Urban Development, the Department of Veterans Affairs, the Department of Agriculture, and the Rural Housing Service to exempt certain refinancings from the income verification requirements in TILA section 129C(a)(4) provided that the conditions identified in TILA section 129C(a)(5)(A) through (G) are met. For the reasons discussed in this section the Bureau believes that this temporary exemption may be necessary to preserve access to affordable and responsible credit by maintaining the status quo in the Federal agency refinancing market until the Federal agencies exercise the authority granted under TILA section 129C(a)(5) or issue rules implementing TILA section 129C(b)(3)(B)(ii). The temporary nature of this exemption ensures that these Federal agencies retain their discretionary authority under TILA section 129C(a)(5).

Proposed comment 43(a)(3)(vii)–1 clarifies that the requirements of § 1026.43(c) through (f) do not apply to an extension of credit that is a refinancing, as defined by § 1026.20(a) but without regard for whether the creditor is the creditor, holder, or servicer of the original obligation, that is eligible to be insured, guaranteed, or made pursuant to programs administered by the Federal agencies identified in § 1026.43(a)(3)(vii), provided that rules issued by such agencies pursuant to TILA section 129C(a)(5) or 129C(b)(3)(B)(ii) have not become effective on or before the date the refinancing is consummated. This proposed comment also provides three illustrative examples. The first example clarifies that, if a consumer applies for a refinancing that is eligible to be insured, guaranteed, or made pursuant to a program administered by the U.S. Department of Veterans Affairs, and the U.S. Department of Veterans Affairs has issued rules pursuant to section 129C(a)(5) or 129C(b)(3)(B)(ii) of TILA that have become effective, the exemption in § 1026.43(a)(3)(vii) does not apply because those rules will separately govern the status of U.S. Department of Veterans Affairs loans.

The second illustrative example in proposed comment 43(a)(3)(vii)–1 rests on two assumptions: first, that a consumer applies for a refinancing of a subordinate-lien mortgage loan that is eligible to be insured, guaranteed, or made pursuant to a program administered by the U.S. Department of Veterans Affairs and the U.S. Department of Veterans Affairs has issued rules pursuant to TILA section 129C(b)(3)(B)(ii) or 129C(a)(5) that have become effective; second, that such effective rules apply to refinancings of first-lien mortgage loans, but not subordinate-lien mortgage loans. Based on these assumptions the exemption in § 1026.43(a)(3)(vii) does not apply, regardless of the status of the particular loans under the rules issued, because the U.S. Department of Veterans Affairs has issued rules pursuant to TILA section 129C(b)(3)(B)(ii) or 129C(a)(5) that have become effective. The exemption does not apply even if the applicability of such Federal agency rules is determined based on program type instead of loan type. Thus, the exemption in § 1026.43(a)(3)(vii) does not apply even if the U.S. Department of Veterans Affairs rules do not apply to the particular U.S. Department of Veterans Affairs program under which the refinancing is eligible to be insured, guaranteed, or made.

The third illustrative example under proposed comment 43(a)(3)(vii)–1 is also predicated on two assumptions: First, that a consumer applies for a refinancing that is eligible to be insured, guaranteed, or made pursuant to a program administered by the Federal Housing Administration and the Federal Housing Administration has issued rules pursuant to TILA section 129C(b)(3)(B)(ii) or 129C(a)(5) that have become effective; second, that the refinancing for which the consumer applies is also eligible to be insured, guaranteed, or made pursuant to a program administered by the U.S. Department of Agriculture, but the U.S. Department of Agriculture has not issued rules pursuant to TILA section 129C(b)(3)(B)(ii) or 129C(a)(5), or the U.S. Department of Agriculture has issued rules implementing TILA section 129C(b)(3)(B)(ii) or 129C(a)(5) that have not yet taken effect at the time the refinancing is consummated. Based on these assumptions the exemption applies to that refinancing because the refinancing is eligible to be insured, guaranteed, or made pursuant to a program administered by a Federal agency identified in § 1026.43(a)(3)(vii), and such Federal agency has not issued rules pursuant to section 129C(b)(3)(B)(ii) or 129C(a)(5) of TILA that have become effective.

Section 1026.43(a)(3)(vii) is proposed pursuant to the Bureau's authority under section 105(a) and (f) of TILA. Pursuant to section 105(a) of TILA, the Bureau finds that this exemption is

[134] 76 FR 27390, 27448.

[135] 76 FR 27390, 27456.

necessary and proper to effectuate the purposes of TILA. This exemption would ensure that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay. In the Bureau's judgment refinancings made pursuant to the Federal agency refinancing programs discussed above sufficiently account for a consumer's ability to repay, and the exemption ensures that consumers are able to obtain refinancing credit under these programs. Furthermore, without the exemption the Bureau believes that consumers seeking Federal agency refinancings would be denied access to the responsible, affordable credit offered under these programs, which is contrary to the purposes of TILA.

The Bureau has considered the factors in TILA section 105(f) and believes that, for the reasons discussed above, an exemption is appropriate under that provision. Specifically, the Bureau believes that the proposed exemption is appropriate for all affected consumers, regardless of their other financial arrangements and financial sophistication and the importance of the loan to them. Similarly, the Bureau believes that the proposed exemption is appropriate for all affected loans, regardless of the amount of the loan and whether the loan is secured by the principal residence of the consumer. Furthermore, the Bureau believes that, on balance, the proposed exemption will simplify the credit process without undermining the goal of consumer protection or denying important benefits to consumers. Based on these considerations and the analysis discussed elsewhere in this proposal, the Bureau believes that the proposed exemptions are appropriate. The Bureau recognizes that its exemption and exception authorities apply to a class of transactions, and proposes to apply these authorities to the loans covered under the proposal of the entities proposed for potential exemption.

43(a)(3)(viii)

As discussed under § 1026.43(a) above, § 1026.43(c), which implements section 129C(a)(1) of TILA, requires a creditor to make a reasonable and good faith determination based on verified and documented information that, at the time the mortgage loan is consummated, the consumer has a reasonable ability to repay the loan according to its terms, including all applicable taxes, insurance (including mortgage guarantee insurance), and assessments. Section 1026.43(a)(1) through (3), which implements TILA sections 103(cc)(5) and 129C(a)(8), applies these ability-to-repay requirements to all closed-end mortgage loans secured by a one- to four-unit dwelling, except loans secured by a consumer's interest in a timeshare plan, reverse mortgages, temporary or ''bridge'' loans with a term of 12 months or less, and the construction phrase of a construction-to-permanent loan. As discussed under § 1026.43(a)(3)(vi) above, a transaction is subject to the ability-to-repay requirements if, pursuant to the definition of refinancing under § 1026.20(a), the existing obligation is satisfied and replaced by the new obligation, provided that the transaction is not otherwise exempt under § 1026.20(a)(1) through (5).

The Board did not include an exemption related to refinancing programs administered by Fannie Mae or Freddie Mac in its 2011 ATR Proposal. However, the Board solicited feedback regarding the impact of certain proposed provisions related to refinancings. The Board requested comment regarding whether exemptions from the ability-to-repay requirements, other than those proposed, were appropriate.[136] The Board specifically solicited comment on whether there were any appropriate exemptions consistent with the Board's authority in TILA section 129C(b)(3)(B)(i).[137] In response, industry commenters, industry trade organization commenters, GSE commenters, and consumer advocate commenters argued that the ability-to-repay requirements should accommodate loans held by Fannie Mae and Freddie Mac while in conservatorship.

As with the Federal homeownership stabilization and Federal agency refinance programs discussed above, the Bureau is concerned that application of the ability-to-repay requirements may constrict certain types of credit, thereby harming certain consumers. The risk of impairing credit availability is of particular concern with respect to programs offered by Fannie Mae and Freddie Mac intended to provide affordable refinancings to consumers harmed by the financial crisis. As discussed in part III above, programs such as HARP enable consumers with high loan-to-value ratios to obtain affordable refinancings. The GSEs implemented these programs while under the conservatorship of FHFA, which has defined these programs as ''eligible targeted refinancing programs.''[138] These programs are intended to assist consumers with loan-to-value ratios that are high enough to make obtaining a refinancing difficult, if not impossible. Programs such as HARP employ underwriting requirements tailored to the unique characteristics of these consumers. The GSEs have modified these programs over time to increase the number of distressed consumers eligible for an affordable refinancing. As the GSEs have expanded access to these programs, FHFA has ensured that these programs require careful underwriting. These carefully calibrated underwriting requirements promote GSE stability by ensuring that consumers who receive these refinancings are able to repay the loan.

Given the complexity of underwriting requirements for programs such as HARP, the Bureau is concerned that the ability-to-repay requirements may add unnecessary additional costs and may cause needless delays for consumers who seek refinancings pursuant to an eligible targeted refinancing program offered by one of these entities. While HARP, which is the most well-known eligible targeted refinancing program, is scheduled to expire prior to the effective date of the Bureau's 2013 ATR Final Rule, FHFA may decide to extend this program, or design a similar program intended to preserve credit for distressed homeowners. Furthermore, the risk of harm to consumers may be insignificant while these entities remain in conservatorship. The current GSE underwriting requirements for targeted eligible refinancing programs appear to sufficiently account for the consumer's ability to repay the mortgage loan, and FHFA supervision may be sufficient to ensure that consumers are extended only affordable and responsible refinancings by these entities.

Accordingly, the Bureau is proposing § 1026.43(a)(3)(viii), which provides that an extension of credit that is a refinancing, as defined under § 1026.20(a) but without regard for whether the creditor is the creditor, holder, or servicer of the original obligation, that is eligible for purchase or guarantee by Fannie Mae or Freddie Mac is exempt from § 1026.43(c) through (f), provided that the refinancing is made pursuant to an eligible targeted refinancing program, as defined under 12 CFR 1291.1, that such entities are operating under the conservatorship or receivership of the Federal Housing Finance Agency pursuant to section 1367 of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. 4617(i)) on the date the refinancing is consummated, that the existing obligation satisfied and replaced by the refinancing is owned by Fannie Mae or Freddie Mac, that the existing obligation

[136] 76 FR 27390, 27448.

[137] 76 FR 27390, 27456.

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

satisfied and replaced by the refinancing was not consummated on or after January 10, 2014, and that the refinancing was not consummated on or after January 10, 2021. Although this proposed exemption may be appropriate, the Bureau is concerned that unscrupulous creditors may use the exemption to engage in loan-flipping or other harmful practices. Therefore, the Bureau believes that this exemption should be limited to transactions where the existing obligation satisfied and replaced by the refinancing was not consummated on or after January 10, 2014, the effective date of the Bureau's 2013 ATR Final Rule. The Bureau requests feedback on whether this exemption is appropriate, whether this exemption will ensure access to responsible and affordable refinancing credit, and whether consumers could be harmed by this exemption.

The proposed exemption refers to eligible targeted refinancing programs, as defined pursuant to regulations prescribed by FHFA. As discussed above, the Bureau believes that FHFA oversight is important to ensure that distressed consumers receive refinancing credit extended in a responsible manner. Further, the Bureau believes that referring to FHFA regulations will ensure that any modifications to the definition will be made after notice and comment, thereby affording the public and the Bureau the opportunity to address potential changes. However, the Bureau requests comment regarding whether it would be more appropriate to refer to another public method of identifying these programs, and, if so, what method of public identification would be appropriate. The Bureau also solicits feedback regarding whether reference to a notice published by FHFA pursuant to 12 CFR 1253.3 or 1253.4 would facilitate compliance more effectively than the proposed reference to 12 CFR 1291.1.

Proposed comment 43(a)(3)(viii)–1 explains that § 1026.43(a)(3)(viii) provides an exemption from the requirements of § 1026.43(c) through (f) for certain extensions of credit that are considered refinancings, as defined in § 1026.20(a) but without regard for whether the creditor is the creditor, holder, or servicer of the original obligation, that are eligible for purchase or guarantee by Fannie Mae or Freddie Mac. The comment further explains that the exemption provided by § 1026.43(a)(3)(viii) is available only while these entities remain in conservatorship. For example, if Fannie Mae remains in conservatorship, but Freddie Mac exits conservatorship, the exemption continues to apply to refinancings that are eligible for purchase by Fannie Mae, provided the other conditions specified in § 1026.43(a)(3)(viii) are met. Further, as noted above, the exemption is available only if the existing obligation that will be satisfied and replaced by the refinancing was consummated prior to January 10, 2014. For example, if a consumer applies for an extension of credit that is a refinancing, as defined by § 1026.20(a), that is eligible to be purchased by Fannie Mae or Freddie Mac, but the consumer's current mortgage loan was consummated on or after January 10, 2014, the exemption provided by § 1026.43(a)(3)(viii) does not apply.

Section 1026.43(a)(3)(viii) is proposed pursuant to the Bureau's authority under section 105(a) and (f) of TILA. Pursuant to section 105(a) of TILA, the Bureau finds that this exemption is necessary and proper to effectuate the purposes of TILA. This exemption would ensure that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay. In the Bureau's judgment the exemption ensures that consumers are able to obtain credit under refinancing programs administered by Fannie Mae and Freddie Mac. Furthermore, without the exemption the Bureau believes that consumers seeking a refinancing would be denied access to the responsible, affordable credit offered by these entities, which is contrary to the purposes of TILA.

The Bureau has considered the factors in TILA section 105(f) and believes that, for the reasons discussed above, an exemption is appropriate under that provision. Specifically, the Bureau believes that the proposed exemption is appropriate for all affected consumers, regardless of their other financial arrangements and financial sophistication and the importance of the loan to them. Similarly, the Bureau believes that the proposed exemption is appropriate for all affected loans, regardless of the amount of the loan and whether the loan is secured by the principal residence of the consumer. Furthermore, the Bureau believes that, on balance, the proposed exemption will simplify the credit process without undermining the goal of consumer protection or denying important benefits to consumers. Based on these considerations and the analysis discussed elsewhere in this proposal, the Bureau believes that the proposed exemptions are appropriate. The Bureau recognizes that its exemption and exception authorities apply to a class of transactions, and proposes to apply these authorities to the loans covered under the proposal of the entities proposed for potential exemption.

43(b) Definitions

43(b)(4)

Background

TILA section 129C(a)(1) through (4) and the Bureau's rules thereunder, § 1026.43(c), prohibit a creditor from making a residential mortgage loan unless the creditor makes a reasonable, good faith determination, based on verified and documented information, that the consumer has a reasonable ability to repay the loan. TILA section 129C(b) provides a safe harbor or rebuttable presumption of compliance with regard to these ability-to-repay requirements if a loan is a qualified mortgage. In general, a loan with a balloon payment cannot be a qualified mortgage. However, TILA section 129C(b)(2)(E) provides that certain balloon loans originated and held in portfolio by small creditors operating predominantly in rural or underserved areas can be qualified mortgages. Creditors may view qualified mortgage status as important at least in part because TILA section 130(a) and (k) provides that, if a creditor fails to comply with the ability-to-repay requirements, a consumer may be able to recover special statutory damages equal to the sum of all finance charges and fees paid within the first three years after consummation and may be able to assert the creditor's failure to comply to obtain recoupment or setoff in a foreclosure action even after the statute of limitations for affirmative claims has passed. TILA section 129C(b)(3)(B)(i) authorizes the Bureau to prescribe regulations that revise, add to, or subtract from the criteria that define a qualified mortgage upon a finding that such regulations are, among other things, necessary or proper to ensure that responsible, affordable credit remains available to consumers in a manner consistent with the purposes of TILA section 129C.

Section 1026.43(e) and (f) defines three categories of qualified mortgages. First, § 1026.43(e)(2) provides a general definition of a qualified mortgage. Second, § 1026.43(e)(4) provides that certain loans that are eligible to be purchased, guaranteed, or insured by certain governmental entities or Fannie Mae or Freddie Mac while operating under conservatorship are qualified mortgages. Section 1026.43(e)(4) expires after seven years and may expire sooner with respect to some loans if other governmental entities exercise their

rulemaking authority under TILA section 129C. Third, § 1026.43(f) provides that certain balloon loans are qualified mortgages if they are made by a small creditor that:

- Had total assets less than $2 billion (adjusted for inflation) as of the end of the preceding calendar year;
- Together with all affiliates, extended 500 or fewer first-lien covered transactions during the preceding calendar year; and
- Extended more than 50 percent of its total covered transactions secured by properties that are in rural or underserved areas during the preceding calendar year.

Section 1026.43(f) includes only loans held in portfolio by these small creditors. Therefore, it includes only loans that were not subject, at consummation, to a commitment to be acquired by any other person. In addition, to prevent evasion, § 1026.43(f) includes only loans that are held in portfolio by the originating creditor for at least three years, subject to certain exceptions.

Section 1026.43(e)(1) provides that a qualified mortgage, regardless of which regulatory definition it falls under, may be subject to one of two different levels of protection from liability based on whether or not it is a higher-priced covered transaction as defined in § 1026.43(b)(4). Under § 1026.43(e)(1)(i), a qualified mortgage that is not a higher-priced covered transaction is subject to a conclusive presumption of compliance, or safe harbor. In contrast, under § 1026.43(e)(1)(ii) a qualified mortgage that is a higher-priced covered transaction is subject to a rebuttable presumption of compliance.

Section 1026.43(b)(4) defines a higher-priced covered transaction to mean a transaction within the scope of § 1026.43 with an annual percentage rate that exceeds the average prime offer rate for a comparable transaction as of the date the interest rate is set by 1.5 or more percentage points for a first-lien covered transaction or by 3.5 or more percentage points for a subordinate-lien covered transaction. These thresholds generally conform to the thresholds for ''higher-priced mortgage loans'' under § 1026.35.

The Bureau's Proposal Regarding Small Creditor Portfolio Loans

As discussed in the section-by-section analysis of § 1026.43(e)(5) below, the Bureau is proposing to create an additional category of qualified mortgages that would include certain loans originated and held in portfolio by small creditors. The Bureau proposes to amend § 1026.43(b)(4) to provide that a first-lien loan that is a qualified mortgage under proposed § 1026.43(e)(5) would be a higher-priced covered transaction if the annual percentage rate exceeds the average prime offer rate for a comparable transaction by 3.5 or more percentage points. This would have the effect of extending the qualified mortgage safe harbor to first-lien qualified mortgages made and held in portfolio by certain small creditors, as described in proposed § 1026.43(e)(5), that have an annual percentage rate between 1.5 and 3.5 percentage points higher than the average prime offer rate. Without the proposed change to § 1026.43(b)(4), these loans would be considered higher-priced covered transactions and would fall under the rebuttable presumption of compliance described in § 1026.43(e)(1)(ii).

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

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

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

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

Small creditors have repeatedly asserted to the Bureau and to other regulators that they are unable or unwilling to assume the risk of litigation associated with the ability-to-repay requirements and therefore are unwilling to make loans outside the scope of the qualified mortgage safe harbor. The Bureau does not believe that the regulatory requirement to make a reasonable and good faith determination based on verified and documented evidence that a consumer has a reasonable ability to repay would entail significant litigation risk for small creditors. As discussed in part III above, small creditors as a group have consistently experienced lower credit losses for residential mortgage loans than larger creditors. The Bureau believes this is strong evidence that small creditors have historically engaged in responsible mortgage underwriting that includes considered determinations of consumers' ability to repay, at least in part because they bear the risk of default associated with loans held in their portfolios. The Bureau also believes that because many small creditors use a lending model based on maintaining ongoing relationships with their customers and have specialized knowledge of the community in which they operate, they therefore may have a more comprehensive understanding of their customers' financial circumstances and may be better able to assess ability to repay than larger creditors. In addition, the Bureau believes that small creditors operating in limited geographical areas may face significant

risk of harm to their reputation within their community if they make loans that consumers cannot repay.

However, the Bureau acknowledges that small creditors may be particularly burdened by the time, effort, and cost of ability-to-repay litigation and that it may be particularly difficult for small creditors to absorb the cost of adverse judgments. The Bureau therefore believes that small creditors may have a particular need for the protection from liability the qualified mortgage safe harbor provides.

The Bureau notes that the Board's proposed § 1026.43 did not include special provisions for portfolio loans made by small creditors and the Board's proposal did not address such an accommodation. However, several commenters on the Board's proposal urged the Bureau to adopt less stringent regulatory requirements for small creditors or for loans held in portfolio by small creditors. For example, at least two commenters on the Board's proposal, a credit union and a state trade group for small banks, urged the Bureau to exempt small portfolio creditors from the ability to repay and qualified mortgage rule. Two other trade group commenters urged the Bureau to adopt less stringent regulatory requirements for small creditors than for larger creditors at least in part because mortgage loans made by small creditors often are held in portfolio and therefore historically have been conservatively underwritten. A number of other commenters expressed concerns that the availability of portfolio mortgage loans from small creditors would be severely limited because the proposed exception for rural balloon loans was too restrictive. In addition, small creditors' concerns about compliance with the ability-to-repay rule and their perceived litigation risk have been repeatedly expressed to the Bureau by their trade associations and prudential regulators.

The existing qualified mortgage safe harbor applies only to loans for which the annual percentage rate is less than 1.5 percentage points above the average prime offer rate for comparable transactions. For the reasons stated above, the Bureau believes that many loans made by small creditors would exceed the current annual percentage rate threshold. The Bureau therefore is concerned that small creditors may reduce the number of mortgage loans they make or cease making mortgage loans altogether if subjected to the current ability-to-repay and qualified mortgage rules. The availability of mortgage credit for some consumers therefore could be limited. The Bureau believes that raising the interest rate threshold as proposed will preserve access to responsible, affordable credit for consumers that are unable to obtain less costly loans from other creditors because they do not qualify for conforming loans or because they live in rural or underserved areas.

Accordingly, the Bureau is proposing to use its authority under TILA sections 105(a) and 129C(b)(3)(B)(i) to permit certain small creditors to make first-lien portfolio loans at a higher annual percentage rate and still benefit from the qualified mortgage safe harbor. For the reasons stated above, the Bureau believes the proposed amendments are consistent with the purposes of TILA generally and TILA section 129C specifically. The Bureau solicits comment regarding whether the proposed amendment to § 1026.43(b)(4) is needed to preserve access to responsible, affordable mortgage credit and regarding any adverse effects the proposed amendment would have on consumers. The Bureau also solicits comment on the proposed 3.5 percentage point threshold and whether another threshold would be more appropriate. Finally, the Bureau solicits comment on whether, in order to preserve access to mortgage credit, the Bureau also should raise the threshold for subordinate-lien covered transactions that are qualified mortgages under § 1026.43(e)(5), and, if so, what threshold would be appropriate for those loans.

As discussed above, the Bureau is aware that certain small creditors originate balloon loans to hedge against interest rate risk. These small creditors usually offer consumers refinancings before the balloon payment becomes due. The Bureau believes that most small creditors that follow this practice will be eligible for either the balloon loan qualified mortgage provision in § 1026.43(f) or the small creditor portfolio exemption in proposed § 1026.43(e)(5). However, the Bureau solicits feedback regarding whether there are small creditors that would not be covered by these provisions. If such small creditors exist, the Bureau requests feedback regarding whether these creditors need additional time, beyond the January 10, 2014 effective date of the Bureau's 2013 ATR Final Rule, to comply with the ability-to-repay requirements, or if such creditors require any additional accommodations, modifications, or exemptions.

The Bureau's Proposal Regarding Balloon Loans

The Bureau also is proposing to amend the definition of higher-priced covered transaction in § 1026.43(b)(4) with respect to qualified mortgages that are balloon loans originated and held in portfolio by small creditors operating predominantly in rural or underserved areas as described in § 1026.43(f). The Board proposes to amend § 1026.43(b)(4) to provide that a first-lien loan that is a qualified mortgage under § 1026.43(f) is a higher-priced covered transaction if the annual percentage rate exceeds the average prime offer rate for a comparable transaction by 3.5 or more percentage points. This would have the effect of extending the qualified mortgage safe harbor described in § 1026.43(e)(1)(i) to first-lien balloon loans made and held in portfolio by small creditors operating predominantly in rural or underserved areas, as described in § 1026.43(f), that have an annual percentage rate between 1.5 and 3.5 percentage points above the average prime offer rate. Without the proposed change to § 1026.43(b)(4), these loans would be considered higher-priced covered transactions and would fall under the rebuttable presumption of compliance described in § 1026.43(e)(1)(ii).

The Bureau believes that the proposed change may be necessary to preserve access to responsible, affordable mortgage credit for consumers in rural and underserved areas. As discussed in part III above, the Bureau understands that larger creditors often are not present in rural and underserved areas and that the only sources of mortgage credit available to consumers in these areas therefore may be small creditors. The Bureau also understands that many of the small creditors lending in these areas depend on balloon payment features to limit their interest rate risk. These creditors rely on the fact that consumers will be forced to refinance before the balloon payment becomes due, giving the creditor an opportunity to impose a higher interest rate if, for example, market interest rates have risen.

These small creditors have repeatedly asserted to the Bureau and other regulators that they will not continue to extend mortgage credit unless they can make balloon loans that are covered by the qualified mortgage safe harbor. Section 1026.43(f), which implements TILA section 129C(b)(2)(E), provides that certain balloon loans made and held in portfolio by small creditors operating predominantly in rural or underserved areas are qualified mortgages. However, the Bureau believes that many of these qualified mortgages will have annual percentage rates higher than the safe harbor threshold.

As discussed above with regard to the Bureau's proposal regarding small creditor portfolio loans and in part III, small creditors, including small creditors operating in rural and underserved areas, may charge consumers higher interest rates and fees for several legitimate business reasons. Small creditors may pay more for funds than larger creditors. Small creditors generally rely heavily on deposits to fund lending activities and therefore pay more in expenses per dollar of revenue as interest rates fall and the spread between loan yields and deposit costs narrow. Small creditors also may rely more on interest income than larger creditors, as larger creditors obtain a higher percentage of their income from noninterest sources such as trading, investment banking, and fiduciary services.

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

As also discussed above, the Bureau does not believe that small creditors, including those operating in rural and underserved areas, face significant litigation risk from the ability-to-repay requirements. Small creditors as a group have consistently experienced lower credit losses for residential mortgages than larger creditors. The Bureau believes this is strong evidence that small creditors have historically engaged in responsible mortgage underwriting that includes considered determinations of consumers' ability to repay, at least in part because they bear the risk of default associated with loans held in their portfolios. The Bureau also believes that because many small creditors use a lending model based on maintaining ongoing relationships with their customers and have specialized knowledge of the communities in which they operate, they therefore may have a more comprehensive understanding of their customers' financial circumstances and may be better able to assess ability to repay than larger creditors. In addition, the Bureau believes that small creditors operating in limited geographical areas may face significant risk of harm to their reputation within their community if they make loans that consumers cannot repay.

However, the Bureau acknowledges that small creditors may be particularly burdened by the time, effort, and cost of ability-to-repay litigation and that it may be particularly difficult for small creditors to absorb the cost of adverse judgments. The Bureau therefore believes that small creditors may have a particular need for the protection from liability the qualified mortgage safe harbor provides.

The existing qualified mortgage safe harbor applies to first-lien loans only if the annual percentage rate is less than 1.5 percentage points above the average prime offer rate for comparable transactions. The Bureau believes that many balloon loans made by small creditors operating in rural and underserved areas will exceed that threshold. The Bureau therefore is concerned that, unless § 1026.43(b)(4) is amended, small creditors operating in rural and underserved areas may reduce the number of mortgage loans they make or stop making mortgage loans altogether, further limiting the availability of mortgage credit in rural and underserved areas.

Accordingly, the Bureau therefore believes that it may be necessary to use its authority under TILA sections 105(a) and 129C(b)(3)(B)(i) to amend § 1026.43(b)(4) as proposed in order to ensure that § 1026.43(f) has the desired effect of preserving access to responsible, affordable mortgage credit in rural and underserved areas. For the reasons stated above, the Bureau believes the proposed amendments are consistent with the purposes of TILA generally and TILA section 129C in particular. Providing for qualified mortgages on this basis would ensure that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay and that responsible affordable mortgage credit remains available to consumers in a manner consistent with the purposes of the ability-to-repay requirements.

The Bureau is proposing this amendment rather than finalizing it as part of the 2013 ATR Final Rule in order to solicit comment on the following issues, among others. The Bureau solicits comment regarding whether the proposed amendment to § 1026.43(b)(4) is needed to preserve access to responsible, affordable mortgage credit in rural and underserved areas and regarding any adverse effects the proposed amendment would have on consumers in these or other areas. The Bureau also solicits comment on the 3.5 percentage point threshold and whether another threshold would be more appropriate. Finally, the Bureau solicits comment on whether, in order to preserve access to mortgage credit in rural and underserved areas, the Bureau also should raise the threshold for subordinate-lien covered transactions that are qualified mortgages under § 1026.43(f), and, if so, what threshold would be appropriate.

43(e) Qualified Mortgages

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

TILA section 129C(a)(1) through (4) and the Bureau's rules thereunder, § 1026.43(c), generally prohibit a creditor from making a residential mortgage loan unless the creditor makes a reasonable, good faith determination that the consumer has a reasonable ability to repay the loan. TILA section 129C(b) and the Bureau's rules thereunder, § 1026.43(e), provide a safe harbor or rebuttable presumption of compliance with regard to these ability-to-repay requirements if a loan is a qualified mortgage.

As described above, § 1026.43(e)(1)(i) provides that a creditor or assignee of a qualified mortgage that is not a higher-priced covered transaction, as defined in § 1026.43(b)(4), complies with the repayment ability requirements. In contrast, § 1026.43(e)(1)(ii) provides that a creditor or assignee of a qualified mortgage that is a higher-priced covered transaction is presumed to comply with the repayment ability requirements, but that presumption can be rebutted by a consumer under certain circumstances. Section 1026.43(e)(2), (e)(4), and (f) establishes standards for three categories of qualified mortgages, as discussed further below.

The Bureau proposes to make conforming changes to § 1026.43(e)(1) to include references to a new category of qualified mortgages defined by proposed § 1026.43(e)(5). Section 1026.43(e)(5) qualified mortgages would be covered by the safe harbor described in § 1026.43(e)(1)(i) if they are not higher-priced covered transactions and would be subject to the rebuttable presumption of compliance described in § 1026.43(e)(1)(ii) if they are higher-priced covered transactions. However, the Bureau is proposing to apply a different definition of higher-priced covered transaction to first-lien qualified mortgages defined under § 1026.43(e)(5). The section-by-section analysis of § 1026.43(b)(4), above, describes the proposed alternate definition of higher-priced covered transactions. The section-by-section analysis of proposed § 1026.43(e)(5),

below, describes the proposed new category of qualified mortgages.

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

The Bureau proposes to make a conforming amendment to § 1026.43(e)(2) to include a reference to § 1026.43(e)(5), as described in the section-by-section analysis of proposed § 1026.43(e)(5), below.

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

Background

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

Section 1026.43(e) and (f) defines three categories of qualified mortgages. First, § 1026.43(e)(2) prescribes the general definition of a qualified mortgage. Under § 1026.43(e)(2), a covered transaction is a qualified mortgage if: it does not include negative amortization, interest-only, or balloon features; it has a term not in excess of 30 years; it complies with the limits on points and fees detailed in § 1026.43(e)(3); the underwriter calculated the required payments in a specified way; the creditor considered and verified certain factors related to the consumer's ability to repay; and the consumer's monthly debt-to-income ratio, calculated according to instructions in appendix Q, does not exceed 43 percent. Second, § 1026.43(e)(4) provides that certain loans that are eligible to be purchased, guaranteed, or insured by certain governmental entities or Fannie Mae or Freddie Mac while operating under conservatorship are qualified mortgages. Section 1026.43(e)(4) expires seven years after its effective date and may expire earlier with respect to certain loans if other government entities exercise their rulemaking authority under TILA section 129C or if the GSEs exit conservatorship. Third, § 1026.43(f) provides that certain loans with a balloon payment made by small creditors operating predominantly in rural or underserved areas are qualified mortgages.

The Bureau's Proposal

Proposed § 1026.43(e)(5) would define a fourth category of qualified mortgages which would include loans originated and held in portfolio by certain small creditors. This additional category of qualified mortgages would be similar in several respects to § 1026.43(f), which provides that certain balloon loans made by small creditors operating predominantly in rural or underserved areas are qualified mortgages. As under § 1026.43(f), the additional category would include loans originated by small creditors, as defined by asset-size and transaction thresholds, and held in portfolio by those creditors. However, proposed § 1026.43(e)(5) would not be limited to small creditors operating predominantly in rural or underserved areas and would not include loans that have a balloon payment.

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

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

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

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

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

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

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

The creditor also would be required to consider the consumer's debt-to-income ratio or residual income and to verify the underlying information generally in accordance with § 1026.43(c). In contrast, the general definition of a qualified mortgage in § 1026.43(e)(2) requires a creditor to calculate the consumer's debt-to-income ratio according to instructions in appendix Q and specifies that the consumer's debt-to-income ratio must be 43 percent or less.

As with all qualified mortgages, a qualified mortgage under § 1026.43(e)(5) would receive either a rebuttable or conclusive presumption of compliance with the ability-to-repay requirements in § 1026.43(c), depending on the annual percentage rate. However, as described above in the section-by-section analysis of § 1026.43(b)(4), the Bureau is proposing an alternate definition of higher-priced covered transaction that would apply to first-lien covered transactions that are qualified mortgages under proposed § 1026.43(e)(5). Amended as proposed, § 1026.43(b)(4) would provide that a first-lien covered transaction that is a qualified mortgage under proposed

§ 1026.43(e)(5) is a higher-priced covered transaction if the annual percentage rate exceeds the average prime offer rate for a comparable transaction by 3.5 or more percentage points. This would have the effect of extending the qualified mortgage safe harbor described in § 1026.43(e)(1)(i) to first-lien qualified mortgages defined under proposed § 1026.43(e)(5) even if those loans have annual percentage rates between 1.5 and 3.5 percentage points higher than the average prime offer rate. Without the proposed amendment to § 1026.43(b)(4), such loans would be covered by the rebuttable presumption of compliance described in § 1026.43(e)(1)(ii). This proposal and the Bureau's rationale for it are discussed in more detail in the section-by-section analysis of § 1026.43(b)(4), above.

The Bureau believes the proposed change is necessary to preserve access to responsible, affordable credit for some consumers. As discussed above in part III and the section-by-section analysis of § 1026.43(b)(4), the Bureau understands that small creditors are a significant source of non-conforming mortgage credit. The Bureau believes that many of these loans would not be made by larger creditors because the consumers or properties involved are not readily assessed using the standardized underwriting criteria used by larger creditors or because larger creditors are unwilling to make loans that cannot be sold to the securitization markets. The Bureau therefore believes that access to mortgage credit for some consumers could be restricted if small creditors stopped making non-conforming loans.

The Bureau believes that such an impact could be particularly significant in rural areas, where the Bureau understands that small creditors are a significant source of credit. Small creditors are significantly more likely than larger creditors to operate offices in rural areas, and there are hundreds of counties nationwide where the only creditors are small creditors and hundreds more where larger creditors have only a limited presence.

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

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

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

However, the Bureau understands that, because of their size, small creditors may be particularly challenged by both the burden and cost of litigation, including litigation regarding ability-to-repay determinations. The Bureau therefore gives credence to small creditors' assertions that they are unable or unwilling to assume the risk of litigation associated with the ability-to-repay requirements and therefore are unwilling to make loans outside the scope of the qualified mortgage safe harbor.

The Bureau therefore is proposing to extend the protections of the qualified mortgage safe harbor to small creditor portfolio loans. The Bureau believes that the proposed rule is necessary to preserve access to responsible, affordable mortgage credit for some consumers.

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

The proposed definition would include portfolio loans made by creditors that have assets of $2 billion or less and, together with all affiliates, originate 500 or fewer first-lien mortgages each year. The Bureau is proposing these specific thresholds because they are consistent with the § 1026.43(f) qualified mortgage definition, which includes certain balloon loans made and held in portfolio by small creditors operating predominantly in rural or underserved areas, and with thresholds used in the Bureau's 2013 Escrows Final Rule. The Bureau believes it is important to maintain consistent criteria, particularly between § 1026.43(e)(5) and (f), for several reasons. First, the Bureau believes the rationale for proposed § 1026.43(e)(5) is similar to the rationale for § 1026.43(f) and the relevant thresholds in § 1026.35(b). The Bureau therefore believes that its stated rationale for these criteria in those contexts also applies in the context of proposed § 1026.43(e)(5). Similarly, the Bureau also believes that if there is a convincing rationale for establishing these criteria in § 1026.43(e)(5), that rationale may apply to adjusting the other sections as well. Second, the

Bureau believes that inconsistencies between the two qualified mortgage sections could create an undesirable regulatory advantage for balloon loans. The Bureau is particularly concerned with avoiding inconsistencies between the two definitions that would create regulatory incentives to make balloon loans where a creditor has the capability of making other mortgages that better protect consumers' interests. Third, the Bureau believes that maintaining consistent criteria between the three provisions will minimize compliance burdens by minimizing the number of metrics that must be tracked in order to determine creditors' eligibility. However, the Bureau also acknowledges that there may be disadvantages to using the same thresholds in § 1026.43(e)(5) in the absence of further limitations such as the requirement that creditors operate predominantly in rural or underserved areas in order to originate balloon-payment qualified mortgages or invoke the exception to the escrows rule. The Bureau is soliciting comment on these issues.

The proposed definition would include only loans originated and held in portfolio. First, the definition would include only loans that are originated without a forward commitment other than a commitment to sell to another institution that is eligible to originate qualified mortgages under § 1026.43(e)(5). Second, the rule would provide that a loan generally loses its qualified mortgage status under § 1026.43(e)(5) if it is sold, assigned, or otherwise transferred, except: if it is transferred three years or more after consummation; if it is transferred to a creditor that also meets the asset-size and number of transaction criteria; if it is transferred pursuant to a supervisory action or by a conservator, receiver, or bankruptcy trustee; or if it is transferred as part of a merger or acquisition of the creditor.

The Bureau believes the discipline imposed when small creditors make loans that they will hold in their portfolio is important to protect consumers' interests and to prevent evasion. The Bureau is proposing that these loans generally must be held in portfolio for three years in order to retain their status as a qualified mortgage to conform to the statute of limitations for affirmative claims for violations of the ability-to-repay rules. If a small creditor holds a qualified mortgage in portfolio for three years, it retains all of the litigation risk for potential violations of the ability-to-repay rules except in the event of a subsequent foreclosure.

The Bureau acknowledges that limitations on the ability of a creditor to sell loans in its portfolio may limit the creditor's ability to manage its regulatory capital levels by adjusting the value of its assets, may affect the creditor's ability to manage interest rate risk by preventing sales of seasoned loans, and may present other safety and soundness concerns. The Bureau has consulted with prudential regulators on these issues and believes the proposed exceptions address these concerns without sacrificing the consumer protection provided by the portfolio requirement. For these reasons, the Bureau is adopting parallel exceptions in the 2013 ATR Final Rule in § 1026.43(f), which describes requirements for balloon-payment qualified mortgages. However, the Bureau is soliciting comment on whether the proposed exceptions are appropriate and on whether other exceptions should be provided, either in addition to or in lieu of those proposed.

Qualified mortgages under § 1026.43(e)(5) would differ from qualified mortgages under the § 1026.43(e)(2) general definition in two key respects. First, the Bureau is proposing to raise the annual percentage rate threshold for the qualified mortgage safe harbor for qualified mortgages under § 1026.43(e)(5), as described above in the section-by-section analysis of § 1026.43(b)(4). Second, the Bureau is proposing to require creditors to consider the consumer's debt-to-income ratio or residual income and to verify the underlying information generally in accordance with § 1026.43(c). In contrast, the general definition of a qualified mortgage in § 1026.43(e)(2) requires a creditor to calculate the consumer's debt-to-income ratio according to appendix Q and specifies that the consumer's debt-to-income ratio must be 43 percent or less.

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

However, for the same reasons that the Bureau declined to impose a specific 43-percent threshold for balloon-payment qualified mortgages under § 1026.43(f), the Bureau does not believe it is necessary to impose a specific debt-to-income or residual income threshold for this category of qualified mortgages. As discussed above, the Bureau believes that small creditors may be particularly able to make highly individualized determinations of ability to repay that take into consideration the unique characteristics and financial circumstances of a particular consumer. While the Bureau believes that many creditors can make mortgage loans with consumer debt-to-income ratios above 43 percent that consumers are able to repay, the Bureau also believes that portfolio loans made by small creditors are particularly likely to be made responsibly and to be affordable for the consumer even if such loans exceed the 43 percent threshold. The Bureau therefore believes that it is appropriate to presume compliance even above the 43 percent threshold for small creditors who meet the criteria set forth in § 1026.43(e)(5). The Bureau believes that the discipline imposed when small creditors make loans that they will hold in their portfolio is sufficient to protect consumers' interests in this regard. Because the Bureau is not proposing a specific limit on consumer debt-to-income ratio, the Bureau does not believe it is necessary to require creditors to calculate debt-to-income ratio in accordance with a particular standard such as that set forth in appendix Q. The Bureau is proposing to make this change to the rule pursuant to its authority under TILA section 129C(b)(2)(vi) to establish guidelines or regulations for debt-to-income ratio with which qualified mortgages must comply.

The Bureau is proposing ten comments to clarify the requirements described in proposed § 1026.43(e)(5). Proposed comment 43(e)(5)–1 would provide additional guidance regarding the requirement to comply with the general definition of a qualified mortgage under § 1026.43(e)(2). The proposed comment would restate the regulatory requirement that a covered transaction must satisfy the requirements of the § 1026.43(e)(2) general definition of qualified mortgage, except with regard to debt-to-income ratio, to be a qualified mortgage under § 1026.43(e)(5). As an example, the proposed comment would explain that a qualified mortgage under § 1026.43(e)(5) may not have a loan term in excess of 30 years because longer terms are prohibited for qualified mortgages under § 1026.43(e)(2)(ii). As another example, the proposed comment would explain that a qualified

mortgage under § 1026.43(e)(5) may not result in a balloon payment because § 1026.43(e)(2)(i)(C) provides that qualified mortgages may not have balloon payments except as provided under § 1026.43(f). Finally, the proposed comment would clarify that a covered transaction may be a qualified mortgage under § 1026.43(e)(5) even though the consumer's monthly debt-to-income ratio exceeds 43 percent, § 1026.43(e)(2)(vi) notwithstanding.

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

Proposed comment 43(e)(5)–3 would note that the term ''forward commitment'' is sometimes used to describe a situation where a creditor originates a mortgage loan that will be transferred or sold to a purchaser pursuant to an agreement that has been entered into at or before the time the transaction is consummated. The proposed comment would clarify that a mortgage that will be acquired by a purchaser pursuant to a forward commitment does not satisfy the requirements of § 1026.43(e)(5), whether the forward commitment provides for the purchase and sale of the specific transaction or for the purchase and sale of transactions with certain prescribed criteria that the transaction meets. However, the proposed comment also would clarify that a forward commitment to another person that also meets the requirements of § 1026.43(e)(5)(i)(D) is permitted. The proposed comment would give the following example: Assume a creditor that is eligible to make qualified mortgages under § 1026.43(e)(5) makes a mortgage. If that mortgage meets the purchase criteria of an investor with which the creditor has an agreement to sell such loans after consummation, then the loan does not meet the definition of a qualified mortgage under § 1026.43(e)(5). However, if the investor meets the requirements of § 1026.43(e)(5)(i)(D), the mortgage will be a qualified mortgage if all other applicable criteria also are satisfied.

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

Proposed comment 43(e)(5)–5 would clarify that creditors generally must hold a loan in portfolio to maintain the transaction's status as a qualified mortgage under § 1026.43(e)(5), subject to four exceptions. The proposed comment would clarify that, unless one of these exceptions applies, a loan is no longer a qualified mortgage under § 1026.43(e)(5) once legal title to the debt obligation is sold, assigned, or otherwise transferred to another person. Accordingly, unless one of the exceptions applies, the transferee could not benefit from the presumption of compliance for qualified mortgages under § 1026.43(e)(1) unless the loan also met the requirements of another qualified mortgage definition. Proposed comment 43(e)(5)–6 would clarify that § 1026.43(e)(5)(ii) applies not only to an initial sale, assignment, or other transfer by the originating creditor but to subsequent sales, assignments, and other transfers as well. The proposed comment would give the following example: Assume Creditor A originates a qualified mortgage under § 1026.43(e)(5). Six months after consummation, Creditor A sells the qualified mortgage to Creditor B pursuant to § 1026.43(e)(5)(ii)(B) and the loan retains its qualified mortgage status because Creditor B complies with the limits on asset size and number of transactions. If Creditor B sells the qualified mortgage, it will lose its qualified mortgage status under § 1026.43(e)(5) unless the sale qualifies for one of the § 1026.43(e)(5)(ii) exceptions for sales three or more years after consummation, to another qualifying institution, as required by supervisory action, or pursuant to a merger or acquisition.

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

Proposed comment 43(e)(5)–8 would clarify that, under § 1026.43(e)(5)(ii)(B), a qualified mortgage under § 1026.43(e)(5) may be sold, assigned, or otherwise transferred at any time to another creditor that meets the requirements of § 1026.43(e)(5)(v). The proposed comment would note that section § 1026.43(e)(5)(v) requires that a creditor, during the preceding calendar year, originated 500 or fewer first-lien covered transactions and had total assets less than $2 billion (adjusted for inflation) at the end of the preceding calendar year. The proposed comment would clarify that a qualified mortgage under § 1026.43(e)(5) that is transferred to a creditor that meets these criteria would retain its qualified mortgage status even if it is transferred less than three years after consummation.

Proposed comment 43(e)(5)–9 would clarify that § 1026.43(e)(5)(ii)(C) facilitates sales that are deemed necessary by supervisory agencies to revive troubled creditors and resolve failed creditors. The proposed comment would note that this section provides that a qualified mortgage under § 1026.43(e)(5) retains its qualified mortgage status if it is sold, assigned, or otherwise transferred to: another person pursuant to a capital restoration plan or other action under 12 U.S.C. 1831o; the actions or instructions of any person acting as conservator, receiver or bankruptcy trustee; an order of a State

or Federal government agency with jurisdiction to examine the creditor pursuant to State or Federal law; or an agreement between the creditor and such an agency. The proposed comment would clarify that a qualified mortgage under § 1026.43(e)(5) that is sold, assigned, or otherwise transferred under these circumstances retains its qualified mortgage status regardless of how long after consummation it is sold and regardless of the size or other characteristics of the transferee. The proposed comment also would clarify that § 1026.43(e)(5)(ii)(C) does not apply to transfers done to comply with a generally applicable regulation with future effect designed to implement, interpret, or prescribe law or policy in the absence of a specific order by or a specific agreement with a governmental agency described in § 1026.43(e)(5)(ii)(C) mandating the sale of one or more qualified mortgages under § 1026.43(e)(5) held by the creditor, or one of the other circumstances listed in § 1026.43(e)(5)(ii)(C). As an example, the proposed comment would explain that a qualified mortgage under § 1026.43(e)(5) that is sold pursuant to a capital restoration plan under 12 U.S.C. 1831o would retain its status as a qualified mortgage following the sale. However, if the creditor simply chose to sell the same qualified mortgage as one way to comply with general regulatory capital requirements in the absence of supervisory action or agreement, the mortgage would lose its status as a qualified mortgage following the sale unless it qualifies under another definition of qualified mortgage.

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

For the reasons stated above, the Bureau believes that the proposed amendments are authorized by TILA sections 105(a) and 129C(b)(3)(B)(i) because they are necessary to ensure that responsible, affordable mortgage credit remains available to consumers and because they are consistent with the purposes of TILA generally and TILA section 129C, regarding repayment ability, specifically.

The Bureau solicits comment on the proposed approach to small creditor portfolio loans generally and also on several specific issues. First, the Bureau solicits comment on whether non-conforming mortgage credit is likely to be unavailable under the current rule and whether amending the rule as proposed would ensure that such credit is made available in a responsible, affordable way.

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

Third, the Bureau solicits comment regarding the requirement that loans be held in portfolio generally, including whether the proposed exemptions are appropriate and whether other criteria, guidance, or exemptions should be included regarding the requirement to hold loans in portfolio, either in lieu of or in addition to those included in the proposal.

Fourth, the Bureau solicits comment on the loan feature and underwriting requirements with which qualified mortgages under proposed § 1026.43(e)(5) would have to comply. The Bureau solicits comment on whether qualified mortgages under proposed § 1026.43(e)(5) should be exempt from additional provisions of § 1026.43(e)(2) and or should be subject to any other loan feature or underwriting requirements, either in lieu of or in addition to those proposed. In particular, the Bureau solicits comment on whether these qualified mortgages should be exempt from the requirement to consider debt-to-income ratio calculated according to appendix Q and the prohibition on debt-to-income ratios in excess of 43 percent and whether other requirements related to debt-to-income ratio or residual income should be provided, either in lieu of or in addition to those proposed.

Finally, the Bureau solicits comment on the following issue. The proposal would provide different legal status to loans with identical terms because the creditor is small and intends to hold the loan in portfolio. As discussed above, the Bureau believes that the size of and relationship lending model employed by small creditors may provide significant assurances that the mortgage credit they extend will be responsible and affordable. However, to the extent that consumers may have a choice of creditors, some of whom are not small, it is not clear that consumers shopping for mortgage loans would be aware that their choice of creditor could significantly impact their legal rights. The Bureau solicits comment on the extent and significance of this risk generally. Specifically, the Bureau solicits comment on whether consumers who obtain small creditor portfolio loans likely could have obtained credit from other sources and on the extent to which a consumer who obtains a portfolio loan from a small creditor would be disadvantaged by the inability to make an affirmative claim of noncompliance with the ability-to-repay rules or to assert noncompliance in a foreclosure action.

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

Section 1026.43(f) provides that certain balloon loans made and held in portfolio by certain small creditors are qualified mortgages. As discussed above in the section-by-section analysis of § 1026.43(e)(5), the Bureau believes that it may be important to preserve consistency among § 1026.43(e)(5) and (f) and § 1026.35(b)(2). The Bureau is not proposing specific amendments to § 1026.43(f) because § 1026.43(e)(5) as proposed is consistent with existing § 1026.43(f). However, if § 1026.43(e)(5) is adopted with significant changes, the Bureau will consider and may adopt parallel amendments to § 1026.43(f) in its final rule.

The Bureau solicits comment on the advantages and disadvantages of maintaining consistency between § 1026.35(b)(2) and § 1026.43(e)(5) and (f) generally and on whether the Bureau should make conforming changes to § 1026.43(f) if necessary to maintain consistency with specific provisions of § 1026.43(e)(5).

43(g) Prepayment Penalties

The Bureau proposes to make a conforming amendment to § 1026.43(g) to include a reference to § 1026.43(e)(5), as described in the section-by-section analysis of proposed § 1026.43(e)(5), above.

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

In developing the final rule, the Bureau has considered potential benefits, costs, and impacts.[139] In addition, the Bureau has consulted, or offered to consult with, the prudential regulators, SEC, HUD, FHFA, the Federal Trade Commission, and the Department of the Treasury, including regarding consistency with any prudential, market, or systemic objectives administered by such agencies. The Bureau also held discussions with or solicited feedback from the United States Department of Agriculture, Rural Housing Service, the Federal Housing Administration, and the Department of Veterans Affairs regarding the potential impacts of the final rule on those entities' loan programs.

This proposal is related to a final rule published elsewhere in today's **Federal Register** (2013 ATR Final Rule). The 2013 ATR Final Rule implements sections 1411, 1412, and 1414 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), which creates new TILA section 129C. Among other things, the Dodd-Frank Act requires creditors to make a reasonable, good faith determination 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.''

The Bureau is proposing certain amendments to the final rule implementing these requirements, including 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 is also seeking feedback on whether additional clarification is needed regarding the inclusion of loan originator compensation in the points and fees calculation.

The proposed exemptions for certain nonprofit creditors and certain homeownership stabilization programs include exemptions for various extensions of credit from the ability-to-repay requirements. These exemptions include: extensions of credit made pursuant to programs administered by HFA; extensions of credit made by certain types of nonprofit creditors including creditors designated by the Treasury Department as Community Development Financial Institutions and creditors designated by the Department of Housing and Urban Development as either a Community Housing Development Organization or a Downpayment Assistance Provider of Secondary Financing; extensions of credit by certain creditors designated as nonprofit organizations under section 501(c)(3) of the Internal Revenue Code that provide credit to LMI borrowers; extensions of credit made pursuant to an Emergency Economic Stabilization Act program, such as extensions of credit made pursuant to a State HHF program; refinancings that are eligible to be insured, guaranteed, or made pursuant to a program administered by the Federal Housing Administration, U.S. Department of Veterans Affairs, or the U.S. Department of Agriculture for a limited period of time; and certain refinancings eligible to be purchased or guaranteed by Fannie Mae or Freddie Mac pursuant to an eligible targeted refinancing program.

The proposed additional definition of a qualified mortgage includes certain loans originated by creditors that have total assets of $2 billion or less at the end of the previous calendar year; and that, together with all affiliates, originated 500 or fewer first-lien covered transactions during the previous calendar year. Loans held in portfolio by these creditors that conform to all of the requirements under the general definition of a qualified mortgage except the 43 percent limit on monthly debt-to-income ratio, and that meet the documentation and verification requirements for qualified mortgages under the general standard, would be considered qualified mortgages. Qualified mortgages under this proposed definition would be provided either a conclusive or rebuttable presumption of compliance with the requirement that creditors make a reasonable, good faith determination of a consumer's ability to repay before originating a mortgage loan.

The Bureau also is proposing to allow small creditors to charge a higher annual percentage rate for first-lien qualified mortgages in the proposed new category and still benefit from a conclusive presumption of compliance or ''safe harbor.'' Under the existing rules, first-lien qualified mortgages with an annual percentage rate less than or equal to the average prime offer rate plus 1.5 percentage points and subordinate-lien qualified mortgages with an annual percentage rate less than or equal to the average prime offer rate plus 3.5 percentage points are within the safe harbor. A qualified mortgage in the proposed new category would be conclusively presumed to comply if the annual percentage rate is equal to or less than the average prime offer rate plus 3.5 percentage points for both first-lien and subordinate-lien loans.

The Bureau also is proposing to allow small creditors operating predominantly in rural or underserved areas to offer first-lien balloon loans with a higher annual percentage rate and still benefit from a conclusive presumption of compliance with the ability-to-repay rules or ''safe harbor.'' The Bureau's current rule provides that certain balloon loans made by small creditors operating predominantly in rural or underserved areas are qualified mortgages. Under the existing rules, first-lien qualified mortgages with an annual percentage rate less than or equal to the average prime offer rate plus 1.5 percentage points and subordinate-lien qualified mortgages with an annual percentage rate less than or equal to the average prime offer rate plus 3.5 percentage points are within the safe harbor. Qualified mortgages with annual percentage rates above these thresholds are presumed to comply with the ability-to-repay rules, but a consumer could rebut that presumption under certain circumstances.

The proposal also provides two alternative comments regarding the provisions of the 2013 ATR Final Rule regarding the inclusion of loan originator compensation in the

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

calculation of points and fees.[140] The analysis generally examines the benefits, costs and impacts of the proposed provisions against the baseline of the January 2013 ATR Rule published elsewhere in today's **Federal Register**. This baseline focuses the discussion of benefits, costs and impacts on the incremental effect of this rulemaking on the mortgage market.

The analysis in this section relies on data that the Bureau have obtained, outreach to industry and other members of the public, and the record established by the Board and Bureau during the development of the 2013 ATR Final Rule. However, the Bureau notes that for some analyses, there are limited data available with which to quantify the potential costs, benefits, and impacts of the proposal. Still, general economic principles together with the limited data that are available provide insight into the benefits, costs, and impacts and where relevant, the analysis provides a qualitative discussion of the benefits, costs, and impacts of the final rule.

The Bureau will further consider the benefits, costs and impacts of the proposed provisions and asks interested parties to provide general information, data, and research results on potential effects on the mortgage loans affected by the proposed exemptions and extensions of qualified mortgage status, the current underwriting practices of entities covered by these provisions and other information that may inform the analysis of the benefits, costs, and impacts of these proposals.

A. Potential Benefits and Costs to Consumers and Covered Persons

1. Exemptions From Ability-to-Repay Requirements

As described in the Section 1022 Analysis of the 2013 ATR rule published elsewhere in today's **Federal Register**, there are a number of situations where lenders may engage in lending with too little regard for the borrower's ability to repay. The 2013 Final ATR Rule is designed to minimize such activity by ensuring proper documentation and verification related to extensions of credit and by requiring consideration of a number of factors including the consumer's debt-to-income ratio and credit history. Lenders who fail to follow these requirements, or who extend credit without a ''reasonable and good faith determination'' of the borrower's ability to repay, are subject to liability. The proposed exemptions from the ability-to-repay requirements are designed to eliminate these requirements and thereby to limit lenders' costs and protect credit availability in carefully defined circumstances, namely programs that have been developed to serve consumers and that assess repayment ability in ways that do not necessarily comport with the requirements of the Act and the final rule.

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

As explained in the 2013 ATR Final Rule, in general, consumers and others could be harmed by this action as it removes particular consumer protections and could allow some deleterious lending to occur. However, in all of the cases discussed above, the Bureau believes, subject to public comment, that the community-focused mission of the creditor organizations and the close interaction between lenders and borrowers should mitigate any potential harms to borrowers and any costs from the rule.

Data regarding the exact scope of lending through these channels are limited as are data regarding the performance of these loans. There are 51 State Housing Finance Agencies and approximately 1,000 CDFIs, 62 percent of which are classified as Community Development (CD) Loan Funds, 22 percent as CD Credit Unions, while the rest are CD Banks, Thrifts, or CD Venture Capital Funds.[141] There are 233 nonprofit agencies and nonprofit instrumentalities of government in the U.S. that are authorized to provide secondary financing,[142] 267 creditors certified by HUD as Community Housing Development Organizations (CHDOs) in connection with HUD's HOME Investment Partnership Program,[143] and 231 organizations certified as Downpayment Assistance through Secondary Financing Providers.[144] A comprehensive list of these institutions is not available; however the Bureau believes that there may be substantial overlap among these institutions. The Bureau seeks information on the quantity and types of credit extended by each of these types of organizations.

The number or volume of loans made by these institutions is limited. There is some data suggesting that SHFA bonds funded approximately 67,000 loans in 2010 with a value of just over $8 billion. Data regarding CDFIs indicate that these institutions funded just under $4 billion in loans, however data on the type of housing supported is unavailable. Lending at CHDOs totaled $64 million in 2011 with just under 500 loans.

The exemption in the proposed rule for certain streamlined refinance programs offers benefits to consumers, creditors and others to the extent that any impediments to refinancings are removed. Some streamlined refinance programs are aimed at efficiently extending mortgage credit to enable current borrowers to obtain more affordable mortgages. Many of these borrowers cannot afford their mortgage payments and/or are underwater and unable to obtain refinancing. Programs that help with refinances can aid these borrowers, their communities and the broader recovery. To the extent that these refinance programs have documentation and underwriting requirements that do not align with the requirements of the 2013 ATR Final Rule, compliance with that rule could harm lending activity; the exemptions in the proposed rule should remove any possible impediments. The limitation of the exemption to government or GSE sponsored streamlined refinance programs limits the risk to borrowers from removal of some of the protections in the final rule.

Programs established under MHA impacted by the proposed rule appear to

[140] Section 1022 requires consideration of benefits and costs of Bureau rules issued under the Federal consumer financial laws to consumers and covered persons. Here, the Bureau discusses the benefits and costs of commentary provisions to better inform the public and its rulemaking. The Bureau reserves discretion in the case of each rule whether to discuss benefits and costs of such commentary provisions.

[141] *See http://www.cdfifund.gov/docs/certification/cdfi/CDFI List-07-31-12.xls.*

[142] *See https://entp.hud.gov/idapp/html/f17npdata.cfm.*

[143] Includes 2011 data for institutions with CHDO reservations and CHDO loans without a rental tenure type. *See http://www.hud.gov/offices/cpd/affordablehousing/reports/open/.*

[144] Includes data for institutions shown to offer secondary financing at *https://entp.hud.gov/idapp/html/f17npdata.cfm.*

have made roughly 67,000 loans between October 2011 and 2012;[145] volume was similar under the HHF program initiated by Treasury.[146] Available data indicate that roughly 312,000 loans were made in 2011 under targeted refinance programs at FHA (similar data for VA and USDA loans are not available).[147] There were just over 400,000 loans issued under HARP in 2011 and the Bureau understands that volume has risen considerably in 2012.[148] The Bureau intends to seek detailed information on each of the government programs including loan volumes, characteristics and performance.

2. Extension of qualified mortgage status

The benefits to covered persons from extending qualified mortgage status to certain loans made by smaller creditors and held on portfolio also derive from limiting the potential costs of these loans. By granting creditors that qualify under the proposed qualified mortgage category a conclusive or rebuttable presumption of compliance with the ability-to-repay provisions, the proposal would limit the legal liability of these creditors and most expected litigation costs. These creditors may also benefit from a reduction in some documentation and verification costs as explained in the 2013 ATR Final rule. These cost reductions in turn could enhance the willingness of such creditors to make these loans or reduce the amount the creditors would otherwise charge for these loans.[149] The costs to consumers of the proposed rule derive from the related reduction in consumer protection for the borrower as borrowers at these institutions will have less recourse in the instances where the creditor did, in fact, offer the mortgage without reaching a 'reasonable and good faith' belief in the borrower's ability-to-repay. There is also the potential for the broader costs that can result from additional lending made without adequate consideration of the borrower's ability to repay as discussed in the Section 1022 analysis of the 2013 Final ATR rule.

Given the lower default and delinquency rates at these smaller community focused institutions, the avoided costs related to liability and litigation are likely small. However, the lower default and delinquency rates at these institutions, the relationship lending that they engage in, and restrictions on reselling the loans on the secondary market, together imply that the risk of consumer harm (and therefore the costs of this proposal) and also very small.[150] The impacts of this proposal are generally expected to be limited.

Based on data from 2011, roughly 9,200 institutions with approximately 450,000 loans on portfolio are likely to be effected by this provision.[151] Based on the Bureau's estimates, on average, 16.7 percent of portfolio loans at these institutions are estimated to have a DTI ratio above 43%. For the subset of these loans that also do not contain any of the prohibited features for qualified mortgages, the proposed rule removes the ability-to-repay liability and grants the creditor a conclusive or rebuttable presumption of compliance. The Bureau is unable to estimate the percentage of these loans that would not qualify for the temporary expansion of the qualified mortgage definition in the final rule.

Similar tradeoffs are involved in the proposal to raise the threshold from 1.5 percentage points above APOR to 3.5 percentage points above APOR for first lien mortgages originated and held by these institutions and for the qualified balloon mortgages made by institutions predominantly operating in rural or underserved areas. For loans in this APR band, including those with a DTI ratio below 43 that are already qualified mortgages and those with a DTI ratio above 43 percent that would be defined as qualified mortgages under this proposal, the presumption of compliance with the ability-to-repay requirements would be strengthened. The Bureau estimates that roughly 8–10 percent of portfolio loans at these institutions are likely to be affected by this change. Strengthening the presumption of compliance for these loans will benefit consumers and/or covered persons to the extent doing so improves credit access or reduces costs. Strengthening the presumption will have a cost to consumers to the extent consumers who are unable to afford their mortgage and would otherwise be able to make out a claim and recover their losses would be unable to do so.

3. Proposed Comments Regarding Points and Fees Calculation

As discussed in detail above, the proposal provides two alternative comments of the provisions in the rule regarding the treatment of compensation paid to a mortgage originator in the calculation of points and fees. One would explicitly preclude offsetting, while the other would allow creditors to offset the amount of loan originator compensation by the amount of finance charges paid by the consumer. The Bureau is also seeking comment on whether other alternatives might be preferable to the ''no offsetting'' result. The Bureau has also proposed a separate clarification, explaining that mortgage brokers need not double-count payments to loan originator employees when determining points and fees.

In general, offsetting across the various sources of compensation will lower the total amount of points and fees relative to calculations without such offsetting. As a result, keeping all other provisions of a given loan fixed, calculations involving offsetting will result in a greater number of loans eligible to be qualified mortgages and less likely to be above the points and fees triggers under HOEPA. The extent to which this occurs, and the extent to which lenders may adjust pricing and compensation practices in response to these provisions will determine the net effect. At present, the Bureau has limited standardized and representative data regarding the total points and fees and mortgage originator compensation.

In general, for most prime loans, the Bureau believes that variations in these

[145] Includes loans made under Second Lien Modification Program (2MP) Activity and HAMP Principal Reduction Alternative. *See* October 2012 Making Home Affordable Report.

[146] Figures reflect differences in outstanding loans across all states from 2011Q3 to 2012Q3 for most states, or latest yearly figures where these were not available. *See http://www.treasury.gov/initiatives/financial-stability/TARP-Programs/housing/Pages/Program-Documents.aspx.*

[147] *http://portal.hud.gov/hudportal/documents/huddoc?id=fhamktq2_2012.pdf.*

[148] *http://www.fhfa.gov/webfiles/24596/Aug-12%20Refi%20Report.pdf.*

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

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

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

calculations will not have major impacts: Current industry pricing practices and the exemption for bona fide discount points suggest that fewer of these loans will be constrained by the points and fees limits. For loans with higher APRs, where the exemption for bona-fide discount points is reduced or eliminated, the method for calculation of points and fees could limit qualified mortgage status for certain loans. Other loans that will still be qualified mortgages, but where the borrower pays for these charges through a higher interest rate may lose the presumption of compliance and instead have only the rebuttable presumption. Any impacts are most likely greater for lenders with affiliated companies where more charges must be included in the points and fees calculations.

B. Potential Specific Impacts of the Final Rule

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

The Bureau does not anticipate that the proposed rule would reduce consumers' access to credit. As discussed above, the Bureau believes that the proposed rule would in fact enhance certain consumers' access to mortgage credit as compared to the January ATR final rule because it would facilitate lending under various programs and under the new qualified mortgage definition.

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

Depository institutions and credit unions with $10 billion or less in total assets as described in Section 1026 would see differential impacts from the proposed rule. The depository institutions and credit unions that are CDFIs, and are therefore covered under the proposed exemption from the ability-to-repay requirements and the institutions covered by new definition of qualified mortgages for small creditor portfolio loans contained in the proposal are all, by definition, in this group and are therefore uniquely impacted by the rule. The provisions for streamlined refinance apply to all creditors who can utilize those programs and therefor these will not have any specific impact.

3. Impact of the Provisions on Consumers in Rural Areas

The proposed rule would have some differential impacts on consumers in rural areas. In these areas, a greater fraction of loans are made by smaller institutions and carried on portfolio and therefore the small creditor portfolio exemption would be likely to have greater impacts. The Bureau understands that mortgage loans in these areas and by these institutions are less standardized and often cannot be sold into the secondary market. As a result, interest rates may be slightly higher on average and therefore, a bigger portion of the transactions will be affected by the rule and, therefore, rural consumers will derive greater benefit from the proposed provisions than non-rural consumers.

The Bureau requests commenters to submit data and to provide suggestions for additional nationally representative data to assess the issues discussed above and other potential benefits, costs, and impacts of the proposed rule. The Bureau also seeks information or data on the potential impact of the proposed rule on depository institutions and credit unions with total assets of $10 billion or less as described in Dodd-Frank Act section 1026 as compared to depository institutions and credit unions with assets that exceed this threshold and their affiliates. Further, the Bureau seeks information or data on the proposed rule's potential impact on consumers in rural areas as compared to consumers in urban areas.

VII. Regulatory Flexibility Act Analysis

A. Overview

The Regulatory Flexibility Act (RFA) generally requires an agency to conduct an initial regulatory flexibility analysis (IRFA) and a final regulatory flexibility analysis (FRFA) of any rule subject to notice-and-comment rulemaking requirements.[152] These analyses must ''describe the impact of the proposed rule on small entities.'' [153] 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.[154] 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.[155]

An IRFA is not required for this proposal because it would not have a significant economic impact on a substantial number of small entities.

The analysis below evaluates the potential economic impact of the proposed rule on small entities as defined by the RFA. The analysis generally examines the regulatory impact of the provisions of the proposed rule and additional proposed modifications against the baseline of the final rule published elsewhere in today's **Federal Register**.

B. Number and Classes of Affected Entities

The proposed rule will apply to all creditors that extend closed-end credit secured by real property or a dwelling. All small entities that extend these loans are potentially subject to at least some aspects of the proposal. This proposal may impact small businesses, small nonprofit organizations, and small government jurisdictions. A ''small business'' is determined by application of SBA regulations and reference to the North American Industry Classification System (NAICS) classifications and size standards.[156] Under such standards, depository institutions with $175 million or less in assets are considered small; other financial businesses are considered small if such entities have average annual receipts (*i.e.,* annual revenues) that do not exceed $7 million. Thus, commercial banks, savings institutions, and credit unions with $175 million or less in assets are small businesses, while other creditors extending credit secured by real property or a dwelling are small businesses if average annual receipts do not exceed $7 million.

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

[152] 5 U.S.C. 601 *et. seq.*

[153] 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).

[154] 5 U.S.C. 605(b).

[155] 5 U.S.C. 609.

[156] 5 U.S.C. 601(3). The current SBA size standards are located on the SBA's Web site at *http://www.sba.gov/content/table-small-business-size-standards.*

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

Category	NAICS Code	Total Entities	Small Entities	Entities That Originate Any Mortgage Loans[b]	Small Entities that Originate Any Mortgage Loans
Commercial Banking	522110	6,505	3,601	6,307[a]	3,466[a]
Savings Institutions	522120	930	377	922[a]	373[a]
Credit Unions[c]	522130	7,240	6,296	4,178[a]	3,240[a]
Real Estate Credit [d e]	522292	2,787	2,294	2,787	2,294[a]
Total		17,462	12,568	14,194	9,373

Source: 2011 HMDA, Dec 31, 2011 Bank and Thrift Call Reports, Dec 31, 2011 NCUA Call Reports, Dec 31, 2011 NMLSR Mortgage Call Reports.

[a] For HMDA reporters, loan counts from HMDA 2011. For institutions that are not HMDA reporters, loan counts projected based on Call Report data fields and counts for HMDA reporters.
[b] Entities are characterized as originating loans if they make one or more loans.

[c] Does not include cooperativas operating in Puerto Rico. The Bureau has limited data about these institutions or their mortgage activity.

[d] NMLSR Mortgage Call Report (MCR) for 2011. All MCR reporters that originate at least one loan or that have positive loan amounts are considered to be engaged in real estate credit (instead of purely mortgage brokers). For institutions with missing revenue values, the probability that institution was a small entity is estimated based on the count and amount of originations and the count and amount of brokered loans.

[e] Data do not distinguish nonprofit from for-profit organizations, but Real Estate Credit presumptively includes nonprofit organizations.

It is difficult to determine the number of small nonprofits that would be subject to the proposed regulation. Nonprofits do not generally file Call Reports or HMDA reports. As explained in part II above, as of November 2012 there are 233 nonprofit agencies and nonprofit instrumentalities of government in the U.S. that are authorized by HUD to provide secondary financing,[157] 267 institutions designated as Community Housing Development Organizations that provided credit in 2011, and 231 institutions designated as Downpayment Assistance through Secondary Financing Providers. A comprehensive list of these institutions is not available; however the Bureau believes that there may be substantial overlap among these institutions and that most of these institutions would qualify as small entities.

Also, as of July 2012 there were 999 organizations designated by the Treasury Department as CDFIs, 356 of which are depository institutions counted above. Among the remaining, some are nonprofits and most likely small.[158]

C. Impact of Exemption for Certain Community-Focused Lending Programs

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

Proposed 1026.43(a)(3)(iii) provides that an extension of credit made pursuant to a program administered by a housing finance agency, as defined by 24 CFR 266.5, is exempt from the requirements of § 1026.43(c) through (f). This provision would remove the burden to small government jurisdictions, and small entities extending credit pursuant to programs administered by these housing finance agencies, of having to modify the underwriting practices associated with these programs to implement the ability-to-repay requirements. This provision would also remove the burden to small entities of having to develop and maintain policies and procedures to monitor compliance with the ability-to-repay requirements.

The proposal provides that an extension of credit made by a creditor designated as a Community Development Financial Institution, a Downpayment Assistance through Secondary Financing Provider, and a Community Housing Development Organization are exempt from the ability-to-repay requirements. This provision would remove the burden to small entities of having to implement the ability-to-repay requirements. This provision would also remove the burden to small entities of having to develop and maintain policies and procedures to monitor compliance with the ability-to-repay requirements.

Regulatory burdens may be associated with obtaining and maintaining one of the designations required to qualify for the exemption. However, this decision is voluntary and the Bureau presumes that a small entity would not do so unless the burden reduction resulting from the exemption outweighed the additional burden imposed by obtaining and maintaining the designation. Thus, additional burdens would still be part of an overall burden reduction.

The proposal provides that an entity with a tax exemption ruling or determination letter from the Internal Revenue Service under section 501(c)(3) of the Internal Revenue Code of 1986 is exempt from the ability-to-repay

[157] *See https://entp.hud.gov/idapp/html/f17npdata.cfm.*

[158] *See http://www.cdfifund.gov/docs/certification/cdfi/CDFI List-07-31-12.xls.*

requirements, provided that: During the calendar year preceding receipt of the consumer's application, the entity extended credit secured by a dwelling no more than 100 times; during the calendar year preceding receipt of the consumer's application, the entity extended credit secured by a dwelling only to consumers with income that did not exceed the qualifying limit for moderate income families as established pursuant to section 8 of the United States Housing Act of 1937; the extension of credit is to a consumer with income that does not exceed this qualifying limit; and that the creditor determines, in accordance with written procedures, that the consumer has a reasonable ability to repay the extension of credit.

For eligible entities, this provision would remove the burden of complying with the ability-to-repay requirements. This provision would also remove the burden to small entities of having to develop and maintain policies and procedures to monitor compliance with the ability-to-repay requirements in the 2013 ATR Final Rule. While small creditors would be required to maintain documentation of their own procedures regarding the determination of a consumer's ability to repay, the Bureau believes that such small nonprofits already have written policies and procedures.

D. Impact of Exemption for Certain Homeownership Stabilization, Foreclosure Prevention, and Refinancing Programs

The proposed provisions related to certain homeownership stabilization, foreclosure prevention, and refinancing programs discussed above all provide exemptions from the ability-to-repay requirements. Measured against the baseline of the burdens imposed by the Bureau's 2013 Final Rule, the Bureau believes that these proposed provisions impose either no or insignificant additional burdens on small entities. The Bureau believes that these proposed provisions will reduce the burdens associated with implementation costs, additional underwriting costs, and compliance costs stemming from the ability-to-repay requirements.

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

The proposal provides that an extension of credit that is a refinancing that is eligible to be insured, guaranteed, or made pursuant to a program administered by the Federal Housing Administration, U.S. Department of Veterans Affairs, or the U.S. Department of Agriculture is exempt from the ability-to-repay requirements, provided that the agency administering the program under which the extension of credit is eligible to be insured, guaranteed, or made has not prescribed rules pursuant to section 129C(a)(5) or 129C(b)(3)(B)(ii) of TILA. This provision would remove the burden to small entities of having to modify the underwriting practices currently used for Federal agency refinance programs to implement the ability-to-repay requirements. This provision would also remove the burden to small entities of having to develop and maintain policies and procedures to monitor compliance with these ability-to-repay requirements, with respect to extensions of credit exempt from these requirements pursuant to this proposed provision. Pursuant to the proposal, small entities need determine only whether regulations applicable to refinancings prescribed by the relevant Federal agency have taken effect. Prior to that point in time, small entities are relieved of any burden imposed by the ability-to-repay requirements with respect to refinancings eligible to be insured, guaranteed, or made pursuant to a Federal agency program.

The proposal covers certain refinancings eligible to be purchased or guaranteed by Fannie Mae or Freddie Mac pursuant to an eligible targeted refinancing program. This provision would remove the burden to small entities of having to modify the underwriting practices currently used for GSE refinance programs to implement the ability-to-repay requirements. This provision would also remove the burden to small entities of having to develop and maintain policies and procedures to monitor compliance with the ability-to-repay requirements, with respect to extensions of credit exempt from these requirements pursuant to this proposed provision. Further, by exempting creditors extending credit pursuant to one of these programs, the proposal removes any economic burdens associated with ability-to-repay litigation risk.

The proposed provision may add an additional burden on small entities by requiring a determination of whether Fannie Mae or Freddie Mac owns the existing obligation to determine if the proposed provision applies. However, in refinancings creditors generally must determine ownership of the existing obligation prior to consummation to determine the accurate amount of the outstanding obligation. Thus, the Bureau believes that the proposed provision will shift this determination to an earlier point in the refinancing process, and will likely not create a new burden on small entities. A small entity may choose not to make use of the proposed provision in the event that such burden outweighed the benefit. The Bureau requests feedback regarding whether this provision will create new or additional burdens on small entities.

E. Small Creditor Qualified Mortgages Retained in Portfolio

The proposal creates a new category of qualified mortgage for certain mortgage loans made and retained by certain small creditors. The proposed new category would apply to creditors that, at the end of the prior calendar year: (1) Had total assets of less than $2 billion; and (2) together with the creditor's affiliates, originated no more than 500 first-lien covered transactions. Each of these loans must have complied with the general requirements applicable to qualified mortgages under § 1026.43(e)(2), except for the 43 percent debt-to-income ratio limitation in § 1026.43(e)(2)(vi). The $2 billion asset threshold in the proposed definition would be adjusted annually based on the year-to-year change in the average of the Consumer Price Index for Urban Wage Earners and Clerical Workers, not seasonally adjusted.

This proposal would reduce burden on small creditors by removing the 43 percent debt-to-income limitation for qualified mortgages. The increase in the threshold from APOR plus 1.5 percentage points to APOR plus 3.5 percentage points would reduce burden for the loans at these institutions between these rates as these loans would now qualify for a conclusive, rather than a rebuttable presumption.

At the small creditors identified, 16.7 percent of mortgage loans on portfolio are estimated to have a debt to income ratios above 43 percent. For these loans, the proposal grants creditors a presumption of compliance with the ability-to-repay requirements; rough estimates indicate that three quarters of these will gain a conclusive presumption and the remaining loans will gain the rebuttable presumption.

It is difficult to estimate the reduction in potential future liability costs

associated with the changes. However, the Bureau notes that lending practices at smaller institutions are reportedly based on a more personal relationship based model and historically, delinquency rates on mortgages at smaller institutions are lower than the average in the industry. As such, the expected litigation costs from the ability-to-repay provisions of the 2013 ATR Final Rule, and therefore the reduced burden from this proposal, should be small. Small creditors will benefit most from the increased certainty regarding the lower frequency of litigation.

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

F. Proposed Clarification Regarding Inclusion of Loan Originator Compensation in the Points and Fees Calculation

As discussed in detail above, the Dodd-Frank Act requires creditors to include all compensation paid directly or indirectly by a consumer or creditor to a mortgage originator from any source, including a mortgage originator that is also the creditor in a table-funded transaction, in the calculation of points and fees. The statute does not express any limitation on this requirement, and thus, the Bureau believes it would be read to require that loan originator compensation be treated as additive to up-front charges paid by the consumer and the other elements of points and fees. The Bureau was concerned that this may not be the optimal outcome, but did not believe that it had sufficient information with which to determine definitively that an alternative approach was warranted.

The proposal provides two alternative comments on the rule.[159] One would explicitly preclude offsetting, while the other would allow creditors to offset the amount of loan originator compensation by the amount of finance charges paid by the consumer. The Bureau is also seeking comment on whether other alternatives might be appropriate. The Bureau has also proposed a separate comment, explaining that mortgage brokers need not double-count payments to loan originator employees when determining points and fees.

Measured against the baseline of the statutory requirements, these proposed alternatives either reduce or have no effect on the burden on small creditors. As discussed above and in the section-by-section analysis, the Bureau believes the statute would be read to require loan originator compensation to be treated as additive to the other elements of points and fees. This places a burden on small creditors, since it makes it more likely that mortgage loans will not be eligible for a presumption of compliance as qualified mortgages under the ability-to-repay rules and will be classified as high-cost mortgages for purposes of HOEPA. One of the alternatives that the Bureau has proposed would simply state this result expressly. The other reduces the burden on small creditors imposed by the statue by providing small creditors with greater pricing flexibility. The second proposed comment, addressing double-counting of employee compensation, also would reduce burden on small entities regardless of what standard the Bureau adopts in connection with the first proposed comment.

G. Conclusion

Each element of this proposal results in an economic burden reduction for these small entities. The proposed exemptions for nonprofit creditors would lessen any economic impact resulting from the ability-to-repay requirements. The proposed exemptions for homeownership stabilization, foreclosure prevention, and refinancing programs would also soften any economic impact on small entities extending credit pursuant to those programs. The proposed new category of qualified mortgage would make it easier for small entities to originate qualified mortgages. While all of these proposed exemptions may entail additional recordkeeping costs, the Bureau believes that these costs are minimal and outweighed by the cost reductions resulting from the proposal. Small entities for which such cost reductions are outweighed by additional record keeping costs may choose not to utilize the proposed exemptions.

Certification

Accordingly, the undersigned certifies that this proposal would not have a significant economic impact on a substantial number of small entities. The Bureau requests comment on the analysis above and requests any relevant data.

VIII. Paperwork Reduction Act

Certain provisions of this notice of proposed rulemaking contain ''collection of information'' requirements within the meaning of the Paperwork Reduction Act of 1995 (44 U.S.C. 3501 *et seq.*) (Paperwork Reduction Act or PRA). The collection of information contained in this proposed rule, and identified as such, has been submitted to the Office of Management and Budget (OMB) for review under section 3507(d) of the PRA. Notwithstanding any other provision of law, under the PRA, the Bureau may not conduct or sponsor, and a person is not required to respond to, this information collection unless the information collection displays a currently valid control number.

This proposed rule would amend 12 CFR part 1026 (Regulation Z), which implements the Truth in Lending Act (TILA). Regulation Z currently contains collections of information approved by OMB. The Bureau's OMB control number for Regulation Z is 3170–0015. As described below, the proposed rule would amend the collections of information currently in Regulation Z.

A. Overview

This proposal is related to a final rule published elsewhere in today's **Federal Register**. That final rule implements sections 1411, 1412, and 1414 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), which creates new TILA section 129C. Among other things, the Dodd-Frank Act requires creditors to make a reasonable, good faith determination 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.''

The Bureau is proposing certain amendments to the final rule implementing these ability-to-repay requirements, including exemptions for certain nonprofit creditors and certain homeownership stabilization programs and an additional definition of a

[159] These proposed commentary provisions do not circumscribe conduct, and therefore do not in themselves present cognizable impacts for purposes of the Regulatory Flexibility Act. Nevertheless, the Bureau has considered such impacts on small entities as part of this particular rulemaking in order to better inform the public and its rulemaking.

qualified mortgage for certain loans made and held in portfolio by small creditors that have total assets less than $2 billion at the end of the previous calendar year; and, together with all affiliates, originated 500 or fewer first-lien covered transactions during the previous calendar year. The Bureau also is proposing to allow small creditors to charge a higher annual percentage rate for first-lien qualified mortgages in the proposed new category and still benefit from a conclusive presumption of compliance or ''safe harbor,'' and to allow small creditors operating predominantly in rural or underserved areas to offer first-lien balloon loans with a higher annual percentage rate and still benefit from a conclusive presumption of compliance with the ability-to-repay rules or ''safe harbor.''

The information collection in the proposed rule is required to provide benefits for consumers and would be mandatory. *See* 15 U.S.C. 1601 *et seq.;* 12 U.S.C. 2601 *et seq.* Because the Bureau does not collect any information under the final rule, no issue of confidentiality arises. The likely respondents would be depository institutions (*i.e.,* commercial banks, savings institutions and credit unions) and non-depository institutions (*i.e.,* mortgage companies or other non-bank lenders) subject to Regulation Z.[160]

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

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

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

B. Information Collection Requirements

1. Ability-To-Repay Verification and Documentation Requirements

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

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

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

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

C. Summary of Burden Hours

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

D. Comments

The Bureau has a continuing interest in the public's opinions of our collections of information. Comments are specifically requested concerning: (i) Whether the proposed collections of information are necessary for the proper performance of the functions of the Bureau, including whether the information will have practical utility; (ii) the accuracy of the estimated burden associated with the proposed collections of information; (iii) how to enhance the quality, utility, and clarity of the information to be collected; and (iv) how to minimize the burden of complying with the proposed collections of information, including the application of automated collection techniques or other forms of information technology. Comments regarding the burden estimate, or any other aspect of this collection of information, including suggestions for reducing the burden, should be sent to: The Office of Management and Budget (OMB), Attention: Desk Officer for the Consumer Financial Protection Bureau, Office of Information and Regulatory Affairs, Washington, DC, 20503, or by the internet to *submissions@omb.eop.gov,* With copies to the Bureau at the Consumer Financial Protection Bureau (Attention: PRA Office), 1700 G Street NW., Washington, DC, 20552, or by the internet to *CFPB_Public_PRA@cfpb.gov.*

List of Subjects in 12 CFR Part 1026

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

Text of Proposed Revisions

Certain conventions have been used to highlight the proposed revisions. New language is shown inside ►bold-faced arrows◄, while language that would be deleted is shown inside [bold-faced brackets].

Authority and Issuance

For the reasons set forth above, the Bureau of Consumer Financial Protection proposes to amend Regulation Z, 12 CFR part 1026, as set forth below:

PART 1026—TRUTH IN LENDING (REGULATION Z)

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

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

Subpart E—Special Rules for Certain Home Mortgage Transactions

■ 2. Section 1026.43, as added elsewhere in this issue of the **Federal Register**, is amended by revising paragraphs (a)(3)(ii) and (iii), adding new paragraphs (a)(3)(iv) through (viii), revising paragraphs (b)(4), (e)(1), (e)(2), and (g)(1)(ii)(B), and adding new paragraph (e)(5), to read as follows:

§ 1026.43 Minimum standards for transactions secured by a dwelling.

(a) * * *

(3) * * *

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

(iii) A construction phase of 12 months or less of a construction-to-permanent loan►;◄ **[.]**

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

(v) An extension of credit made by:

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

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

(C) A creditor designated as a Community Housing Development Organization, as defined under 24 CFR 92.2, operating in accordance with regulations prescribed by the U.S. Department of Housing and Urban Development applicable to such persons; or

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

(*1*) During the calendar year preceding receipt of the consumer's application, the entity extended credit secured by a dwelling no more than 100 times;

(*2*) During the calendar year preceding receipt of the consumer's application, the entity extended credit secured by a dwelling only to consumers with income that did not exceed the qualifying limit for moderate income families as established pursuant to section 8 of the United States Housing Act of 1937 and amended from time to time by the U.S. Department of Housing and Urban Development;

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

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

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

(vii) An extension of credit that is a refinancing, as defined under § 1026.20(a) but without regard for whether the creditor is the creditor, holder, or servicer of the original obligation, that is eligible to be insured, guaranteed, or made pursuant to a program administered by the Federal Housing Administration, U.S. Department of Veterans Affairs, or the U.S. Department of Agriculture, provided that the agency administering the program under which the extension of credit is eligible to be insured, guaranteed, or made has not prescribed rules pursuant to section 129C(a)(5) or 129C(b)(3)(B)(ii) of TILA; or

(viii) An extension of credit that is a refinancing, as defined under § 1026.20(a) but without regard for whether the creditor is the creditor, holder, or servicer of the original obligation, that is eligible to be purchased or guaranteed by the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation, provided that:

(A) The refinancing is made pursuant to an eligible targeted refinancing program, as defined under 12 CFR 1291.1;

(B) Such entities are operating under the conservatorship or receivership of the Federal Housing Finance Agency pursuant to section 1367 of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. 4617(i)) on the date the refinancing is consummated;

(C) The existing obligation satisfied and replaced by the refinancing is owned by the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation;

(D) The existing obligation satisfied and replaced by the refinancing was not consummated on or after January 10, 2014; and

(E) The refinancing is not consummated on or after January 10, 2021.◄

(b) * * *

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

* * * * *

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

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

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

obligations, alimony, child support, and the consumer's monthly payment (including mortgage-related obligations) on the covered transaction and on any simultaneous loans of which the creditor was aware at consummation would leave the consumer with insufficient residual income or assets other than the value of the dwelling (including any real property attached to the dwelling) that secures the loan with which to meet living expenses, including any recurring and material non-debt obligations of which the creditor was aware at the time of consummation.

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

* * * * *

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

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

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

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

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

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

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

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

(C) The qualified mortgage is sold, assigned, or otherwise transferred to another person pursuant to a capital restoration plan or other action under 12 U.S.C. 1831o, actions or instructions of any person acting as conservator, receiver, or bankruptcy trustee, an order of a State or Federal government agency with jurisdiction to examine the creditor pursuant to State or Federal law, or an agreement between the creditor and such an agency; or

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

* * * * *

(g) * * *

(1) * * *

(ii) * * *

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

* * * * *

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

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

i. Under *32(b) Definitions:*

a. Under *Paragraph 32(b)(1)(ii),* as amended elsewhere in this issue of the **Federal Register**, paragraph 5 under that heading is added.

B. Under *Section 1026.43—Minimum Standards for Transactions Secured by a Dwelling,* as added elsewhere in this issue of the **Federal Register**:

i. Under *43(a) Scope:*

a. The heading *Paragraph 43(a)(3)(v)(D)* and paragraph 1 under that heading are added.

b. The heading *Paragraph 43(a)(3)(vi)* and paragraph 1 under that heading are added.

c. The heading *Paragraph 43(a)(3)(vii)* and paragraph 1 under that heading are added.

d. The heading *Paragraph 43(a)(3)(viii)* and paragraph 1 under that heading are added.

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

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

Supplement I to Part 1026—Official Interpretations

* * * * *

Subpart E—Special Rules for Certain Home Mortgage Transactions

* * * * *

Section 1026.32—Requirements for High-Cost Mortgages

* * * * *

32(b) Definitions.

Paragraph 32(b)(1).

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

* * * * *

►5. *Loan originator compensation—calculating loan originator compensation in connection with other charges or payments included in the finance charge or made to loan originators.* i. *Consumer payments to mortgage brokers.* Mortgage broker fees already included in the points and fees calculation under § 1026.32(b)(1)(i) need not be counted again under § 1026.32(b)(1)(ii). For example, assume a mortgage broker charges a consumer a $3,000 fee for a transaction. The $3,000 mortgage broker fee is included in the finance charge under § 1026.4(a)(3). Because the $3,000 mortgage broker fee is already included in points and fees under § 1026.32(b)(1)(i), it is not counted again under § 1026.32(b)(1)(ii).

ii. *Payments by a mortgage broker to its individual loan originator employee.* Compensation paid by a mortgage broker to its individual loan originator employee is not included in points and fees under § 1026.32(b)(1)(ii). For example, assume a consumer pays a $3,000 fee to a mortgage broker, and the mortgage broker pays a $1,500 commission to its individual loan originator employee for that transaction. The $3,000 mortgage broker fee is included in points and fees, but the $1,500 commission is not included in points and fees because it has already been included in points and fees as part of the $3,000 mortgage broker fee.

Alternative 1

iii. *Creditor's origination fees.* Section 1026.32(b)(1)(ii) requires a creditor to include compensation paid by a consumer or creditor to a loan originator in the calculation of points and fees in addition to any fees or charges paid by the consumer to the creditor included in points and fees under § 1026.32(b)(1)(i). For example, assume that a consumer pays to the creditor a $3,000 origination fee and that the creditor pays to its loan officer employee $1,500 in compensation attributed to the transaction. Assume further that the consumer pays no other charges to the creditor that are included in points and fees under § 1026.32(b)(1)(i) and the loan officer receives no other compensation that is included in points and fees under § 1026.32(b)(1)(ii). For purposes of calculating points and fees, the $3,000 origination fee is included in points and fees under § 1026.32(b)(1)(i)

and the $1,500 in loan officer compensation is included in points and fees under § 1026.32(b)(1)(ii), equaling $4,500 in total points and fees, provided that no other points and fees are paid or compensation received.

Alternative 2

iii. *Creditor's origination fees.* Section 1026.32(b)(1)(ii) requires a creditor to reduce the amount of loan originator compensation included in the points and fees calculation under § 1026.32(b)(1)(ii) by any amount included in the points and fees calculation under § 1026.32(b)(1)(i). For example, assume that a consumer pays to the creditor a $3,000 origination fee and that the creditor pays to the loan originator $1,500 in compensation attributed to the transaction. Assume further that the consumer pays no other charges to the creditor that are included in points and fees under § 1026.32(b)(1)(i) and the loan originator receives no other compensation that is included in points and fees under § 1026.32(b)(1)(ii). For purposes of calculating points and fees, the $3,000 origination fee is included in points and fees under § 1026.32(b)(1)(i), but the $1,500 in loan originator compensation need not be included in points and fees. If, however, the consumer pays to the creditor a $1,000 origination fee and the creditor pays to the loan originator $1,500 in compensation, then the $1,000 origination fee is included in points and fees under § 1026.32(b)(1)(i), and $500 of the loan originator compensation is included in points and fees under § 1026.32(b)(1)(ii), equaling $1,500 in total points and fees, provided that no other points and fees are paid or compensation received. This example illustrates the requirements of § 1026.32(b)(1)(ii) for both retail and wholesale transactions.◄

* * * * *

Section 1026.43—Minimum Standards for Transactions Secured by a Dwelling

43(a) Scope

* * * * *

►*Paragraph 43(a)(3)(v)(D).*

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

Paragraph 43(a)(3)(vi).

1. *General.* The requirements of § 1026.43(c) through (f) do not apply to a mortgage loan modification made in connection with a program authorized by sections 101 and 109 of the Emergency Economic Stabilization Act of 2008. If a creditor is underwriting an extension of credit that is a refinancing, as defined by § 1026.20(a), that will be made pursuant to a program authorized by sections 101 and 109 of the Emergency Economic Stabilization Act of 2008, the creditor also need not comply with § 1026.43(c) through (f). A creditor need not determine whether the mortgage loan modification is considered a refinancing under § 1026.20(a) for purposes of determining applicability of § 1026.43; if the transaction is made in connection with these programs, the requirements of § 1026.43(c) through (f) do not apply. In addition, if a creditor underwrites a new extension of credit, such as a subordinate-lien mortgage loan, that will be made pursuant to a program authorized by sections 101 and 109 of the Emergency Economic Stabilization Act of 2008, the creditor need not comply with the requirements of § 1026.43(c) through (f).

Paragraph 43(a)(3)(vii).

1. *General.* The requirements of § 1026.43(c) through (f) do not apply to an extension of credit that is a refinancing, as defined by § 1026.20(a) but without regard for whether the creditor is the creditor, holder, or servicer of the original obligation, that is eligible to be insured, guaranteed, or made pursuant to programs administered by the Federal agencies identified in § 1026.43(a)(3)(vii), provided that rules issued by such agencies pursuant to section 129C(b)(3)(B)(ii) or 129C(a)(5) of TILA have not become effective on or before the date the refinancing is consummated. For example:

i. Assume that a consumer applies for a refinancing that is eligible to be insured, guaranteed, or made pursuant to a program administered by the U.S. Department of Veterans Affairs. If the U.S. Department of Veterans Affairs has issued rules pursuant to TILA section 129C(b)(3)(B)(ii) or 129C(a)(5) that have become effective, the exemption in § 1026.43(a)(3)(vii) does not apply because those rules will separately govern the status of U.S. Department of Veterans Affairs loans.

ii. Assume that a consumer applies for a refinancing of a subordinate-lien mortgage loan that is eligible to be insured, guaranteed, or made pursuant to a program administered by the U.S. Department of Veterans Affairs and the U.S. Department of Veterans Affairs has issued rules pursuant to TILA section 129C(b)(3)(B)(ii) or 129C(a)(5) that have become effective. Assume further that such effective rules apply to refinancings of first-lien mortgage loans, but not subordinate-lien mortgage loans. The exemption in § 1026.43(a)(3)(vii) does not apply, regardless of the status of the particular loans under the rules issued, because the U.S. Department of Veterans Affairs has issued rules pursuant to TILA section 129C(b)(3)(B)(ii) or 129C(a)(5) that have become effective. The exemption does not apply even if the applicability of such Federal agency rules is determined based on program type instead of loan type. Thus, the exemption in § 1026.43(a)(3)(vii) does not apply even if the U.S. Department of Veterans Affairs rules do not apply to the particular U.S. Department of Veterans Affairs program under which the refinancing is eligible to be insured, guaranteed, or made.

iii. Assume that a consumer applies for a refinancing that is eligible to be insured, guaranteed, or made pursuant to a program administered by the Federal Housing Administration and the Federal Housing Administration has issued rules pursuant to TILA section 129C(b)(3)(B)(ii) or 129C(a)(5) that have become effective. Assume further that the refinancing for which the consumer applies is also eligible to be insured, guaranteed, or made pursuant to a program administered by the U.S. Department of Agriculture, but the U.S. Department of Agriculture has not issued rules pursuant to TILA section 129C(b)(3)(B)(ii) or 129C(a)(5), or the U.S. Department of Agriculture has issued rules implementing TILA section 129C(b)(3)(B)(ii) or 129C(a)(5) that have not yet taken effect at the time the refinancing is consummated. The exemption applies to that refinancing because the refinancing is eligible to be to be insured, guaranteed, or made pursuant to a pursuant to program administered by a Federal agency identified in § 1026.43(a)(3)(vii), and such Federal agency has not issued rules pursuant to section 129C(b)(3)(B)(ii) or 129C(a)(5) of TILA that have become effective.

Paragraph 43(a)(3)(viii).

1. *General.* Section 1026.43(a)(3)(viii) provides an exemption from the requirements of § 1026.43(c) through (f) for certain extensions of credit that are considered refinancings, as defined in § 1026.20(a) but without regard for whether the creditor is the creditor, holder, or servicer of the original obligation, that are eligible for purchase or guarantee by Fannie Mae or Freddie Mac. The exemption provided by § 1026.43(a)(3)(viii) is available only while these entities remain in conservatorship. For example, if Fannie Mae remains in conservatorship, but Freddie Mac exits conservatorship, the exemption continues to apply to refinancings that are eligible for purchase by Fannie Mae, provided the other conditions specified in § 1026.43(a)(3)(viii) are met. Further, the exemption is available only if the existing obligation that will be satisfied and replaced by the refinancing was consummated prior to January 10, 2014. For example, if a consumer applies for an extension of credit that is a refinancing, as defined by § 1026.20(a), that is eligible to be purchased by Fannie Mae or Freddie Mac, but the consumer's current mortgage loan was consummated on or after January 10, 2014, the exemption provided by § 1026.43(a)(3)(viii) does not apply.◄

* * * * *

43(e) Qualified mortgages.

* * * * *

►*Paragraph 43(e)(5).*

1. *Satisfaction of qualified mortgage requirements.* For a covered transaction to be a qualified mortgage under § 1026.43(e)(5), the mortgage must satisfy the requirements for a qualified mortgage under § 1026.43(e)(2), other than the requirements regarding debt-to-income ratio. For example, a qualified mortgage under § 1026.43(e)(5) may not have a loan term in excess of 30 years because longer terms are prohibited for qualified mortgages under § 1026.43(e)(2)(ii). Similarly, a qualified mortgage under § 1026.43(e)(5) may not result in a balloon payment because § 1026.43(e)(2)(i)(C) provides that qualified mortgages may not have balloon payments except as provided under § 1026.43(f). However, a covered transaction need not comply with § 1026.43(e)(2)(vi), which prohibits consumer monthly debt-to-income ratios in excess of 43 percent. A covered transaction therefore can be a qualified mortgage under § 1026.43(e)(5) even though the consumer's monthly debt-to-income ratio is greater than 43 percent.

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

3. *Forward commitments.* A creditor may make a mortgage loan that will be transferred or sold to a purchaser pursuant to an agreement that has been entered into at or before the time the transaction is consummated. Such an agreement is sometimes known as a ''forward commitment.'' A mortgage that will be acquired by a purchaser pursuant to a forward commitment does not satisfy the requirements of § 1026.43(e)(5), whether the forward commitment provides for the purchase and sale of the specific transaction or for the purchase and sale of transactions with certain prescribed criteria that the transaction meets. However, a forward commitment to another person that also meets the requirements of § 1026.43(e)(5)(i)(D) is permitted. For example: assume a creditor that is eligible to make qualified mortgages under § 1026.43(e)(5) makes a mortgage. If that mortgage meets the purchase criteria of an investor with which the creditor has an agreement to sell loans after consummation, then the loan does not meet the definition of a qualified mortgage under § 1026.43(e)(5). However, if the investor meets the requirements of § 1026.43(e)(5)(i)(D), the mortgage will be a qualified mortgage if all other applicable criteria also are satisfied.

4. *Creditor qualifications.* To be eligible to make qualified mortgages under § 1026.43(e)(5), a creditor must satisfy the requirements stated in § 1026.35(b)(2)(iii)(B) and (C). Section 1026.35(b)(2)(iii)(B) requires that, during the preceding calendar year, the creditor and its affiliates together originated 500 or fewer first-lien covered transactions. Section 1026.35(b)(2)(iii)(C) requires that, as of the end of the preceding calendar year, the creditor had total assets of less than $2 billion, adjusted annually by the Bureau for inflation.

5. *Requirement to hold in portfolio.* Creditors generally must hold a loan in portfolio to maintain the transaction's status as a qualified mortgage under § 1026.43(e)(5), subject to four exceptions. Unless one of these exceptions applies, a loan is no longer a qualified mortgage under § 1026.43(e)(5) once legal title to the debt obligation is sold, assigned, or otherwise transferred to another person. Accordingly, unless one of the exceptions applies, the transferee could not benefit from the presumption of compliance for qualified mortgages under § 1026.43(e)(1) unless the loan also met the requirements of another qualified mortgage definition.

6. *Application to subsequent transferees.* The exceptions contained in § 1026.43(e)(5)(ii) apply not only to an initial sale, assignment, or other transfer by the originating creditor but to subsequent sales, assignments, and other transfers as well. For example,

assume Creditor A originates a qualified mortgage under § 1026.43(e)(5). Six months after consummation, Creditor A sells the qualified mortgage to Creditor B pursuant to § 1026.43(e)(5)(ii)(B) and the loan retains its qualified mortgage status because Creditor B complies with the limits on asset size and number of transactions. If Creditor B sells the qualified mortgage, it will lose its qualified mortgage status under § 1026.43(e)(5) unless the sale qualifies for one of the § 1026.43(e)(5)(ii) exceptions for sales three or more years after consummation, to another qualifying institution, as required by supervisory action, or pursuant to a merger or acquisition.

7. *Transfer three years after consummation.* Under § 1026.43(e)(5)(ii)(A), if a qualified mortgage under § 1026.43(e)(5) is sold, assigned, or otherwise transferred three years or more after consummation, the loan retains its status as a qualified mortgage under § 1026.43(e)(5) following the transfer. The transferee need not be eligible to originate qualified mortgages under § 1026.43(e)(5). The loan will continue to be a qualified mortgage throughout its life, and the transferee, and any subsequent transferees, may invoke the presumption of compliance for qualified mortgages under § 1026.43(e)(1).

8. *Transfer to another qualifying creditor.* Under § 1026.43(e)(5)(ii)(B), a qualified mortgage under § 1026.43(e)(5) may be sold, assigned, or otherwise transferred at any time to another creditor that meets the requirements of § 1026.43(e)(5)(v). That section requires that a creditor, during the preceding calendar year, together with all affiliates, 500 or fewer first-lien covered transactions and had total assets less than $2 billion (as adjusted for inflation) at the end of the preceding calendar year. A qualified mortgage under § 1026.43(e)(5) transferred to a creditor that meets these criteria would retain its qualified mortgage status even if it is transferred less than three years after consummation.

9. *Supervisory sales.* Section 1026.43(e)(5)(ii)(C) facilitates sales that are deemed necessary by supervisory agencies to revive troubled creditors and resolve failed creditors. A qualified mortgage under § 1026.43(e)(5) retains its qualified mortgage status if it is sold, assigned, or otherwise transferred to another person pursuant to: a capital restoration plan or other action under 12 U.S.C. 1831o; the actions or instructions of any person acting as conservator, receiver or bankruptcy trustee; an order of a State or Federal government agency with jurisdiction to examine the creditor pursuant to State or Federal law; or an agreement between the creditor and such an agency. A qualified mortgage under § 1026.43(e)(5) that is sold, assigned, or otherwise transferred under these circumstances retains its qualified mortgage status regardless of how long after consummation it is sold and regardless of the size or other characteristics of the transferee. Section 1026.43(e)(5)(ii)(C) does not apply to transfers done to comply with a generally applicable regulation with future effect designed to implement, interpret, or prescribe law or policy in the absence of a specific order by or a specific agreement with a governmental agency described in § 1026.43(e)(5)(ii)(C) directing the sale of one or more qualified mortgages under § 1026.43(e)(5) held by the creditor or one of the other circumstances listed in § 1026.43(e)(5)(ii)(C). For example, a qualified mortgage under § 1026.43(e)(5) that is sold pursuant to a capital restoration plan under 12 U.S.C. 1831o would retain its status as a qualified mortgage following the sale. However, if the creditor simply chose to sell the same qualified mortgage as one way to comply with general regulatory capital requirements in the absence of supervisory action or agreement it would lose its status as a qualified mortgage following the sale unless it qualifies under another definition of qualified mortgage.

10. *Mergers and acquisitions.* A qualified mortgage under § 1026.43(e)(5) retains its qualified mortgage status if a creditor merges with, is acquired by, or acquires another person regardless of whether the creditor or its successor is eligible to originate new qualified mortgages under § 1026.43(e)(5) after the merger or acquisition. However, the creditor or its successor can originate new qualified mortgages under § 1026.43(e)(5) only if it complies with all of the requirements of § 1026.43(e)(5) after the merger or acquisition. For example, assume a creditor that originates 250 covered transactions each year and originates qualified mortgages under § 1026.43(e)(5) is acquired by a larger creditor that originates 10,000 covered transactions each year. Following the acquisition, the small creditor would no longer be able to originate § 1026.43(e)(5) qualified mortgages because, together with its affiliates, it would originate more than 500 covered transactions each year. However, the § 1026.43(e)(5) qualified mortgages originated by the small creditor before the acquisition would retain their qualified mortgage status. ◀

Dated: January 10, 2013.

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[FR Doc. 2013–00739 Filed 1–16–13; 11:15 am]

BILLING CODE 4810–AM–P