BUREAU OF CONSUMER FINANCIAL PROTECTION

12 CFR Parts 1024 and 1026

[Docket No. CFPB–2013–0010]

RIN 3170–AA37

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

AGENCY: Bureau of Consumer Financial Protection.

ACTION: Final rule; official interpretations.

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

DATES: This rule is effective January 10, 2014, except for the amendment to § 1026.35(e), which is effective July 24, 2013. See part V, Effective Date, in **SUPPLEMENTARY INFORMATION.**

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SUPPLEMENTARY INFORMATION:

I. Summary of Final Rule

In January 2013, the Bureau issued several final rules concerning mortgage markets in the United States (2013 Title XIV Final Rules), pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). Public Law 111–203, 124 Stat. 1376 (2010). On January 10, 2013, the Bureau issued the 2013 ATR Final Rule; [1] on January 17, 2013, the Bureau issued the 2013 Mortgage Servicing Final Rules; [2] and on May 16, 2013, the Bureau issued Amendments to the 2013 Escrows Final Rule.[3] This final rule makes several amendments to those rules. These amendments clarify, correct, or amend provisions on (1) the relation to State law of Regulation X's servicing provisions; (2) implementation dates for adjustable-rate mortgage disclosures; (3) exclusions from the repayment ability and prepayment penalty requirements for higher-priced mortgage loans (HPMLs); (4) the small servicer exemption from certain of the new servicing rules; (5) the use of government-sponsored enterprise (GSE) and Federal agency purchase, guarantee or insurance eligibility for determining qualified mortgage (QM) status; and (6) the determination of debt and income for purposes of originating QMs. In addition to these six revisions and clarifications, which are discussed more fully below, the Bureau is making certain technical corrections to the regulations with no substantive change intended.

First, the Bureau is amending the commentary to the preemption provision of Regulation X to clarify that the regulation does not occupy the field of regulation of the practices covered by the Real Estate Settlement Procedures Act (RESPA) or Regulation X, including with respect to mortgage servicers or mortgage servicing. The rule also redesignates the Regulation X preemption provision, § 1024.13, as § 1024.5(c).

Second, in response to industry requests, the Bureau is providing clarification of the implementation dates for adjustable-rate mortgage provisions § 1026.20(c) and (d) of the 2013 TILA Servicing Final Rule. This clarification is provided in the section-by-section analysis and does not revise the 2013 TILA Servicing Final Rule or its official commentary.

Third, the Bureau is revising § 1026.35(e) of Regulation Z, as amended by the Amendments to the 2013 Escrows Final Rule,[4] to clarify that construction and bridge loans and reverse mortgages are not subject to its requirements regarding repayment abilities and prepayment penalties for HPMLs.

Fourth, the Bureau is clarifying the scope and application of the exemption for small servicers that is set forth in Regulation Z's periodic statement provision, § 1026.41, and incorporated by cross-reference in certain provisions of Regulation X. The rule clarifies which mortgage loans to consider in determining small servicer status and the application of the small servicer exemption with regard to servicer/affiliate and master servicer/subservicer relationships. Further, the rule provides that three types of mortgage loans will not be considered in determining small servicer status: mortgage loans voluntarily serviced for an unaffiliated entity without remuneration, reverse mortgages, and mortgage loans secured by a consumer's interest in timeshare plans.

Fifth, the Bureau is revising regulatory text and an official interpretation adopted in the 2013 ATR Final Rule and adding a new official interpretation to describe qualified mortgages that are entitled to a presumption of compliance with the ability-to-repay requirements under the Dodd-Frank Act. Specifically, the Bureau is providing clarifications with regard to § 1026.43(e)(4), which allows qualified mortgage status to certain loans that are eligible for purchase, guarantee, or insurance by the GSEs or federal agencies. Section 1026.43(e)(4)(ii)(A)–(E) is amended to make clear that matters wholly unrelated to ability to repay will not be relevant to determination of QM status under this provision. Comment 43(e)(4)–4 explains that matters wholly unrelated to ability to repay are those matters that are wholly unrelated to credit risk or the underwriting of the loan. Comment 43(e)(4)–4 also clarifies the standards a creditor must meet when relying on a written guide or an automated underwriting system to determine qualified mortgage status under § 1026.43(e)(4). In addition, the revised comment specifies that a creditor relying on approval through an automated underwriting system to establish qualified mortgage status must also meet the conditions on approval that are generated by that same system.

The Bureau is also revising comment 43(e)(4)–4 to clarify that a loan meeting eligibility requirements provided in a written agreement with one of the GSEs, HUD, VA, USDA, or RHS is also eligible for purchase or guarantee by the GSEs or insured or guaranteed by the agencies for the purposes of § 1026.43(e)(4). In addition, the comment has been clarified to provide that loans receiving individual waivers from GSEs or agencies will be considered eligible as

[1] Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act (Regulation Z) (2013 ATR Final Rule), 78 FR 6407 (Jan. 30, 2013).

[2] Mortgage Servicing Rules Under the Real Estate Settlement Procedures Act (Regulation X) (2013 RESPA Servicing Final Rule) and Mortgage Servicing Rules Under the Truth in Lending Act (Regulation Z) (2013 TILA Servicing Final Rule) (together, 2013 Mortgage Servicing Final Rules), 78 FR 10695 (Feb. 14, 2013) (Regulation X), 78 FR 10901 (Feb. 14, 2013) (Regulation Z).

[3] Amendments to the 2013 Escrows Final Rule under the Truth in Lending Act (Regulation Z), 78 FR 30739 (May 23, 2013). Those amendments revised 78 FR 4726 (Jan. 22, 2013) (2013 Escrows Final Rule).

[4] 78 FR 30739 (May 23, 2013).

well. Thus, such loans could be qualified mortgages.

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

Sixth, the Bureau is amending appendix Q of Regulation Z to facilitate compliance and ensure access to credit by assisting creditors in determining a consumer's debt-to-income ratio (DTI) for the purposes of § 1026.43(e)(2), the primary qualified mortgage provision. The Bureau is making changes to address compliance challenges raised by stakeholders, as well as technical and wording changes for clarification purposes. The Bureau's revisions include clarifications to appendix Q on: (1) Stability of income, and the creditor requirement to evaluate the probability of the consumer's continued employment; (2) with regard to salary, wage, and other forms of consumer income, the creditor requirement to determine whether the consumer's income level can reasonably be expected to continue; (3) creditor analysis of consumer overtime and bonus income; (4) creditor analysis of consumer Social Security income; (5) requirements related to the analysis of self-employed consumer income; (6) requirements related to non-employment related consumer income, including creditor analysis of consumer trust income; and (7) creditor analysis of rental income. The Bureau is also revising the introduction to appendix Q to make clear that creditors may refer to other federal agency and GSE guidance that is in accordance with appendix Q as a resource, and to provide default rules and an optional safe harbor when appendix Q's standards do not otherwise resolve how to treat a particular type of debt or income.

II. Background

A. Title XIV Rulemakings Under the Dodd-Frank Act

In response to an unprecedented cycle of expansion and contraction in the mortgage market that sparked the most severe U.S. recession since the Great Depression, Congress passed the Dodd-Frank Act, which was signed into law on July 21, 2010. In the Dodd-Frank Act, Congress established the Bureau and, under sections 1061 and 1100A, generally consolidated the rulemaking authority for Federal consumer financial laws, including the Truth in Lending Act (TILA) and RESPA, in the Bureau.[5] At the same time, Congress significantly amended the statutory requirements governing mortgage practices with the intent to restrict the practices that contributed to and exacerbated the crisis. Under the statute, most of these new requirements would have taken effect automatically on January 21, 2013, if the Bureau had not issued implementing regulations by that date.[6] To avoid uncertainty and potential disruption in the national mortgage market at a time of economic vulnerability, the Bureau issued several final rules in a span of less than two weeks in January 2013 to implement these new statutory provisions and provide for an orderly transition.

On January 10, 2013, the Bureau issued the 2013 ATR Final Rule, Escrow Requirements Under the Truth in Lending Act (Regulation Z) (2013 Escrows Final Rule),[7] and High-Cost Mortgages and Homeownership Counseling Amendments to the Truth in Lending Act (Regulation Z) and Homeownership Counseling Amendments to the Real Estate Settlement Procedures Act (Regulation X) (2013 HOEPA Final Rule).[8] On January 17, 2013, the Bureau issued the 2013 Mortgage Servicing Final Rules. On January 18, 2013, the Bureau issued Appraisals for Higher-Priced Mortgage Loans (Regulation Z)[9] (issued jointly with other agencies) and Disclosure and Delivery Requirements for Copies of Appraisals and Other Written Valuations Under the Equal Credit Opportunity Act (Regulation B) (2013 Appraisals Final Rule).[10] On January 20, 2013, the Bureau issued Loan Originator Compensation Requirements Under the Truth in Lending Act (Regulation Z) (2013 Loan Originator Final Rule).[11] Most of these rules will become effective on January 10, 2014.

Concurrent with the 2013 ATR Final Rule, on January 10, 2013, the Bureau issued Proposed Amendments to the Ability-to-Repay Standards Under the Truth in Lending Act (Regulation Z) (2013 ATR Concurrent Proposal).[12] This proposal has now been made final (May 2013 ATR Final Rule).[13] The May 2013 ATR Final Rule provides exemptions for creditors with certain designations, loans pursuant to certain programs, certain nonprofit creditors, and mortgage loans made in connection with certain Federal emergency economic stabilization programs. The final rule also provides an additional definition of a qualified mortgage for certain loans made and held in portfolio by small creditors and a temporary definition of a qualified mortgage for balloon loans. Finally, the May 2013 ATR Final Rule modifies the requirements regarding the inclusion of loan originator compensation in the points and fees calculation.

B. Implementation Initiative for New Mortgage Rules

On February 13, 2013, the Bureau announced an initiative to support implementation of its new mortgage rules (Implementation Plan),[14] under which the Bureau would work with the mortgage industry and other stakeholders to ensure that the new rules can be implemented accurately and expeditiously. The Implementation Plan included (1) coordination with other agencies; (2) publication of plain-language guides to the new rules; (3) publication of additional corrections and clarifications of the new rules, as needed; (4) publication of readiness guides for the new rules; and (5) education of consumers on the new rules.

This final rule is the third final rule providing additional revisions and clarifications of and amendments to the 2013 Title XIV Final Rules. In addition, the Bureau issued a proposed rule with further revisions and clarifications of and amendments to several of the 2013 Title XIV Final Rules on June 24, 2013. The purpose of these updates is to address important questions raised by industry, consumer groups, or other agencies. Priority for these updates is given to issues that are important to a large number of stakeholders and that critically affect mortgage companies' implementation decisions. Previously, the Bureau issued a final rule[15] providing corrections and clarifications of its 2013 Escrows Final Rule, and a final rule delaying the effective date for a provision related to credit insurance

[5] 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.

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

[7] 78 FR 4726 (Jan. 22, 2013).

[8] 78 FR 6855 (Jan. 31, 2013).

[9] 78 FR 10367 (Feb. 13, 2013).

[10] 78 FR 7215 (Jan. 31, 2013).

[11] 78 FR 11279 (Feb. 15, 2013).

[12] 78 FR 6622 (Jan. 30, 2013).

[13] 78 FR 35429 (Jun. 12, 2013).

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

[15] 78 FR 30739 (May 23, 2013).

financing in the 2013 Loan Originator Final Rule. On June 24, 2013, the Bureau issued additional proposed clarifications [16] to several of the new mortgage rules, including the servicing rules touched on here and the 2013 Loan Originator Final Rule. The Bureau expects to review the comments received and finalize that proposal later this summer. Going forward, the Bureau will continue to assess whether additional clarifications or revisions are warranted.

Comments on the Proposed Rule

The Bureau received 73 comments on the proposed rule [17] on which this final rule is based. Many of these comments discussed issues that the proposed rule did not touch upon such as disparate impact in regard to fair lending enforcement, calculation methods for residual income, and whether or not the special QM provision at § 1026.43(e)(4) should be eliminated before the rule goes into effect. The Bureau notes that it would be inconsistent with the Administrative Procedure Act (APA) to make changes outside the scope of the proposal because the other commenters and the public would not have notice and opportunity to comment. In addition, these regulatory updates are intended to focus on specific narrow implementation issues, and broader policy changes would not be appropriate as part of this process.

The Bureau has examined all comments submitted and will discuss those that were responsive to the proposal in the section-by-section analysis below.

III. Legal Authority

The Bureau is issuing this final rule pursuant to its authority under RESPA, TILA, and the Dodd-Frank Act. Section 1061 of the Dodd-Frank Act transferred to the Bureau the ''consumer financial protection functions'' previously vested in certain other Federal agencies, including the Federal Reserve Board (Board). The term ''consumer financial protection function'' is defined to include ''all authority to prescribe rules or issue orders or guidelines pursuant to any Federal consumer financial law, including performing appropriate functions to promulgate and review such rules, orders, and guidelines.'' [18] Section 1061 of the Dodd-Frank Act also transferred to the Bureau all of HUD's consumer protection functions relating to RESPA.[19] Title X of the Dodd-Frank Act, including section 1061, along with RESPA, TILA, and certain subtitles and provisions of title XIV of the Dodd-Frank Act are Federal consumer financial laws.[20]

A. RESPA

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

B. TILA

Section 105(a) of TILA, 15 U.S.C. 1604(a), authorizes the Bureau to prescribe regulations to carry out the purposes of TILA. Under 105(a) such regulations may contain such additional requirements, classifications, differentiations, or other provisions, and may provide for such adjustments and exceptions for all or any class of transactions, as in the judgment of the Bureau are necessary or proper to effectuate the purposes of TILA, to prevent circumvention or evasion thereof, or to facilitate compliance therewith. A purpose of TILA is ''to assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit.'' TILA section 102(a), 15 U.S.C. 1601(a). In particular, it is a 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. 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. Accordingly, the Bureau has authority to issue regulations pursuant to title X as well as RESPA and TILA, as amended by title XIV.

In addition, to constitute a qualified mortgage a loan must meet ''any guidelines or regulations established by the Bureau relating to ratios of total monthly debt to monthly income or alternative measures of ability to pay regular expenses after payment of total monthly debt, taking into account the income levels of the borrower and such other factors as the Bureau may determine are relevant and consistent with the purposes described in [TILA section 129C(b)(3)(B)(i)].'' The Dodd Frank Act also provides the Bureau with authority to prescribe regulations that revise, add to, or subtract from the criteria that define a qualified mortgage upon a finding that such regulations are necessary or proper to ensure that responsible, affordable mortgage credit remains available to consumers in a manner consistent with the purposes of the ability-to-repay requirements; or are necessary and appropriate to effectuate the purposes of the ability-to-repay requirements, to prevent circumvention or evasion thereof, or to facilitate compliance with TILA sections 129B and 129C. TILA section 129C(b)(3)(B)(i), 15 U.S.C. 1639c(b)(3)(B)(i). In addition, TILA section 129C(b)(3)(A) provides the Bureau with authority to prescribe regulations to carry out the purposes of the qualified mortgage provisions, such as to ensure that responsible and 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. 1639c(b)(3)(A).

C. The Dodd-Frank Act

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

[16] 78 FR 39902 (July 2, 2013).

[17] 78 FR 25638 (May 2, 2013).

[18] 12 U.S.C. 5581(a)(1).

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

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

thereof.'' 12 U.S.C. 5512(b)(1). Title X of the Dodd-Frank Act is a Federal consumer financial law. Accordingly, the Bureau is exercising its authority under the Dodd-Frank Act section 1022(b) to prescribe rules that carry out the purposes and objectives of title X, as well as of RESPA, TILA, and the enumerated subtitles and provisions of title XIV of the Dodd-Frank Act, and to prevent evasion of those laws.

The Bureau is amending certain rules finalized in January, 2013, that implement a number of Dodd-Frank Act provisions. In particular, the Bureau is clarifying or amending regulatory provisions and associated commentary adopted by the 2013 ATR Final Rule,[21] the 2013 TILA Servicing Final Rule,[22] the 2013 RESPA Servicing Final Rule,[23] and the 2013 Escrows Final Rule[24] as amended by the 2013 Amendments to the 2013 Escrows Final Rule.[25]

IV. Section-by-Section Analysis

A. Regulation X

Subpart A—General Provisions

The Bureau proposed a technical amendment to the heading for Subpart A of Regulation X from ''Subpart A—General'' to ''Subpart A—General Provisions'' to conform the heading in the text of the regulation to the heading set forth in the corresponding commentary. No comments were received on this change, and it is adopted as proposed.

Section 1024.5 Coverage of RESPA

The Proposal

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

The Bureau further proposed to add commentary for proposed § 1024.5(c) to make clear that Regulation X does not create field preemption. Since issuing the 2013 RESPA Servicing Final Rule, the Bureau had received inquiries as to whether Regulation X's mortgage servicing rules result in preemption of the field of mortgage servicing regulation. The Bureau had addressed this question in the preamble to the final rule, stating that ''the Final Servicing Rules generally do not have the effect of prohibiting State law from affording borrowers broader consumer protection relating to mortgage servicing than those conferred under the Final Servicing Rules.''[26] The preamble further stated that, although ''in certain circumstances, the effect of specific requirements of the Final Servicing Rules is to preempt certain limited aspects of state law'' in general, ''the Bureau explicitly took into account existing standards (both State and Federal) and either built in flexibility or designed its rules to coexist with those standards.''[27]

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

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

Comments

Numerous consumer and community groups provided similar comments supporting the proposed changes to the Regulation X preemption provision. These commenters supported the relocation of the preemption provision to § 1024.5(c) in the General Provisions subpart and the addition of comment 5(c)(1)–1. Many of these consumer and community groups further suggested that the regulatory text itself be changed to replace the phrase ''settlement practices'' with language more clearly inclusive of servicing activities. Several also requested that an example be included with comment 5(c)(1)–1 showing that a state law more protective of consumers will not be preempted by Regulation X.

Two industry commenters supported the proposed changes to the Regulation X preemption provision. One trade association suggested that the Bureau should promote uniform servicing standards to help create certainty in the market. Another industry commenter stated that the current regulation covered the situation sufficiently and the proposed guidance was unnecessary.

Two trade associations stated that the Bureau was narrowing the existing preemption provision to reduce the likelihood of preemption. One opposed the idea that state laws more protective of consumers are not preempted, and so opposed the inclusion of the comment. The other stated that the preemption provision for mortgage servicing transfers functions statutorily as a general preemption of mortgage servicing.

Several industry commenters pointed out that the statute and regulation use the word ''inconsistent'' when explaining which state laws may be preempted, while the proposed comment uses the more common term ''conflict'' to describe the situation. They suggested that the comment also use the term ''inconsistent'' to avoid confusion.

Final Rule

The relocation of the preemption provision and the guidance in proposed comment 5(c)(1)–1 were not intended to change the current preemption regime under Regulation X and the Bureau does not believe that they do so. The sentence in the regulation that consumer and community groups urged the Bureau to change simply replicates text in RESPA section 18. Therefore the Bureau does not believe that a change to that sentence would be appropriate. Comment 5(c)(1)–1 provides the

[21] 78 FR 6408 (Jan. 30, 2013).

[22] 78 FR 10902 (Feb. 14, 2013).

[23] 78 FR 10696 (Feb. 14, 2013).

[24] 78 FR 4726 (Jan. 22, 2013).

[25] 78 FR 30739 (May 23, 2013).

[26] 78 FR 10706 (Feb. 14, 2013).

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

Bureau's official interpretation of that regulatory language. As stated in the proposal, the Bureau believes that the relocation of the preemption provision and the addition of the comment are necessary and appropriate to eliminate any confusion as to how the preemption provision operates. In addition, the Bureau believes that the comment is sufficiently clear and does not consider an example to be necessary.

The final rule adopts the amendments as proposed, but changes the word ''conflict'' in the comment to ''inconsistent'' to avoid confusion.

B. Regulation Z

Section 1026.20 Disclosure Requirements Regarding Post-Consummation Events

20(c) Rate Adjustments With a Corresponding Change in Payment

20(d) Initial Rate Adjustment

Implementation Date. In its proposal, the Bureau did not seek to revise or clarify § 1026.20(c) and (d), the adjustable-rate mortgage (ARM) servicing regulations issued by the Bureau in the 2013 TILA Servicing Final Rule. Nevertheless, the Bureau received unsolicited queries regarding the implementation dates for these rules. Despite the unsolicited nature of these comments, the Bureau believes it would be helpful to clarify the ARM implementation dates.

ARM regulations § 1026.20(c) and (d) generally apply to ARMs originated both prior to and after the January 10, 2014, effective date. However, no servicer is required to comply with the rule until the effective date.

Implementation Date for § 1026.20(d). Because the notice required by § 1026.20(d) must be provided to the consumer between 210 and 240 days before the first payment is due after the initial interest rate adjustment, *servicers will not be required to provide the § 1026.20(d) notice when such payment is due 209 or fewer days from the effective date.* However, payments due 210 or more days from the effective date are subject to the rule.

Implementation Date for § 1026.20(c). Because the notice required by § 1026.20(c) must be provided to the consumer between 60 and 120 days before the first payment is due after an interest rate adjustment causing a corresponding change in payment, *servicers will not be required to provide the § 1026.20(c) notice when such payment is due 25 to 59 days from the effective date.* Note that, under the time frame of current § 1026.20(c), notices are required 25 to 120 days before the first payment is due after the interest rate adjustment. Thus, servicers already will have provided the § 1026.20(c) notices required by the current rule when such payment is due 24 or fewer days from the January 10, 2014, effective date.

Section 1026.35 Requirements for Higher-Priced Mortgage Loans

35(e) Repayment Ability, Prepayment Penalties

The Bureau is concerned that its recently published Amendments to the 2013 Escrows Final Rule [28] requiring industry to comply with certain provisions regarding repayment ability and prepayment penalties for HPMLs could be interpreted as requiring that certain transactions excluded from such requirements are now subject to those requirements. The Bureau believes that the amendments, properly understood, continue the exclusion for such transactions from the requirements. To provide certainty, the Bureau is revising § 1026.35(e) [29] to explicitly exclude from coverage construction and bridge loans and reverse mortgages—loans that were previously explicitly excluded from such requirements, as discussed below.

In January 2013, the Bureau issued the 2013 Escrows Final Rule,[30] which implements certain provisions of the Dodd-Frank Act relating to escrow accounts. That final rule revised the definition of ''higher-priced mortgage loan'' in 12 CFR 1026.35(a) by removing certain exclusions from the scope of consumer credit transactions that may be HPMLs. The loans no longer excluded from the definition of HPML are: Transactions to finance the initial construction of a dwelling (construction loans); temporary or ''bridge loans'' with a terms of twelve months or less, such as a loan to purchase a new dwelling where the consumer plans to sell a current dwelling within twelve months (bridge loans); and reverse mortgages subject to § 1026.33 (reverse mortgages). The Bureau removed these exclusions from the general definition of HPML and located them directly into the individual provisions regarding appraisal, escrow, ability to repay, and prepayment penalty requirements for HPMLs.[31]

Since adopting the above-referenced rules, the Bureau adopted Amendments to the 2013 Escrows Final Rule [32] to prevent the inadvertent and temporary elimination of certain consumer protections for HPMLs concerning ability to repay and prepayment penalties that were codified in 12 CFR 1026.35(b) prior to June 1, 2013. The 2013 Escrows Final Rule took effect June 1, 2013, while the 2013 ATR and HOEPA Final Rules [33] do not take effect until January 10, 2014. Consequently, the existing ability-to-repay and prepayment penalty protections for HPMLs would have been removed, pursuant to the 2013 Escrows Final Rule, over seven months before parallel provisions would take effect. The Amendments to the 2013 Escrows Final Rule restored those protections temporarily in, and re-codified them as part of, newly created 12 CFR 1026.35(e), which took effect June 1, 2013, and will be effective through January 9, 2014.

The Bureau's renumbering of the ability-to-repay and prepayment penalty provisions in § 1026.35(e) of Regulation Z, without excluding reverse mortgages and construction and bridge loans from coverage under that section, could be seen as removing these exclusions from the requirements of that temporary provision. To clarify that the Amendments to the 2013 Escrows Final Rule did not have that effect, the Bureau is revising temporary § 1026.35(e) to explicitly exclude construction loans, bridge loans, and reverse mortgages from its requirements. The Bureau is replacing current § 1026.35(e)(3) with new § 1026.35(e)(3), which states that the requirements of § 1026.35(e) do not apply to construction loans, bridge loans, and reverse mortgages. The Bureau is renumbering current § 1026.35(e)(3), ''Sunset of requirements on repayment ability and prepayment penalties,'' as new § 1026.35(e)(4). The general language in § 1026.35(e) is also revised to reflect the addition of these exclusions. As noted below, the amendment to § 1026.35(e) will apply to any transaction consummated on or after June 1, 2013, for which the creditor receives an application on or before January 9, 2014. Then, at the time § 1026.35(e) expires, the exclusions for construction loans, bridge loans, and reverse mortgages in the 2013 ATR and HOEPA Final Rules will take effect. Thus, the revision of § 1026.35(e) in this

[28] 78 FR 30739 (May 23, 2013).

[29] *Id.*

[30] 78 FR 4726 (Jan. 22, 2013).

[31] *See* § 1026.35(c)(2) of the 2013 TILA Appraisals Rule, 78 FR 10368 (Feb. 13, 2013) (which was adopted by the Bureau, together with several other Federal agencies, as an inter-agency rulemaking); § 1026.35(b)(2) of the 2013 Escrows Final Rule, 78 FR 4727 (Jan. 22, 2013); § 1026.43(a) of the 2013 ATR Final Rule, 78 FR 6408 (Jan. 30, 2013); and § 1026.32(a) of the 2013 HOEPA Final Rule, 78 FR 6856 (Jan. 31, 2013).

[32] 78 FR 30739 (May 23, 2013).

[33] 78 FR 6408 (Jan. 30, 2013); 78 FR 6856 (Jan. 31, 2013), respectively.

final rule will make clear that construction loans, bridge loans, and reverse mortgages have continued and will continue to be excluded from certain HPML requirements regarding prepayment penalties and a consumer's ability to repay the loan.

Legal authority. Construction loans, bridge loans, and reverse mortgages have always been excluded from the requirements of Regulation Z regarding repayment ability and prepayment penalties. The mortgage rules referenced above that implement the Dodd-Frank Act continue to exclude such loans from their requirements, including those governing repayment ability and prepayment penalties. Thus, the revisions to § 1026.35(e) in this final rule are merely technical changes to clarify the temporary provision's consistency with the historical and current treatment of such loans under Regulation Z.

For these reasons, the Bureau is revising temporary amendment § 1026.35(e) to explicitly exclude construction loans, bridge loans, and reverse mortgages from its requirements regarding ability to repay and prepayment penalties for HPMLs, pursuant to its authority to provide for adjustments and exceptions under TILA section 105(a) and (f), and with reliance on the authority used by the Board in amending Regulation Z to include these requirements,[34] including TILA section 129(p). As the Board concluded before it, the Bureau does not believe subjecting these loans to the repayment ability and prepayment penalty requirements would effectuate the purposes of, or facilitate compliance with TILA and Regulation Z. Many of the characteristics of these loans make it inappropriate or unnecessary to apply the repayment ability and prepayment penalty requirements of § 1026.35(e). For example, because the structure of reverse mortgages does not provide for repayment, the requirements related to repayment are not appropriate for such loans. The Bureau also notes that it anticipates undertaking a rulemaking to address how the Dodd-Frank Act title XIV requirements apply to reverse mortgages, and consumer protection issues in the reverse mortgage market may be addressed through such a rulemaking. Thus, the Bureau both interprets § 1026.35(e) not to subject the affected loans to its requirements and also, pursuant to 105(a) and 105(f) of TILA, continues to exclude those loans from the requirements of § 1026.35(e).

Notice and comment are not necessary for this revision of § 1026.35(e), which merely makes explicit in the regulation the Bureau's continuing interpretation that certain loans have been excluded from certain legal requirements throughout the renumbering process. Moreover, the Bureau finds good cause to proceed without notice and comment. 5 U.S.C. 553(b)(B). This revision merely clarifies the operation of the rule that should already have been apparent to many market participants. Notice and comment are therefore unnecessary. In addition, the length of the notice and comment period make it impracticable to correct erroneous interpretations of a rule that is already in effect and that expires within months. For these reasons and under the authority cited above, the Bureau is expressly excluding construction and bridge loans and reverse mortgages from the ability-to-repay and prepayment penalty requirements for HPMLs under interim § 1026.35(e).

[34] 73 FR 44522 (July 30, 2008).

Section 1026.41 Periodic Statements for Residential Mortgage Loans

41(a) In General

41(a)(1) Scope

Section 1026.41(a)(1) of the 2013 TILA Servicing Final Rule addresses the scope of the mortgage loans subject to the periodic statement requirements, stating that the rule applies to closed-end consumer credit transactions secured by a dwelling, subject to certain exemptions set forth in § 1026.41(e). It goes on to say that, for purposes of § 1026.41, ''such transactions are referred to as *mortgage loans.''*

To eliminate any confusion as to which loans ''such transactions'' refers, and thus to which loans the periodic statement rule applies, the Bureau proposed to clarify § 1026.41(a)(1). The proposed revision would have replaced the indefinite reference ''such transactions'' in § 1026.41(a)(1) with a reiteration of the loans to which the rule applies, that is, closed-end consumer credit transactions secured by a dwelling. This revision would have clarified which transactions are considered ''mortgage loans'' for purposes of § 1026.41.

The proposal stated that the Bureau believed this change also would reduce uncertainty about which loans to consider in determining a servicer's eligibility for one of the exemptions under § 1026.41(e), the small servicer exemption. Section 1026.41(e)(4)(ii) defines a small servicer as a servicer that services 5,000 or fewer mortgage loans, for all of which the servicer (or an affiliate) is the creditor or assignee.[35] The Bureau reasoned that the proposed text would have clarified that, in general, a servicer determines whether it is a small servicer by considering the closed-end consumer credit transactions secured by a dwelling that it services—including coupon book loans, which are exempt from some of the requirements of the periodic statement rule. The proposal noted that, pursuant to proposed § 1026.41(e)(4)(iii), reverse mortgages and transactions secured by consumers' interests in timeshares, which are exempt from all of the requirements of § 1026.41, would be excluded from consideration for purposes of determining small servicer status.

The Bureau received no comments on its proposed change to the regulatory text of § 1026.41(a)(1) and therefore is adopting it as proposed. The Bureau did, however, receive comments regarding the mortgage loans covered by the small servicer exemption, and those comments are discussed below in the sections specifically addressing the small servicer exemption.

41(e) Exemptions

41(e)(4) Small Servicers

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

The Proposal

The proposed rule explained that, for the reasons set forth in the 2013 Servicing Final Rules,[36] the Bureau determined that it was appropriate to exempt small servicers from certain mortgage servicing requirements. The proposal set forth the rules from which small servicers, as defined by § 1026.41(e)(4), are exempt: the Regulation Z requirement to provide periodic statements for residential mortgage loans [37] and, in Regulation X, (1) certain requirements relating to obtaining force-placed insurance,[38] (2) the general servicing policies, procedures, and requirements,[39] and (3) certain requirements and restrictions relating to communicating with borrowers about, and evaluation of applications for, loss mitigation options.[40]

Scope and application of the small servicer exemption. The Bureau's proposal would have clarified the scope and application of the small servicer

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

[36] *See, e.g.,* 78 FR 10718–10720 (Feb. 14, 2013).

[37] 12 CFR 1026.41(e).

[38] 12 CFR 1024.17(k)(5).

[39] 12 CFR 1024.30(b)(1).

[40] *Id.*

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

To ensure understanding of the small servicer exemption, the Bureau proposed to amend the commentary to § 1026.41(e)(4)(ii) to specifically identify which mortgage loans are considered for purposes of determining eligibility for the small servicer exemption. To this end, the Bureau proposed to add comment 41(e)(4)(ii)–1, which would have clarified that, in general and pursuant to § 1026.41(a)(1), the mortgage loans considered in determining qualification for the small servicer exemption are closed-end consumer credit transactions secured by a dwelling. Proposed comment 41(e)(4)(ii)–1 also would have highlighted that, pursuant to § 1026.41(e)(4)(iii), certain closed-end consumer credit transactions secured by a dwelling are not considered in determining status as a small servicer, as discussed further below in connection with proposed § 1026.41(e)(4)(iii).

The Bureau requested comments and data regarding whether proposed comment 41(e)(4)(ii)–1 would appropriately clarify the scope of mortgage loans that must be considered for determining if a servicer qualifies as a small servicer. The Bureau specifically requested comment and data regarding whether any servicers service a significant number of closed-end consumer credit transactions secured by a dwelling, which are subject to Regulation Z, but service significantly fewer ''federally related mortgage loans,'' which are subject to Regulation X. By way of example, the Bureau requested comment and data regarding whether any servicers would not be considered a small servicer if the small servicer exemption were based on whether a servicer services 5,000 or fewer closed end consumer credit transactions secured by a dwelling, but would be a small servicer if the small servicer exemption were based on whether a servicer services 5,000 or fewer ''federally related mortgage loan[s],'' as that term is defined in 12 CFR 1024.2. The proposal provided a specific example in a footnote of a servicer that services 10,000 construction loans, which are not considered ''federally related mortgage loans'' pursuant to 12 CFR 1024.2, and 100 mortgage loans that are considered ''federally related mortgage loans'' pursuant to 12 CFR 1024.2.[41] Such a servicer, the Bureau stated, would be considered to service 10,100 closed-end consumer credit transactions secured by a dwelling and would not qualify for the small servicer exemption. The proposal, however, underscored the fact that, in any case, only the 100 federally related mortgage loans serviced by the servicer would be subject to the mortgage servicing requirements set forth in Regulation X pursuant to 12 CFR 1024.31.

[41] 78 FR 25638, 25642 n.27 (May 2, 2013).

Comments

In response to its request for comment, the Bureau received several comments expressing general support for its proposed clarification of the scope of loans to consider in determining whether a servicer is a small servicer, and received no comments opposing the proposed clarification. Nor did the Bureau receive any data or comment with regard to servicers servicing a disproportionate number of federally related mortgage loans, as defined by Regulation X, compared to the number of ''mortgage loans'' they service, as defined by Regulation Z.

The Bureau also received a number of comments that were beyond the scope of the proposal. Three national trade associations urged the Bureau to revise the rule itself so that more servicers could qualify for the small servicer exemption, but provided no data or reasoning in support of this position. Similarly, a credit union trade association recommended that the Bureau revise the rule to consider only ''federally related mortgage loans'' instead of the more inclusive ''mortgage loans,'' as defined by the rule, but likewise provided no supporting data or reasoning. A trade association representing community banks generally urged the Bureau to reduce the loan pool used to determine small servicer status by limiting it to ''federally related mortgage loans'' and, in the alternative, specifically recommended carving out construction loans—one of the categories of loans not included in the definition of ''federally related mortgage loans''—from the category of ''mortgage loans.'' The trade association set forth reasons why construction loans require less oversight than other mortgage loans. Finally, a trade association representing home builders voiced concern that the proposal's reference to construction loans in the footnote example might cause ''confusion'' which could result in community banks reducing their construction loan portfolio to preserve their small servicer status. To avoid this possibility, the trade association recommended excluding construction loans from the loans considered in determining small servicer status.

Final Rule

As stated above in section I, this final rule generally does not address comments not directly related to the clarifications and revisions proposed by the rule. Absent opposition or responsive comments and in view of the support the Bureau received for its proposed clarification that the scope of loans considered in determining small servicer status are mortgage loans, as defined by § 1026.41, the Bureau is adopting comment 41(e)(4)(ii)–1 as proposed and declines to revise § 1026.41 with regard to the scope of loans considered in determining small servicer status.

The Proposal

Affiliate and master/subservicer relationships. The Bureau also proposed to amend § 1026.41(e)(4)(ii)(A), which states that a small servicer is a servicer that ''services 5,000 or fewer mortgage loans, for all of which the servicer (or an affiliate) is the creditor or assignee.'' Proposed § 1026.41(e)(4)(ii)(A) would have provided clarification that, for purposes of determining small servicer status, a servicer considers the mortgage loans it services *together with any mortgage loans serviced by any affiliates.* This change, the Bureau explained, would conform that section with § 1026.41(e)(4)(iii), which states that small servicer status is determined by counting ''the number of mortgage loans serviced by the servicer and any affiliates as of January 1 for the remainder of the calendar year.'' To avoid any risk of inconsistency, the Bureau believed it would have been appropriate to amend § 1026.41(e)(4)(ii)(A) to conform the language to § 1026.41(e)(4)(iii) by adding the clause ''together with any affiliates'' such that a small servicer is a servicer that ''services, *together with any affiliates,* 5,000 or fewer mortgage loans, for all of which the servicer (or an affiliate) is the creditor or assignee.'' As stated in the proposal, this change would more fully conform the language of § 1026.41(e)(4)(ii)(A) with the language of § 1026.41(e)(4)(iii) but would not change the meaning of the small servicer exemption.

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

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

Proposed comment 41(e)(4)(ii)–2 also would have provided examples of specific circumstances demonstrating these requirements. The first example would have illustrated the effect affiliation has on the loan count requirement of the small servicer test. Proposed comment 41(e)(4)(ii)–2.i stated that if a servicer services 3,000 mortgage loans, but is affiliated (as defined at § 1026.32(b)(2)) [42] with another servicer that services 4,000 other mortgage loans, both servicers are considered to service 7,000 mortgage loans and neither servicer is considered a small servicer. The second example would have illustrated the ownership requirement of the small servicer test. Proposed comment 41(e)(4)(ii)–2.ii stated that if a servicer services 3,100 mortgage loans, including 100 mortgage loans it neither owns nor originated but for which it owns the mortgage servicing rights, the servicer is not a small servicer. The proposal explained that this is because the servicer services some mortgage loans for which the servicer (or an affiliate) is not the creditor or assignee, notwithstanding that the total number of mortgage loans serviced is fewer than 5,000.

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

Proposed comment 41(e)(4)(ii)–3 would have clarified that a small servicer does not lose its small servicer status because it retains a subservicer, as that term is defined in 12 CFR 1024.31, to service any of its mortgage loans. The comment also would have clarified that, for a subservicer, as that term is defined in 12 CFR 1024.31, to gain the benefit of the small servicer exemption, both the master servicer and the subservicer must be small servicers. The comment also would have pointed out that, generally, a subservicer will not qualify as a small servicer because it does not own or did not originate the mortgage loans it subservices. However, the comment went on to state, a subservicer would qualify as a small servicer if it is an affiliate of a master servicer that qualifies as a small servicer.

Proposed comment 41(e)(4)(ii)–3 also would have removed the example in 2013 TILA Servicing Rule comment 41(e)(4)(ii)–2 described above in favor of three other examples that would have demonstrated the implication of a master servicer/subservicer relationship for purposes of qualifying for the small servicer exemption. In the first proposed example, a credit union services 4,000 mortgage loans—all of which it originated or owns. The credit union retains a credit union service organization to subservice 1,000 of the mortgage loans and the credit union services the remaining 3,000 mortgage loans itself. The credit union has no affiliation relationship with the credit union service organization. The credit

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

union is a small servicer and, thus, the small servicer exemption applies to the 3,000 mortgage loans the credit union services itself. The credit union service organization is not a small servicer because it services mortgage loans it does not own or did not originate. Accordingly, the credit union service organization does not gain the benefit of the small servicer exemption and, thus, must comply with any applicable mortgage servicing requirements for the 1,000 mortgage loans it subservices.

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

Proposed comment 41(e)(4)(ii)–3.iii would have posited the example of a nonbank servicer that services 4,000 mortgage loans, all of which it originated or owns. The servicer retains a ''component servicer'' to assist it with servicing functions. The component servicer is not engaged in ''servicing'' as defined in 12 CFR 1024.2; that is, the component servicer does not receive any scheduled periodic payments from a borrower pursuant to the terms of any mortgage loan, including amounts for escrow accounts, and does not make the payments to the owner of the loan or other third parties of principal and interest and such other payments with respect to the amounts received from the borrower as may be required pursuant to the terms of the mortgage servicing loan documents or servicing contract. In this proposed example, the component servicer is not a subservicer pursuant to 12 CFR 1024.31 because it is not engaged in servicing, as that term is defined in 12 CFR 1024.2. The nonbank servicer is a small servicer and the small servicer exemption applies to all 4,000 mortgage loans it services.

Comments

Many commenters expressed their appreciation for the Bureau's clarification of the affiliate and master/subservicer relationships. Among them, a trade association representing the banking industry noted that the proposed clarification of the affiliate relationship was consistent with the regulation as issued by the Bureau. Several commenters submitted comments outside the scope of this rulemaking recommending that the Bureau reconsider altogether the inclusion of affiliate loans in determining eligibility for the small servicer exemption. A trade association representing credit union service organizations (CUSOs), a national and state trade association representing credit unions, and two individual credit unions raised concerns that the affiliate relationships some CUSOs have with one or more credit unions would prevent those CUSOs (and their credit union affiliates) from qualifying for the small servicer exemption. (The proposed example clarifying the master/subservicer relationship included a CUSO that was not an affiliate.) These commenters recommended that the Bureau either revise the rule to remove affiliates and their mortgage loans from consideration in determining small servicer status or that the Bureau provide clarification regarding how to take into account the loans of CUSO affiliates that are not wholly-owned by credit unions or of CUSOs with multiple owners. Two of the commenters explained that many credit unions have an affiliate relationship with a CUSO to facilitate mortgage lending and borrowing. The trade associations noted the many cases of multiple credit unions affiliating with a single CUSO in order to achieve economies of scale and to maintain competitiveness in the marketplace. They indicated that these arrangements are particularly important for small credit unions with limited capacity. The trade association representing CUSOs voiced concern that the affiliate requirement in § 1026.41 could have a chilling effect on the mortgage CUSO industry by encouraging credit unions to divest their interests in CUSOs to maintain their small servicer exemption or by discouraging credit unions that qualify as small servicers from investing in an affiliate relationship with a CUSO.

Final Rule

In view of the comments supporting the proposed clarification of affiliate and master/subservicer relationships with regard to small servicer qualification and in the absence of responsive comments to the contrary, the Bureau is adopting the clarifications as proposed. With respect to the comments outside the scope of this rulemaking recommending that the Bureau exclude the mortgage loans of affiliates from consideration in determining small servicer status, the Bureau declines to revise the rule. In addition to the fact that reopening consideration of a major policy decision would require notice and comment relatively late in the implementation process, the Bureau continues to believe that the reasons underlying the rule as set forth in the 2013 Servicing Final Rules are persuasive on the merits.

For clarification with regard to CUSOs and their relationships with one or more credit unions, the Bureau directs both the CUSOs and the credit unions to the Bank Holding Company Act of 1956 (12 U.S.C. 1841 *et seq.*) to determine whether their particular business relationships constitute affiliate relationships.[43] For further clarification, the Bureau notes that, pursuant to the affiliate requirement in § 1026.41, in any affiliate relationship with a CUSO, the total number of the mortgage loans of the affiliated entities must be considered in determining small servicer status. For example, for a credit union and its CUSO affiliate, the total number of mortgage loans serviced by both entities must be considered to determine the small servicer status for both the credit union and the CUSO.[44] The same is true for credit unions that are deemed affiliates under the Bank Holding Company Act of 1956.

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

Section 1026.41(e)(4)(iii) of the 2013 TILA Servicing Final Rule sets forth certain criteria regarding how to determine if a servicer qualifies as a small servicer. In addition, that section explains that small servicer determination is based on the number of mortgage loans serviced by the servicer and any affiliates as of January 1 for the remainder of the calendar year. It also specifies that a servicer that ''crosses the threshold,'' and thus loses its small

[43] Pursuant to § 1026.32(b)(2), § 1026.41 is subject to the definition of ''affiliate'' as set forth in the Bank Holding Company Act of 1956 (the Act). *See* proposed comment 41(e)(4)(ii)–3.ii. Under the Act, ''affiliate'' is defined as any company that controls, is controlled by, or is under common control with another company. The percentage of control is a determining factor in whether an affiliate relationship exists. The Bureau notes that, absent other determining factors, if a credit union's percentage of control over a CUSO falls below the statutory minimum, there would be no affiliate relationship.

[44] For the small servicer status of a credit union/master servicer and the small servicer status of its *unaffiliated* CUSO/subservicer, see proposed comment 41(e)(4)(ii)–3.i, which the Bureau is adopting as proposed in this final rule.

servicer status and its small servicer exemption, has six months after crossing the threshold or until the next January 1, whichever is later, to comply with any requirements from which the servicer is no longer exempt.

The Proposal

To provide clarification regarding the date for determining small service status and when a servicer that loses small servicer status must begin to comply with regulations from which it had been exempt, and that those dates apply to both elements of the small servicer exemption (loan count and ownership status), proposed § 1026.41(e)(4)(iii) included a number of revisions to the 2013 TILA Servicing Final Rule § 1026.41(e)(4)(iii). First, proposed § 1026.41(e)(4)(iii) would have replaced the reference to a servicer that ''crosses the threshold'' for determining if the servicer qualifies as a small servicer with broader language indicating that a servicer that ''ceases to qualify'' as a small servicer will have six months or until the next January 1, whichever is later, to comply with any requirements for which a servicer is no longer exempt as a small servicer. The Bureau stated it believed that the broader phrase ''ceases to qualify'' would more accurately reflect the fact that there are two elements to determining if a servicer qualifies as a small servicer and pointed to the discussion above to underscore that either one of these elements could cause a servicer to lose exempt status.

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

Comments and Final Rule

The Bureau did not receive any responsive comments regarding the proposed clarifications discussed above, outside of general support for providing clarification regarding this issue. In order to clarify the timing provision, the Bureau is adopting the changes as proposed.

In this final rule, the Bureau also is revising a comment to § 1026.41(e)(4)(iii) that provides three examples of the timing for when a small servicer is no longer considered a small servicer and when that former small servicer must start complying with any requirements from which it previously was exempt as a small servicer. The Bureau is revising comment 41(e)(4)(iii)–2 to maintain consistency with and further clarify the changes to the regulatory text the Bureau is adopting in § 1026.41(e)(4)(iii), as discussed above.

To this end, the Bureau is revising the heading of comment 41(e)(4)(iii)–2. The Bureau is removing the reference to ''threshold'' and is amending the heading to read: ''*Timing for small servicer exemption''* for the same reasons discussed above and to maintain consistency with the adopted regulatory changes to § 1026.41(e)(4)(iii). In addition, the Bureau is amending the examples in the comment to conform to and further clarify the changes the Bureau is adopting in the regulatory text. The first of the current examples states that a servicer that begins servicing more than 5,000 loans on October 1 and is servicing more than 5,000 loans as of January 1 of the following year would no longer be considered a small servicer on April 1 of that following year. The second current example states that a servicer that begins servicing more than 5,000 mortgage loans on February 1, and services more than 5,000 loans as of January 1 of the following year, would no longer be considered a small servicer on January 1 of that following year. The third example states that a servicer that begins servicing more than 5,000 mortgage loans on February 1, but services less than 5,000 loans as of January 1 of the following year, is considered a small servicer for that following year.

The revised examples clarify two points. The first point is that the application of the calendar dates apply to both elements of the small servicer test, *i.e.,* exceeding the allowable maximum number of loans serviced *and* servicing mortgage loans a servicer either does not own or did not originate. The second point of clarification is that January 1 is the date used to determine whether or not a servicer is considered a small servicer and the other dates (the latter of six months from the time the servicer ceases to be a small servicer or until the next January 1) are used to determine when a small servicer that has lost its small servicer status must begin complying with the regulations for which it had been exempt.

The first revised example explains that a small servicer that begins servicing more than 5,000 mortgage loans (or begins servicing one or more mortgage loans it does not own or did not originate) on October 1 and is servicing 5,000 mortgage loans (or services one or more mortgage loans it does not own or did not originate) as of January 1 of the following year, would no longer be considered a small servicer on January 1 of that following year and would have to comply with any requirements from which it is no longer exempt as a small servicer on April 1 of that following year. The second revised example states that a small servicer that begins servicing more than 5,000 mortgage loans (or begins servicing one or more mortgage loans it does not own or did not originate) on February 1, and services more than 5,000 mortgage loans (or begins servicing one or more mortgage loans it does not own or did not originate) as of January 1 of the following year, would no longer be considered a small servicer on January 1 of that following year and would have to comply with any requirements from which it is no longer exempt as a small servicer on that same January 1. The third revised example states that a servicer that begins servicing more than 5,000 mortgage loans (or begins servicing one or more mortgage loans it does not own or did not originate) on February 1, but services less than 5,000 mortgage loans (or no longer services mortgage loans it does not own or did not originate) as of January 1 of the following year, is considered a small servicer for that following year. In sum, the amended heading and examples conform to and provide further clarification of the proposed changes to the regulatory text discussed above that the Bureau is adopting in this final rule.

The Proposal

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

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

The Bureau expressed concern that including charitably serviced mortgage loans in determining small servicer status would cause servicers to refrain from charitable servicing rather than lose the benefits of a small servicer exemption. The Bureau stated its belief that such a result would not further the goal of consumer protection for the affected consumers and might instead negatively affect the availability and costs of credit for consumers whose mortgage loans would otherwise be serviced pursuant to such charitable arrangements. Further, the Bureau believed that consumers would be more likely to receive superior service from an entity in the business of servicing that is willing to donate its services than they would if nonprofit entities that are not experienced in the business of servicing were forced to take on those duties themselves. Finally, the Bureau stated that it believed that the benefits of excluding charitably serviced mortgage loans from small servicer determination would outweigh the potential risks to consumers that exclusion may pose.

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

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

Legal authority. The Bureau proposed to exclude charitably serviced mortgage loans and reverse mortgage transactions from consideration in determining a servicer's status as a small servicer for purposes of the small servicer exemption in § 1024.41(e)(4) pursuant to its authority to provide for adjustments and exceptions under TILA section 105(a) and (f).[45] The proposal went on to say that, with respect to charitably serviced mortgage loans, the Bureau believed, for the reasons described above, that declining to consider such mortgage loans for purposes of determining eligibility as a small servicer would effectuate the purposes of, and would facilitate compliance with TILA and Regulation Z. The proposal further stated that, consistent with TILA

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

section 105(f) and in light of the factors in that provision, the Bureau believed that requiring servicers to consider mortgage loans they charitably service for purposes of determining eligibility as a small servicer would cause mortgage servicers to withdraw from such charitable relationships and not provide a meaningful benefit to consumers in the form of useful information or protection. In addition, the Bureau expressed its concern regarding the extent to which any requirement to consider such loans would complicate, hinder, or make more expensive the credit process for such mortgage loan transactions, especially considering the status of the borrowers that typically secure mortgage loans that are charitably serviced. The Bureau said that ultimately it believed the goal of consumer protection would be undermined if it were to consider, for purposes of small servicer qualification, mortgage loans voluntarily serviced by a servicer for a creditor or assignee that is not an affiliate of the servicer and for which the servicer does not receive any compensation or fees.

In the proposed rule, the Bureau said it similarly believed that not considering reverse mortgages in determining whether a servicer is a small servicer would effectuate the purposes of, and would facilitate compliance with, TILA and Regulation Z. The Bureau said it believed this for the same reasons set forth in the 2013 TILA Servicing Final Rule [46] exempting reverse mortgages from the requirements of § 1026.41. The Bureau pointed to the discussion in that final rule that the periodic statement requirements were designed for a traditional mortgage product and that information relevant and useful for consumers with reverse mortgages differs substantially from the information required on the periodic statement and, thus, would not provide a meaningful benefit to consumers of reverse mortgages. Finally, the proposal put forth the Bureau's belief that not considering reverse mortgages in determining whether a servicer is a small servicer is proper irrespective of the amount of the loan, the status of the consumer (including related financial arrangements, financial sophistication, and the importance to the consumer of the loan), or whether the loan is secured by the principal residence of the consumer.

Comments and Final Rule

The Bureau received only positive comments regarding its proposed clarification that reverse mortgage transactions and mortgage loans secured by a consumer's interest in timeshare plans, which are exempt from all provisions of § 1026.41, are excluded from the loan pool used to determine eligibility for the small servicer exemption. However, one national trade association representing credit unions contested the Bureau's clarification that fixed-rate loans with coupon books must be considered for purposes of determining eligibility for the small servicer exemption. The commenter said that including fixed-rate loans with coupon books in the loan pool used to determine small servicer status but excluding them from the requirement to provide periodic statements would create confusion without providing adequate benefits. The Bureau disagrees and notes, as discussed above, that fixed-rate loans with coupon books are exempt only from some of the requirements of § 1026.41—as opposed to reverse mortgage transactions and mortgage loans secured by a consumer's interest in timeshare plans which are not subject to any of the requirements of § 1026.41. Servicers servicing fixed-rate loans with coupon books are exempt from the requirement to provide periodic statements for these loans under § 1026.41, but servicers nevertheless have to provide to consumers with such loans the information contained in the periodic statement, either in the coupon book or in some other form. Because servicers servicing fixed-rate loans with coupon books must comply with the requirements of § 1026.41 regarding those mortgage loans, it is appropriate that such loans would be considered in determining whether such servicers are small servicers and therefore exempt from complying with the requirements of § 1026.41 with regard to those loans. Conversely, it is appropriate to exclude reverse mortgage transactions and mortgage loans secured by a consumer's interest in timeshare plans from the loan pool used to determine small servicer status because, regardless of that servicer's small servicer status, there is no requirement for the servicer to comply with any of the requirements of § 1026.41 with regard to those loans.

The Bureau received strong support for its proposed revision of § 1026.41 to exclude charitably serviced loans from consideration in determining whether a servicer qualifies as a small servicer, that is, mortgage loans voluntarily serviced for a non-affiliate creditor or assignee and for which the servicer does not receive any compensation or fees. Commenters agreed that, absent the Bureau's proposal, small servicers likely would relinquish their volunteer efforts in order to preserve their small servicer status. In response to one commenter's request for clarification, the Bureau notes that its proposed revision of the rule with regard to volunteer servicing is not limited to the servicing of mortgage loans owned or originated by nonprofit organizations, although the Bureau suspects that most charitable servicing is done on behalf of such organizations. Due to the support received by the Bureau for its proposed revision of § 1026.41(e)(4)(iii)(A) excluding charitably serviced mortgage loans from the loan pool used to determine small servicer eligibility, and for the reasons stated above, the Bureau is adopting the revision as proposed.

In addition to requesting comment regarding the appropriateness of excluding charitably serviced mortgage loans when determining small servicer status, the proposal solicited comment on whether other mortgage loans serviced through similar limited arrangements should not be considered in determining whether a servicer is a small servicer. The Bureau did not receive comments recommending that any other servicing arrangements be excluded from consideration for purposes of determining small servicer status. The Bureau did receive a comment outside of the scope of the proposal from a national trade association requesting guidance regarding the trade association's conclusion that certain depository services some of its members provide for depositors who self-finance the sale of residential real estate do not qualify as "servicing," as defined in 12 CFR 1024.2(b). The trade association explained that, for a minimal fee, some banks—usually small banks—receive mortgage payments from a borrower and deposit the funds into that customer's account. According to the trade association, the agreement between the bank and the depositor/creditor typically excludes any other services, such as providing servicing in the case of delinquency. The trade association expressed concern that small institutions will discontinue this service for their depository customers who owner-finance the sale of real property for fear of losing their small servicer status if the depository service could be construed as servicing mortgage loans that the bank does not own or did not originate.

Because the comment was outside the scope of the proposal, the Bureau declines to provide the requested guidance. Moreover, even if the comment were within the scope of the proposal, the Bureau is not able to

[46] *See* 78 FR 10901, 10973 (Feb. 14, 2013).

provide guidance at this juncture because the trade association did not provide sufficient information about the banking service described.

Section 1026.43 Minimum Standards for Transactions Secured by a Dwelling

43(e) Qualified Mortgages

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

The 2013 ATR Final Rule generally requires creditors to make a reasonable, good faith determination of a consumer's ability to repay any consumer credit transaction secured by a dwelling (excluding an open-end credit plan, timeshare plan, reverse mortgage, or temporary loan) and establishes certain protections from liability under this requirement for ''qualified mortgages.'' These provisions, in § 1026.43(c), (e)(2), (e)(4), (e)(5), (e)(6) [47] and (f), implement the requirements of TILA section 129C(a)(1) and the qualified mortgage provisions of TILA section 129C(b).

To determine the qualified mortgage status of a loan, creditors must analyze whether the loan meets one of the definitions of ''qualified mortgage'' in § 1026.43(e)(2), (e)(4), (e)(5), (e)(6) or (f). Section 1026.43(e)(4) provides a definition of qualified mortgage for loans that (1) meet the prohibitions on certain risky loan features (*e.g.,* negative amortization and interest only features); (2) do not exceed certain limitations on points and fees under § 1026.43(e)(2); and (3) either are eligible for purchase or guarantee by one of the GSEs, while under the conservatorship of the Federal Housing Finance Agency, or are eligible to be insured or guaranteed by HUD under the National Housing Act (12 U.S.C. 1707 *et seq.*), the VA, the USDA, or RHS.[48] HUD, VA, USDA, and RHS have authority under the Dodd-Frank Act to define qualified mortgage standards for the types of loans they insure, guarantee, or administer. *See* TILA section 129C(b)(3)(B)(ii). Coverage under § 1026.43(e)(4) for such loans will sunset once each agency promulgates its own qualified mortgage standards and such rules take effect. Coverage of GSE-eligible loans will sunset when conservatorship ends.

Even if the Federal agencies do not issue additional rules or conservatorship does not end, the temporary qualified mortgage definition in § 1026.43(e)(4) will expire seven years after the effective date of the rule.[49] Covered transactions that satisfy the requirements of § 1026.43(e)(4) that are consummated before the sunset of § 1026.43(e)(4) will retain their qualified mortgage status after the temporary definition expires. However, a loan consummated after the sunset of § 1026.43(e)(4) may be a qualified mortgage only if it satisfies the requirements of another qualified mortgage provision in effect at that time.

Eligibility Under GSE/Agency Guides and Automated Underwriting Systems

The Proposal

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

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

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

However, the Bureau recognized in the proposed rule that the GSEs and agencies impose a wide variety of requirements relating not only to underwriting of potentially eligible loans, but also to the mechanics of sale, guarantee, or insurance and post-consummation activities. Because

[47] The May 2013 ATR Final Rule amended the 2013 ATR Final Rule in part by adding two new types of qualified mortgages, at § 1026.43(e)(5) and (6). See 78 FR 35430 (June 12, 2013).

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

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

underwriting is a complex process that involves assessment of the consumer's ability to repay the loan as well as other credit risk factors, the Bureau believed that it was appropriate to base qualified mortgage status under § 1026.43(e)(4) on the GSEs' and agencies' general standards concerning borrower, product, and mortgage eligibility and underwriting. While some of these underwriting requirements may be more closely or directly related to assessing a consumer's ability to repay than others, the Bureau believed that attempting to disaggregate them would be an extraordinarily complex task that would defeat the purposes of the temporary definition in adopting widely recognized standards to facilitate compliance and access to responsible credit. Where groups of requirements are wholly unrelated to underwriting (*i.e.,* wholly unrelated to assessing ability to repay and other risk-related factors), however, the Bureau believed that it was appropriate to specify that such requirements do not affect qualified mortgage status.

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

Comments

Only one consumer group commented on the Bureau's inclusion of guidance stating that issues wholly unrelated to ability to repay would not affect a loan's QM status. This consumer group is also a nonprofit lender. Its comment suggested that the Bureau should state clearly those issues that are ''related'' to ability to repay, such as income or obligations that materially impact ability to repay, and violations of specific QM product restrictions, and rule out such things as credit score and appraisal requirements. This commenter also stated that failure to make this guidance clearer could reduce credit availability.

Industry commenters overwhelmingly supported the interpretation that issues wholly unrelated to ability to repay should not be considered in assessing the QM status of a loan under § 1026.43(e)(4). Most, however, also suggested that the guidance on what would be considered wholly unrelated to ability to repay should be clarified and the excluded items or categories expanded. Commenters agreed that failure to comply with post-consummation requirements should be excluded. As did the consumer group in the comment referenced above, some industry commenters requested that the Bureau make clear that items deemed related to ability to repay be limited to narrow issues of a borrower's ability to make the loan's payments, and that other risk-related factors be excluded. Specifically, commenters asked that factors related to willingness to repay (as opposed to ability to repay) and issues involving the attributes or defects of the collateral be excluded. Some commenters raised the issue of excluding jumbo loans.[50] Two commenters requested that a time limit be imposed so that repurchase or indemnification claims on seasoned loans would be disregarded. One commenter stated that income determinations are variable and subjective, so errors made in good faith should not invalidate QM status. Another commenter asked for guidance on some of the issues above, rather than specifically requesting exclusion.

In addition, commenters generally suggested that various other topics should be specifically listed as wholly unrelated to ability to repay, including: (1) Failure to comply with laws and regulations, including consumer protection laws and regulations; (2) purchase of a state-issued title guarantee for loans held in portfolio; (3) delayed note certification; (4) Ginnie Mae modification; (5) early buy-out programs; (6) non-material technical defects triggering repurchase or indemnification; and (7) ''additional repurchase requirements.''

The two GSEs both commented on the proposed rule, and both discussed the ''wholly unrelated to ability to repay'' guidance. One specifically stated support for the guidance, and both urged the Bureau to state that collateral-related issues were wholly unrelated to ability to repay.

Final Rule

The Bureau adopts the guidance on issues of what is wholly unrelated to ability to repay substantially as proposed, but has adopted the standard in the regulatory text to harmonize the eligibility requirements that must be met for the temporary qualified mortgage definition under the rule with those permitted under the Commentary. In addition, comment 43(e)(4)–4 has been revised to state that matters wholly unrelated to ability to repay are those matters that are wholly unrelated to credit risk or the underwriting of the loan, and to provide more detailed guidance on applying the standard.

As stated in the proposed rule, underwriting is a complex process that involves assessment of the consumer's ability to repay the loan as well as a variety of other credit risk factors. The Bureau made a deliberate decision in the 2013 ATR Final Rule to base qualified mortgage status under § 1026.43(e)(4) on the GSEs' and agencies' general underwriting and credit risk analysis standards. While some of these factors may be more closely and directly focused on consumers' ability to repay than others, the Bureau continues to believe that attempting to disaggregate GSE and agency underwriting requirements based on degree of relationship to ability to repay would be an extraordinarily complex task that would defeat the purposes of the temporary definition in adopting widely recognized standards to facilitate compliance and access to responsible credit. Indeed, the statute itself requires consideration of a borrower's credit history, which could relate to willingness as well as ability to repay. Exclusion of requirements regarding collateral and other risk-related factors

[50] Although one commenter asked that jumbo size, which renders a loan too large to be eligible for GSE purchase or guarantee, be deemed wholly unrelated to ability to repay, another commenter merely asked for guidance on whether or not jumbos would be excluded. The Bureau stated in the January 2013 final rule that the temporary qualified mortgage definition does not include ''jumbo'' loans in 1026.43(e)(4), given, in part, that the Bureau views the jumbo market as already robust and stable. Excluding jumbo loan size eligibility conditions for GSEs would effectively reverse the Bureau's conclusion on this matter. The Bureau continues to believe that the jumbo loan market does not need the benefit of temporary qualified mortgage definition and notes that jumbo loans can be qualified mortgages to the extent that they meet the other qualified mortgage definitions.

would require line-drawing exercises that could potentially interfere with the regulatory purpose. Moreover, allowing disaggregation would not be consistent with the use of AUS determinations to demonstrate compliance, as they involve interdependent risk factors and do not focus solely on a borrower's capacity to make payments.

The Bureau has revised the final comment to add an express general statement that matters wholly unrelated to ability to repay are those matters wholly unrelated to credit risk or the underwriting of the loan. The Bureau believes that this language, in conjunction with the reference to specific sets of requirements that are wholly unrelated to assessing ability to repay at the time of consummation (such as those related to selling, securitizing, or delivering consummated loans), provides useful guidance to stakeholders.

As stated in the proposed rule, and consistent with the final rule, QM status depends on eligibility for sale, insurance, or guarantee at consummation, not on an actual executed sale, insuring, or guarantee of the individual loan. Accordingly, the Bureau considers events occurring after consummation and GSE and agency requirements concerning execution of an actual sale, insuring, or guarantee of the loan to be wholly unrelated to ability to repay.[51] In addition, the Bureau believes that in regard to very limited matters, such as the status of a creditor's approval or eligibility to do business with a GSE, additional pre-consummation occurrences may also be wholly unrelated to ability to repay. Accordingly, the Bureau has revised the language in the final comment to identify specifically that these sets of requirements are considered wholly unrelated to ability to repay for purposes of the rule.

Although the Bureau has reviewed many of the requests for determinations as to particular requirements in the comments received, the Bureau notes that with respect to certain of these inquiries, there was not sufficient detail or background information to discern the precise nature of the request or question. For instance, commenters' bare suggestion that ''additional purchase requirements'' be deemed wholly unrelated to ability to repay was simply too vague to analyze, and would require further specification in order to apply the standard.

[51] Because the determination is based on the situation at consummation, the later repayment history or ''seasoning'' of the loan would not be an appropriate metric for this standard.

Use of Automated Underwriting Systems

The Proposal

The Bureau also proposed to revise comment 43(e)(4)–4 to clarify eligibility as determined by an automated underwriting system of a GSE or one of the agencies. As explained in comment 43(e)(4)–4 as adopted in the 2013 ATR Final Rule, the AUSs and the written guides of the GSEs as well as the agencies can be used for eligibility purposes under § 1026.43(e)(4). The proposed revision of the comment explained that to rely upon an AUS recommendation to demonstrate qualified mortgage status a creditor must have (1) accurately inputted the loan information into the automated system, and (2) satisfied any accompanying requirements or conditions to the AUS approval that would otherwise invalidate the recommendation, unless, as discussed above, the conditions are wholly unrelated to the consumer's ability to repay. The comment as adopted in the 2013 ATR Final Rule assumed that any recommendation used for compliance would be valid, and these clarifications merely listed two criteria that should be monitored to ensure that validity. In particular, because the AUSs generate a list of conditions that must be met in support of the approval designation, the Bureau believed that those conditions must be satisfied to show eligibility for purchase, guarantee, or insurance. The Bureau sought comment on these revisions as well and also proposed technical edits to comment 43(e)(4)–4 for clarity and accuracy.

Comments

The consumer and community group commenters did not discuss the guidance in comment 43(e)(4)–4 requiring that an AUS determination be based on accurate inputs, and that the creditor comply with any requirements and conditions specified by the AUS. About half of the industry commenters that specifically discussed this guidance supported its inclusion. Industry commenters asked that the Bureau make clear that QM status will not be invalidated by minor inaccuracies and by inaccuracies that would not change the outcome of the AUS determination. One commenter stated that it will not be possible to determine whether or not a loan would have been approved with accurate inputs.

Final Rule

The Bureau adopts the comment as proposed, with minor edits for clarity. As stated in the regulation, a loan is a QM if it is eligible for purchase, insurance or guarantee by a GSE or agency other than with regard to issues wholly unrelated to ability to repay, and meets the other relevant requirements. For this reason, minor inaccuracies in input data that do not affect eligibility will not affect QM status. The Bureau believes the convenience and ease of compliance made possible by this provision are more important than avoiding those few situations in which it is difficult to determine which inaccuracies will affect the AUS outcome.

Although the reference to issues wholly unrelated to ability to repay in the main paragraph of the proposed comment applied to the requirements and conditions accompanying an AUS determination, and unquestionably do now that the standard is in the regulatory language, the Bureau believes that repeating such language in paragraph ii will enhance the clarity of the comment, and is doing so.

Effect of Written Contract Variances

The Proposal

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

Comments

Two consumer and community group commenters discussed the use of variances with § 1026.43(e)(4). One comment, from a group of organizations, stated that allowing use of variances was a mistake because the agreements are private and this would make them very difficult for consumers to enforce when they are violated. This comment also suggested that if the variance provision is adopted the Bureau should make clear that a borrower would have access to such variance agreements by sending a qualified written request under RESPA. The other consumer group commenter, which operates a nonprofit lender, supported the use of variances as provided in the comment.

Industry commenters were very supportive of allowing the use of variances. However, one association representing credit unions opposed allowing the use of variances, stating that it would disadvantage smaller market participants. A real estate association commented that variances should be allowed but should be required to be made public so that any creditor could request use of their terms. Other industry commenters requested that the Bureau make clear that later assignees could rely on the QM status of loans originated pursuant to a variance. Another commenter asked that the Bureau specify that, in order to be relied on, a variance must be in effect at the time of consummation of the loan.

Several industry commenters pointed out that these variances are often used with correspondent lenders, and the creditor who has negotiated the variance agreement acts as an aggregator or sponsor, pooling loans originated by others. They stated that the comment as proposed would present a problem because it states that the variance can only be used by a creditor who is a party to the agreement with the GSE. They further stated that this problem could interfere with the origination of a large number of loans that meet the GSEs' standards, and argued that correspondent lenders should be allowed to rely on the variances of their sponsors or aggregators. One large bank, however, opposed the idea of allowing one creditor to rely on another's variance, stating that this might allow loans to become QMs after consummation.

One of the GSEs provided comment on the variance provision, strongly supporting it, and pointing out in addition that both GSEs sometimes grant individual loan waivers of their standards. The GSE stated that these waivers do not proceed from an increase in its appetite for risk, and are only granted "on an exceptional basis," and that they should be treated the same as the negotiated variances. One industry association also asked that such individual waivers be treated this way.

Final Rule

The language regarding variances is adopted substantially as proposed, with two important changes. The Bureau agrees that disallowing correspondent use of variances would interfere unduly with the market, and is adding language to clarify use in such circumstances without allowing wholly unrelated entities to rely on some other creditor's agreement. Also, the Bureau believes that individual waivers granted by the GSEs should benefit from the same treatment as creditor-specific variances negotiated with the GSEs.

As with all the QM provisions, the status of a loan is determined at the time of consummation. The variance applied to a transaction must be in effect at the time a loan is consummated, and the loan must meet all relevant requirements at that time. For this reason, a loan cannot be retroactively made into a QM by a creditor or assignee. In addition, because the status is determined at consummation, later assignees can rely on that status if it is valid. Allowing correspondents to rely on the variances of their sponsors or aggregators in effect at the time of consummation will not change this situation, and it will help to alleviate concerns that only larger market participants may take advantage of negotiated variances. The language of comment 43(e)(4)–4 has been crafted to ensure that the correspondent is involved in a direct relationship with the variance holder and originating the QM pursuant to that relationship.

In addition, the Bureau does not believe that allowing use of variances will disadvantage smaller market participants, since it is intended only to maintain the current market situation. Although variances are private agreements, with the potential for attendant disadvantages described by commenters above such as difficulty of enforcement, the Bureau does not believe it is appropriate to regulate transparency for these agreements through this narrowly focused amendatory rulemaking, without further review. As always, the Bureau will monitor the effects of its rules on the marketplace going forward.

The Bureau has decided to allow loans benefitting from individual waivers granted by the GSEs to be treated the same as loans originated following negotiated variances. The Bureau has no reason to believe that these loans present undue risk to consumers, and notes that the GSEs are under government conservatorship.

The provision regarding variances is adopted as proposed, with the two changes discussed above.

Repurchase and Indemnification Demands

The Proposal

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

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

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

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

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

Comments

One consumer group and nonprofit lender commented on the explanation of how repurchase and indemnification demands should be understood in relation to QM status, stating support for the Bureau's rule but requesting more fully developed guidance on the issue.

Industry commenters overwhelmingly supported the addition of comment 43(e)(4)–5, but also had various suggestions for changes. One industry commenter, along with one of the GSEs, stated that the first example given, in which an accurate determination that the creditor-reported income did not support QM status meant that QM status was invalid, appeared to suggest that the repurchase demand was indeed dispositive. A trade association asked that the Bureau not include as ''loans for which repurchase or indemnification demand has been made'' those loans that are not eventually repurchased or indemnified.

Both GSEs commented on this guidance, and both supported the addition of comment 43(e)(4)–5. One GSE also suggested that the Bureau should delete the examples given because they would cause confusion. One also requested that the Bureau make clear that even if QM status under § 1026.43(e)(4) is invalidated, the loan may still have qualified for QM status under another provision.

Final Rule

Comment 43(e)(4)–5 is adopted as proposed, with two small edits to make clear that only QM status under § 1026.43(e)(4) is being discussed in the examples and that in the second example the critical fact is that the loan still meets Fannie Mae's eligibility requirements.

Regarding the first example in the comment, it is not the repurchase demand nor the quality control review that is dispositive as to QM status, but the fact that the finding that the income figure is unsupported by the documentation is stated to be ''accurate.'' The example is a hypothetical, and assuming the accuracy of an issue that would normally have to be established through an investigation of the facts and circumstances of the transaction allows for better explanation of how the rule works. As for the issue of what should be considered a repurchase or indemnification demand, the question is irrelevant to QM status. Repurchase or indemnification demands are potentially relevant to QM status only because they may indicate or lead to evidence that a loan did not qualify as a QM at the time of consummation. In addition, the Bureau believes that the examples will increase clarity for stakeholders, and not cause confusion. Accordingly, the Bureau considers the two examples presented as providing clear and appropriate guidance on the issue, with the edits mentioned above.

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

Overview

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 (DTI) that is less than or equal to 43 percent. To determine whether the consumer meets the specific DTI requirement, the creditor must calculate the consumer's monthly DTI in accordance with appendix Q. The Bureau adopted the 43 percent DTI requirement and other modifications to the statutory criteria pursuant to its authorities under TILA section 129C and 105(a).[52]

Appendix Q, as adopted, contains detailed requirements for determining ''debt'' and ''income'' for the purposes of the DTI calculation based on the definitions of those terms set forth in HUD Handbook 4155.1, *Mortgage Credit Analysis for Mortgage Insurance on One-to-Four-Unit Mortgage Loans.* The standards in the Handbook are used by creditors originating residential mortgages insured by the Federal Housing Administration (FHA) to determine and verify a consumer's total monthly debt and monthly income. For the purposes of appendix Q, the Bureau largely codified the Handbook, but modified various portions of it to remove standards and references unique to the FHA underwriting process.

In adopting appendix Q in the 2013 ATR Final Rule, the Bureau believed that using, to the extent possible, existing HUD/FHA underwriting guidelines as the foundation for determining ''debt'' and ''income'' for DTI purposes would provide creditors with well-established standards for determining whether a loan is a qualified mortgage under § 1026.43(e)(2).

Following publication of the 2013 ATR Final Rule, the Bureau received a number of inquiries from industry stakeholders regarding provisions codified in the appendix that they believed had been intended to function as flexible standards used by the FHA for insurance underwriting purposes, rather than codified as bright-line requirements for determining debt and income. Concerns were raised that these provisions may be properly suited for the purposes of a holistic and qualitative underwriting analysis but are not well-suited to function as regulatory requirements that are not subject to discretionary variance or waiver on an individual basis. Stakeholders also expressed concern that many of these provisions provided little clarity or guidance for creditors for compliance purposes. Similarly, stakeholders expressed concerns that the broad nature of these provisions could undermine the presumption of compliance available to creditors who make qualified mortgages and expose them to significant litigation risk.

In response to these concerns, the Bureau included certain proposed revisions to appendix Q in its proposed rule to facilitate compliance when determining DTI and to further the purposes of the ATR Final Rule. The Bureau agreed that certain provisions of appendix Q as adopted were not properly suited to function as regulations. The Bureau intended appendix Q to serve as a reliable mechanism for creditors to evaluate income and debts for the purpose of determining DTI and not as a general and flexible underwriting policy for assessing risk (as it is used by FHA in the context of insurance). The Bureau also recognized that it would not have the same level of discretion regarding the application of appendix Q.[53]

The Bureau therefore proposed revisions to appendix Q on: (1) Stability of income, and the creditor requirement to evaluate the probability of the consumer's continued employment; (2) with regard to salary, wage, and other forms of consumer income, the creditor requirement to determine whether the consumer's income level can reasonably be expected to continue; (3) creditor analysis of consumer overtime and bonus income; (4) creditor analysis of consumer Social Security income; (5) requirements related to the analysis of self-employed consumer income; (6) requirements related to non-employment related consumer income, including creditor analysis of consumer trust income; and (7) creditor analysis of rental income.

The Bureau also proposed other revisions to clarify the application of appendix Q, as well as general technical and wording changes throughout appendix Q for consistency and clarification, including technical changes to conform to the specific purpose that appendix Q serves in the 2013 ATR Final Rule, as opposed to the function that the HUD Handbook serves for FHA underwriting.

Overview of Comments on Bureau's Appendix Q Proposals

Commenters, including both industry and consumer commenters, generally supported the Bureau's proposed changes to appendix Q. A bank for example stated that it appreciated the Bureau's efforts to establish clear and reliable standards within appendix Q, and that it generally believed the proposed amendments would allow creditors to underwrite loans with improved confidence that appendix Q standards have been met. A bank trade association stated that it appreciated the Bureau's efforts to clarify the ability-to-repay regulations and stated that it believed the Bureau's proposals would go a long way in improving the final rules. A state credit union association stated that it strongly supported the Bureau's proposed changes to appendix Q as certain provisions adopted in appendix Q are not suitable to function as regulations. A consumer organization stated its support for the Bureau's clarifications of appendix Q but also suggested the need for further clarifications. Most commenters suggested additional clarifications to appendix Q, some specific to the Bureau's proposals, and some beyond the Bureau's specific proposals—including general revisions.

Response to General Comments on Appendix Q

The Bureau appreciates the comments received on its appendix Q proposals. The Bureau believes that the proposals as adopted in this final rule will further the purpose and intent of appendix Q by establishing clearer requirements for assessing the debt and income of consumers, while at the same time facilitating creditor compliance and access to credit for consumers. The comments received generally support the Bureau's view.

I. CONSUMER ELIGIBILITY

A. Section I.A. Stability of Income

The Proposal

The Bureau proposed revising the criteria in appendix Q for determining whether a consumer's income is ''stable'' for the purposes of DTI.

Appendix Q as adopted required in section I.A.3.a that creditors evaluate the ''probability of continued employment'' by analyzing, among other things, (1) the consumer's past employment record; (2) the consumer's qualification for the position; (3) the consumer's previous training and education; and (4) the employer's confirmation of continued employment. Stakeholders had raised concerns that, beyond analysis of a consumer's past employment record and current employment status, each of these requirements was incompatible with appendix Q's purpose of providing clear rules for determining debt and income, and was likely to result in compliance difficulty and significant exposure to litigation risk for creditors attempting to avoid such risk by originating qualified mortgages and thereby taking advantage of the presumption of compliance. Stakeholders, for example, indicated

[52] The Bureau notes that the specific 43 percent debt-to-income requirement applies only to qualified mortgages under § 1026.43(e)(2). The specific DTI requirement does not apply to loans that meet the qualified mortgage definitions in § 1026.43(e)(4), (5), (6), or (f), or that are not qualified mortgages and instead comply with the general ability-to-repay standard.

[53] 78 FR 25648.

that many employers were likely to be unwilling for various reasons (including but not limited to economic uncertainty) to confirm that a consumer's employment will continue into the future, and similarly creditors may be unqualified to evaluate a consumer's education, training, and job qualifications.

In response to these concerns, the Bureau proposed to amend appendix Q in section I.A.3.a to eliminate the requirements that creditors determine the ''probability of continued employment'' by considering a consumer's ''qualifications for the position'' and ''previous training and education.'' The Bureau proposed instead to amend the section to require creditors to examine a consumer's past and current employment. The Bureau also proposed to remove the requirement that creditors obtain the ''employer's confirmation of continued employment'' and instead require only that the creditor examine the ''employer's confirmation of current, ongoing employment status.'' The Bureau believed that requirements for a creditor to evaluate a consumer's training, education, and qualifications for his or her position are not well-suited to function as regulations designed to enable creditors to determine debts and income and in turn calculate DTI, and may increase exposure to litigation risk. Specifically, the Bureau indicated that it was not entirely clear what creditors would need to do in order to comply with these requirements, or how those determinations would affect a consumer's income for the purpose of calculating DTI.

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

The Bureau stated further that a confirmation of current, ongoing employment status is adequate to verify employment for purposes of determining income. To that end, the Bureau also proposed for clarification purposes a proposed note to section I.A.3 that states creditors may assume that employment is ongoing if a consumer's employer verifies current employment and does not indicate that employment has been, or is set to be terminated. The proposed note made clear, however, that creditors should not rely upon a verification of current employment that includes an affirmative statement that the employment is likely to cease, such as a statement that indicates the employee has given (or been given) notice of employment suspension or termination.

Finally, the Bureau also proposed several other technical, non-substantive changes to section I.A for clarification purposes.

Comments

Commenters, primarily from industry, who submitted comments concerning the Bureau's proposed changes to section I.A.3 were generally supportive of those changes although some clarification or additional guidance was suggested by several.

Several bank trade associations and a bank, in expressing support for the changes, noted that: (1) While it is reasonable to require an examination of current employment, provisions which require a creditor to speculate or predict future employment are problematic; (2) creditors should not be asked to second guess employer hiring decisions or be expert in establishing qualifications for positions; (3) the eliminated criteria could have a negative impact on consumers with ''on the job'' education; and (4) employers will not discuss certainty of continued employment for fear that it could create a new employment contract for at-will employees. These commenters also suggested that the Bureau provide guidance that verbal confirmation would satisfy the requirement that the creditor examine the employer's confirmation of the consumer's ''current, ongoing employment status'' as provided in I.A.3.a as proposed by the Bureau.

A state banking association commenter, in expressing support for the Bureau's proposal to replace the section I.A.3.a requirement that the creditor obtain an employer's ''confirmation of continued employment'' for an applicant with a requirement to ''confirm current, ongoing employment,'' requested that the Bureau provide additional clarification for instances in which employment is inherently dependent on contingencies outside the employee's or employer's control—such as applicants whose salaries are funded through ongoing grants, agency funded positions at a nonprofit organization or federal work programs, or applicants who are political appointees. A national banking association commenter requested similar clarification noting that flexibility is required to ensure that all populations are adequately served.

One commenter, a manufactured housing lender, with regard to the Bureau's proposed note amending section I.A.3.a, stated that the Bureau should make clear that the creditor has no obligation to inquire—either in writing or verbally—as to the employee's job performance and/or whether any suspension or termination is imminent.

A credit union commenter that indicated that it serves the education community stated, in referring to the Bureau's proposed note amending I.A.3.a, that the employment of many of its members who are teachers, professors and other educators is established by year-to-year contracts that generally include a termination date. The commenter noted that these contracts are generally renewable and negotiated through the teacher's association or other union representation. The commenter stated that the Bureau's proposed note would likely preclude it from relying upon a copy of a member's contract as evidence of stability of income since if the contract included a termination date the commenter would be unable to assume that the member's employment is ''ongoing.'' The commenter suggested the proposed note be expanded to consider fields of employment that may be viewed as ''seasonal'' or industries where employment is established by contract, such as the education community, so that a creditor could also examine past and current employment as part of its analysis of the stability of income.

The manufactured housing lender commenter also suggested that if the Bureau adopted its proposal to amend section I.A.3.a to eliminate the obligation of creditors to predict a consumer's likelihood of continued employment, that it remove existing section I.A.3.b. Section I.A.3.b provides that ''creditors may favorably consider the stability of a consumer's income if he/she changes jobs frequently within the same line of work, but continues to advance in income or benefits. In this analysis, income stability takes precedence over job stability.'' The commenter stated that this section existed as a caveat to the obligation of creditors to predict a consumer's future employment or advancement, and with the elimination of that requirement it is no longer necessary.

Final Rule

The Bureau is adopting the revisions to section I.A.3 as proposed. The Bureau agrees with commenters that elimination of the requirements that the creditor: (1) examine the consumer's qualifications for the position, previous training and education; and (2) examine the employer's confirmation of the consumer's continued employment—will provide clearer and more appropriate standards for creditors under appendix Q, and facilitate compliance with the Bureau's ATR Final Rule.

With regard to the comment suggesting that the Bureau amend its proposed note in section I.A.3.a to expand it to consider industries where employment is established by contract, including the education community, the Bureau appreciates the comment and recognizes the special circumstances confronted by contract employees. The Bureau believes, however, that additional revisions to section I.A.3.a are not necessary given the existing provisions of appendix Q with regard to the treatment of seasonal employment and income. That language, at sections I.A.2.b and I.B.5, provides the means for creditor assessment of the employment and stability of income of contract employees for purposes of appendix Q.[54]

With regard to the comment requesting that the Bureau clarify that the creditor has no obligation to inquire about a consumer's job performance and/or whether any suspension or termination is imminent, the Bureau's revisions to I.A.3.a do not require creditors to affirmatively make such inquiries. That section, as revised, only provides that a creditor cannot rely on a verification of current employment if it includes an affirmative statement that employment is likely to cease.

Concerning the comment requesting that the Bureau provide guidance to explicitly allow verbal confirmation by employers of the consumer's current, ongoing employment status, the Bureau would like to review this request further to ensure that such guidance would be consistent with the purposes of appendix Q and the ATR Final Rule. Similarly, with regard to the comment requesting clarification that a creditor's obligation to only consider a consumer's past and current and ongoing (and not continual) employment as proposed by the Bureau includes employment in contingent situations outside of the employee's or employer's control, the Bureau plans to review this issue further to determine whether such clarification to the existing appendix Q requirements is necessary, and how any such clarification would be framed. As discussed above, the Bureau believes appendix Q provides creditors with the ability to assess the employment and stability of income of employees generally and contract employees in particular.

Finally, with regard to the comment recommending the deletion of section I.A.3.b as unnecessary with the adoption of the Bureau's proposed revisions to section I.A.3.a, the Bureau disagrees, as it believes that section I.A.3.b, as amended by the Bureau's proposed revisions, has continuing relevance in the determination of the stability of the consumer's income. As revised, section I.A.3.a requires an examination of the consumer's past employment record and a verification of current, ongoing employment status as a method of assessing stability of income. Section I.A.3.b provides creditors with an additional method of assessing stability of income, and of meeting the ability to repay and qualified mortgage requirements, in the situation where a consumer changes jobs frequently.

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

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

In response to these issues raised by stakeholders, the Bureau proposed several amendments to section I.B of appendix Q to explain and clarify the criteria for calculating a consumer's employment income and to determine whether a consumer's income is continuing for the purposes of the DTI calculation.

I.B.1. General Policy on Consumer Income Analysis

The Proposal

The Bureau proposed to amend section I.B.1.a to require creditors to evaluate only whether a consumer's income level would not be reasonably expected to continue based on the documentation provided, with no three-year requirement. In support of this proposal, the Bureau stated its belief that the intended purpose of appendix Q would not be served by requiring creditors to predict a consumer's employment status up to three years after application. The Bureau stated further that creditors should be required to analyze recent and current employment, along with any evidence in the applicant's documentation indicating whether employment is likely to continue. The Bureau therefore, proposed to add a note to section 1.B.1.a to make clear that creditors should not assume that a consumer's wage or salary income can be reasonably expected to continue if the verification of current employment includes an affirmative statement that the employment is likely to cease, such as a statement that indicates the employee has given (or been given) notice of employment suspension or termination. The Bureau stated however, that if the consumer's application and the employment confirmation indicate that the consumer is currently employed and provide no such indication that employment will cease, the Bureau believed, as reflected in the proposed note, that the creditor should be able to use that consumer's income without an obligation to predict whether or not that consumer will be employed on some future date.

Comments

Various industry participants commented on the Bureau's proposed amendments to section 1.B.1.a of appendix Q, and the elimination of the 3-year requirement. These commenters

[54] The Bureau notes that Section II.E.4, Projected Income for New Job, provides the means for creditor assessment of projected income where such income does not already satisfy the requirements of Section I.

suggested additional clarifications to this section.

A joint bank trade association and a bank recommended revising section 1.B.1.a to require each consumer to disclose to the lender whether the consumer has reason to believe that their income level will not continue through the first three years of the mortgage. These commenters noted that consumers are in the best position to know whether they expect to retire, take a leave of absence or otherwise not have their income continue for the first three years of the mortgage loan, and that lenders have no way to reliably determine this. They stated further that questioning consumers about retirement or time off to raise children raises potential fair lending issues. They also requested guidance on the treatment of statements from consumers such as, ''I might retire.''

Another bank trade association, in commenting on the Bureau's proposed elimination of the requirement to analyze whether the consumer's income level can reasonably be expected to continue through the first three years of the mortgage loan, requested clarification of how far into the future creditors must reasonably expect income to continue.

One bank commenter in stating its support for the Bureau's proposed changes in sections I.B.1, 2 and 3, stated that it agreed with the Bureau that creditors cannot be reasonably expected to evaluate and document whether a consumer's income level can be expected to continue for a three-year period.

Various other commenters suggested several other changes to section I.B. For example, similar to the joint bank trade association comment on I.B.1.a discussed above, several commenters raised possible fair lending issues with regard to the section I.B.1 notes, specifically, section i, which states that effective income for consumers planning to retire during the first three-year period must include documented retirement benefits, Social Security payments, and other payments expected to be received in retirement. One bank, for example, stated that while it supported the existing section i it recommended that, to mitigate potential fair lending risks based on age, the Bureau add a clarification that creditors should not ask consumers about future retirement plans, but should consider documented retirement benefits and payments if a consumer disclosed a plan to retire during the first three-year period. Another bank commenter similarly requested that the Bureau explicitly state, for fair lending reasons, that creditors are not expected to ask consumers if they plan to retire. This commenter also noted that it would be impracticable if not impossible to get documented benefits and payments if the consumer has yet to actually receive any retirement income and may not activate the source for up to a period of three years. The joint bank trade association commenter referred to above suggested adding language to section i of the notes indicating that effective income requirements for consumers planning to retire only applies to those who disclose such plans. A bank commenter, citing existing section ii of the notes, which prohibits creditors from asking consumers about possible future maternity leave, suggested, for fair lending reasons, that the Bureau add a clarification that creditors should not ask consumers about future medical leaves, and a joint bank trade association commenter suggested changing the term ''maternity'' leave to ''medical'' leave in section ii of the notes.

Final Rule

The Bureau is adopting the revisions to section I.B.1 as proposed. The Bureau continues to believe that the requirement in section I.B.1.a eliminated by the Bureau's proposal, *i.e.,* that the consumer's income must be analyzed to determine whether the consumer's income level can be reasonably expected to continue ''through the first three years of the mortgage loan,'' does not serve the intended purposes of appendix Q. Instead, as proposed, the Bureau revises section I.B.1.a to require only that the creditor determine whether a consumer's income level ''can be reasonably expected to continue.'' New section iii of the notes to section I.B.1, adopted by this final rule, provides that creditors can assume that the consumer's salary or wage income can be reasonably expected to continue if the consumer's employer verifies current employment and income and does not indicate that employment has been or is set to be terminated. That section states further, however, that this assumption cannot be made by the creditor if a verification of current employment includes an affirmative statement that the consumer's employment is likely to cease—such as a statement that the consumer has given or been given notice of employment suspension or termination. The Bureau believes that, as revised by this final rule, section I.B.1 effectively sets out the analysis required of the creditor for assessing the continuance of consumer salary and wage income, and is consistent with the purposes of appendix Q.

With regard to the commenter that requested clarification to appendix Q on how far into the future creditors must reasonably expect a consumer's income to continue, the Bureau believes that section I.B.1.a, as revised by the Bureau, effectively sets out the standard needed to be followed by creditors. As stated in new section iii of the notes, creditors can ''assume that salary or wage income . . . can be reasonably expected to continue if the consumer's employer verifies current employment and income and does not indicate that employment has been or is set to be terminated.'' That section, as revised by the Bureau, does not require creditors to make a determination that the consumer's income will continue through the first three years of the mortgage loan, or any other specified period.

The Bureau appreciates the recommendations from some commenters that section I.B.1 be amended to require consumers to disclose whether they have reason to believe their income level will not continue as the consumer is in the best position to know their future employment and income status. However, section I.B.1 already provides that creditors may assume that the consumer's salary or wage income can be reasonably expected to continue if the consumer's employer verifies current employment and income and does not indicate that employment has been, or is set to be terminated. Where no such appropriate verification is provided, the creditor must analyze the consumer's income and determine whether the consumer's income level can be reasonably expected to continue. In such cases, the Bureau believes that further analysis should be required of creditors, and that, as revised, section I.B provides creditors with an effective regulatory framework for carrying out that analysis.

With regard to the fair lending concerns raised by some commenters regarding questions presented to consumers relating to future retirement plans, the Bureau agrees that the final rule and appendix Q do not obligate creditors to ask consumers when they expect to retire. If, however, a consumer discloses a plan to retire during the first three-year period by making an affirmative statement of such plans, creditors should consider documented retirement benefits, Social Security payments, and other payments expected to be received in retirement. The Bureau similarly believes that the ATR Final Rule and appendix Q do not require creditors to ask whether a consumer may, in the future, take medical leave. The Bureau does not believe it is necessary, however, to amend appendix Q with specific statements in that regard. In all cases, the Bureau expects creditors to fully comply with all applicable fair lending laws.

I.B.2. Overtime and Bonus Income.

The Proposal

The Bureau also proposed changes to section 1.B.2 regarding overtime and bonus income.[55] Specifically, the Bureau proposed to eliminate the requirement in section I.B.2.a that creditors determine whether such income ''will continue.'' Instead, the proposal would have amended section I.B.2.a. to provide that creditors must focus on evaluating the consumer's documented overtime and bonus income history for the past two years and any submitted documentation indicating whether the income likely will cease. In proposing this change the Bureau stated that it recognized that overtime and bonus income may vary from year to year and generally may be less reliable than salary but noted that, in certain occupations, overtime and bonus income may be an integral and reliable component of the consumer's income. The Bureau stated further that while it believed that creditors must confirm that overtime and bonus income is not anomalous, the requirement to analyze the consumer's two-year overtime and bonus income history, and to verify that the submitted documentation does not indicate overtime or bonus income will cease, would adequately address this concern while satisfying the purposes of the qualified mortgage provision.

Comments

Several industry commenters, including several banks, a joint trade association, several state bank associations, and a state credit union association provided comments specific to the Bureau's proposed change to section I.B.2.a. These commenters generally supported the Bureau's proposed changes. Some of these commenters suggested additional changes to sections I.B.2 and I.B.3.

A bank commenter, in stating support for the Bureau's proposed change eliminating language requiring creditors to determine whether overtime and bonus income will continue, and substituting language focusing on a two-year income history, commented that the change would facilitate better access to credit for consumers who rely on overtime and bonus income. Two state bank associations similarly expressed support for the Bureau's proposed change, with one stating that while most employers are not willing to indicate bonus income is likely to continue, they are willing to affirm such bonus payments were paid and if they have ceased to exist. This second bank association commenter stated further that in the absence of confirmation from the employer that a bonus program or overtime is no longer available to an employee, past history is an excellent predictive tool. Another bank commenter, in stating that the Bureau's analysis supporting its proposed change to I.B.2.a on overtime and bonus income was sound, recommended that the formulation for assessing overtime and bonus income in that section be applied to other parts of appendix Q, on different types of income.

A state credit union association commenter stated that while the Bureau's proposed change to section I.B.2.a is adequate to satisfy the qualified mortgage provision, there are still concerns from credit unions that warrant further guidance. Specifically, this commenter requested that the Bureau provide examples of documentation and/or further clarification to assist in determining whether bonus and overtime income is anomalous.

A joint trade association commenter suggested revisions to section I.B.2.a to provide that overtime and bonus income can be used if the consumer has received the income for the past two years and there is no evidence in the loan file that it will not continue. In support of this revision, the commenter stated that the lender should not be in a position to determine that the income will or will not continue. The commenter further stated that the two-year history should satisfy this element on its own absent evidence to the contrary.

A credit union commenter stated that in some lines of work such as nursing, overtime is a standard component of the overall compensation plan. It stated further that the requirement in section I.B.2.a, as revised by the Bureau's proposal, to document and evaluate at least two years of overtime income, could adversely impact certain consumers who are new to their field or recently hired and do not yet have two years of overtime history. The commenter urged the Bureau to reconsider the impact on nurses, firefighters and law enforcement personnel who are just beginning their careers, and to make appropriate adjustments to the proposed revision.

A mortgage lender specializing in the financing of manufactured housing commented on section I.B.2.b, which, in addition to requiring creditors to develop an average of bonus and overtime income for the past two years, states that ''periods of overtime and bonus income less than two years may be acceptable provided the creditor can *justify and document* in writing the reason for using the income for qualifying purposes'' (emphasis added). This commenter stated that without clear direction and guidance from the Bureau as to what justification and documentation would suffice in these instances, lenders will instead choose to exclude this income rather than face regulatory scrutiny and a potential lawsuit for choosing to include the income. A joint trade association commenter suggested several technical edits to I.B.2.b.

Several industry commenters provided comments on section I.B.3. Section I.B.3.a requires a creditor to establish and document an earnings trend for overtime and bonus income and, if either type of income shows a continual decline, to document in writing a sound rationalization for including the income when qualifying the consumer. Section I.B.3.b provides that a period of more than two years must be used in calculating the average overtime and bonus income if the income varies significantly from year to year.

With regard to section I.B.3, a joint trade association commenter suggested removing and reformatting this section as part of a new I.B.2.c and I.B.2.d to provide that eligible bonus or overtime income be calculated as the lesser of the current year or the average of the previous two years, as long as there is no evidence in the loan file that the income will not continue, and the creditor documents in writing a sound rationalization for including the income. This commenter noted that income from bonuses and overtime, commissions and self-employment can be variable and susceptible to significant declines from circumstances within and outside of the control of the consumer. The commenter stated that the revisions it was proposing to this section and others in appendix Q would provide a new and simple qualitative test for determining the amount of income to include in the DTI analysis. The commenter stated that the test would require lenders to use the lesser amount of the average of two

[55] The Bureau's proposed rule preamble at 78 FR 25650 also briefly referred to Bureau changes to section I.B.3. However, this was a typographical error and no Bureau changes were proposed to section I.B.3.

year's past income or the most recent year's earnings.

With specific regard to section I.B.3.b, which states that 'a period of more than two years must be used in calculating the average overtime and bonus income if the income varies significantly from year to year,'' this joint trade association commenter stated that the word ''significantly'' in that section is too vague for a legal standard and will invite litigation. It stated further that lenders should only use the most recent income, not the average, for declining income and provide a rationale for the inclusion of the income. A bank similarly commented on section I.B.3.b, that as the term ''varies significantly'' in that section is not defined that the requirement in that section that a period of more than two years must be used in calculating the average overtime and bonus income either be eliminated or clarified.

Final Rule

The Bureau is adopting the revisions to section I.B.2 regarding overtime and bonus income as proposed. The Bureau believes that the revisions proposed to section I.B.2.a, eliminating language requiring creditors to determine whether overtime and bonus income will continue, and substituting language that states that such income can be used if the consumer has received it for the past two years and documentation submitted for the loan does not indicate this income will likely cease, will facilitate creditor compliance and, as stated by a commenter, better access to credit for consumers who are dependent upon overtime and bonus income. At the same time the Bureau believes that the changes to this section otherwise further the purpose and intent of appendix Q and the qualified mortgage provision through clear requirements for a creditor assessment of the consumer's receipt of the overtime or bonus income for the previous two years, and a review of the loan documentation for indications that the income will likely cease. As some commenters noted, employers may not be willing to indicate if bonus income, for example, is likely to continue, and in the absence of employer confirmation, past history can be used as a predictive tool.

With regard to other proposed changes to section I.B.2.a raised by commenters, such as a suggestion to substitute language that there is no evidence in the loan file that the overtime or bonus income will not continue, or possible changes to address the potential impact of the two-year requirement on new employees who depend on overtime or bonus income, the Bureau believes that the Bureau's revisions strike the right balance between facilitating compliance and ensuring an adequate assessment of consumer income for purposes of the DTI and the ATR requirements. For example, as revised by this final rule, section I.B.2.a provides that bonus or overtime income may be used if the documentation in the loan file does not indicate that the consumer's overtime or bonus income ''will likely cease,'' which is very similar to the language suggested by the commenter. To the extent that the commenter's proposed language would have a different effect, the Bureau believes that the final rule's approach provides clear, objective guidance to creditors that is consistent with the analysis required by the rest of appendix Q. As for the potential impact of the two-year requirement on new employees, the Bureau believes that current section I.B.2.b, as discussed further below, provides creditors with the ability to assess the overtime and bonus income of new employees.

As for comments on sections beyond the Bureau's specific proposed changes to section I.B.2.a, for example with regard to sections I.B.2.b and I.B.3, the Bureau does not believe any changes to those sections are warranted at this time. With regard to section I.B.2.b for example, the Bureau believes that section provides flexibility for creditors to justify and properly document the use of a period of overtime and bonus income of less than two years. The other requirements of section I.B.2.a (that documentation submitted for the loan does not indicate the overtime or bonus income will likely cease) and section I.B.3.a will continue to apply to the income analysis of the consumer. With regard to the comments on section I.B.3, suggesting a removal of that section and a reformatting into a new test in section I.B.2.c. for determining the amount of income to include in the DTI analysis, the Bureau appreciates the comment but believes that sections I.B.2, as amended by this final rule, and I.B.3, provide for a required income analysis consistent with the purposes and intent of appendix Q. Regarding the comments on section I.B.3.b, the Bureau will continue to review this section to determine if further clarification is needed with regard to a creditor determination of whether overtime or bonus income ''varies significantly,'' but is not making any changes at this time. The Bureau needs additional information in order to fully assess whether this standard requires additional clarification for creditors in making the necessary appendix Q determinations, and whether possible alternative standards would be adequate.

I.B.11. Social Security Income

The Proposal

The Bureau proposed several clarifications to the provisions in section I.B.11 of appendix Q as adopted, explaining how to account for Social Security income.

Section I.B.11 as adopted by the ATR Final Rule required that (1) Social Security income either be verified by the Social Security Administration (SSA) or through Federal tax returns; (2) the creditor obtain a complete copy of the current awards letter; and (3) the creditor obtain proof of continuation of payments, given that not all Social Security income is for retirement-aged recipients. The Bureau proposed to amend section I.B.11 to remove the mention of Federal tax returns and instead require only that creditors obtain a benefit verification letter issued by the SSA. In support of this change the Bureau stated its belief that a Social Security benefit verification letter would provide easily accessible proof of the receipt of Social Security benefits and their continuance.

The Bureau also proposed to clarify in section I.B.11 that a creditor shall assume a benefit is ongoing and will not expire within three years absent evidence of expiration. The Bureau stated, in support of this change, its belief that this would provide a more workable and accurate standard for verification of Social Security income.

Comments

Several banks, national and state banking trade associations, a state credit union, and a consumer group submitted comments on the Bureau's proposal to amend section I.B.11 to remove the reference to Federal tax returns and to require creditors to obtain a benefit verification letter. Most industry commenters saw the change as reducing compliance flexibility, and the consumer group requested further changes to protect against falsification of income.

With regard to the industry commenters, a bank trade association stated that it could find no justification for what it saw as eliminating the flexibility of allowing the use of Federal tax returns in the current rule. It stated that while it agreed with the Bureau's explanation for the change, *i.e.,* that a Social Security benefit verification letter would more easily provide proof of the receipt of Social Security benefits and their continuance, the explanation did not provide a reason to eliminate the Federal tax return option. A bank commenter requested that I.B.11 be revised to permit Federal tax returns or other alternative documentation that verifies receipt of Social Security Income. A state banking association commented that in many cases applicants have lost or misplaced their award letters but that they can easily document and verify Social Security income through Federal tax returns and/or monthly bank statements. Another state banking association stated that the Federal tax return option would facilitate compliance. A state credit union commented that it was concerned that limiting verification to a benefit verification letter could facilitate discrimination. Another state credit union trade association, in stating its concern about the supposed elimination of the Federal tax return option, stated that it could delay the lending process as a result of consumers who cannot locate their Social Security benefit verification letter and who therefore need to request a copy from the SSA, resulting in a potential increased workload for the SSA. A credit union commenter, in recommending the Federal tax return option, stated that sole reliance on the Social Security benefit verification letter could pose a potential risk of fraud through a modification of the letter by the recipient before it is received by the lending institution.

One bank commenter stated that it supported the Bureau's proposal to require creditors to obtain a Social Security benefit verification letter to verify Social Security income, but recommended the adoption of language acknowledging that creditors may obtain federal tax returns in addition to verification letters. This commenter noted that tax returns may be useful to creditors to determine an applicable tax rate used to gross up non-taxable Social Security income, and that they may be needed to verify income received other than from Social Security. This commenter also stated its support for the Bureau's proposed clarification providing that Social Security income shall be assumed not to expire within three years, absent evidence of expiration, stating that it would reduce potential barriers to accessing credit for Social Security income recipients, while providing creditors clear guidance to mitigate fair lending risk.

A consumer group commenter stated that so long as the documentation requirements for Social Security income require that the Social Security benefit verification letter come directly from the SSA, this documentation is sufficient. It noted, however, that if the verification letter is delivered to the lender through a broker or originator working for the lender, this is not sufficient documentation as it may become a vehicle for falsification of income. The commenter therefore recommended that section I.B.11 be revised to require creditors to use either tax returns or bank statements showing the deposit of benefits into the bank account, in addition to requiring a verification letter—where the verification letter cannot be obtained directly from the government payor. The commenter noted that the additional information will provide more substantial verification in a form that is still readily available to applicants. It concluded on this point that this approach will ensure that homeowners have easy access to needed income documentation without providing a means for public benefit documentation to be used to inflate income on a loan. This commenter also suggested, referring to section ii of the notes to section I.B.11 (which allows some portion of Social Security income to be ''grossed up'' if deemed non-taxable by the IRS), that the Bureau should specify that grossing up of Social Security benefits should be done based on a tax bracket that is appropriate for the income received. It stated further on this point that the language currently in I.B.11 will lead to and support the existing practice of grossing up that allows, rather than prevents, many unaffordable loans, as many homeowners who receive Social Security benefits have their income grossed up to the top tax bracket.

Final Rule

The Bureau is adopting the revisions to section I.B.11 as proposed. The Bureau believes that the Social Security benefit verification letter provides the best method of verifying receipt of Social Security income by the consumer and its continuance. The Bureau understands the concerns expressed by various industry commenters regarding the potential limitation on compliance flexibility resulting from the removal of the supposed option to verify Social Security income through Federal tax returns. The Bureau notes, however, that section I.B.11 as adopted in the 2013 ATR Final Rule required, in addition to income verification by the SSA or Federal tax returns, a complete copy of the current awards letter, and documented continuation of payments. The proposed revisions to section I.B.11 simplify these requirements by providing that one document—the Social Security benefit verification letter—satisfies all needs for documentation. A Federal tax return is of less value in demonstrating a consumer's continued receipt of Social Security income and would not be available for consumers who only recently began to receive Social Security benefits. Section I.B.11 as revised by the final rule specifically provides that if the Social Security benefit verification letter does not indicate a defined expiration date within three years of loan origination, the creditor must consider the income effective and likely to continue. The consumer's bank statements, suggested by some commenters as an alternative means to verify income, also are of less value in demonstrating continuance of receipt. The Bureau notes moreover that continuing to require the Social Security benefits letter to verify that such benefits are not likely to cease parallels the general requirement of employer verification of current, ongoing employment.

As far as the concern expressed by a commenter that the Social Security benefit verification letter could become a vehicle for falsification of income if not required to be received directly from the government payor—and in which case it was suggested that tax returns or bank statements be required as additional verification—the Bureau believes that effective due diligence by creditors will limit such a possibility. The Bureau expects that creditors will exercise the same due diligence against fraud with regard to their review of Social Security benefit verification letters that they apply in their review of any mortgage loan related documents submitted to them. With regard to the comments received expressing concern about consumers who are unable to locate their Social Security Benefit verification letters, it is the Bureau's understanding that benefit verification letters may be requested on-line or over the phone toll-free from the SSA or from a local SSA office.

Finally, with regard to the comment requesting that the Bureau put limitations on the grossing up of Social Security benefits (as permitted under section I.B.11 in some instances), the Bureau is not addressing that issue at this time, as this requires further review and consideration. Other commenters made suggestions for changes with regard to section II.E, Non-Taxable and Projected Income, and the gross-up rate allowed for non-taxable income generally (discussed later in this preamble) which, in addition to Social Security income, includes Federal government employee retirement income, State government retirement income, military allowances, as well as other types of income. The Bureau needs additional time to fully consider and evaluate the implications of these comments, including those specifically related to Social Security income, to ensure consistency with and furtherance of the purposes of appendix Q.

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

The Proposal

Section I.D of appendix Q, as adopted, permitted income from self-employed consumers to be considered income for the purposes of the DTI calculation if certain criteria were met, including various documentation requirements and analysis of the financial strength of the consumer's business. The documentation requirements in section I.D.4 included the requirement to provide a ''business credit report for corporations and 'S' corporations.'' The analysis of the financial strength of the business in section I.D.6 required that the creditor carefully analyze the ''source of the business's income'' and the ''general economic outlook of similar businesses in the area.'' Following the publication of appendix Q the Bureau received inquiries from stakeholders concerning these requirements and also noted compliance difficulties and increased risk of litigation that could arise from them. Industry raised specific concerns that business credit reports can be expensive and difficult to obtain, and that a requirement to assess economic conditions for geographic areas can be both costly and difficult, as well as imprecise.

The Bureau proposed to make several amendments to these income stability requirements for self-employed consumers. The Bureau's first proposed amendment eliminated the requirement in current section I.D.4 that self-employed consumers provide a business credit report for corporations and ''S'' corporations. In proposing this amendment the Bureau stated that it recognized that business credit reports for many smaller businesses can be difficult or very expensive to obtain. The Bureau also stated its belief that while these reports may provide some valuable information for the purposes of an underwriting analysis, they are less suited to function as a requirement to determine income for self-employed consumers.

The Bureau's second proposed amendment eliminated two requirements under the requirement to analyze a business's financial strength in section I.D.6. Section I.D.6, as adopted, required creditors (1) to evaluate the sources of the business's income and (2) to evaluate the general economic outlook for similar businesses in the area. In proposing this amendment the Bureau stated its belief that both of these requirements demand that the creditor engage in complex analysis without providing clarity concerning what types of evaluations are satisfactory for the purpose of complying with the rule. The Bureau also stated that such a provision is better suited to function as part of an underwriting analysis subject to waiver, variance, and guidance rather than a regulatory rule.

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

Comments

Industry commenters—several banks and national and state trade associations—submitted comments on the Bureau's proposed changes to sections I.D.4 and I.D.6. The commenters generally supported the Bureau's proposals.

A bank stated that it agreed with the Bureau's proposals to eliminate the requirement for business credit reports, citing the potential difficulty and expense associated with obtaining such reports. The bank stated that requiring a business credit report could increase the cost of credit or restrict access to credit for self-employed consumers. The bank also noted that appendix Q requires creditors to obtain year-to-date profit and loss statements and balance sheets from self-employed consumers, and suggested, in the alternative, that creditors be permitted to accept quarterly tax filings if the consumers most recent tax return is greater than four months old. This commenter also stated its agreement with the Bureau's proposal to eliminate creditor requirements to evaluate both the sources of consumer's business income and the general economic outlook for similar businesses in the area stating that it agreed with the Bureau's conclusion that such requirements are ill-suited to a regulatory rule designed for consumer transactions. The commenter added further that such requirements are too subjective for purposes of establishing documentation standards for income.

Another bank commenter expressed support for the Bureau's proposed elimination of the business credit report requirement in section I.D.4, and with regard to the Bureau's proposed elimination of the creditor requirements in section I.D.6 stated that it agreed that requiring creditors to analyze a business's financial strength is beyond the scope of the DTI standard. This commenter suggested the removal of section I.D.6 entirely from appendix Q, stating that the type of determination required by this section is highly subjective and that such subjectivity greatly undermines the certainty presumed to be tied to a safe harbor test. This commenter also suggested a change to section I.D.4.c to make clear that profit and loss statements will only be required if quarterly tax returns are not available.

A joint trade association commenter also suggested the entire deletion of section I.D.6, stating that subjective criteria should be removed in favor of documented income. This commenter also supported the elimination of the business credit report requirement in section I.D.4.d. It also suggested changes to section I.D.4.c, stating that profit and loss statements and balance sheets should only be required if they are needed because quarterly taxes are not available.

Two state banking association commenters also supported the Bureau's proposal to eliminate the requirements in section I.D.4.d, and I.D.6. One association, with regard to section I.D.4.d, noted that credit reports for small businesses can be difficult to obtain and quite expensive. The other association stated, with regard to I.D.6, that the creditor requirements proposed to be eliminated by the Bureau in that section would be inherently difficult for creditors to make and would carry no indication of accuracy. A state credit union association also expressed support for the Bureau's changes in these sections.

A national trade association that represents real estate agents commented that it supported the Bureau's proposals eliminating the requirements relating to self-employed consumers in I.D.4.d and I.D.6, stating that it agreed with the Bureau's assessment that these requirements are too expensive and complex, and without clarity. This commenter also suggested additional clarifications beyond the Bureau's proposals, to section I.D and section I.B.7, as those sections relate to many of its members who work as self-employed contractors working in association with real estate brokers, not as employees. In particular this commenter requested additional clarity on how creditors should consider real estate commission income.

Final Rule

The Bureau is adopting its revisions to section I.D.4 and I.D.6 as proposed.

With regard to the revisions to section I.D.4, and the elimination from the documentation requirements for self-employed consumers business credit reports for corporations and ''S'' corporations, the Bureau recognizes the concerns expressed by commenters regarding the expense associated with obtaining such reports, and agrees with commenters that this additional expense could increase the cost of credit or restrict access to credit for self-employed consumers.

With regard to the Bureau's revisions to section I.D.6 and the elimination of the requirements that creditors evaluate sources of the consumer's business income, and the general economic outlook for similar businesses in the area, the Bureau agrees with commenters who noted the subjective nature of these requirements, and recognizes the difficulty for creditors in making these assessments. The Bureau believes that these requirements are better suited to a flexible underwriting analysis than a regulatory rule. With regard to those commenters who recommended the elimination of section I.D.6 in its entirety, the Bureau believes that the revisions to that section adopted by the Bureau significantly improve this requirement as an assessment of the business's financial strength, and make this an effective and useful measure for purposes of the DTI analysis. Furthermore, the standard as revised is straightforward for creditors, *i.e.,* annual earnings that are stable or increasing are acceptable, while income from businesses that show a significant decline in income over the analysis period is not acceptable.

The Bureau notes the other changes to these sections beyond the Bureau's specific proposals recommended by some commenters, including, for example, that creditors be permitted to accept quarterly tax filings as an alternative to profit and loss statements and balance sheets under section I.D.4.c, and additional clarification on self-employed contractors, and real estate commission income, under I.D. and I.B.7. The Bureau appreciates those recommendations, but will need to fully evaluate them for purposes of consistency with and furtherance of the purposes of appendix Q, and the implications for all stakeholders.

II. NON-EMPLOYMENT RELATED CONSUMER INCOME

A. Section II.B. Investment and Trust Income

The Proposal

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

The Bureau proposed an amendment to this section to delineate more clearly the breadth of the analysis for trust income by specifying that the analysis is limited to the documents appendix Q requires. Specifically, the proposal revised ''if guaranteed, constant payments will continue for at least the first three years of the mortgage term'' by adding ''as evidenced by trust income documentation.'' Under the requirements in section II.B.2 as adopted, there was no specific cut-off for the amount of diligence required or information that must be collected to satisfy the requirement. The Bureau stated its belief in proposing the amendment that it would facilitate compliance and help ensure access to credit by making the standard clear and easy to apply.

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

Comments

Industry commenters who submitted comments on the Bureau's proposal to revise section II.B.2 of appendix Q either supported the changes or requested additional clarification on existing language in the section.

A bank commenter, for example, stated that the change to section II.B.2.a concerning trust income provided clearer guidance with respect to the required documentation, and would help facilitate continued access to credit for recipients of such income. This commenter expressed concerns, however, with the requirement that trust income be ''guaranteed'' and recommended its elimination. This commenter stated that while trust income documentation may provide insight into periods of likely income continuance, it is unclear as to whether such documentation would provide evidence of an absolute guarantee of payment. Other commenters similarly objected to the word ''guaranteed.'' Another bank commenter stated that while it agreed with the Bureau's proposed changes to limit the analysis for trust income only to trust documentation, it encouraged the Bureau to remove ''guaranteed'' as it seems to imply that documentation will be available in the form of a guarantee or that an individual can be requested to provide such a guarantee. This commenter stated that the creditor should be expected to review the trust documentation to ensure the income is not clearly scheduled to end in the first three years of the mortgage. A joint trade association commenter also suggested the deletion of the word ''guaranteed'' in this section, stating that it is unclear who would provide the guarantee, and that this is not in keeping with current practice. A state banking association stated that it supported the Bureau's proposed addition of the phrase ''as evidenced by the trust income documentation'' to section II.B.2.a so long as the provision regarding required trust income documentation allows for the consumer to provide a trustee's statement confirming the amount of the trust, frequency of distribution and duration of payments. This state banking association commenter stated that reliance on a trustee's statement would allow its state's banks to take advantage of the protection afforded by state law (rather than having to collect a complete copy of the trust agreement).

With regard to the Bureau's proposed changes to section II.B.3, a bank commenter agreed with the Bureau's proposal to eliminate the requirement for creditors to establish that consumers are holders in due course if the consumer is not the original payee on the note. This commenter noted that creditors will be required to obtain a copy of the note, which should generally be sufficient to establish enforceability. This commenter also recommended shortening the documentation period to evidence consistency of payment receipts in section II.B.3.b from 12 months to six months. Finally, this commenter stated that the list of acceptable documentation in section II.B.3.b to establish that evidence of receipt of notes receivable (*i.e.,* deposit slips, cancelled checks or tax returns) is too restrictive, and does not take into account other common electronic payment methods. The commenter recommended modifying the list of acceptable documentation types to include, but not be limited to, deposit slips or receipts, cancelled checks, bank statements or tax returns. A joint trade association and a bank also recommended expansion of the list of acceptable documentation in section II.B.3.b to include bank statements and other deposit accounts, as electronic payments are an increasingly common way to transfer money regularly between consumers.

Final Rule

The Bureau is adopting the revisions to sections II.B.2 and II.B.3 as proposed with two modifications. The changes proposed by the Bureau to both sections were generally accepted by commenters. However, with regard to section II.B.2 the Bureau agrees with commenters that the use of the word ''guarantee'' in that section, *i.e.,* that income from the trust may be used if ''guaranteed'' constant payments will continue, is unclear and should be eliminated. The Bureau believes that the requirement for creditor evaluation of the trust documentation, with proper due diligence by the creditor in the review of such documentation, is sufficient to meet the requirement in section II.B.2 with regard to the continuance of the trust income. With regard to the state banking association commenter recommending that required trust documentation include a trustee's statement, the Bureau notes that section II.B.2 specifically provides that ''required trust documentation'' includes a trustee statement confirming the amount of the trust, the frequency of the distribution, and the duration of payments.

With regard to section II.B.3, the Bureau agrees with the commenters that suggested a modification of the list of acceptable documentation in section II.B.3.ii to take into account common electronic payment methods. The Bureau is therefore modifying this list to include, in addition to deposit slips, cancelled checks and tax returns, also deposit receipts and bank or other account statements. Finally, with regard to the comment recommending shortening the documentation period in section II.B.3.b from 12 months to six months, the Bureau appreciates the comment but believes this requires further evaluation to ensure consistency with the purposes of appendix Q and the ATR Final Rule.

B. Section II.D. Rental Income

The Proposal

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

Following publication of the 2013 ATR Final Rule, the Bureau became aware of concerns regarding requirements that boarders be related to the homeowner in order for rental income payable to the consumer to be considered ''income'' for DTI purposes. The Bureau did not believe that the relation requirement was useful in determining whether or not the rental income should be used in determining DTI. The Bureau therefore proposed to eliminate the requirement that boarders be related by blood, marriage, or law from section II.D.3.a.

Comments

Commenters generally supported the Bureau's proposed change to section II.D.3.a, eliminating the prohibition on considering rental income payable to a consumer from boarders in a single-family property who are not related by blood, marriage or by law. Various commenters recommended further clarifications to this section.

A joint trade association commenter in recommending the same change to section II.D.3.a. as proposed by the Bureau, stated that rental income evidenced on tax returns should be given equal treatment regardless of the relationship status of renters. Another national trade association commenter stated that it generally agreed with the Bureau's proposed changes to this section, but that it believed that the guidelines need to be further modified to be workable. Specifically this commenter stated that the requirements as currently written will be difficult to administer because they depend on distinctions and varying definitions of the terms ''roommate'' and ''boarder.'' The commenter noted that these terms are not defined in the regulation, and they have no set meaning in law or custom. The commenter stated that it did not believe that these regulations should impose or dictate the types of habitation agreements that people choose to enter. A state bank association commenter noted that the Bureau's proposal retains the prohibition on using rental income paid by roommates, and that neither the rule nor appendix Q provides a definition of roommate or boarder. Stating that the provision to limit rental income to boarders is unnecessarily restrictive, the commenter requested that creditors be permitted to consider rental income received from roommates or boarders, provided such income is shown on the applicant's tax return. A similar comment from another state bank association stated that if the distinction between rental income received from roommates and boarders is retained it requested that the Bureau define within the regulation the terms ''roommate'' and ''boarder.''

Final Rule

The Bureau agrees with those commenters on the Bureau's proposed revisions to section II.D.3 that the requirements as proposed would be difficult to administer and comply with as they depend on distinctions between ''roommate'' and ''boarder'' which are undefined terms in that section, and in appendix Q generally. The Bureau believes that rental income established through tax returns is the relevant factor for purposes of a DTI analysis, and that the distinction between the terms roommate and boarder is not relevant to that determination. Therefore the Bureau is modifying section II.D.3.a to eliminate the prohibition on the acceptability of income from roommates in a single family property occupied as the consumer's primary residence, and to provide that income from either roommates or boarders is acceptable. The Bureau retains the section II.D.3.b requirement that rental income may be considered effective if shown on the consumer's tax return, and states further that, if not on the tax return, rental income paid by the roommate or boarder may not be used in qualifying.

Clarifications and other Technical Changes

As noted above, the Bureau proposed various other technical and wording changes in appendix Q, for consistency and clarification. The Bureau is adopting those revisions as proposed.

Comments on Aspects of Appendix Q beyond Bureau's Specific Proposals

As noted previously, various commenters submitted comments on aspects of appendix Q that were not the subject of the Bureau's specific proposals, including suggestions for significant revisions to appendix Q. Those comments are summarized and addressed below.

Adopt or Allow Use of GSE Guidelines

Several banks and a joint trade association commenter recommended that the Bureau either allow creditors to use GSE guidelines in certain instances not addressed by appendix Q, or to look to and adopt certain existing GSE guideline language. Specifically, one bank commenter urged the Bureau to expressly allow creditors to use GSE guidelines for any matter not addressed by appendix Q, as GSE guidance is widely used by industry and is consistent with prudent underwriting. This commenter stated, for example, that appendix Q does not specify how to annuitize assets, but that GSE guidance spells out how to annuitize a consumer's assets in qualifying a borrower. It also stated that, as a general matter, appendix Q should be revised to allow creditors to ''add back'' amounts deducted from a borrower's income, consistent with a Fannie Mae worksheet. This commenter also noted several other specific areas where adoption of GSE guidance on add-backs was requested, for example, certain add-backs permitted by the GSEs with regard to section I.E. Income Analysis: Individual Tax Returns (IRS Form 1040); and with regard to section II.D.5. Rental Income, Analyzing IRS Form 1040 Schedule E. In addition this commenter recommended with regard to section II.E.4. Projected Income for a New Job, adoption of the GSEs' approach in assessing the projected income of certain teachers. A joint trade association commenter similarly recommended replacing, for reasons of clarity, appendix Q language in section I.B.12. Automobile Allowances and Expense Account Payments, with GSE guidance, and replacing language in sections I.E, F, G and H with a requirement to follow GSE guidelines for self-employed cash flow analysis, including the use of several GSE forms, and the adoption of GSE requirements in section II.E.2. Adding Non-Taxable Income to a Consumer's Gross Income. This commenter also recommended that appendix Q follow current GSE guidelines for an identified list of areas where it stated appendix Q is silent and where it was seeking additional clarity.

Another bank commenter stated that there are instances in which the Appendix Q guidelines fail to reflect the level of detail needed to underwrite in the current mortgage market, and noted that the GSEs have adopted guidelines which provide greater detail and in some instances would be clearer and better suited to setting a regulatory requirement. This commenter encouraged the Bureau to review certain specifically identified sections of the GSE guidelines which it stated might provide more clarity than the present appendix Q rules. This commenter stated, however, that it was not recommending that the Bureau defer to the GSE guidelines which are subject to change without opportunity for notice and comment. It requested the Bureau review, for example, GSE guidelines with regard to ''income from other sources'' in section I.B.1.b, giving as an example GSE guidelines on documenting of tips and foreign income. Like the previously discussed commenters, it also suggested review of sections I.E, F, G and H.

Generally Revise Appendix Q to Eliminate Subjective Determinations

Several commenters suggested major revisions to appendix Q to address what the commenters viewed as standards that require creditors to make subjective determinations on a consumer's debt and income. For example, a joint trade association commenter stated that it was concerned that appendix Q mandates a calculation of DTI that will require lenders to establish essentially a manual underwriting process due to the numerous subjective determinations prescribed by the rule. It stated further that if qualified mortgages will comprise a significant fraction of mortgage originations, the proper calculation of DTI under appendix Q must be able to be incorporated into an automated underwriting system. The commenter therefore urged the Bureau to revise appendix Q to minimize the requirements for subjective determinations by lenders and to provide sufficient certainty to allow its integration into automated underwriting systems. It stated further that, for appendix Q to be an effective bright-line rule, the application of appendix Q should ideally deliver the same result regardless of the lender implementing it. However, the commenter noted, to do that would mean requirements for quantitative inputs, with supporting documentation, that eliminate any need for subjective determinations. This commenter concluded that appendix Q will be relied upon to verify the sufficiency of the lender's determination whether a loan is a qualified mortgage and should be able to be conclusively proven by written evidence, such as a loan file, in a court of law. This commenter supplemented its comment with a detailed chart with suggested revisions and comments on the Bureau's proposals, and on a number of other appendix Q provisions beyond the Bureau's specific proposals.

A bank commenter echoed the comments of the joint trade association commenter that appendix Q needs to be revised to remove requirements for subjective determinations. This commenter stated, however, that it believes the structure and form of appendix Q can be retained while making tailored changes to its provisions as necessary to allow it to serve the intended purposes of appendix Q and the ATR Final Rule. A lender specializing in manufactured housing financing requested that the Bureau examine all of appendix Q with the goal of providing clarity and reducing litigation, and commented further that in order to incentivize lenders to gravitate towards qualified mortgages, the guidelines for making a qualified mortgage must be as objective as possible. To that end this commenter stated that should the Bureau ultimately decide not to remove the DTI requirements and appendix Q, it should amend certain sections of appendix Q that the commenter believes may not function properly as regulations.

A GSE commenter recommended that the Bureau treat appendix Q as guidance rather than regulation that is subject to notice and comment rulemaking as it is the commenter's opinion that there are provisions of appendix Q that are not properly suited to be regulations. This commenter stated that such guidance could be revised as needed, and in relatively short order, in response to changing market conditions and industry practices, and that, in contrast, if appendix Q remains as a regulation subject to notice and comment it loses such flexibility. Another GSE commenter also recommended that the Bureau issue appendix Q in the form of a handbook or other written guidance, akin to the manner in which FHA provides underwriting standards to lenders, citing the Bureau's loss of flexibility and ability to respond promptly, if appendix Q remains a regulation subject to notice and comment rulemaking.

A consumer group commenter stated that while it supported the Bureau's proposed clarifications to appendix Q it recommended that the Bureau go further to clarify it in a way that is consistent with automated underwriting. This commenter stated further that while manual underwriting is used by some lenders, lenders should not be required to underwrite in this manner simply to comply with the definitions of debt and income included in appendix Q.

Other Comments on Aspects of Appendix Q beyond the Bureau's Proposals

In addition to the comments discussed above, various commenters had comments on certain specific sections in appendix Q, relating to matters not included in the Bureau's proposals. As noted, a joint trade association commenter supplemented its comment letter with a detailed chart of suggested changes to a variety of appendix Q sections both with regard to sections which were included in the Bureau's specific proposals, and sections that were not included. Various bank commenters stated that they endorsed the comments made by this commenter. Included in the joint trade association commenter's suggested changes of sections outside of the Bureau's proposals, for example, were changes to sections II.A. Alimony, Child Support, and Maintenance Income Criteria; II.C. Military Government Agency and Assistance and Program Income; and III.2. Debt to Income Ratio Computation for Recurring Obligations. As discussed above, this commenter also identified a list of areas where it stated appendix Q is silent and where it was seeking additional guidance. In its comment letter, this commenter also suggested a new quantitative test for determining the amount of consumer income to include in the DTI analysis, which it suggested not only be applied to overtime and bonus income, but other income analysis in appendix Q as well. Another Bank association commenter identified various areas with regard to sources of income that it stated appendix Q did not address, or did not adequately address, and for which it was seeking additional clarification, including, for example, asset amortization, stock options, capital gain income, foreign income, relocation earnings, and contractor and other irregular income situations. This commenter also requested additional guidance on section I.C. Consumers Employed by a Family Owned Business, and suggested changes with regard to section II.E. Non-Taxable and Projected Income to allow creditors to use a 25 percent ''gross-up'' rate for all non-taxable income. Other commenters that raised issues on sections outside of those sections that were the subject of the Bureau's specific proposals included a consumer commenter that recommended that the 12-month maximum for defining projected obligations (in section V.1) should be extended for loans with predictable repayment requirements and inflexible repayment terms, such as private student loans and student loan repayment programs.

Response to Comments on Aspects of Appendix Q beyond Bureau's Specific Proposals

The Bureau appreciates the comments received on other aspects of appendix Q that were not the subject of the Bureau's specific proposals. These comments will assist the Bureau in its efforts to ensure the continuing effectiveness and utility of appendix Q as a part of the DTI analysis.

The Bureau notes that a substantial number of industry commenters cited particular areas of appendix Q that they asserted either provided no guidance, or insufficient guidance, to enable creditors to make the required income and debt determinations. As described above, many of these commenters suggested that the Bureau adopt, allow creditors to use, or look to GSE guidelines with regard to certain types of income and/or debt not specifically addressed by appendix Q in order to, in effect, provide a means for filling this gap. The Bureau believes in general that the long history and experience of other federal agencies as well as the GSEs in matters addressed by appendix Q can be helpful in this context and acknowledges that requirements established by the other federal agencies and the GSEs already play a significant role in the mortgage market.

Indeed, the Bureau notes that the temporary qualified mortgage status established by the ATR Final Rule provides creditors with the option to issue qualified mortgages without relying on the standards set forth in Appendix Q. Under Section 1026.43(e)(4), creditors who prefer federal agency or GSE underwriting rules can use those rules to obtain qualified mortgage status by ensuring that, among other things, their loans either are eligible for purchase or guarantee by the GSEs or to be insured or guaranteed by the agencies.

The Bureau notes further, however, that while appendix Q does not specifically refer to every possible type of debt or income, it does set forth basic guidelines for the treatment of debt and income. Section I of appendix Q addresses consumer employment related income, and section I.B.1 sets out standards for analysis of salary, wage, and other consumer employment related income. Section I.B.1.b provides that income from sources other than salaries or wages ''can be considered as effective'' when it is ''properly verified and documented by the creditor.'' This provision sets the rule for the treatment of types of income whose treatment is not otherwise more specifically addressed by appendix Q. Likewise, section III.2.a provides as a general rule that recurring charges extending ten months or more for specified recurring obligations and ''other continuing obligations'' must be treated as debt.

In light of these circumstances, the Bureau has revised the introduction to appendix Q to make two points. First, where guidance issued by federal agencies including the U.S. Department of Housing and Urban Development, the U.S. Department of Veterans Affairs, the U.S. Department of Agriculture, or the Rural Housing Service, or issued by the GSEs, Fannie Mae and Freddie Mac, while operating under the conservatorship or receivership of the Federal Housing Finance Agency, or issued by a limited-life regulatory entity succeeding the charter of either Fannie Mae or Freddie Mac (collectively, Agency or GSE guidance) is in accordance with appendix Q, creditors may look to that guidance as a helpful resource in applying appendix Q. Thus, where only the broad principle contained in section I.B.1.b applies to a particular type of income, a creditor may look to Agency or GSE guidance that is in accordance with appendix Q's standards in determining whether that income has been properly documented and verified. For example, appendix Q does not specifically address additional steps a creditor might take to document and verify wage or salary income when it is earned from foreign sources and paid in foreign currency. Agency or GSE guidance may therefore be used to provide more specific standards with regard to verification or calculation of such income, as long as the guidance used is not inconsistent with the requirements of appendix Q. Similarly, where the treatment of a particular recurring obligation is not specifically addressed in appendix Q, the creditor may look to Agency or GSE guidance for purposes of determining how to assess that obligation, as long as that guidance is in accordance with the requirements of section III of appendix Q.

Second, in the event that there may be consumer situations that present questions that appendix Q simply does not presently address at all, the Bureau is adding language to the introduction providing that when the standards contained in appendix Q do not resolve the treatment of a specific kind of debt or income, the creditor may either (1) exclude the income or include the debt, or (2) treat the income or debt in accordance with guidance issued by the federal agencies or GSEs. The introduction makes clear, however, that the Bureau expects that the above-described default rule on excluding income and including debts and the optional safe harbor reliance on GSE or Agency guidance will be used sparingly. The introduction emphasizes that the creditor may not rely on Agency or GSE guidance to reach a resolution contrary to that provided by appendix Q's standards, even if the Agency or GSE guidance specifically addresses the particular type of debt or income but the appendix Q standards are more generalized. For clarity, the introduction provides a definition for when appendix Q's standards resolve the appropriate treatment of a specific kind of income or debt: where the appendix Q standards provide a discernible answer to the question of how to treat the debt or income. Under this definition, the Bureau believes that the use of the default rule or the optional safe harbor should only rarely be necessary. Thus, while the Bureau's revisions to appendix Q reflect commenters' concerns about the possibility of gaps in appendix Q, the Bureau emphasizes that as revised by this final rule, the introduction to appendix Q only allows creditors to use Agency or GSE guidance whenever appendix Q does not resolve how to treat a particular type of debt or income (or where such guidance is used in applying appendix Q consistent with its standards, as discussed above). Add-backs to income permitted by Agency or GSE guidance, for example, are not permitted by appendix Q except in accordance with its standards.

With regard to the request by some commenters for a major revision to appendix Q, including, for example, the removal of all requirements for subjective determinations, the Bureau believes that the revisions made by today's final rule, including the default rule and the optional safe harbor just described, will provide creditors with the means necessary to effectively carry out the analysis required by appendix Q. The Bureau will continue to review the implementation of appendix Q to ensure that creditors can readily comply with its requirements, but the Bureau believes that, with today's final rule, appendix Q currently meets that standard.

As discussed, some commenters suggested that the appendix Q requirements be revised to allow its integration into automated underwriting systems. After the Bureau's rules go into effect in January 2014, the Bureau, in reviewing the implementation of those rules, including the ATR Final Rule, will give additional consideration to the suggestions raised by these commenters. In the meantime, the Bureau believes that the temporary qualified mortgage provisions established by the ATR Final Rule should provide the needed flexibility for creditors. Regarding the comments suggesting that the Bureau treat appendix Q as guidance rather than as a regulation subject to notice and comment in order to respond to changing market conditions and industry practices, as previously stated, the Bureau ''did not intend for appendix Q to function as a general flexible underwriting policy for assessing risk (as it is used by FHA in the context of insurance), and recognizes that the Bureau will not have the same level of discretion regarding the application of appendix Q.'' [56] Indeed, the Bureau believes that appendix Q could not fully serve its intended purpose of providing clarity and certainty as to the DTI determination were it treated as guidance. Moreover, the Bureau believes that appendix Q, particularly as clarified and revised by today's final rule, provides creditors with sufficient and appropriate standards for assessing the income and debt of consumers.

V. Effective Date

The amendments in this rule are effective January 10, 2014, except for the change to § 1026.35(e). The amendment to § 1026.35(e) is effective immediately on publication of this rule in the **Federal Register**. As explained above, this amendment clarifies the Bureau's interpretation of § 1026.35(e); it is therefore an interpretive rule, for which an immediate effective date is appropriate. In addition, the Bureau concludes that good cause exists to make the amendment effective immediately. The clarification will provide certainty to the industry and imposes no obligations with which mortgage lenders must comply.

Applicability date. The amendment to § 1026.35(e) applies to any transaction consummated on or after June 1, 2013, and for which the creditor receives an application on or before January 9, 2014.

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

A. Overview

In developing the final rule, the Bureau has considered potential benefits, costs, and impacts.[57] In addition, the Bureau has consulted, or offered to consult with, the prudential regulators, SEC, HUD, VA, USDA, FHFA, the Federal Trade Commission, and the Department of the Treasury, including regarding consistency with any prudential, market, or systemic objectives administered by such agencies.

As noted above, this rule makes amendments to some of the final mortgage rules issued by the Bureau in January of 2013.[58] These amendments clarify, correct, or amend provisions on (1) the relation to State law of Regulation X's servicing provisions; (2) implementation transition requirements for adjustable-rate mortgage disclosures; (3) the small servicer exemption from certain of the new servicing rules; (4) exclusions from the repayment ability and prepayment penalty requirements for higher-priced mortgage loans (HPMLs); (5) the use of government-sponsored enterprise (GSE) and Federal agency purchase, guarantee or insurance eligibility for determining qualified mortgage (QM) status; and (6) the determination of debt and income for purposes of originating QMs. In addition to these revisions, which are discussed more fully below, the Bureau is also making certain technical corrections to the regulations with no substantive change intended.

The analysis in this section relies on data that the Bureau has obtained and the record established by the Board and Bureau during the development of the 2013 Title XIV Final Rules. However, the Bureau notes that for some analyses, there are limited data available with which to quantify the potential costs, benefits, and impacts of this final rule. In particular, the Bureau did not receive comments specifically addressing the Section 1022 analysis in the proposed rule. 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.

B. Potential Benefits and Costs to Consumers and Covered Persons

The Bureau believes that, compared to the baseline established by the final rules issued in January 2013,[59] the

[56] 78 FR 25648.

[57] 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.

[58] For convenience, the reference to these January 2013 rules is also meant to encompass the rules issued in May 2013 that amended the January rules, including the final rule amending the 2013 Escrows Final Rule, issued on May 16, 2013.

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

primary benefit of most of the provisions of the final rule to both consumers and covered persons is an increase in clarity and precision of the regulations and an accompanying reduction in compliance costs.

More specifically, the provisions that clarify: (1) That the preemption provisions in Regulation X do not preempt the field of regulation of the practices covered by RESPA and Regulation X; (2) the timing of required disclosures for adjustable-rate mortgages; and, (3) the exclusion of construction loans, bridge loans, and reverse mortgages from the requirements of the ability-to-repay and prepayment penalty provisions in § 1026.35(e) generally conform the rules to the policies articulated by the final rules already issued. The discussion of benefits, costs, or impacts discussed in part VII of each of the January rules included consideration of each of these provisions.

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

The provisions that clarify and amend the definition of qualified mortgage should also add clarity to the rules and thus lower costs of compliance. These include the clarification of the test that they be eligible for purchase or guarantee by the GSEs or insured or guaranteed by the agencies, the clarification that a repurchase or indemnification demand by the GSEs, FHA, VA, USDA, or RHS is not determinative of qualified mortgage status, and the revisions clarifying that a loan meeting eligibility requirements provided in a written agreement with one of the GSEs, HUD, VA, USDA, or RHS is also eligible as are loans receiving individual waivers from GSEs or agencies.

These provisions make explicit that matters wholly unrelated to ability to repay will not be relevant to determination of QM status and that a creditor is not required to satisfy certain mandates concerning loan delivery and other requirements that are wholly unrelated to assessing a consumer's ability to repay the loan. They also clarify that loans meeting GSE or agency eligibility requirements set forth in an applicable written contract variance or individual waiver at the time of consummation are eligible for GSE or agency purchase, guarantee, or insurance under § 1026.43(e)(4). As such, these provisions should lower the burden for these loans to be qualified mortgages. The Bureau believes that these changes provide useful guidance to industry and generally conform the rules to the policies intended by the final rules issued in January. Accordingly, the discussion of benefits, costs, or impacts discussed in part VII of each of the January rules included consideration of the effects of each of these provisions.

The amendments to appendix Q in this final rule reduce the creditor's requirements to obtain affirmative confirmation that several types of income will continue in the future. Under these amendments, creditors may assume in the absence of contrary evidence, that certain past, current, and/or ongoing conditions can be reasonably expected to continue. Other provisions clarify the types of evidence that creditors may rely on to verify income, while another expands the types of rental income that may be used in the DTI calculation. The Bureau is also revising the introduction to appendix Q to clarify that creditors may look to guidance from certain federal agencies and the GSEs in applying appendix Q so long as that guidance is in accordance with the standards in appendix Q and to provide a default rule of excluding income and including debts and an optional safe harbor for reliance on GSE or Agency guidance when appendix Q's standards do not otherwise resolve how to treat a particular type of debt or income. As noted earlier, the Bureau believes that these provisions will establish clearer requirements for assessing the debt and income of consumers while at the same time facilitating creditor compliance. More specifically, these provisions should increase the probability that certain loans are originated as qualified mortgages and receive a presumption of compliance with the ability-to-repay standards. For such loans, the costs of origination may be slightly lower as a result of the slightly decreased liability for the lender and any assignees and for possibly decreased compliance costs. Consumers may benefit from slightly increased access to credit and lower costs on the affected loans; however, these consumers will also not have the added consumer protections that accompany loans made under the general ability-to-repay provisions. A more detailed discussion of these effects is contained in the discussion of benefits, costs, and impacts in part VII of the 2013 ATR Final Rule.

The final rule is generally not expected to have a differential impact on depository institutions and credit unions with $10 billion or less in total assets as described in section 1026 or on consumers in rural areas. The main exception is for those depository institutions and credit unions, which by virtue of their size, are more likely to qualify for the small servicer exemption and to benefit from the reduction in compliance burden.

Given the nature of the changes made by the final rule, the Bureau does not believe that the final rule will materially reduce consumers' access to consumer products and services. Rather, the reduced burden in many of the changes in this rule should generally help to improve access to credit.

VII. Regulatory Flexibility Act Analysis

The Regulatory Flexibility Act (RFA) generally requires an agency to conduct an initial regulatory flexibility analysis (IRFA) and a final regulatory flexibility analysis (FRFA) of any rule subject to notice-and-comment rulemaking requirements.[60] These analyses must ''describe the impact of the proposed rule on small entities.''[61] 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,[62] or if the agency considers a series of closely related rules as one rule for

[60] 5 U.S.C. 601 *et seq.*

[61] 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 nonprofit 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).

[62] 5 U.S.C. 605(b).

purposes of complying with the IRFA or FRFA requirements.[63] 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.[64]

This rulemaking is part of a series of rules that have revised and expanded the regulatory requirements for entities that originate or service mortgage loans. In January 2013, the Bureau adopted the 2013 ATR Final Rule and the 2013 Mortgage Servicing Final Rules, along with other related rules mentioned above. Part VIII of the supplementary information to each of these rules set forth the Bureau's analyses and determinations under the RFA with respect to those rules. *See* 78 FR 10861 (Regulation X), 78 FR 10994 (Regulation Z—servicing), 78 FR 6575 (Regulation Z—ATR). Because this final rule generally makes clarifying changes to conform the January rules to their intended purposes, the RFA analyses associated with those rules generally take into account the impact of the changes made by this final rule.

Because these rules qualify as ''a series of closely related rules,'' for purposes of the RFA, the Bureau relies on those analyses and determines that it has met or exceeded the IRFA and FRFA requirements.

In the alternative, the Bureau also concludes that the final rule will not have a significant impact on a substantial number of small entities. As noted, this final rule generally clarifies the existing rules. These changes will not have a material impact on small entities. In the instance of the small servicer exemption, the rule likely reduces burden for the affected firms. In addition, the changes to appendix Q will likely reduce compliance costs by increasing clarity and providing more objective standards for evaluating certain kinds of income. The changes to appendix Q should also increase the probability that certain loans are originated as qualified mortgages and receive a presumption of compliance with the ability-to-repay standards. Therefore, the undersigned certifies that the rule will not have a significant impact on a substantial number of small entities.

VIII. Paperwork Reduction Act

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

[63] 5 U.S.C. 605(c).

[64] 5 U.S.C. 609.

List of Subjects

12 CFR Part 1024

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

12 CFR Part 1026

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

Authority and Issuance

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

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

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

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

Subpart A—General Provisions

■ 2. The subpart A heading is revised to read as set forth above.

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

§ 1024.5 Coverage of RESPA.

* * * * *

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

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

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

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

(3) Any person may request the Bureau to determine whether an inconsistency exists by submitting to the address established by the Bureau to request an official interpretation, a copy of the State law in question, any other law or judicial or administrative opinion that implements, interprets or applies the relevant provision, and an explanation of the possible inconsistency. A determination by the Bureau that an inconsistency with State law exists will be made by publication of a notice in the **Federal Register**. ''Law'' as used in this section includes regulations and any enactment which has the force and effect of law and is issued by a State or any political subdivision of a State.

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

Subpart B—Mortgage Settlement and Escrow Accounts

§ 1024.13 [Removed and Reserved]

■ 4. Section 1024.13 is removed and reserved.

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

Supplement I to Part 1024—Official Bureau Interpretations

* * * * *

Subpart A—General Provisions

§ 1024.5 Coverage of RESPA

5(c) Relation to State laws.

Paragraph 5(c)(1).

1. State laws that are inconsistent with the requirements of RESPA or

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

* * * * *

PART 1026—TRUTH IN LENDING (REGULATION Z)

■ 6. The authority citation for part 1026 is revised to read as follows:

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

Subpart E—Special Rules for Certain Home Mortgage Transactions

■ 7. Section 1026.35 is amended by revising paragraph (e) introductory text, redesignating paragraph (e)(3) as paragraph (e)(4), and adding new paragraph (e)(3) to read as follows:

§ 1026.35 Requirements for higher-priced mortgage loans.

* * * * *

(e) *Repayment ability, prepayment penalties.* Except as provided in paragraph (e)(3) of this section, higher-priced mortgage loans are subject to the following restrictions:

* * * * *

(3) *Exclusions.* This paragraph (e) does not apply to a transaction to finance the initial construction of a dwelling; a temporary or ''bridge'' loan with a term of twelve months or less, such as a loan to purchase a new dwelling where the consumer plans to sell a current dwelling within twelve months; or a reverse mortgage transaction subject to § 1026.33.

* * * * *

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

§ 1026.41 Periodic statements for residential mortgage loans.

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

* * * * *

(e) * * *

(4) * * *

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

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

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

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

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

(B) Reverse mortgage transactions.

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

■ 9. Section 1026.43 is amended by revising paragraphs (e)(4)(ii)(A) introductory text through (E) to read as follows:

§ 1026.43 Minimum standards for transactions secured by a dwelling.

* * * * *

(e) * * *

(4) * * *

(ii) * * *

(A) A loan that is eligible, except with regard to matters wholly unrelated to ability to repay:

* * * * *

(B) A loan that is eligible to be insured, except with regard to matters wholly unrelated to ability to repay, by the U.S. Department of Housing and Urban Development under the National Housing Act (12 U.S.C. 1707 *et seq.*);

(C) A loan that is eligible to be guaranteed, except with regard to matters wholly unrelated to ability to repay, by the U.S. Department of Veterans Affairs;

(D) A loan that is eligible to be guaranteed, except with regard to matters wholly unrelated to ability to repay, by the U.S. Department of Agriculture pursuant to 42 U.S.C. 1472(h); or

(E) A loan that is eligible to be insured, except with regard to matters wholly unrelated to ability to repay, by the Rural Housing Service.

* * * * *

■ 10. Appendix Q to Part 1026 is revised to read as follows:

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

Section 1026.43(e)(2)(vi) provides that, to satisfy the requirements for a qualified mortgage under § 1026.43(e)(2), the ratio of the consumer's total monthly debt payments to total monthly income at the time of consummation cannot exceed 43 percent. Section 1026.43(e)(2)(vi)(A) requires the creditor to calculate the ratio of the consumer's total monthly debt payments to total monthly income using the following standards, with additional requirements for calculating debt and income appearing in § 1026.43(e)(2)(vi)(B). Where guidance issued by the U.S. Department of Housing and Urban Development, the U.S. Department of Veterans Affairs, the U.S. Department of Agriculture, or the Rural Housing Service, or issued by the Federal National Mortgage Association (Fannie Mae) or the Federal Home Loan Mortgage Corporation (Freddie Mac) while operating under the conservatorship or receivership of the Federal Housing Finance Agency, or issued by a limited-life regulatory entity succeeding the charter of either Fannie Mae or Freddie Mac (collectively, Agency or GSE guidance) is in accordance with appendix Q, creditors may look to that guidance as a helpful resource in applying appendix Q. Moreover, when the following standards do not resolve how a specific kind of debt or income should be treated, the creditor may either (1) exclude the income or include the debt, or (2) rely on Agency or GSE guidance to resolve the issue. The following standards resolve the appropriate treatment of a specific kind of debt or income where the standards provide a discernible answer to the question of how to treat the debt or income. However, a creditor may not rely on Agency or GSE guidance to reach a resolution contrary to that provided by the following standards, even if such Agency or GSE guidance specifically addresses the particular type of debt or income but the following standards provide more generalized guidance.

I. Consumer Employment Related Income

A. Stability of Income

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

2. *Verifying Employment History.*

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

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

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

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

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

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

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

i. The consumer's past employment record; and

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

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

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

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

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

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

i. Traditional employment verifications; and/or

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

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

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

B. Salary, Wage and Other Forms of Income

1. *General Policy on Consumer Income Analysis.*

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

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

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

a. Documented retirement benefits;

b. Social Security payments; or

c. Other payments expected to be received in retirement.

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

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

2. *Overtime and Bonus Income.*

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

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

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

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

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

4. *Qualifying Part-Time Income.*

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

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

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

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

5. *Income from Seasonal Employment.*

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

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

ii. Expects to be rehired the next season.

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

i. Umpiring baseball games in the summer; or

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

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

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

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

7. *Commission Income.*

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

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

ii. The most recent pay stub.

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

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

ii. Soundly rationalize accepting the commission income.

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

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

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

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

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

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

9. *Employer Differential Payments.*

If the employer subsidizes a consumer's mortgage payment through direct payments, the amount of the payments:

a. Is considered gross income, and

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

10. *Retirement Income.*

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

11. *Social Security Income.*

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

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

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

12. *Automobile Allowances and Expense Account Payments.*

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

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

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

ii. Employer verification that the payments will continue.

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

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

i. The consumer's monthly car payment; and

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

C. Consumers Employed by a Family Owned Business.

1. *Income Documentation Requirement.*

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

a. Copies of signed personal tax returns, or

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

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

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

1. *Definition: Self-Employed Consumer.*

A consumer with a 25 percent or greater ownership interest in a business is considered self-employed.

2. *Types of Business Structures.*

There are four basic types of business structures. They include:

a. Sole proprietorships;

b. Corporations;

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

d. Partnerships.

3. *Minimum Length of Self Employment.*

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

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

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

4. *General Documentation Requirements for Self-Employed Consumers.*

Self-employed consumers must provide the following documentation:

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

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

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

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

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

b. If a consumer:

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

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

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

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

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

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

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

1. *General Policy on Adjusting Income Based on a Review of IRS Form 1040.*

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

2. *Guidelines for Analyzing IRS Form 1040.*

The table below contains guidelines for analyzing IRS Form 1040:

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

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

1. *Description: Corporation.*

A corporation is a State-chartered business owned by its stockholders.

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

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

i. Corporate tax return IRS Form 1120; and

ii. Individual tax returns.

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

3. *Analyzing Corporate Tax Returns.*

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

i. Be determined; and

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

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

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

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

1. *Description: "S" Corporation.*

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

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

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

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

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

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

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

1. *Description: Partnership.*

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

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

2. *Analyzing Partnership Tax Returns.*

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

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

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

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

II. Non-Employment Related Consumer Income

A. Alimony, Child Support, and Maintenance Income Criteria.

Alimony, child support, or maintenance income may be considered effective, if:

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

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

i. Final divorce decree;

ii. Legal separation agreement;

iii. Court order; or

iv. Voluntary payment agreement; and

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

i. Cancelled checks;

ii. Deposit slips;

iii. Tax returns; or

iv. Court records.

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

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

B. Investment and Trust Income.

1. *Analyzing Interest and Dividends.*

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

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

2. *Trust Income.*

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

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

i. Amount of the trust;

ii. Frequency of distribution; and

iii. Duration of payments.

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

3. *Notes Receivable Income.*

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

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

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

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

4. *Eligible Investment Properties.*

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

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

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

1. *Military Income.*

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

i. Income from variable housing allowances;

ii. Clothing allowances;

iii. Flight or hazard pay;

iv. Rations; and

v. Proficiency pay.

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

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

2. *VA Benefits.*

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

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

3. *Government Assistance Programs.*

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

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

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

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

4. *Mortgage Credit Certificates.*

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

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

5. *Homeownership Subsidies.*

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

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

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

d. The assistance payment must be:

i. Paid directly to the servicing creditor; or

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

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

D. Rental Income.

1. *Analyzing the Stability of Rental Income.*

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

i. A current lease;

ii. An agreement to lease; or

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

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

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

2. *Rental Income From Consumer Occupied Property.*

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

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

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

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

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

a. Rental income from roommates or boarders in a single family property occupied as the consumer's primary residence is acceptable.

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

4. *Documentation Required To Verify Rental Income.*

Analysis of the following required documentation is necessary to verify all consumer rental income:

a. IRS Form 1040 Schedule E; and

b. Current leases/rental agreements.

5. *Analyzing IRS Form 1040 Schedule E.*

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

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

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

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

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

b. In order to calculate the rental income:

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

ii. Subtract PITI and any homeowners association dues; and

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

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

another principal residence, except under the conditions described below:

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

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

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

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

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

E. Non-Taxable and Projected Income

1. *Types of Non-Taxable Income.*

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

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

b. Certain types of disability and public assistance payments;

c. Child support;

d. Military allowances; and

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

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

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

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

c. The creditor:

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

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

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

3. *Analyzing Projected Income.*

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

i. Cost-of-living adjustments;

ii. Performance raises; and

iii. Bonuses.

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

i. Verified in writing by the employer; and

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

4. *Projected Income for New Job.*

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

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

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

III. Consumer Liabilities: Recurring Obligations

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

a. All installment loans;

b. Revolving charge accounts;

c. Real estate loans;

d. Alimony;

e. Child support; and

f. Other continuing obligations.

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

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

i. Monthly housing expense; and

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

a. Payments on installment accounts;

b. Child support or separate maintenance payments;

c. Revolving accounts; and

d. Alimony.

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

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

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

a. 5 percent of the balance; or

b. $10.

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

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

IV. Consumer Liabilities: Contingent Liability

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

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

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

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

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

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

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

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

5. *Contingent Liability on Cosigned Obligations.*

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

i. A car loan;

ii. A student loan;

iii. A mortgage; or

iv. Any other obligation.

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

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

1. Projected Obligations

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

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

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

2. Obligations Not Considered Debt

Obligations not considered debt, and therefore not subtracted from gross income, include:

a. Federal, State, and local taxes;

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

c. Commuting costs;

d. Union dues;

e. Open accounts with zero balances;

f. Automatic deductions to savings accounts;

g. Child care; and

h. Voluntary deductions.

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

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

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

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

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

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

i. Under *43(e)(4) Qualified mortgage defined-special rules,* paragraph 4 is revised and paragraph 5 is added.

The revisions and additions read as follows:

Supplement I to Part 1026—Official Interpretations

* * * * *

Subpart E—Special Rules for Certain Home Mortgage Transactions

* * * * *

§ 1026.41 Periodic Statements for Residential Mortgage Loans

* * * * *

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

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

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

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

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

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

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

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

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

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

* * * * *

2. Timing for small servicer exemption. The following examples demonstrate when a servicer either is considered or is no longer considered a small servicer:

i. A servicer that begins servicing more than 5,000 mortgage loans (or begins servicing one or more mortgage loans it does not own or did not originate) on October 1, and services more than 5,000 mortgage loans (or services one or more mortgage loans it does not own or did not originate) as of January 1 of the following year, would no longer be considered a small servicer on January 1 of that following year and would have to comply with any requirements from which it is no longer exempt as a small servicer on April 1 of that following year.

ii. A servicer that begins servicing more than 5,000 mortgage loans (or begins servicing one or more mortgage loans it does not own or did not originate) on February 1, and services more than 5,000 mortgage loans (or services one or more mortgage loans it does not own or did not originate) as of January 1 of the following year, would no longer be considered a small servicer on January 1 of that following year and would have to comply with any requirements from which it is no longer exempt as a small servicer on that same January 1.

iii. A servicer that begins servicing more than 5,000 mortgage loans (or begins servicing one or more mortgage loans it does not own or did not originate) on February 1, but services less than 5,000 mortgage loans (or no longer services mortgage loans it does not own or did not originate) as of January 1 of the following year, is considered a small servicer for that following year.

* * * * *

3. *Mortgage loans not considered in determining whether a servicer is a small servicer.* Mortgage loans that are not considered for purposes of determining whether a servicer is a small servicer pursuant to § 1026.41(e)(4)(iii) are not considered either for determining whether a servicer, together with any affiliates, services 5,000 or fewer mortgage loans or whether a servicer is servicing only mortgage loans that it owns or originated. For example, assume a servicer services 5,400 mortgage loans. Of these mortgage loans, the servicer owns or originated 4,800 mortgage loans, voluntarily services 300 mortgage loans that it does not own or did not originate for an unaffiliated nonprofit organization for which the servicer does not receive any compensation or fees, and services 300 reverse mortgage transactions that it does not own and did not originate. Because the only mortgage loans considered are the 4,800 mortgage loans owned or originated by the servicer, the servicer is considered a small servicer and qualifies for the small servicer exemption with regard to all 5,400 mortgage loans it services. Note that reverse mortgages and mortgage loans secured by consumers' interests in timeshare plans, in addition to not being considered in determining small servicer qualification, are also exempt from the requirements of § 1026.41. In contrast, although charitably serviced mortgage loans, as defined by § 1026.41(e)(4)(iii), are likewise not considered in determining small servicer qualification, they are not exempt from the requirements of § 1026.41. Thus, a servicer that does *not* qualify as a small servicer would not have to provide periodic statements for reverse mortgages and timeshare plans because they are exempt from the rule, but would have to provide periodic statements for mortgage loans it charitably services.

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§ 1026.43 Minimum Standards for Transactions Secured by a Dwelling

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

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4. *Eligible for purchase, guarantee, or insurance except with regard to matters wholly unrelated to ability to repay.* To satisfy § 1026.43(e)(4)(ii), a loan need not be actually purchased or guaranteed by Fannie Mae or Freddie Mac or insured or guaranteed by one of the

Agencies (the U.S. Department of Housing and Urban Development (HUD), U.S. Department of Veterans Affairs (VA), U.S. Department of Agriculture (USDA), or Rural Housing Service (RHS)). Rather, § 1026.43(e)(4)(ii) requires only that the creditor determine that the loan is eligible (*i.e.,* meets the criteria) for such purchase, guarantee, or insurance at consummation. For example, for purposes of § 1026.43(e)(4), a creditor is not required to sell a loan to Fannie Mae or Freddie Mac (or any limited-life regulatory entity succeeding the charter of either) for that loan to be a qualified mortgage; however, the loan must be eligible for purchase or guarantee by Fannie Mae or Freddie Mac (or any limited-life regulatory entity succeeding the charter of either), including satisfying any requirements regarding consideration and verification of a consumer's income or assets, credit history, debt-to-income ratio or residual income, and other credit risk factors, but not any requirements regarding matters wholly unrelated to ability to repay. To determine eligibility for purchase, guarantee or insurance, a creditor may rely on a valid underwriting recommendation provided by a GSE automated underwriting system (AUS) or an AUS that relies on an Agency underwriting tool; compliance with the standards in the GSE or Agency written guide in effect at the time; a written agreement between the creditor or a direct sponsor or aggregator of the creditor and a GSE or Agency that permits variation from the standards of the written guides and/or variation from the AUSs, in effect at the time of consummation; or an individual loan waiver granted by the GSE or Agency to the creditor. For creditors relying on the variances of a sponsor or aggregator, a loan that is transferred directly to or through the sponsor or aggregator at or after consummation complies with § 1026.43(e)(4). In using any of the four methods listed above, the creditor need not satisfy standards that are wholly unrelated to assessing a consumer's ability to repay that the creditor is required to perform. Matters wholly unrelated to ability to repay are those matters that are wholly unrelated to credit risk or the underwriting of the loan. Such matters include requirements related to the status of the creditor rather than the loan, requirements related to selling, securitizing, or delivering the loan, and any requirement that the creditor must perform after the consummated loan is sold, guaranteed, or endorsed for insurance such as document custody, quality control, or servicing.

Accordingly, a covered transaction is eligible for purchase or guarantee by Fannie Mae or Freddie Mac, for example, if:

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

ii. The loan has been granted an individual waiver by a GSE, which will allow purchase or guarantee in spite of variations from the applicable standards; or

iii. The creditor inputs accurate information into the Fannie Mae or Freddie Mac AUS or another AUS pursuant to a written agreement between the creditor and Fannie Mae or Freddie Mac that permits variation from the GSE AUS; the loan receives one of the recommendations specified below in paragraphs A or B from the corresponding GSE AUS or an equivalent recommendation pursuant to another AUS as authorized in the written agreement; and the creditor satisfies any requirements and conditions specified by the relevant AUS that are not wholly unrelated to ability to repay, the non-satisfaction of which would invalidate that recommendation:

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

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

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

i. Assume eligibility to purchase a loan was based in part on the consumer's employment income of $50,000 per year. The creditor uses the income figure in obtaining an approve/eligible recommendation from DU. A quality control review, however, later determines that the documentation provided and verified by the creditor to comply with Fannie Mae requirements did not support the reported income of $50,000 per year. As a result, Fannie Mae demands that the creditor repurchase the loan. Assume that the quality control review is accurate, and that DU would not have issued an approve/eligible recommendation if it had been provided the accurate income figure. The DU determination at the time of consummation was invalid because it was based on inaccurate information provided by the creditor; therefore, the loan was never a qualified mortgage under § 1026.43(e)(4).

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

* * * * *

Dated: July 10, 2013.

Richard Cordray,

Director, Bureau of Consumer Financial Protection.

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