

INFOBYTES SPECIAL ALERT:

CFPB FINALIZES ADDITIONAL AMENDMENTS TO THE ABILITY-TO-REPAY/QUALIFIED MORTGAGE RULE AND OTHER 2013 MORTGAGE RULES; AGENCIES PROPOSE AMENDMENTS TO APPRAISALS RULE

July 12, 2013

On July 10, the Consumer Financial Protection Bureau (“Bureau”) finalized [important amendments](#) (the “Amendments”) to its ability-to-repay / qualified mortgage rule (the “QM / ATR Rule”) that are intended to ease certain compliance challenges with making qualified mortgages (“QMs”).¹ In response to industry concerns on the extensive underwriting requirements in Regulation Z’s new Appendix Q, the Bureau acknowledged that certain of its provisions were “not well-suited to function as regulatory requirements”² and, as a result, finalized major revisions to the methodology for determining a consumer’s monthly debt and income for purposes of making a QM under the 43% debt-to-income (“DTI”) underwriting alternative.

The Amendments, which had been proposed in April of this year (the “April Proposal”),³ also finalize clarifications to its mortgage servicing and escrows rules that were issued this January.⁴ Like the mortgage rules themselves, the Amendments will take effect on January 10, 2014.

Separately, on the same date, the Bureau, together with the Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Federal Housing Finance Agency, National Credit Union Administration, and Office of the Comptroller of the Currency (the “Agencies”) issued [proposed amendments](#) to their January 2013 final rule governing appraisal practices.⁵

I. AMENDMENTS TO THE QM / ATR RULE

A. Amendments to Appendix Q (Standards for Determining Monthly Debt and Income)

Appendix Q contains detailed rules regarding what and how to consider income and liability items for purposes of calculating the borrower’s DTI ratio, as well as how such items must be verified. Among the more significant changes, the Amendments ease the general requirement that a lender determine that the

¹ Bureau of Consumer Financial Protection, Final Rule, Amendments to the 2013 Mortgage Rules under the Real Estate Settlement Procedures Act (Regulation X) and the Truth in Lending Act (Regulation Z) (July 10, 2013), http://files.consumerfinance.gov/f/201307_cfpb_final-rule_titlexiv.pdf (publication in the Federal Register forthcoming) [hereinafter “Amendments Release”].

² *Amendments Release* at 65.

³ Bureau of Consumer Financial Protection, Proposed Rule with Request for Public Comment, Amendments to the 2013 Mortgage Rules Under the Real Estate Settlement Procedures Act (Regulation Z) and the Truth in Lending Act (Regulation Z), 78 Fed. Reg. 25638 (May 2, 2013).

⁴ Bureau of Consumer Financial Protection, Mortgage Servicing Rules Under the Real Estate Settlement Procedures Act (Regulation X), 78 Fed. Reg. 10696 (Feb. 14, 2013) [hereinafter “2013 RESPA Servicing Rule”]; Bureau of Consumer Financial Protection, Mortgage Servicing Rules Under the Truth in Lending Act (Regulation Z), 78 Fed. Reg. 10902 (Feb. 14, 2013) [hereinafter “2013 TILA Servicing Rule”, and together with the 2013 RESPA Servicing Rule, “2013 Mortgage Servicing Rules”].

⁵ Bureau of the Consumer Financial Protection Bureau, the Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Federal Housing Finance Agency, National Credit Union Administration, and Office of the Comptroller of the Currency, Appraisals for Higher-Priced Mortgage Loans – Supplemental Proposal, Proposed Rule, http://files.consumerfinance.gov/f/201307_cfpb_appraisal-requirement-exemptions_fr-notice.pdf (July 10, 2013) (publication in the Federal Register forthcoming).

consumer's income is "reasonably expected" to continue through at least the first three years of the loan. When assessing the stability of a consumer's income, the Amendments also eliminate the requirements that a lender analyze both a consumer's probability of continued employment and the consumer's training, education, and qualifications for the job. Other amendments to Appendix Q include:

- *Analyzing and Verifying a Consumer's Employment History.* At industry's urging, the Amendments eliminate the requirement that a lender obtain an employer's confirmation of the consumer's continued employment. Instead, the Bureau permits lenders to assume that employment is ongoing if the consumer's employer verifies his current employment and does not indicate that such employment has been, is set to be, or is likely to be terminated.
- *Salary, Wages and Other Forms of Income.* The Amendments revise the standards for bonus or overtime income, social security income and self-employment income:
 - *Bonus and Overtime Income.* A lender will no longer be required to determine whether bonus or overtime income will continue, and may count such income provided it has not received documentation indicating that it will cease.
 - *Social Security Income.* The Bureau will only require a lender to obtain a benefit letter from the Social Security Administration ("SSA") to verify social security income. The QM / ATR Rule as promulgated in January required verification from the SSA and supporting tax returns. Lenders may also assume that social security benefits are ongoing absent evidence that it will expire within 3 years.
 - *Self-employment Income.* The QM / ATR Rule issued in January would require lenders to analyze the business's source of income, obtain business credit reports for certain corporations, and the general economic outlook of similar businesses in the geographic region. In response to industry concerns that such analyses would be imprecise as well as difficult and costly to obtain, the Bureau eliminated each of these requirements.
- *Non-employment Related Consumer Income.* The Amendments revise the standards pertaining to trust income, notes receivable income and rental income for purposes of determining and verifying a consumer's DTI. Among these changes, lenders may count rental income from roommates or boarders in the consumer's primary residence as income. In contrast, the QM / ATR Rule issued in January prohibited inclusion of this income unless the boarders were related by blood, marriage or law.

Moreover, the Bureau permits creditors to rely on standards established by Fannie Mae or Freddie Mac (the "GSEs") or by the Department of Housing and Urban Development, Department of Veterans Affairs, Department of Agriculture, Rural Housing Service (the "Federal Agencies") as "a helpful resource in applying appendix Q" so long as those standards are consistent with Appendix Q's requirements.⁶ With respect to the treatment of items that are not covered by Appendix Q, the Bureau revised the introduction to Appendix Q to provide that a creditor may choose to "exclude the income or include the debt" or rely on GSE or Federal Agency guidance on how to resolve the issue.⁷

⁶ New Appendix Q to Part 1026; *Amendments Release* at 123.

⁷ *Id.*

B. Clarifications Related to the GSE / Federal Agency Alternative

The Bureau finalized amendments that provide guidance on when a loan is a QM because it meets the underwriting requirements to be purchased by the GSEs or insured or guaranteed by a Federal Agency (the “GSE / Federal Agency” alternative).⁸ To determine eligibility, the Bureau clarifies that:

- A lender may rely on a recommendation (presumably an approval) provided by a GSE or Federal Agency Automated Underwriting System (“AUS”) or written guide.⁹
- A lender may rely on a written agreement between it and the GSE or Federal Agency that permits variation from the standards of the written guides and/or AUSs (so-called “contract variances”). A correspondent lender in a direct relationship with a variance holder may also rely on negotiated contract variances.¹⁰
- A lender need not satisfy GSE or Federal Agency requirements that are “wholly unrelated” to credit risk or the underwriting of the loan, including “requirements related to the status of the creditor rather than the loan, requirements related to selling, securitizing, or delivering the loan and any requirement the creditor is required to perform after the consummated loan is sold, guaranteed, or endorsed for insurance such as document custody, quality control and servicing.” The Bureau states that requirements wholly unrelated to credit risk or the underwriting of the loan are wholly unrelated to a consumer’s ability-to-repay.¹¹

The Preamble to the Amendments also states the Bureau’s view that minor inaccuracies in input data that do not affect the loan’s eligibility for purchase, guarantee or insurance should not affect its QM status, although this clarification is not expressed in the text of the amended regulation or commentary.¹² Further, a repurchase or indemnification demand by a GSE or Federal Agency would not automatically strip a loan of its QM status because “[s]ome repurchase or indemnification demands are not related to eligibility criteria at consummation.”¹³

The Bureau indicated that among the 73 comments it received on the April Proposal, many requested guidance on other significant aspects of the QM / ATR Rule, such as how to comply with the QM / ATR Rule in light of the use of the disparate impact theory in light of the use of fair lending enforcement and how to calculate residual income for purposes of making rebuttable presumption QMs.¹⁴ The Bureau did not address these concerns, emphasizing that the Amendments were intended to “focus on specific narrow implementation issues, and broader policy changes would not be appropriate as part of this process.”¹⁵

⁸ § 43(e)(4). Unless otherwise specified, this Alert hereafter uses shortened citations such as “§ 32” and “§ 43” to mean “12 C.F.R. § 1026.32” and “12 C.F.R. § 1026.43.” Similarly, unless otherwise specified, the shortened citations “Cmt. 32” and “Cmt. 43” refer to the Comments to 12 C.F.R. § 1026.32 and § 1026.43, respectively. We also distinguish between “New § 32” — which refers to the provisions of § 32 that will become effective in January 2014 — and “Current § 32.” Because there is no current version of § 43, we refer to it simply as “§ 43.”

⁹ New Cmt. 43(e)(4)-4.

¹⁰ *Id.*

¹¹ *Id.*

¹² *Id.*; Amendments Release at 55.

¹³ New Cmt. 43(e)(4)-5.

¹⁴ Amendments Release at 8-9.

¹⁵ *Id.* at 9.

II. MORTGAGE SERVICING AMENDMENTS

Preemption of State Law. The Amendments respond to questions about the extent to which the loss mitigation and other requirements adopted under the Real Estate Settlement Procedures Act preempt State mortgage servicing and foreclosure laws. Specifically, the Bureau states that, although State laws that are inconsistent with the Bureau's requirements may be preempted, State laws that give greater protection to consumers are not. The Bureau also states that nothing in its rules should be construed to preempt the entire field of regulation.¹⁶

Effective Date & Rate Adjustment Notices. The Bureau's mortgage servicing rules take effect on January 10, 2014. The Bureau clarifies that, although the new notice requirements for adjustable rate mortgages ("ARMs") apply to loans made before January 10, 2014, servicers are not required to comply with those requirements prior to that date.¹⁷

- *New notice under 12 CFR § 1026.20(d).* The mortgage servicing rules require a new notice 210 to 240 days before the first payment is due after the first interest rate adjustment on an ARM. The Bureau states in the Amendments that servicers will not be required to provide this notice when that payment is due 209 or fewer days after the effective date (*i.e.*, on or before August 7, 2014).¹⁸
- *Revised notice under 12 CFR § 1026.20(c).* Under the current § 1026.20(c), a notice is required 25 to 120 days before the first payment is due after an interest rate adjustment causing a corresponding change in payment. The mortgage servicing rules revise the content of the § 1026.20(c) notice and require that it be provided 60 to 120 days before the new payment is due. The Bureau states in the Preamble to the Amendments that "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" (*i.e.*, on or before February 3, 2014). The Bureau also states that "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" (*i.e.*, from February 4 through March 10, 2014). Although the Bureau has stated that no notice is required for new payments due during this period, it would be prudent for servicers to provide either the current or revised § 1026.20(c) notice.¹⁹
- *Other requirements.* Although not expressly stated in the Amendments, these clarifications indicate that the Bureau does not intend to require servicers to comply with a new requirement or prohibition prior to the effective date. If this is correct, then, for example, a servicer could make the first notice or filing in the foreclosure process on January 9, 2014, even if the borrower is less than 120 days delinquent at that time. On or after January 10, 2014, however, the new rules will prohibit that action unless and until the borrower became more than 120 days delinquent.

Exemptions for Small Servicers. A servicer that services 5,000 or fewer mortgage loans that it or an affiliate originated or owns is a "small servicer" and therefore exempt from certain requirements in the mortgage servicing rules, including periodic statements and some of the requirements regarding loss mitigation and lender-placed insurance. The Amendments clarify which loans must be considered when making this

¹⁶ New Cmt. 5(c)(1)-1.

¹⁷ *Amendments Release* at 17.

¹⁸ *Id.*

¹⁹ *Id.*

determination. In particular, all dwelling-secured closed-end consumer credit transactions must be considered (not just federally related mortgage loans) as well as loans serviced by an affiliate of the servicer.²⁰

III. ESCROWS RULE AMENDMENTS

The Bureau provided more guidance on its recent amendments to its escrows rule which took effect on June 1.²¹ Specifically, the Amendments clarify that construction loans, bridge loans and reverse mortgages are not subject to the rule's requirements regarding the ability-to-repay requirements and prepayment penalty provisions for higher priced mortgage loans ("HPMLs").²²

IV. PROPOSED AMENDMENTS TO INTERAGENCY APPRAISAL RULE

Separately, on July 10, 2014, the Agencies issued proposed amendments to their January 2013 final rule.²³ That rule requires creditors making HPMLs to obtain one or more written appraisals and to provide consumers with a notice regarding the use of appraisals and a free copy of each appraisal. The proposed amendments would exempt the following transactions from these requirements:

- Transactions secured solely by an existing manufactured home and not land
- "Streamlined" refinances where the owner or guarantor of the refinance loan is the current owner or guarantor of the existing obligation, provided that (1) the refinanced payments are not interest-only and do not result in negative amortization or balloon payments, and (2) the refinance is not a "cash-out" refinance
- Transactions of \$25,000 or less, indexed annually for inflation

Comments are due by September 9, 2013.

* * *

Questions regarding the matters discussed in this Alert may be directed to any of our lawyers listed below, or to any other BuckleySandler attorney with whom you have consulted in the past.

- Jeffrey P. Naimon, (202) 349-8030, jnaimon@buckleysandler.com
- Clinton R. Rockwell, (310) 424-3901, crockwell@buckleysandler.com
- Joseph J. Reilly, (202) 349-7965, jreilly@buckleysandler.com
- John P. Kromer, (202) 349-8040, jkromer@buckleysandler.com
- Joseph M. Kolar, (202) 349-8020, jkolar@buckleysandler.com
- Benjamin K. Olson, (202) 349-7924, bolson@buckleysandler.com
- Jon Langlois (202) 349-8045, janglois@buckleysandler.com
- Shara M. Chang, (202) 349-8096, schang@buckleysandler.com

²⁰ *Id.* at 23-45.

²¹ Bureau of Consumer Financial Protection, Amendments to the 2013 Escrows Final Rule under the Truth in Lending Act (Regulation Z), 78 Fed. Reg. 30739 (May 23, 2013).

²² New § 35(e).

²³ Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Bureau of the Consumer Financial Protection Bureau, Appraisals for Higher-Priced Mortgage Loans – Supplemental Proposal, Proposed Rule, http://files.consumerfinance.gov/f/201307_cfpb_appraisal-requirement-exemptions_fr-notice.pdf (July 10, 2013) (publication in the Federal Register forthcoming).