Charles G. Cooper
Commissioner

TEXAS DEPARTMENT OF BANKING
2601 North Lamar Blvd., Austin, Texas 78705
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INDUSTRY NOTICE
Date: September 2, 2016

Guidance on CFPB Amendments to the Mortgage Rule

At the beginning of 2016, the Consumer Financial Protection Bureau (CFPB) finalized several amendments to the mortgage rules related to small creditors and rural or underserved areas under the Truth in Lending Act. On April 26, 2016, Texas Department of Banking Commissioner and Conference of State Bank Supervisors (CSBS) Chairman Charles G. Cooper organized a meeting with members of the Texas banking community and CFPB Director Cordray to discuss recurring questions among bankers about the CFPB's mortgage rules. The results of the meeting are recapped in the attached letter from Director Cordray dated July 14, 2016.

During the April meeting, we learned that the CFPB was drafting a letter to provide clarity about the mortgage rules to the state industry trade associations; however, it is unclear how widely this letter of clarification was distributed. As a result, the CFPB was asked to provide a similar letter to CSBS. The letter to CSBS highlights some of the important changes to the mortgage rules that likely apply to many of the small creditors that you supervise. A copy of the letter addressed to CSBS is attached.

We encourage bankers to review the mortgage rule changes. The CFPB has made several resources available to help navigate through the changes to the mortgage rule, including a factsheet, an executive summary of the interim final rule that was issued in March, and a qualified mortgage flow chart designed for small creditors.

Consumer Financia
Protection Bureau

1700 G Street, N.W., Washington, DC 20552

July 14, 2016

The Honorable Charles G. Cooper
Texas Department of Banking
2601 North Lamar Blvd.
Austin, TX 78705-4294

Dear Commissioner Cooper:

Thank you for meeting with me, Tuesday, April 26, 2016, and bringing members of the Texas banking community with you to discuss recurring questions among bankers, especially small bankers, in Texas about the Consumer Financial Protection Bureau's mortgage rules. We are committed to an open dialogue with stakeholders about all of our rules. This dialogue is especially helpful among our state partners who have joint jurisdiction and who see how our regulations are working in real-time.

Our conversation focused on three areas of concern. First, many bankers were unclear whether they qualify as a small creditor under the Bureau's rules and which loans they make are considered Qualified Mortgage (QM). As discussed during our meeting, the Bureau recently finalized changes to several definitions in our mortgage rules that we believe would provide additional clarity.

If an institution and its affiliates have less than $2 billion in assets (adjusted annually for inflation) and originated fewer than 2,000 first-lien mortgages during the prior year (excluding any originated loans held in portfolio), the institution would likely qualify as a small creditor.
As a small creditor, any loan an institution makes that meets the product feature requirements[1] that an institution holds in portfolio is a QM as long as the institution has considered and verified a borrower's debt-to income ratio (though no specific DTI limit applies).

In addition, small creditors operating in rural or underserved areas can originate balloon-payment QMs and balloon-payment Home Ownership and Equity Protection Act loans and may be exempt from the requirement to establish an escrow account for higher priced mortgage loans. Through the Helping Expand Lending Practices in Rural Communities Act and the Bureau's implementing rule, creditors that extended one covered transaction secured by a first lien on a property located in a rural or underserved area in the prior year are now able to take advantage of these provisions.

The second area of concern was the perception by some, of uneven supervision of the mortgage rules, especially the Ability-to-Repay and QM requirements among the prudential regulators. I frequently meet with the prudential regulators, and will be sure to bring up your concerns. Additionally, there are several federal supervisory working groups that members of my staff sit on

[1] Where the points and fees are less than or equal to 3 percent of the loan amount (for loan amounts less than $100,000, higher percentage thresholds are allowed), there are no risky features (for example: negative amortization or interest-only), the maximum loan term is less than or equal to 30 years.

with representatives from the other prudential regulatory agencies, where we can raise these concerns.

The third area of concern was a specific question about the Bureau's Know Before You Owe mortgage disclosures rules apply when commercial real estate is used to secure an extension of consumer credit. The Know Before You Owe mortgage disclosure rule, consistent with the pre-existing TILA interpretation in Regulation Z and the Official Staff Interpretations, requires the use of the Integrated Disclosures in "a closed-end consumer credit transaction secured by real property."[2] As long as the credit extended meets the definition of consumer credit in TILA[3] in a closed-end credit transaction secured by real estate, the Know Before You Owe mortgage disclosures should be provided, whether the property used to secure the transaction is commercial or residential. Several bankers at the meeting had questions about this topic; let me know if there are questions still about it. I will have someone from my team follow-up with them.

Thank you again for meeting with me and for your continued interest in the Bureau's work and your commitment to bringing concerns to our attention. I look forward to working together on other matters of importance to you in the future.

Sincerely,

Richard

Richard Cordray
Director

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[2] 12 CFR § 1026.19(e)(1)(i) and 12 CFR § 1026.19(f)(1)(i)
[3] 12 CFR § 1026.2(a) (12), "credit offered or extended to a consumer primarily for personal, family, or household purposes."

Consumer Financial Protection Bureau

1700 G Street NW, Washington, DC 20552

August 29, 2016

John Ryan
President and CEO
Conference of State Bank Supervisors
1129 20th Street, N.W., 9th Floor
Washington, DC 20036

RE: Amendments Relating to Small Creditors and Rural or Underserved Areas Under the Truth in Lending Act (Regulation Z)

Dear Mr. Ryan:

Recently, the Consumer Financial Protection Bureau (CFPB) finalized several changes to our mortgage rules related to the definitions of small creditor and rural. I would like to take this opportunity to highlight some of the important changes that likely apply to your members.

Since issuing the mortgage rules, we have continued to monitor the mortgage market and seek public input. After extensive feedback, we finalized changes to our mortgage rules that extended small creditor status to more creditors. According to the revised rule:

> **If you and your affiliate(s), together, have less than $2 billion in assets (adjusted annually for inflation) and originated fewer than 2,000 first-lien mortgages during the prior year, excluding any originated loans that you or your affiliates held in portfolio, your institution may qualify as a small creditor.**

The Bureau included certain special provisions in our mortgage rules for small creditors and for small creditors operating in rural or underserved areas. For example, if you are a small creditor, any loan you make that meets the product feature requirements and that you hold in portfolio is a Qualified Mortgage (QM) as long as you have considered and verified a borrower's debt-to-income ratio. In addition, small creditors operating in rural or underserved areas can originate balloon-payment QMs and balloon-payment HOEPA loans and may be exempt from the requirement to establish an escrow account for higher priced mortgage loans.

We also expanded the definition of “rural.” Many of you told us our definition was too narrow, so we took another look. Our October 15, 2015 rule added all of the census blocks that are not in urban areas, which expanded the definition to embrace about 22 percent of the population. By expanding the definition to include rural pockets within counties that are non-rural, I think you will find this new definition provides more clarity and granularity than the prior county-based metric. To facilitate compliance with the newly expanded definition of “rural,” there is a tool on the Bureau’s website that allows creditors to ascertain whether a property is located in a rural or underserved area.

In December 2015, Congress weighed in with the Helping Expand Lending Practices (HELP) in Rural Communities Act. As a result, on March 22, 2016, the Bureau issued an interim final rule that further expands the class of small creditors that are eligible to originate balloon-payment QMs and HOEPA loans and qualify for the escrow exemption. Beginning on March 31, small creditors that extended one covered transaction secured by a first lien on a property located in a rural or underserved area in the prior year are able to take advantage of these provisions. For instance, they would be exempt from the requirement to maintain escrow accounts for higher-priced mortgage loans, unless they establish such an account for an application received on or after May 1, 2016 (except at a distressed borrower’s request). About 6,000 additional small creditors are now eligible as a result of this change.

In addition, a new application process the Bureau established on March 2, 2016 allows members of the public to apply for additional areas to be considered rural. However, most small creditors may already satisfy the simple requirement of the rural or underserved test and will not need to use this process to take advantage of the special provisions.

I want to stress that this letter is not an exhaustive summary of changes to the small creditor rule. The Bureau’s website contains additional resources to help you navigate the changes, including a factsheet, an executive summary of the interim final rule that we issued in March, and a qualified mortgage flow chart designed for small creditors. I encourage you to visit the Bureau’s regulatory implementation page to learn more about the new changes and how these resources may assist in compliance efforts.

Sincerely,

Richard Cordray
Director

Small creditors operating in a rural or underserved area

Small creditors that operate in a rural or underserved area can originate balloon-payment qualified mortgages and balloon-payment high cost mortgages. They would also be exempt from the requirement to maintain escrow accounts for certain higher-priced mortgage loans, unless they establish such an account for an application received on or after May 1, 2016 (except as an accommodation to a distressed borrower).

The Bureau recently issued rules that changed the small creditor and rural-or-underserved tests. The Bureau also established an application process to request that the Bureau designate a county or census block as rural. Importantly, the Bureau anticipates that most small creditors already satisfy the new rural-or-underserved test and will not need to use the application process to take advantage of the special provisions mentioned above. Before submitting an application under that process, you should review the changes discussed below to make sure the application is truly necessary.

Small creditor

A creditor is a small creditor if, during the prior calendar year: (1) the creditor and its affiliates together originated 2,000 or fewer first-lien covered transactions that were sold, assigned or otherwise transferred (with no limit on loans held in portfolio); and (2) the creditor, together with its affiliates that regularly extend first-lien covered transactions, have less than $2 billion in assets (adjusted annually for inflation). Additionally, there is a grace period. For loan applications received before April 1 of a particular year, a creditor is a small creditor if it meets these requirements during either of the two prior calendar years.

Generally, a covered transaction is a consumer credit transaction that is secured by a dwelling (i.e., mortgage loan). Certain mortgage loans that are exempt from the Ability to Repay Rule, such as open-end lines of credit, are not covered transactions.

Operating in a rural or underserved area

A creditor operates in a rural or underserved area if it originated at least one covered transaction secured by a first lien on a property located in a rural or underserved area in the prior calendar year. There is also a grace period for the rural-or-underserved test. For loan applications received before April 1 of a particular year, a creditor meets the test if it originated at least one covered transaction secured by a first lien on a property located in a rural or underserved area in either of the two prior calendar years. A creditor is no longer required to "operate predominantly" (i.e., make more than half of its covered transactions) in rural or underserved areas to qualify for these provisions.

A rural area includes not only a rural county but also a census block that is not in an urban area as defined by the Census Bureau. The Bureau has provided a tool that creditors can use to determine whether a specific property is located in a rural or underserved area.

March 22, 2016

Executive Summary of the Rules Implementing the Helping Expand Lending Practices in Rural Communities Act

On March 22, 2016, the Consumer Financial Protection Bureau issued an Interim Final Rule (Interim Final Rule) to implement certain portions of the Helping Expand Lending Practices in Rural Communities Act (HELP Act). This Interim Final Rule is effective on March 31, 2016.

The Bureau separately issued a final rule (Procedural Rule), which was effective on March 3, 2016, to implement the portions of the HELP Act that directed the Bureau to establish an application process to have an area designated as rural under Federal consumer financial laws. The Bureau will begin accepting applications pursuant to the Procedural Rule on March 31, 2016. Because the HELP Act includes a sunset date for the application process, the Procedural Rule shall cease to have any force or effect on December 4, 2017.

Background

In the fall of 2015, the Bureau issued a final rule (2015 Final Rule) that revised the Regulation Z definitions of "small creditor" and "rural area" and made technical changes and clarifications to other sections of Regulation Z. These revisions affected which creditors were eligible to rely on certain special provisions, including special provisions allowing balloon-payment qualified mortgages and high-cost mortgages, and an exemption to an escrow requirement under Regulation Z.

Prior to the January 1, 2016 effective date of the 2015 Final Rule, Congress enacted the HELP Act, which broadened the class of creditors which may be eligible under the Truth in Lending Act (TILA) for the special provision that permits a qualified mortgage to have a balloon-payment feature and the exemption from the escrow requirement for certain higher-priced mortgage loans (HPMLs) under Regulation Z. The pertinent sections of TILA previously permitted the Bureau to grant the special provision and exemption to certain small creditors that operate predominantly in rural or underserved areas. The HELP Act removed the "predominantly" requirement from those provisions, giving the Bureau authority to extend those provisions to certain small creditors who operate in rural or underserved areas, even if they do not operate predominantly in such areas. The HELP Act also directed the Bureau to establish a process for individuals and entities to apply to have the Bureau designate an area as rural for purposes of Federal consumer financial laws.

Operate in a Rural or Underserved Area: Originated One First Lien Covered Loan in a Rural or Underserved Area in the Preceding Calendar Year

In response to the HELP Act, the Bureau issued the Interim Final Rule, which expands eligibility for the special provisions allowing balloon-payment qualified mortgages and balloon-payment high-cost mortgages and for the escrow exemption. Pursuant to the Interim Final Rule, a small creditor is no longer required to extend more than 50 percent of its covered transactions secured by first liens on properties located in rural or underserved areas in order to be eligible for either of the two special balloon-payment provisions or the exemption to the escrow requirement under Regulation Z. Effective March 31, 2016, a small creditor may be eligible to rely on those special provisions and the exemption if it originated at least one covered transaction[a] secured by a first lien on a property located in a rural or underserved area in the preceding calendar year.

The Interim Final Rule does not alter the grace period adopted in the 2015 Final Rule for applications received before April 1 of a given year. Even if a creditor did not originate a covered loan secured by a first lien on a property in a rural or underserved area in the prior calendar year, the creditor may still rely on the special provisions and exemption for applications received before April 1 of a particular year if it originated a covered transaction secured by a first lien on property in a rural or underserved area in either of the two preceding calendar years. To illustrate, assume a small creditor did not originate any loans secured by property in rural or underserved areas in 2016. However, the small creditor did originate a covered transaction secured by a property in a rural area in 2015. This small creditor may rely on the special provisions and may be able to rely on the escrow exemption (if other requirements are met) for applications received before April 1, 2017.

[a] For this purpose, a "covered transaction" is generally a consumer credit transaction that is secured by a first-lien on a dwelling, other than a transaction exempt from the Ability to Repay Rule under 12 CFR 1026.43(a), such as a reverse mortgage, a temporary or bridge loan with a term of 12 months, an extension of credit pursuant to a program administered by a Housing Finance Agency, *etc*.

Special Provisions and Exemption Affected by the Interim Final Rule

A small creditor[b] that extends a covered transaction secured by a first lien on a property located in a rural or underserved area may originate qualified mortgages and high-cost mortgages with balloon-payment features. Additionally, a small creditor that operates in a rural or underserved area may be exempt from establishing escrows for certain HPMLs.

Generally, a small creditor cannot rely on the exemption to the escrow requirement if the small creditor maintains an escrow account for real estate- or dwelling-secured consumer credit that it or an affiliate services, unless the escrow was established as an accommodation to a distressed consumer or for a first-lien HPML during a period designated in Regulation Z. The 2015 Final Rule set that period as April 1, 2010 to January 1, 2016. To prevent a small creditor that has not been able to rely on the escrow exemption (and has been required to establish escrow accounts) from losing the ability to rely on the exemption in the future, the Interim Final Rule revises the period designated in Regulation Z. A small creditor that extends a covered transaction secured by a first lien on a property located in a rural or underserved area will be able to rely on the exemption from the escrow requirement even if it continues to maintain escrow accounts established for first-lien HPMLs if the applications for such HPMLs were received between April 1, 2010 and May 1, 2016 or if the escrow account was established as an accommodation to a distressed consumer.

As a reminder, the temporary provisions that permit any small creditor, regardless of where it operates, to originate balloon-payment qualified mortgages and balloon-payment high-cost mortgages only applies to applications received before April 1, 2016.

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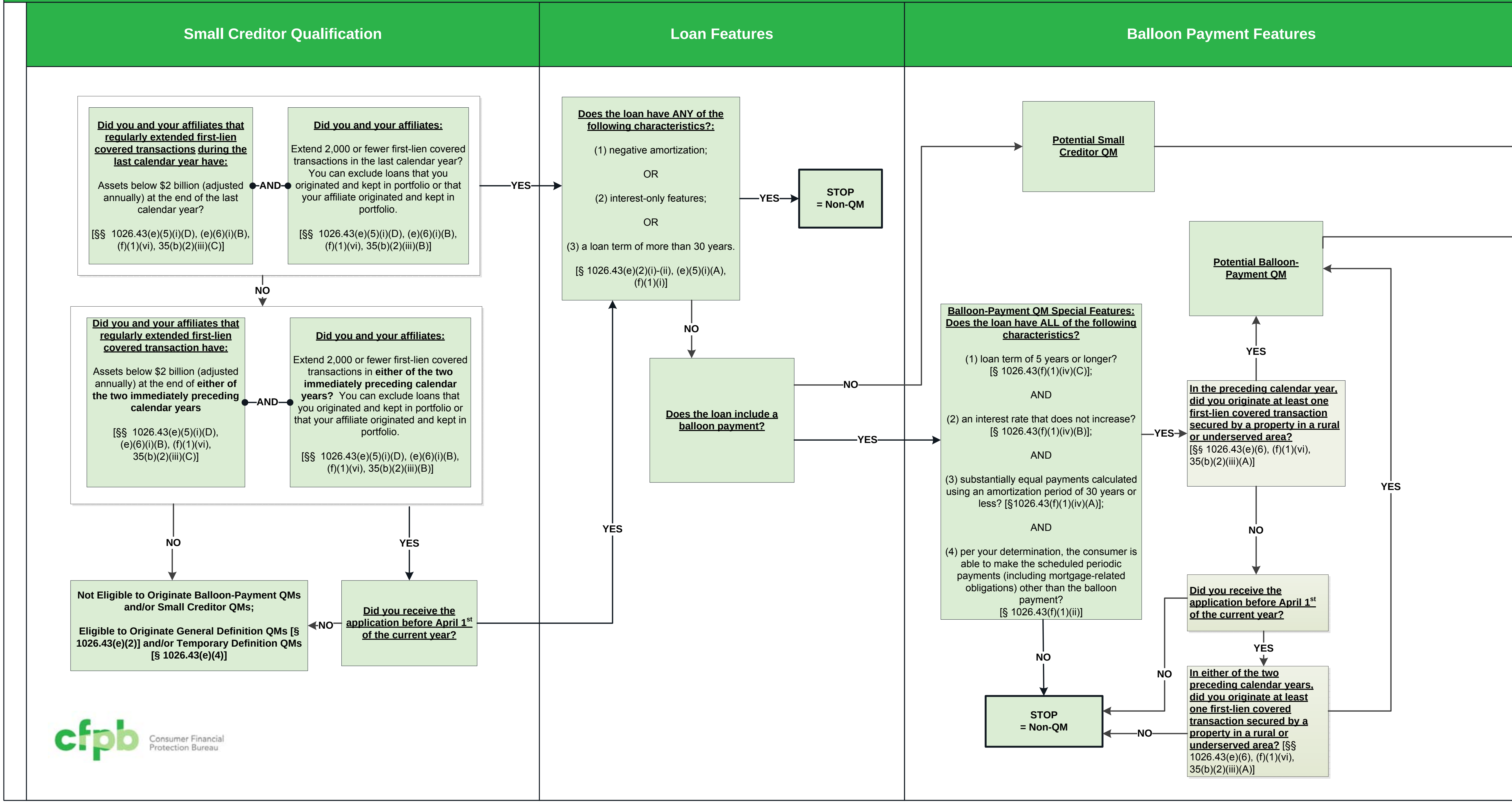
[b] A creditor is a small creditor if, during the preceding calendar year: (1) the creditor and its affiliates together extended no more than 2,000 first-lien covered loans that were transferred by the creditor or affiliate to another person or that were subject to commitment to be acquired by another person at consummation; and (2) the assets of the creditor and its affiliates that regularly extended first-lien covered loans are less than $2 billion, as adjusted annually. Additionally, for applications received prior to April 1, a creditor is a small creditor, if during either of the two preceding calendar years: (1) the creditor and its affiliates together extended no more than 2,000 first-lien covered loans that were transferred by the creditor or affiliate to another person or that were subject to commitment to be acquired by another person at consummation; and (2) the assets of the creditor and its affiliates that regularly extended first-lien covered loans are less than $2 billion, as adjusted annually. The Interim Final Rule does not change the definition of small creditor.

The Application Process and the Definition of Rural Area

The Interim Final Rule revises Regulation Z's definition of "rural area" to include a county or census block that the Bureau has designated as rural under the new application procedure set forth in the Procedural Rule. If the Bureau designates an area as rural through the application procedure, the designation is only effective before December 4, 2017. The Interim Final Rule also establishes that, consistent with the interpretation of rural area already set forth in Regulation Z, only counties or census blocks are eligible for designation as rural under the application procedure.

A person, including but not limited to a natural person, may submit an application to the Bureau to have a census block or county designated as "rural" for purposes of Federal consumer financial laws, including eligibility for the balloon-payment special provisions and the escrow exemption. The application must: (1) specifically identify the census block or county that the person wants to be designated as rural and the name of the state in which the block or county is located; (2) provide certain information to support a designation of the area as rural; and (3) include certain applicant information. The applicant must submit the application by email, mail, courier, or hand delivery to the applicable address provided in the Procedural Rule. Upon receipt, the Bureau shall review the application for certain preliminary matters. If it determines that the application is not complete, the Bureau shall notify the applicant and specify the additional information required to complete the application. The Bureau will notify the applicant that it will not consider the application if the area identified in the application is already designated as rural, is an area for which an application is already pending, or is an area for which an application has been denied less than 90 days before the applicant's application. The Bureau will also notify the applicant that it will not consider the application if the Bureau determines that the applicant does not live or do business in the state in which the area is located. Otherwise, within 60 days of receiving a complete application, the Bureau shall publish the application in the *Federal Register* and accept public comment for not fewer than 90 days. Within 90 days of the end of the public comment period, the Bureau shall grant or deny the application, in whole or in part, and publish its decision in the *Federal Register.*

Small Creditor Qualified Mortgages – This document reflects rules in effect on April 1, 2016



Underwriting	Points and Fees	Portfolio	Type of Compliance Presumption: Higher-Priced Loan

Underwriting

Did you do ALL of the following?:

(1) Consider and verify the consumer's debt obligations and income or assets? [via § 1026.43(c)(7), (e)(5)(i)(B), (f)(1)(iii)];

AND

(2) Calculate the consumer's monthly payment on the loan? [§ 1026.43(e)(2)(iv), (e)(5)(i)(B), (f)(1)(iv)];

AND

(3) Consider the consumer's monthly debt-to-income ratio (DTI) or residual income (RI)? [via § 1026.43(c)(7), (e)(5)(i)(B), (f)(1)(iii)]

YES → Points and Fees

NO → **STOP = Non-Small Creditor QM = Non-Balloon-Payment QM**

Points and Fees

Does the loan amount fall within the following points-and-fees limits?

Points-and-fees caps (adjusted annually)

If Loan Amount ≥ $100,000, then = 3% of total
If $100,000 > Loan Amount ≥ $60,000, then = $3,000
If $60,000 > Loan Amount ≥ $20,000, then = 5% of total
If $20,000 > Loan Amount ≥ $12,500, then = $1,000
If Loan Amount < $12,500, then = 8% of total

[§ 1026.43(e)(2)(iii), (e)(3), (e)(5)(i)(A), (f)(1)(i)]

YES → Portfolio

NO → **STOP = Non-QM**

Portfolio

At the time of consummation:

Was the loan subject to forward commitment?

[§ 1026.43(e)(5)(i)(C), (f)(1)(v)]

YES → **STOP = Non-Small Creditor QM = Non-Balloon-Payment QM**

NO ↓

Is the loan still held by the originating creditor?

YES → The loan is a Small Creditor QM or a Balloon-Payment QM.

NO ↓

If the loan was transferred after consummation, was it either:

(1) Sold more than three years after consummation?

(2) Sold—at any time—pursuant to a supervisory action or agreement?

(3) Transferred—at any time—as part of a merger or acquisition of or by the creditor? or

(4) Sold—at any time—to another creditor who meets the criteria for:

(a) [Small Creditor QM] Number of originations (not more than 2,000) and asset size (below $2B)?

(b) [Balloon-Payment QM] Number of originations (not more than 2,000), asset size (below $2B, adjusted annually), and operating in rural or underserved areas?

[§ 1026.43(e)(5)(ii), (f)(2)]

YES → The loan is a Small Creditor QM or a Balloon-Payment QM.

NO → **STOP = Non-Small Creditor QM = Non-Balloon-Payment QM**

Type of Compliance Presumption: Higher-Priced Loan

The loan is a Small Creditor QM or a Balloon-Payment QM. Is the loan "higher-priced" for QM purposes?

A Small Creditor or Balloon-Payment QM is higher-priced if the APR, when the interest rate is set, exceeds the APOR by 3.5 percentage points or more.

[§ 1026.43(b)(4)]

YES → **Rebuttable Presumption Applies**

(QM is presumed to comply with ATR requirements if it's a higher-priced loan, but consumers can rebut the presumption by showing insufficient residual income based on information available at the time of consummation)

[§ 1026.43(e)(1)(ii)]

NO → **Safe Harbor Applies**

(QM is conclusively presumed to comply with ATR requirements when it is not a higher-priced loan)

[§ 1026.43(e)(1)(i)]

Consumer Financial Protection Bureau