Buckley Sandler LLP

INFOBYTES SPECIAL ALERT:

CFPB FINALIZES AMENDMENTS TO THE ABILITY-TO-REPAY/QUALIFIED MORTGAGE RULE

MAY 30, 2013

Yesterday afternoon, the Consumer Financial Protection Bureau ("Bureau") finalized important amendments (the "Amendments") [1] to its ability-to-repay / qualified mortgage rule (the "Rule")[2] concerning the extent to which loan originator compensation must be included as "points and fees" under the Rule. The calculation of points and fees is a critical aspect of the Rule because a loan generally cannot be a "qualified mortgage" ("QM") – a designation that provides the lender with a degree of protection against asserted violations of the ability-to-repay requirements – if points and fees exceed 3% of the loan balance. Furthermore, the same calculation method is used to determine whether points and fees exceed 5% of the loan balance for purposes of coverage under the Home Ownership and Equity Protection Act ("HOEPA"). The Amendments, which had been proposed concurrently with the Rule itself in January of this year (the "Concurrent Proposal"),[3] address instances in which the Rule would have required lenders to "double count" payments of loan originator compensation as points and fees.

Benjamin K. Olson, who joined BuckleySandler on May 28 after serving as the Bureau's Deputy Assistant Director for the Office of Regulations, observed that: "By excluding from the points and fees calculation compensation paid by creditors and mortgage brokers to their employees, the Bureau prevents some double counting and avoids the significant practical difficulty involved in determining the amount of compensation paid to individual loan officers and mortgage brokers by their employers, which may vary based on factors that are unrelated to the specific transaction. As the Bureau acknowledges, however, the Amendments do not prevent the double counting that may occur when both payments from the consumer to the creditor and payments from the creditor to the mortgage broker are included in points and fees." (The press release announcing Olson's start with BuckleySandler may be found here.)

Despite industry requests, the Amendments make no changes to the provision in the Rule requiring that many payments to creditor affiliates be included in points and fees. In addition to points and fees, the Amendments address how "small creditors" can make QMs, and contain narrow exemptions from the Rule for certain types of creditors and for extensions of credit made pursuant to certain lending programs. Like the Rule itself, the Amendments will take effect on January 10, 2014. Concurrent with the Amendments, the Bureau delayed the effective date of a separate provision, which generally prohibits creditors from financing credit insurance premiums, from June 1, 2013 to January 10, 2014.

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[1] Bureau of Consumer Financial Protection, Final Rule, Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act (Regulation Z) (May 29, 2013), http://files.consumerfinance.gov/f/201305_cfpb_final-rule_atr-concurrent-final-rule.pdf (publication in the Federal Register forthcoming) [hereinafter "*Amendments Release*"].

[2] Bureau of Consumer Financial Protection, Final Rule, Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act (Regulation Z), 78 *Fed. Reg.* 6408 (Jan. 30, 2013).

[3] Bureau of Consumer Financial Protection, Final Rule, Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act (Regulation Z), 78 *Fed. Reg.* 6622 (Jan. 30, 2013) [hereinafter "*Concurrent Proposal Release*"].

I. LOAN ORIGINATOR COMPENSATION AS "POINTS AND FEES"

The Rule provides that to be a QM, the "points and fees payable in connection with the loan" cannot exceed specified amounts or percentages of the total loan amount. For loan amounts of $100,000 or more, the cap is 3%. One of many components of points and fees under the Rule as finalized in January was:

> [a]ll compensation paid directly or indirectly by a consumer or creditor to a loan originator … that can be attributed to that transaction at the time the interest rate is set.[4]

The Amendments address the question of calculating "compensation paid directly or indirectly by a consumer or creditor to a loan originator," and specifically how to account for instances in which compensation may be double counted as points and fees.[5]

The definition of "loan originator," although not changed by the Amendments, is key to understanding the double counting issues. The term generally means a person who for — or in expectation of — compensation, "takes an application, offers, arranges, assists a customer in obtaining or applying to obtain, negotiations or otherwise obtains or makes" a loan for another person.[6] Because the word "person" in this definition includes both individuals and organizations, "loan originator" can include a mortgage brokerage, employees hired by either a brokerage or a creditor, and independent individual mortgage brokers. But it excludes a creditor that provides the funds for the transaction.[7] We use "creditor" below in that sense.

A. No Double Counting of Payments by a Mortgage Brokerage to Its Employees

As the Bureau recognized in its Concurrent Proposal, one double counting problem arises from within the four corners of the text of § 32(b)(1)(ii) itself. Specifically, the inclusion in "points and fees" of loan originator compensation "paid *directly or indirectly* by a consumer or creditor to a *loan originator*" would potentially double-count payments where both a mortgage brokerage and an employee of it work on a transaction because both are "loan originators." For example, assume a consumer or creditor pays $1,000 to a mortgage brokerage, which passes along $500 of that amount to its employee.[8] Because

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[4] New 12 C.F.R. § 1026.32(b)(1)(ii). 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."

[5] The Amendments do not address at all the second half of the provision, *i.e.*, issues of "attribut[ion]" and "tim[ing]"; for a discussion of those issues, as well as the definition of "compensation," please see our Alert on the Rule.

[6] New § 36(a)(1)(i). The definition also includes a person who "represents to the public that [he] can or will perform any" of the above-mentioned activities. Under the new definition, there also are several exclusions that are outside the scope of this Alert. *Id.* This definition of "loan originator" comes from the new loan originator rules, which amend the current definition effective January 10, 2014. *See* Bureau of Consumer Financial Protection, *Loan Originator Compensation Requirements Under the Truth in Lending Act (Regulation Z)*, 78 *Fed. Reg.* 11,280 (Feb. 15, 2013) [hereinafter "*Loan Originator Compensation Final Rule*"].

[7] New § 36(a)(1)(i).

[8] Regulation Z currently provides that where a loan originator receives compensation directly from a consumer in connection with a mortgage loan, no loan originator may receive compensation from another person in connection with the same transaction. § 36(d)(2). Under the *Loan Originator Compensation Final Rule*, released by the Bureau on January 20, 2013, however, a mortgage brokerage may, from a consumer payment to it, pay its loan originator employees commissions, provided that the commissions cannot be based on the terms of the loans that they originate. New § 36(d)(2)(i)(C) in *Loan Originator Compensation Final Rule*, 78 *Fed. Reg.*11,280.

both the brokerage and the employee are "loan originators," each of the two payments would be included in "points and fees": the first as a *"direct[]"* payment from a "consumer or creditor to a loan originator," and the second as an *"indirect[]"* payment from a "consumer or creditor to a loan originator." Thus, even though the two "loan originators" keep only a total of $1,000 between them, the amount included in "points and fees" would be $1,500.

Fortunately, the Amendments solve that problem by providing that compensation is not included in points and fees where it is "paid by a mortgage broker … to a loan originator that is an employee of the mortgage broker."[9] "Mortgage broker" as used in the Amendments simply means any loan originator that is not an employee of the creditor;[10] thus, "mortgage broker" can refer to a brokerage, a brokerage employee, and an independent broker. In the example above, then, the Amendments mean that the $1,000 "*direct[]*" payment would be included in "points and fees," but the $500 "*indirect[]*" payment would not be.

B. No Double Counting of Consumer Payments to Mortgage Brokers

As the Bureau also recognized in its Concurrent Proposal, another problem in calculating what "compensation" should be included in points and fees under the Rule as originally promulgated is that direct payments *by a consumer* to either a mortgage broker or a creditor are non-interest finance charges that count as "points and fees" under a different Rule provision, New § 32(b)(1)(i). The issues presented by the consumer's payments to a mortgage broker versus to a creditor are different, however.

In the former case, because a mortgage broker is a "loan originator," *the very same fee* from the consumer to the mortgage broker would be both a non-interest finance charge under Paragraph (i) of New § 32(b)(1) and "compensation paid directly … by a consumer … to a loan originator" under Paragraph (ii). The same fee would therefore be counted twice under the Rule as the Bureau finalized it. If the fee were $1,000, then $2,000 would count as points and fees.

Fortunately, the Amendments avoid this result by providing that compensation is not included in points and fees where "it is paid by a consumer to a mortgage broker … and already has been included in points and fees under" New § 32(b)(1)(i).[11] In the example immediately above, then, only $1,000 would count as points and fees. (And if that $1,000 were paid to a broker organization that then passed along $500 to an employee, the $500 pass on payment would be excluded from points and fees under New § 32(b)(1)(ii)(B), discussed above.)

C. Consumer Payments to a Creditor

The latter case described above, where the consumer pays a fee to the creditor, presents a different double-counting issue. Here, there is no problem of double counting *the very same fee*, because a creditor (as we are using the term here) is not a loan originator; accordingly, the payment is included in "points and fees" only in Paragraph (i) of New § 32(b)(1) and not under Paragraph (ii). Instead, the problem arises where the creditor in receipt of the consumer's fee makes, as part of the same loan transaction, a payment to an employee or to a mortgage broker, both of which *are* loan originators. That second payment, under the Rule as finalized in January, is "compensation paid directly by a … creditor to a loan originator" (as well as "compensation paid … indirectly by a consumer … to a loan originator," for that matter), and therefore would be separately included in "points and fees" even if it constitutes merely

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[9] New § 32(b)(ii)(B); *see also* New Cmt. 32(b)(1)(ii)-4.ii.

[10] Current § 36(a)(2); New § 36(a)(2).

[11] New § 32(b)(1)(ii)(A); *see also* New Cmt. 32(b)(1)(ii)-4.i.

the employee's or mortgage broker's share of what the consumer paid the creditor. For example, if the consumer paid the creditor a $3,000 fee and the creditor passed along $1,500 of that amount to an employee or to a mortgage broker, $4,500 would be included in "points and fees."

1. No Double Counting Where Consumer Pays Creditor and Creditor Pays Its Employee

The Amendments avoid the double-counting result where the creditor pays its own employee by providing that "points and fees" do not include amounts "paid by a creditor to a loan originator that is an employee of the creditor."[12] In the example above, therefore, if the creditor paid $1,500 to its employee, that amount would be excluded and only the consumer's payment of $3,000 to the creditor would count as points and fees.

2. "Additive" Approach Where Consumer Pays Creditor and Creditor Pays a Mortgage Broker

But the Bureau deliberately chose not to exclude payments from creditors to mortgage brokers. Thus, under what the Bureau termed its "additive" approach, if in the example above the creditor paid the same $1,500 to a mortgage broker rather than the creditor's own employee, points and fees would equal $4,500.[13] The Bureau made clear that this result should obtain; in the commentary the agency explained that the result should achieve symmetry with a situation in which the consumer himself pays both the creditor and the mortgage broker:

> Compensation paid by a consumer or creditor to a [mortgage broker] is included in the calculation of points and fees under § 1026.32(b)(1)(ii). Such compensation is included in points and fees in addition to any origination fees or charges paid by the consumer to the creditor that are included in points and fees under § 1026.32(b)(1)(i).[14]

The Bureau acknowledged that, in these circumstances, the additive approach "makes it more difficult for creditors to impose up-front charges and still remain under the qualified mortgage points and fees limits and the [HOEPA] threshold."[15] Nevertheless, the Bureau decided not to exclude payments from creditors to mortgage brokers principally because (i) the burden of calculating such payments is minimal (as opposed to the higher burden of calculating payments from a creditor to its employees); and (ii) in the Bureau's view, mortgage brokers could steer consumers to more costly transactions.[16]

II. "SMALL CREDITOR" PORTFOLIO LOANS AS QMs

The Rule issued in January allows certain balloon-payment mortgages to be designated as QMs if they are originated and held in portfolio by "small creditors" operating predominantly in rural or underserved counties.[17] "Small creditor" under the Rule generally means creditors with no more than $2 billion in assets that (along with affiliates) originate no more than 500 first-lien mortgages covered under the ability-

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12 New § 32(b)(1)(ii)(C).

13 *E.g., Amendments Release* at 4.

14 New Cmt. 32(b)(1)(ii)-4.iii.

15 *Amendments Release* at 100.

16 *Id.* at 94-95.

17 § 43(f).

to-repay rules per year.[18] The Bureau has issued a list of rural and underserved counties for 2013 and plans to issue a revised list for 2014 once the necessary information is available from the USDA Economic Research Service.[19]

The Amendments make several changes to the Rule that favor small creditors:

- *New QM Category for Small Creditor Portfolio Loans*. The Bureau has created a new category of QMs for certain non-balloon-payment loans originated and held in portfolio for at least three years (subject to certain limited exceptions) by small creditors.[20] These loans are QMs even if the creditor does not operate predominantly in rural or underserved areas and the loan does not have a debt-to-income (DTI) ratio of 43%. However, these loans still must meet the general requirements on QMs with regard to loan features and points and fees, and creditors must evaluate consumers' DTI ratio or residual income.
- *More Favorable Safe Harbor Treatment for Small Creditor Loans*. The Bureau has loosened the safe harbor requirements for loans made by small creditors under the balloon-payment loan or small creditor portfolio QM categories. Because small creditors often have higher cost of funds, the Amendments shift the threshold separating QMs that receive a safe harbor from those that receive a rebuttable presumption of compliance with the Rule from 1.5 percentage points above the average prime offer rate (APOR) on first-lien loans to 3.5 percentage points above APOR.[21]
- *Transition Period for Small Creditor Balloon-Payment Loans*. The Bureau has provided a two-year transition period during which small creditors that do not operate predominantly in rural or underserved areas can offer balloon-payment QMs if they hold the loans in portfolio.[22] During the two-year transition period, the Bureau intends to study whether the definitions of "rural" or "underserved" should be adjusted and to work with small creditors to transition to other types of products, such as adjustable-rate mortgages, that satisfy other QM definitions.[23]

III. SPECIFIC ADDITIONAL EXEMPTIONS

The Amendments also exempt entirely from the Rule's ability-to-repay requirements loans made by creditors operating under certain government housing programs or making loans to low-to-moderate income ("LMI") consumers.[24]

A. Credit Extended by Certain Creditors and Nonprofit Organizations

Under certain conditions, the Amendments exempt:

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18 § 43(f)(1)(vi); Cmt. 43(f)(1)(vi).

19 Bureau of Consumer Financial Protection, Final list of rural and underserved counties for use in 2013, http://files.consumerfinance.gov/f/201305_cfpb_final-list_2013-rural-or-underserved-counties.pdf.

20 § 43(e)(5).

21 § 43(b)(4).

22 § 43(e)(6).

23 *Amendments Release* at 220-21.

24 § 43(a). Section 43 also separately mandates, in § 43(g), limitations on prepayment penalties. The prepayment penalty limitations apply to extensions of credit made by the creditors and nonprofit organizations discussed below, whereas the ability-to-repay requirements do not.

- creditors designated by the U.S. Department of the Treasury as Community Development Financial Institutions (“CDFIs”)[25];
- creditors designated by the U.S. Department of Housing and Urban Development as either a Community Housing Development Organization (“CHDOs”)[26] or a Downpayment Assistance Provider of Secondary Financing (“DAPs”)[27]; and
- in general, creditors designated as nonprofit organizations under section 501(c)(3) of the Internal Revenue Code that extend credit secured by a dwelling no more than 200 times annually, provide credit only to LMI consumers, and follow their own written procedures to determine that consumers have a reasonable ability to repay their loans.[28]

B. Credit Extended Pursuant to Certain Lending Programs

The Amendments also provide exemptions from the Rule’s ability-to-repay requirements for extensions of credit:

- made pursuant to programs administered by a Housing Finance Agency; and
- made pursuant to an Emergency Economic Stabilization Act program, such as extensions of credit made pursuant to the Home Affordable Modification Program (“HAMP”) or a State Hardest Hit Fund program.[29]

The Amendments do not adopt the Bureau’s proposal to exempt from the Rule refinances that are eligible to be insured, guaranteed, or made under a program administered by a federal agency.[30] In addition, the Amendments do not adopt the Bureau’s proposal to exempt refinances that are eligible to be purchased by a GSE if the refinance is made pursuant to an eligible, targeted refinancing program, as defined under the Federal Housing Finance Agency’s regulations.[31] After conducting further analyses, the Bureau determined that these proposed exemptions would be “inappropriate,” and believes that the Rule’s temporary GSE / Federal Agency underwriting alternative would “ensur[e] access to responsible, affordable credit during the current transition period.”[32]

IV. DELAYED EFFECTIVE DATE FOR PROHIBITION ON FINANCING CREDIT INSURANCE PREMIUMS

In a separate issuance, the Bureau extended the effective date for a provision that prohibits creditors from financing single premium credit insurance in connection with certain closed-end and open-end loans secured by a dwelling.[33] This prohibition, which was established by the Dodd-Frank Wall Street Reform

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25 § 43(a)(3)(v)(A).

26 § 43(a)(3)(v)(C).

27 § 43(a)(3)(v)(B).

28 § 43(a)(3)(v)(D).

29 § 43(a)(3)(vi).

30 Proposed § 43(a)(3)(vii)-(viii); *see Amendments Release* at 154.

31 Proposed § 43(a)(3)(viii)(D)-(E); *see Amendments Release* at 163.

32 *See Amendments Release* at 154-55 and 163.

33 Bureau of Consumer Financial Protection, Loan Originator Compensation Requirements under the Truth in Lending Act (Regulation Z); Prohibition on Financing Credit Insurance Premiums; Delay of Effective Date (May 29, 2013),

and Consumer Protection Act and implemented in the Bureau's Loan Originator Compensation rule, was scheduled to take effect on June 1, 2013.[34] Because of uncertainty about the application of the prohibition to certain types of periodic credit insurance premiums, the Bureau announced its intention to propose clarifications and delayed the effective date until January 10, 2014, when most other provisions of the Bureau's mortgage rules take effect. The Bureau suggested, however, that it may establish an earlier effective date when it issues its final clarifications.

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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
- Shara M. Chang, (202) 349-8096, schang@buckleysandler.com

http://files.consumerfinance.gov/f/201305_cfpb_final-rule_credit-insurance-effective-date-delay-final-rule-for-ofr-submission.pdf (publication in the Federal Register forthcoming).

[34] Loan Originator Compensation Final Rule, 78 Fed. Reg.11,280.