New Reporting Requirements for Mortgage Loan Originators

SAR's – Suspicious Reporting Report and FinCen (Financial Crimes Enforcement Network of the U.S. Department of the Treasury

Anti-Money Laundering ("ALM") Requirements – Suspicious Activity Reporting

New reporting rules for loan originators and finance companies are to be enforced by FinCen, the Financial Crimes Enforcement Network of the U.S. Department of the Treasury will be effective on April 16, 2012, with compliance by mortgage loan originators no later than August 13, 2012.

The intent of the new Anti-Money Laundering reporting regulations is to prohibit occurrences of mortgage fraud and to place upon providers of financing the obligation to put procedures into place to prevent mortgage fraud. As FinCen states:

"Among the many mortgage related scams FinCEN has identified in its reports are false statement, use of straw buyers, fraudulent flipping, flopping, and identity theft. The new regulations likely will significantly increase the number of mortgage related SAR filings; give law enforcement and regulators more comprehensive data on specific crimes; and provide government and industry a more complete perspective on mortgage related crime trends nationwide."

Much like the Red Flags regulations, companies, including sole proprietorships, that offer mortgage loans or residential mortgage financing will be required to develop written controls and policies to monitor risk assessment for potential mortgage fraud in conjunction with their Consumer identification Programs. This will also apply to providers of financing for manufactured homes.

While the SAFE Act runs to individual licensing requirements, the ALM and SAR's requirements for consumer finance controls and reporting will apply to entities. These requirements will apply to *all* entities, without regard to size or sales volume of the company. There is no minimum standard – if your company offers lending for manufactured housing or the company engages in self-financing for manufactured homes, new or used, these controls and reporting requirements will apply to your company.

The following is a summary of the new regulatory requirements:

1. Development of Written Internal Policies & Controls – Create a Risk-Assessment Report for your company

   Look at your customer base and sales of your product, including sales of all new and used manufactured homes. What is your sales procedure for securing credit information and identification from your customers? Prepare a risk assessment of the way you obtain credit information and identification, the types of

identification you ask for and how you keep that information in your records. This should be already addressed in your Red Flags policy.

2. Customer Identification Program – If you don't have one, prepare one

   You should have in place a CIP – a "Customer Identification Program" where you have a procedure listed for the types of customer identification you obtain, how you request the information and how you secure that information for financing purposes. Driver's license, credit history, all of the documentation you request and the ways you authenticate that information when assessing the financing potential for the customer's manufactured home purchase.

3. Designate a Compliance Officer

   Just like having a Red Flags Coordinator, your company will need to select a Compliance Officer to monitor, authenticate and secure the customer information you obtain for financing purposes. Your company compliance officer needs to:

   - Keep the Customer Identification Program updated
   - Keep all the company employees updated on the CIP
   - Provide "appropriate and periodic" training. A conference with your employees every six months is advised as a minimum.

4. Periodic Testing of your Company

   Your company needs to conduct periodic testing of the customer identification program to see that compliance is occurring. This testing is *not* to be done by the compliance officer but by either a third party or a company insider other than the compliance officer.

As with Red Flags, when you come across identity information that is suspicious or the manner of payment becomes suspicious, you will have the obligation as a provider of financing to report that in a Suspicious Activity Report – a "SAR" – involving any transaction over Five Thousand Dollars ($5,000)

The standard is whether a company "knows, suspects or has reason to suspect" that funds derived from an illegal activity are being used in the transaction or identification provided is intended to hide or disguise assets derived from illegal activity.

Further, if a customer requests that the transaction be broken up over separate sub-transactions, that is a "red flag" and where the sub-transactions add up to $10,000 and a SAR must be submitted to FinCen.

FOR ALL SALES OF MH HOMES: Where a customer's identification and credit history do not support a cash payment over $10,000, the transaction must be reported as a SAR. If there is no reasonable explanation for the cash funds i.e., there is no work

history or poor credit, this is a transaction which is obligated to be SAR reported. Current law has also required that MH retailers, brokers and communities involved in MH sales report any suspicion that the manufactured home or services being sold may be used for illegal activity.

HOW TO FILE A SAR

FinCen anticipates an electronic filing method on-line by the August 13, 2012 compliance date however, forms are available on-line at the FinCen website and may be printed, completed and sent to the address provided.

Please note that a SAR should be filed no later than 30 days after a company becomes aware of a suspicious transaction or no more than 60 days after the date of the initial detection of the issue where the suspect cannot be identified.

Use basic language in your reports – no special terminology is required . Keep all records of SAR's reports you have made along with the supporting documentation for at least five (5) years.

Please also note that all SAR's are confidential and that the information be kept securely by you. If in hard copy, then secure it in a locked file cabinet or other secure storage facility. If computerized, then keep your computer files password protected. Just like Red Flags, sensitive customer identification information should be secure as well as your SAR's records.

AML Questionnaire

1. Which of the following is your business involved with:

[ ] makes residential mortgage loans;

[ ] is named as the person to whom residential mortgage loans are initially payable;

[ ] sells manufactured homes using a retail installment contract;

[ ] helps consumers complete credit applications;

[ ] reviews the contents of a credit application;

[ ] relays loan terms to/from consumer or residential mortgage lender;

[ ] discusses specific financing terms with consumers

If no boxes are checked stop here, AML regulations do not apply to your business otherwise complete the information below.

2. Describe the organizational structure of the business:

☐ C-corp ☐ LLC ☐ LLP ☐ Sole proprietor ☐ Other _____

Who are owners? _____

& their titles _____

_____

3. Who will be your Compliance Officer? _____

The Compliance Officer is responsible for ensuring that:

(1) the AML program is developed and implemented effectively, including monitoring compliance with your employees with their obligations under the program;

(2) the AML program is updated as necessary;

(3) making sure the business is providing ongoing training of appropriate persons concerning their responsibilities under the AML program; and

(4) assuring that the business uses independent testing to monitor and maintain the AML program.

4. Prior to engaging in a transaction with a customer your business must obtain

(1) customer's name;

(2) customer's date of birth;

(3) customer's residential or business address (or if those are not available, APO or FPO address, or address of next of kin or another contact for the customer); and

(4) identification number (for a U.S. person, social security number or taxpayer identification number) (for a non-U.S. person, taxpayer identification number, passport number/country of issue, alien registration card, or number and country of issue of another governmentally issued photo identification).

What process will the business employ to gather this information?

_____

_____

5. The business must retain records of the customer's identity for at least five (5) years after the transaction including:

(1) the description of any document that established the customer's identity (noting the type of document, any identification number contained in the document, the place of issuance and, if any, the date of issuance and expiration date);

(2) a description of the methods and the results of any measures undertaken to verify the identity of the customer; and

(3) a description of the resolution of any substantive discrepancy discovered when verifying the identifying information obtained.

Does the business have a recordkeeping system to accomplish this? ☐ Yes ☐ No

6. Federal law requires a notice to customers regarding your need to obtain identity information. A sample notice appears below:

Important Information About Procedures Required by Law

To help the government fight the funding of terrorism and money laundering activities, Federal law requires all financial institutions including organizations involved in home finance to obtain, verify, and record information that identifies each person with whom it transacts business.

What this means for you: We will ask for your name, address, date of birth, and other information that will allow us to identify you. We may also ask to see your driver's license or other identifying documents.

Do you provide this to customers? ☐ Yes ☐ No

7. Risk Assessment

Does the business operate in any of these counties which have been designated as High Intensity Drug Trafficking Areas?

☐Brown☐Dane☐Kenosha☐Milwaukee☐Racine☐Rock☐Waukesha

8. Risk Assessment based on business practices.

What percentage of your annual revenue comes from these areas:

____ Originate loans secured by owner-occupied manufactured homes

____ Sale of manufactured housing units to individuals for investment purposes.

____ Sale of manufactured housing units to individuals for cash

9. Testing

Federal law requires that an independent testing function will assess AML compliance program. You must choose whether your personnel or a qualified outside party will perform this function. This decision will depend on your size and resources since the any employee you choose cannot be the Compliance Officer or someone involved with other AML functions.

As a general matter, independent testing of the AML compliance program will include, at a minimum:

(1) evaluating the overall integrity and effectiveness of the AML compliance program;
(2) evaluating the business' procedures for AML reporting and recordkeeping requirements;
(3) evaluating the implementation and maintenance of the Customer Identification Program;
(4) evaluating customer due diligence requirements;
(5) evaluating transactions, with an emphasis on high-risk areas;
(6) evaluating the adequacy of the staff training program;
(7) evaluating automated or manual processes for identifying suspicious activity;
(8) evaluating the system for reporting suspicious activity;
(9) evaluating the policy for reviewing accounts that generate multiple SAR filings; and
(10) evaluating the response to previously identified deficiencies.

The testing function will be performed by:

☐ An Employee _____

☐ An Independent firm _____

THE SAFEGUARDS RULE

From the Federal Trade Commission (FTC) 2004

The Safeguards Rule requires companies to develop a written information security plan that describes their program to protect customer information. The plan must be appropriate to the company's size and complexity, the nature and scope of its activities, and the sensitivity of the customer information it handles. As part of its plan, each company must:

- designate one or more employees to coordinate its information security program;
- identify and assess the risks to customer information in each relevant area of the company's operation, and evaluate the effectiveness of the current safeguards for controlling these risks;
- design and implement a safeguards program, and regularly monitor and test it;
- select service providers that can maintain appropriate safeguards, make sure your contract requires them to maintain safeguards, and oversee their handling of customer information; and
- evaluate and adjust the program in light of relevant circumstances, including changes in the firm's business or operations, or the results of security testing and monitoring.

The requirements are designed to be flexible. Companies should implement safeguards appropriate to their own circumstances. For example, some companies may choose to put their safeguards program in a single document, while others may put their plans in several different documents — say, one to cover an information technology division and another to describe the training program for employees. Similarly, a company may decide to designate a single employee to coordinate safeguards or may assign this responsibility to several employees who will work together. In addition, companies must consider and address any unique risks raised by their business operations — such as the risks raised when employees access customer data from their homes or other off-site locations, or when customer data is transmitted electronically outside the company network.

SECURING INFORMATION

The Safeguards Rule requires companies to assess and address the risks to customer information in all areas of their operation, including three areas that are particularly important to information security: Employee Management and Training; Information Systems; and Detecting and Managing System Failures. One of the early steps companies should take is to determine what information

they are collecting and storing, and whether they have a business need to do so. You can reduce the risks to customer information if you know what you have and keep only what you need.

Depending on the nature of their business operations, firms should consider implementing the following practices:

Employee Management and Training. The success of your information security plan depends largely on the employees who implement it. Consider:

- Checking references or doing background checks before hiring employees who will have access to customer information.
- Asking every new employee to sign an agreement to follow your company's confidentiality and security standards for handling customer information.
- Limiting access to customer information to employees who have a business reason to see it. For example, give employees who respond to customer inquiries access to customer files, but only to the extent they need it to do their jobs.
- Controlling access to sensitive information by requiring employees to use "strong" passwords that must be changed on a regular basis. (Tough-to-crack passwords require the use of at least six characters, upper- and lower-case letters, and a combination of letters, numbers, and symbols.)
- Using password-activated screen savers to lock employee computers after a period of inactivity.
- Developing policies for appropriate use and protection of laptops, PDAs, cell phones, or other mobile devices. For example, make sure employees store these devices in a secure place when not in use. Also, consider that customer information in encrypted files will be better protected in case of theft of such a device.
- Training employees to take basic steps to maintain the security, confidentiality, and integrity of customer information, including:
    - Locking rooms and file cabinets where records are kept;
    - Not sharing or openly posting employee passwords in work areas;
    - Encrypting sensitive customer information when it is transmitted electronically via public networks;
    - Referring calls or other requests for customer information to designated individuals who have been trained in how your company safeguards personal data; and
    - Reporting suspicious attempts to obtain customer information to designated personnel.
- Regularly reminding all employees of your company's policy — and the legal requirement — to keep customer information secure and confidential. For example, consider posting reminders about their responsibility for security in areas where customer information is stored, like file rooms.
- Developing policies for employees who telecommute. For example, consider whether or how employees should be allowed to keep or access customer data at home. Also, require

employees who use personal computers to store or access customer data to use protections against viruses, spyware, and other unauthorized intrusions.

- Imposing disciplinary measures for security policy violations.
- Preventing terminated employees from accessing customer information by immediately deactivating their passwords and user names and taking other appropriate measures.

Information Systems. Information systems include network and software design, and information processing, storage, transmission, retrieval, and disposal. Here are some suggestions on maintaining security throughout the life cycle of customer information, from data entry to data disposal:

- Know where sensitive customer information is stored and store it securely. Make sure only authorized employees have access. For example:
    - Ensure that storage areas are protected against destruction or damage from physical hazards, like fire or floods.
    - Store records in a room or cabinet that is locked when unattended.
    - When customer information is stored on a server or other computer, ensure that the computer is accessible only with a "strong" password and is kept in a physically-secure area.
    - Where possible, avoid storing sensitive customer data on a computer with an Internet connection.
    - Maintain secure backup records and keep archived data secure by storing it off-line and in a physically-secure area.
    - Maintain a careful inventory of your company's computers and any other equipment on which customer information may be stored.
- Take steps to ensure the secure transmission of customer information. For example:
    - When you transmit credit card information or other sensitive financial data, use a Secure Sockets Layer (SSL) or other secure connection, so that the information is protected in transit.
    - If you collect information online directly from customers, make secure transmission automatic. Caution customers against transmitting sensitive data, like account numbers, via email or in response to an unsolicited email or pop-up message.
    - If you must transmit sensitive data by email over the Internet, be sure to encrypt the data.
- Dispose of customer information in a secure way and, where applicable, consistent with the FTC's Disposal Rule. For example:
    - Consider designating or hiring a records retention manager to supervise the disposal of records containing customer information. If you hire an outside disposal company, conduct due diligence beforehand by checking references or requiring that the company be certified by a recognized industry group.
    - Burn, pulverize, or shred papers containing customer information so that the information cannot be read or reconstructed.

- Destroy or erase data when disposing of computers, disks, CDs, magnetic tapes, hard drives, laptops, PDAs, cell phones, or any other electronic media or hardware containing customer information.

Detecting and Managing System Failures. Effective security management requires your company to deter, detect, and defend against security breaches. That means taking reasonable steps to prevent attacks, quickly diagnosing a security incident, and having a plan in place for responding effectively. Consider implementing the following procedures:

- Monitoring the websites of your software vendors and reading relevant industry publications for news about emerging threats and available defenses.
- Maintaining up-to-date and appropriate programs and controls to prevent unauthorized access to customer information. Be sure to:
  - check with software vendors regularly to get and install patches that resolve software vulnerabilities;
  - use anti-virus and anti-spyware software that updates automatically;
  - maintain up-to-date firewalls, particularly if you use a broadband Internet connection or allow employees to connect to your network from home or other off-site locations;
  - regularly ensure that ports not used for your business are closed; and
  - promptly pass along information and instructions to employees regarding any new security risks or possible breaches.
- Using appropriate oversight or audit procedures to detect the improper disclosure or theft of customer information. It's wise to:
  - keep logs of activity on your network and monitor them for signs of unauthorized access to customer information;
  - use an up-to-date intrusion detection system to alert you of attacks;
  - monitor both in- and out-bound transfers of information for indications of a compromise, such as unexpectedly large amounts of data being transmitted from your system to an unknown user; and
  - insert a dummy account into each of your customer lists and monitor the account to detect any unauthorized contacts or charges.
- Taking steps to preserve the security, confidentiality, and integrity of customer information in the event of a breach. If a breach occurs:
  - take immediate action to secure any information that has or may have been compromised. For example, if a computer connected to the Internet is compromised, disconnect the computer from the Internet;
  - preserve and review files or programs that may reveal how the breach occurred; and
  - if feasible and appropriate, bring in security professionals to help assess the breach as soon as possible.

- Considering notifying consumers, law enforcement, and/or businesses in the event of a security breach. For example:
    - notify consumers if their personal information is subject to a breach that poses a significant risk of identity theft or related harm;
    - notify law enforcement if the breach may involve criminal activity or there is evidence that the breach has resulted in identity theft or related harm;
    - notify the credit bureaus and other businesses that may be affected by the breach.
    - check to see if breach notification is required under applicable state law.

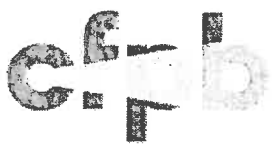
AUGUST 14, 2013

Ability-to-Repay and Qualified Mortgage Rule

SMALL ENTITY COMPLIANCE GUIDE

The Bureau recently finalized changes to this rule. The June 2013 ATR/QM Concurrent Final Rule and July 2013 Final Rule both amend the final rule issued January 10, 2013, which is set to take effect on January 10, 2014. This guide is updated for these changes.

The Bureau issued a proposed rule in June to further clarify and revise the ATR/QM rule. The Bureau will consider comments received and plans to issue a final rule soon.



Consumer Financial Protection Bureau

Summary of Changes

The Bureau updated this guide on August 14, 2013 to reflect finalized changes to the rule. The revisions amend the final rule issued January 10, 2013, which is set to take effect on January 10, 2014. Notable changes impacting guide content include:

- ☐ *Exemptions:* Regulation Z generally prohibits a creditor from making a mortgage loan unless the creditor determines that the consumer will have the ability to repay the loan. The June 2013 ATR/QM Concurrent Final Rule provides an exemption to these requirements 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. *(See "Which types of creditors and loan programs are exempt from the ability-to-repay requirements? (§ 1026.43(a)(3)(iv) to (vi))" on page 26.)*
- ☐ *Qualified Mortgages (QMs): Loans Held in Portfolio by Small Creditors.* The June 2013 ATR/QM Concurrent Final Rule provides an additional definition of a qualified mortgage for certain loans made and held in portfolio by small creditors. *(See "What types of QMs can small creditors originate?" on page 33.)*
- ☐ *Qualified Mortgages: Balloon Loans.* The June 2013 ATR/QM Concurrent Final Rule provides a transitional definition of creditors eligible to originate Balloon-Payment QMs. *(See "What types of QMs can small creditors originate?" on page 33.)*
- ☐ *Qualified Mortgages: Higher-Priced Mortgage Determination.* The June 2013 ATR/QM Concurrent Final Rule shifts the annual percentage rate (APR) threshold for Small Creditor and Balloon-Payment QMs from 1.5 percentage points above the average prime offer rate (APOR) on first-lien loans to 3.5 percentage points above APOR. *(See "What makes a QM loan higher-priced" on page 30.)*

- ☐ *Points-and-Fees Calculation: Inclusion of Loan Originator Compensation.* The June 2013 ATR/QM Concurrent Final Rule modifies the requirements regarding the inclusion of loan originator compensation in the points-and-fees calculation. *(See "What are the QM points-and-fees caps and what do I include when calculating points and fees? (§§ 1026.32(b)(1) and 1026.43(e)(3))" on page 37.)*

- ☐ *Qualified Mortgages: Determining Eligibility under the Temporary Definition.* The July 2013 Final Rule clarifies how eligibility will be determined for QMs under the temporary provision allowing QM status for loans eligible for purchase, guaranty, or insurance by the GSEs or certain federal agencies. *(See "What types of QMs can all creditors originate? Type 2 on page 32.)*

- ☐ *Qualified Mortgages: Determining Debt and Income under the General Definition.* The July 2013 Final Rule amends and clarifies how debt and income will be determined under appendix Q for the purpose of meeting the 43% DTI requirement under the general QM provision. *(See "What types of QMs can all creditors originate? Type 1 on page 31.)*

Please reference the *Version Log* on page 50 for information about previous versions of this guide.

Table of Contents

1. Introduction

During the years preceding the mortgage crisis, too many mortgages were made to consumers without regard to the consumers' ability to repay the loans. Loose underwriting practices by some creditors – including failure to verify consumers' income or debts and qualifying consumers for mortgages based on "teaser" interest rates after which monthly payments would jump to unaffordable levels – contributed to a mortgage crisis that led to the nation's most serious recession since the Great Depression.

In response to this crisis, in 2008 the Board of Governors of the Federal Reserve System adopted a rule under the Truth in Lending Act prohibiting creditors from making higher-priced mortgage loans without assessing consumers' ability to repay the loans. Creditors have had to follow these requirements since October 2009.

In the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), Congress adopted similar (but not identical) Ability-to-Repay (ATR) requirements for virtually all closed-end residential mortgage loans. Congress also established a presumption of compliance with the ATR requirements for a certain category of mortgages, called Qualified Mortgages (QMs).

In January 2013, the Consumer Financial Protection Bureau adopted a rule that implements the ATR/QM provisions of the Dodd-Frank Act. In May and July 2013, the Bureau issued rules amending certain provisions of the January 2013 rule. The ATR/QM rule is the subject of this guide.

This rule generally applies to closed-end consumer credit transactions that are secured by a dwelling for which you receive an application on or after January 10, 2014.

As you will see in reading this guide, the ATR rule describes the minimum standards you must use to determine that consumers have the ability to repay the mortgages they are extended.

While the ATR rule provides eight specific factors you must consider (including verifications of income or assets relied on, employment if relied on, and review of credit history), the rule does not dictate that you follow particular underwriting models.

The rule also contains special requirements for creditors that are refinancing their own customers into more affordable loans to help those customers avoid payment shock.

In addition to the general ATR requirements, the rule also defines the requirements for Qualified Mortgages and how QM status works if there is a question about whether a creditor has assessed the borrower's ATR.

The rule provides a safe harbor for QMs that are not higher-priced. Loans that are higher-priced and meet the definition of a Qualified Mortgage have a different protection, that of a rebuttable presumption that the creditor complied with the ATR requirements.

This guide explains the requirements for creditors to follow to determine whether the loans your organization originates meet the QM requirements and, if so, whether they will receive either a safe harbor or rebuttable presumption of compliance with the ATR requirements.

It also discusses the grounds for rebutting the presumption for higher-priced QMs – principally, that the consumer's income, debt obligations, and payments on the loan and any simultaneous loans – did not leave the consumer with sufficient residual income/assets left to live on.

Qualified Mortgages have three types of requirements: restrictions on loan features, points and fees, and underwriting. One of the underwriting requirements under the general definition for Qualified Mortgages is that the borrower's total debt-to-income ratio is not higher than 43 percent.

For a temporary, transitional period, certain loans that are eligible for sale or guarantee by a government-sponsored enterprise (GSE) – the Federal National Mortgage Association (Fannie Mae) or the Federal Home Loan Mortgage Corporation (Freddie Mac) – or are eligible under specified federal agencies' guarantee or insurance programs will be considered Qualified Mortgages under a temporary definition. The loans must meet certain QM restrictions on loan features and points and fees, but they are not subject to a flat 43 percent DTI limit.

In response to the special concerns of small creditors and to preserve access to nonconforming mortgages and mortgages in rural and underserved areas, there are also special provisions for Qualified Mortgages held in portfolio by small creditors, including some types of balloon-payment mortgages. These Qualified Mortgages have a different, higher threshold for when they are considered higher-priced for Qualified Mortgage purposes than other Qualified Mortgages. They also are not subject to the 43 percent DTI limit.

Finally, the rule bans most prepayment penalties, except on certain non-higher-priced Qualified Mortgages with either fixed or step rates. Prepayment penalties are allowed on these non-higher-priced loans only if the penalties satisfy certain restrictions and are permitted under law and if the creditor has offered the consumer an alternative loan without such penalties.

I. What is the purpose of this guide?

The purpose of this guide is to provide an easy-to-use summary of the ATR/QM rule. This guide also highlights issues that small creditors, and those that work with them, might find helpful to consider when implementing the rule.

This guide also meets the requirements of Section 212 of the Small Business Regulatory Enforcement Fairness Act of 1996, which requires the Bureau to issue a small-entity compliance guide to help small businesses comply with these new regulations.

Although underwriting standards and verification practices have tightened considerably since the financial crisis, creditors may want to review their processes, underwriting guidelines, software, contracts, or other aspects of their business operations in order to identify any changes needed to comply with this rule.

Changes related to this rule may take careful planning, time, or resources to implement. This guide will help you identify and plan for any necessary changes.

To support rule implementation and ensure the industry is ready for the new consumer protections, the Bureau will coordinate with other agencies, publish plain-language guides, publish updates to the Official Interpretations, and publish readiness guides.

The guide summarizes the ATR/QM rule, but it is not a substitute for the rule. Only the rule and its Official Interpretations (also known as Commentary) can provide complete and definitive information regarding its requirements. The discussions below provide citations to the sections of the rule on the subject being discussed. Keep in mind that the Official Interpretations, which provide detailed explanations of many of the rule's requirements, are found after the text of the rule and its appendices. The interpretations are arranged by rule section and paragraph for ease of use. The complete rule, as issued on January 10, 2013, and the Official Interpretations are available at http://www.consumerfinance.gov/regulations/Ability-To-Repay-and-qualified-mortgage-standards-under-the-truth-in-lending-act-regulation-z/. Additionally, CFPB issued two final rules to amend and clarify provisions in the January 2013 Final Rule: the June 2013 ATR/QM Concurrent Final Rule and the July 2013 Final Rule.

The focus of this guide is the ATR/QM rule. This guide does not discuss other federal or state laws that may apply to the origination of closed-end credit.

At the end of this guide, there is more information about the rule and related implementation support from the Bureau.

II. Who should read this guide?

If your organization originates closed-end residential mortgage loans, you may find this guide helpful. This guide will help you determine your compliance obligations for the mortgage loans you originate.

This guide may also be helpful to secondary market participants, software providers, and other companies that serve as business partners to creditors.

III. Who can I contact about this guide or the ATR/QM rule?

For more information on the rule content, please contact the Bureau's Office of Regulations at 202-435-7700, or email questions to CFPB_reginquiries@cfpb.gov.

Email comments about the guide to CFPB_TitleXIVRules@cfpb.gov. Your feedback is crucial to making this guide as helpful as possible. The Bureau welcomes your suggestions for improvements and your thoughts on its usefulness and readability.

The Bureau is particularly interested in feedback relating to:

- ☐ How useful you found this guide for understanding the rule
- ☐ How useful you found this guide for implementing the rule at your business
- ☐ Suggestions you have for improving the guide, such as additional implementation tips

2. Overview of the Ability-to-Repay/Qualified Mortgage Rule

I. What is the ATR/QM rule about?

The ATR/QM rule requires that you make a reasonable, good-faith determination before or when you consummate a mortgage loan that the consumer has a reasonable ability to repay the loan, considering such factors as the consumer's income or assets and employment status (if relied on) against:

- ☐ The mortgage loan payment
- ☐ Ongoing expenses related to the mortgage loan or the property that secures it, such as property taxes and insurance you require the consumer to buy
- ☐ Payments on simultaneous loans that are secured by the same property
- ☐ Other debt obligations, alimony, and child-support payments

The rule also requires you to consider and verify the consumer's credit history.

As discussed in more detail below, the rule provides a presumption that you have complied with the ATR rule if you originate QMs.

QMs generally cannot contain certain risky features (such as allowing interest-only payments or negative amortization). In addition, points and fees on QMs are limited. For a loan to be a QM, it also must meet certain underwriting criteria.

In exchange for meeting these requirements, QMs receive either a conclusive or a rebuttable presumption that you, the creditor, complied with the ATR requirements. The type of presumption depends on the pricing of the loan - whether the loan is not higher-priced or is higher-priced.

The ATR/QM rule also implements other provisions of the Dodd-Frank Act that:

- ☐ Limit prepayment penalties
- ☐ Require that you retain records for three years after consummation showing you complied with ATR and other provisions of this rule

II. When do I have to start following this rule?

This rule applies to transactions covered under the rule for which you receive an application on or after January 10, 2014.

III. What transactions are covered by the ATR/QM rule? (§ 1026.43(a))

The Bureau's ATR/QM rule applies to almost all closed-end consumer credit transactions secured by a dwelling including any real property attached to the dwelling. This means loans made to consumers and secured by residential structures that contain one to four units, including condominiums and co-ops. Unlike some other mortgage rules, the ATR/QM rule is not limited to first liens or to loans on primary residences.

However, some specific categories of loans are excluded from the rule. Specifically, the rule **does not apply to:**

- ☐ Open-end credit plans (home equity lines of credit, or HELOCs)
- ☐ Time-share plans
- ☐ Reverse mortgages
- ☐ Temporary or bridge loans with terms of 12 months or less (with possible renewal)
- ☐ A construction phase of 12 months or less (with possible renewal) of a construction-to-permanent loan

Implementation Tip: The Truth in Lending Act applies to a loan modification only if it is considered a refinancing under Regulation Z. If a loan modification is not subject to the Truth in Lending Act, it is not subject to the ATR/QM rule. Therefore, you should determine if a loan modification is a refinancing to see if the ATR/QM rule applies. You will find the rules for determining whether a loan workout is a modification or a refinance in Regulation Z at § 1026.20(a) and accompanying Commentary.

☐ Consumer credit transactions secured by vacant land

In addition, certain types of creditors or loan programs may be exempt from the ATR requirements. *(See "Which types of creditors and loan programs are exempt from the ability-to-repay requirements?" on page 26.)*

IV. How long do I have to keep records on compliance with the ATR/QM rule? (§ 1026.25(c)(3))

The rule requires that you retain evidence that you complied with the ATR/QM rule, including the prepayment penalty limitations, for three years after consummation, though you may want to keep records longer for business purposes.

Manufactured Housing Institute

Early Overview of the Ability-to-Repay and Qualified Mortgage Rule Issued by the Consumer Financial Protection Bureau on January 10, 2013

(Released: January 14, 2013)

On January 10, 2013, the Consumer Financial Protection Bureau ("CFPB") issued a final rule amending Regulation Z to implement an expanded ability-to-repay requirement and to define a "qualified mortgage" in accordance with various amendments to the Truth in Lending Act ("TILA") set forth in the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") (the "Final Rule").[1]

Effective January 10, 2014, the Final Rule (i) applies a broad ability-to-repay requirement to virtually the entire residential mortgage market, (ii) defines a new category of "qualified mortgage" and (iii) establishes a two-tier safe harbor/rebuttable presumption framework for determining compliance with the ability-to-repay requirement for qualified mortgages. Concurrent with issuing the Final Rule, the CFPB is requesting public comments on a proposal to amend some provisions of the ability-to-repay requirements that were not previously published for public comment.[2]

The ability-to-repay requirement and the "qualified mortgage" standard will define the US residential mortgage market for the foreseeable future. Under the Final Rule, creditors have three options for originating a "qualified mortgage." Under the first option, the loan must satisfy basic documentation and verification requirements for income, assets and debt and the consumer must have a total debt-to-income ("DTI") ratio of 43 percent or less. A loan that satisfies these criteria and is not a higher-priced covered transaction enjoys a conclusive presumption that the creditor satisfied the ability-to-repay requirements and qualifies for a legal safe harbor.

Under a second, temporary option, the loan is a "qualified mortgage" if it meets (i) the prohibitions on certain loan features, (ii) certain limits on points and fees and (iii) eligibility requirements

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[1] The Final Rule and official interpretations issued by the CFPB on ability-to-repay and qualified mortgage standards under the Truth in Lending Act (Regulation Z) may be found at http://files.consumerfinance.gov/f/201301_cfpb_final-rule_ability-to-repay.pdf.

[2] This paper provides an early overview of the Final Rule and the concurrent proposal for public comment issued by the CFPB. Together, the Final Rule and the concurrent proposal are almost 1,000 pages in length and will take more time to analyze fully.

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for purchase or guarantee by Fannie Mae or Freddie Mac while operating under conservatorship or receivership of the Federal Housing Finance Agency or while operating as a successor limited-life regulated entity, or the eligibility requirements for insurance by the US Department of Housing and Urban Development (Federal Housing Administration), for guarantee by the US Department of Veterans Affairs or the US Department of Agriculture ("USDA") or for insurance by the USDA Rural Housing Service. This temporary expansion of the general definition of "qualified mortgage" expires when the conservatorships of Fannie Mae and Freddie Mac end and for each other category of loans, on the effective date of a rule adopted by the Federal agency with respect to those loans, or if neither of these circumstances occurs, seven years after the effective date of the Final Rule or January 10, 2021. There are no specific monthly DTI ratio, documentation, verification or payment calculation requirements under this option, except as required for purchase or guarantee by Fannie Mae or Freddie Mac, or for insurance or guarantee by the specified Federal agencies. A loan that satisfies these criteria and is not a higher-priced covered transaction enjoys a conclusive presumption that the creditor satisfied the ability-to-repay requirements and qualifies for a legal safe harbor.

The third option for originating a "qualified mortgage" exists only for small creditors that operate predominantly in rural or underserved areas and that originate balloon-payment qualified mortgages to hold in portfolio. Loans are eligible if they have a term of at least five years and no more than 30 years, a fixed interest rate, meet certain basic underwriting standards and are not subject to a forward commitment at the time of consummation of the loan. These loans are not subject to the 43 percent DTI requirement, though creditors must consider DTI. Under the Final Rule, a balloon-payment mortgage is a "qualified mortgage" if the creditor (i) originated at least 50 percent of its first-lien mortgages in rural or underserved counties in the preceding calendar year, (ii) has assets equal to or less than $2 billion (adjusted annually for inflation), and (iii) together with all affiliates, originated no more than 500 first-lien mortgages in the preceding calendar year. A loan that satisfies these criteria and is not a higher-priced covered transaction enjoys a conclusive presumption that the creditor satisfied the ability-to-repay requirements and qualifies for a legal safe harbor for as long as the loan is held in portfolio by the creditor that originated the loan. The safe harbor also applies to such loans that are sold three or more years following consummation of the loan.

A mortgage loan that satisfies the criteria established under any one of the three options for originating a "qualified mortgage" and that is a higher-priced covered transaction receives a rebuttable

presumption of compliance with the ability-to-repay requirements. A consumer who seeks to rebut the presumption of compliance must prove that, at the time of loan consummation, considering the consumer's income and debt obligations, the consumer's monthly payment (including mortgage-related obligations) on the covered transaction and any simultaneous loans of which the creditor was aware, would leave the consumer without sufficient residual income or assets (other than the value of the dwelling that secures the loan) with which to meet living expenses, including recurring and material non-debt obligations of which the creditor was aware at the time of consummation of the loan.

A mortgage loan that does not meet the ability-to-repay requirement and that is not a "qualified mortgage" could subject the creditor and subsequent assignees to civil liability under TILA and provide the borrower with a defense to foreclosure. In addition to actual damages, statutory damages in an individual or class action, and court costs and attorneys' fees, the Dodd-Frank Act also amended TILA to include special statutory damages for a violation of the ability-to-repay requirement equal to the sum of all finance charges and fees paid by the consumer, unless the failure to comply was not material.[3]

In conjunction with issuing the Final Rule, the CFPB has requested public comments on a concurrent proposal to amend some provisions of the ability-to-repay requirements that were not previously published for public comment. The concurrent proposal would extend "qualified mortgage" status to loans originated by small creditors that make and hold loans in their own portfolios.[4] The CFPB believes that this proposal is necessary to preserve access to responsible, affordable mortgage credit for some consumers. Small creditors would (i) have $2 billion or less in assets (adjusted annually for inflation), and (ii) together with their affiliates, originate no more than 500 first-lien mortgages during the preceding calendar year.

The CFPB is also requesting public comments on how to calculate loan origination compensation, which is part of the points and fees calculation applicable to the "qualified mortgage" criteria. Additionally, the CFPB is proposing to increase the threshold separating "safe harbor" and

[3] Dodd-Frank Act, § 1416.

[4] The concurrent proposal issued by the CFPB may be found at http://files.consumerfinance.gov/f/201301_cfpb_concurrent-proposal_ability-to-repay.pdf

"rebuttable presumption" qualified mortgages for small creditors to 3.5 percentage points above the average prime offer rate for first-lien loans to reflect the higher cost of funds for these creditors.

The CFPB expects to act on the entire concurrent proposal on an expedited basis by Spring 2013 so that creditors will have time to prepare for compliance by the January 10, 2014 effective date of the Final Rule. Comments on the concurrent proposal are due by February 25, 2013.

Ability-to-Repay Requirement

The Final Rule establishes a general ability-to-repay requirement: "A creditor shall not make a loan that is a covered transaction unless the creditor makes a reasonable and good faith determination at or before consummation that the consumer will have a reasonable ability to repay the loan according to its terms."[5] The Final Rule thus expands and extends the ability-to-repay rule applicable to "higher-priced mortgage loans" since 2009 under Regulation Z.[6] The ability-to-repay requirement in the Final Rule is applicable to virtually all closed-end credit secured by a dwelling, not only to "higher-priced mortgage loans." Coverage excludes home equity lines of credit, timeshare plans, reverse mortgages and temporary or "bridge" loans with a term of 12 months or less. The specific ability-to-repay requirements are similar, but not identical, to those currently in effect for "higher-priced mortgage loans."

The Final Rule requires the creditor to determine whether the consumer will be able to repay both principal and interest on the loan, assuming substantially equal monthly payments over the term of the loan. Interest payment obligations must be evaluated using the higher of a fully-indexed rate or an introductory rate. Special rules apply to mortgage loans with balloon payments, interest-only payments or negative amortization.

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[5] The language in the Final Rule is substantially similar to the statutory language in the Dodd-Frank Act and adds the clarification that the "reasonable and good faith determination" may be made at or before consummation.

[6] 12 C.F.R. § 1026.35(a)(1) ("For purposes of this section, except as provided in paragraph (b)(3)(v) of this section [certain jumbo loans], a higher-priced mortgage loan is a consumer credit transaction secured by the consumer's principal dwelling with an annual percentage rate that exceeds the average prime offer rate for a comparable transaction as of the date the interest rate is set by 1.5 or more percentage points for loans secured by a first lien on a dwelling, or by 3.5 or more percentage points for loans secured by a subordinate lien on a dwelling"); 12 C.F.R. § 1026.35(b)(1) ("A creditor shall not extend credit based on the value of the consumer's collateral without regard to the consumer's repayment ability as of consummation as provided in § 1026.34(a)(4)").

Although the Final Rule does not impose a particular underwriting model, a creditor must, at a minimum, consider eight discrete underwriting factors pertaining to the individual consumer in determining ability-to-repay:

1. current or reasonably expected income or assets (other than the value of the dwelling, including any real property attached to the dwelling) that secures the loan;
2. current employment status;
3. the monthly payment on the loan, calculated using the greater of a fully-indexed rate or any introductory rate and using monthly, fully amortizing payments that are substantially equal;[7]
4. the monthly payment on any simultaneous loan associated with the property;
5. the monthly payment for mortgage-related obligations (*e.g.,* property taxes and insurance premiums);
6. current debt obligations, alimony, and child support;
7. the monthly debt-to-income ratio or residual income (*i.e.,* total monthly debt divided by total monthly gross income); and
8. credit history.

The creditor must verify the information that it relies upon in determining a consumer's ability-to-repay using reasonably reliable third-party records. In effect, the Final Rule prohibits no-documentation and low-documentation (*i.e.,* Alt-A) mortgage loans.

Exemption for Refinancing of "Non-Standard Mortgages"

The Final Rule includes a special exemption for a creditor that refinances a riskier non-standard mortgage (*e.g.,* an adjustable rate loan, an interest-only loan, a negative amortization loan) into a standard mortgage with more stable characteristics. This exemption applies if the following conditions are met:

- the creditor has considered whether the standard mortgage likely will prevent a default by the consumer on the non-standard mortgage once the loan is recast;[8]

[7] Special rules apply to mortgage loans with balloon payments, interest-only payments or negative amortization.

- the creditor for the standard mortgage is the current holder or servicer of the existing non-standard mortgage;
- the monthly payment for the standard mortgage is materially lower than that for the non-standard mortgage;[9]
- the creditor receives the consumer's written application within two months after the non-standard mortgage has recast;
- the consumer has made no more than one payment more than thirty days late during the twelve months preceding the creditor's receipt of the written application;
- the consumer has made no payment more than thirty days late during the six months preceding the creditor's receipt of the written application; and
- if the non-standard mortgage was consummated after January 10, 2014, it was made in accordance with the ability-to-repay requirement or was a "qualified mortgage."

The standard loan must have regular periodic payments that do not cause the principal balance to increase, do not allow the consumer to defer repayment of principal and do not result in a balloon payment. In addition, total points and fees may not exceed the level required for a "qualified mortgage," the term cannot exceed forty years, interest must be fixed for at least the first five years, and the proceeds must be used to pay off the outstanding balance of the non-standard mortgage and closing or settlement charges.

These types of transactions would be used to "rescue" consumers in existing adjustable rate, interest-only or negative amortization loans who are vulnerable to default, but likely have far greater prospects of performing under a more conservative obligation.

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[8] The term "recast" means the expiration of an introductory period for an adjustable rate loan, the expiration of an interest-only period for an interest-only loan or the expiration of the period during which negatively amortizing payments are permitted for a negative amortization loan.

[9] Special calculation rules apply for the comparison. For the non-standard loan, the monthly payment must be based on substantially equal, monthly, fully amortizing payments of principal and interest using a fully indexed rate, the remaining term of the loan as of the date of recast, and a remaining loan amount equal to the outstanding principal balance as of the date of recast (or, for a negative amortization loan, the maximum loan amount). For the standard loan, the monthly payment must be based on substantially equal, monthly, fully amortizing payments based on the maximum interest rate that may apply during the first five years after consummation).

"Qualified Mortgage" Definition

In order for a mortgage loan to constitute a "qualified mortgage" and be eligible for the "safe harbor, described below, the loan must meet the following criteria:

- points and fees (including loan originator compensation) may not exceed three percent of the total loan amount, less *bona fide* discount points for "prime" loans;
- the loan may not allow the consumer to defer repayment of principal (*e.g.*, no interest-only loans);
- the loan may not result in an increase of the principal balance (*e.g.*, no negative amortization loans);
- the loan may not have a balloon payment (*i.e.*, a scheduled payment that is more than twice as large as the average of earlier scheduled payments); provided, however, that certain special criteria apply to a small creditor operating predominantly in rural or underserved areas;
- the loan may not have a term longer than 30 years; and
- the total (*i.e.*, back-end) debt-to-income ratio may not exceed 43 percent based on monthly payments calculated using the highest payment that will apply in the first five years of the loan; provided, however, that for a transitional period, a loan with a debt-to-income ratio in excess of 43 percent will be included if the loan is eligible to be purchased, guaranteed or insured by (i) Fannie Mae or Freddie Mac while they operate under government conservatorship or receivership, or (ii) by the US Department of Housing and Urban Development, the US Department of Veterans Affairs, the US Department of Agriculture or the USDA Rural Housing Service.

The CFPB adopted the exception to the debt-to-income ratio limitation based on a concern that creditors may be unwilling to make a loan that is not a "qualified mortgage" in the current market, even if the loan is responsibly underwritten. This transitional period will phase-out based on a variety of criteria, as described above, but in no event will it extend more than seven years after the effective date of the rule, January 10, 2021.

A transaction is <u>not</u> a "qualified mortgage" unless the total points and fees payable in connection with the loan do not exceed:

- For a loan amount greater than or equal to $100,000, 3 percent of the total loan amount;
- For a loan amount greater than or equal to $60,000 but less than $100,000, $3,000;
- For a loan amount greater than or equal to $20,000 but less than $60,000, 5 percent of the total loan amount;
- For a loan amount greater than or equal to $12,500 but less than $20,000, $1,000;
- For a loan amount less than $12,500, 8 percent of the loan amount.

These amounts are indexed for inflation.

"Safe Harbor" and "Rebuttable Presumption"

Section 1412 of the Dodd-Frank Act amended TILA to provide that a creditor with respect to a residential mortgage loan, and any assignee of such loan, may presume that the loan has met the ability-to-repay requirement if the loan is a qualified mortgage. However, as the Board of Governors of the Federal Reserve System (the "Board") observed in its original proposed rule, it is unclear whether Congress intended this provision to constitute a "safe harbor" or a "rebuttable presumption" of compliance with the ability-to-repay requirement. The Board's earlier proposal offered two alternative formulations to address this statutory ambiguity, based on competing policy considerations. In the Final Rule, the CFPB adopted both a "safe harbor" and a "rebuttable presumption." This component of the Final Rule is essentially consistent with the media reports issued during the Fall.

The Final Rule includes a "safe harbor" for loans that meet the definition of "qualified mortgage" and that are not higher-priced mortgage loans. The CFPB views loans eligible for the "safe harbor" as lower-priced, less risky "prime" loans. For any loan that meets the definition of a "qualified mortgage," the creditor will be conclusively presumed to have made a good faith and reasonable determination of the consumer's ability to repay, although the consumer could still challenge that the loan did not actually meet the criteria for a "qualified mortgage."

The Final Rule also includes a "rebuttable presumption" for loans that meet the definition of "qualified mortgage" but that are higher-priced mortgage loans. The CFPB considers these to be "subprime" loans extended primarily to consumers with a weak or insufficient credit history. This "rebuttable presumption" would enable a consumer to assert a violation of Regulation Z if the consumer could demonstrate that, at the time that the loan was originated, the consumer's income and debt

obligations left insufficient residual income or assets to meet living expenses, taking into consideration the monthly payments of the loan, loan-related obligations, any simultaneous loan obligations of which the creditor was aware and any recurring, material living expenses of which the creditor was aware. The CFPB indicated that a consumer is less likely to prevail in rebutting the presumption the longer that the consumer has made timely payments, without modification or accommodation, and, for adjustable rate mortgage loans, after recast.

Concurrent Proposal

At the same time as the CFPB issued the Final Rule, the CFPB requested comments on proposed amendments to the ability-to-repay requirement that were not previously published for public comment, including:

- exemptions for nonprofit community-based creditors that help low- to moderate-income consumers obtain affordable housing;
- exemptions for housing finance agencies and lenders participating in housing finance agency programs intended to foster community development; and
- exemptions for homeownership stabilization programs that work to prevent foreclosures (*e.g.*, programs operating in conjunction with the Making Home Affordable program).

As noted above, the Final Rule implements a provision in the Dodd-Frank Act that treats certain balloon-payment mortgages as qualified mortgages if they are originated and held in portfolio by small creditors that operate predominantly in rural or underserved areas. Loans are eligible if they have a term of at least five years and no more than 30 years, a fixed interest rate, meet certain basic underwriting standards and are not subject to a forward commitment at the time of consummation of the loan. These loans are not subject to the 43 percent DTI requirement, though creditors must consider DTI. Under the Final Rule, a balloon-payment mortgage is a "qualified mortgage" if the creditor (i) originated at least 50 percent of its first-lien mortgages in rural or underserved counties in the preceding calendar year, (ii) has assets equal to or less than $2 billion (adjusted annually for inflation), and (iii) together with all affiliates, originated no more than 500 first-lien mortgages in the preceding calendar year.

The CFPB has requested comment on extending "qualified mortgage" status to loans originated by small creditors that make and hold loans in their own portfolios - this is a more broadly applicable version of the exception in the Final Rule for loans with balloon-payment features made by small creditors that operate primarily in rural and underserved areas. The new category of loans would not be limited to loans with balloon-payment features or geographically limited to rural and underserved areas. However, the same general requirements regarding the asset size threshold (equal to or less than $2 billion) and number of annual transactions would apply (500 first-lien transactions per year). The CFPB is requesting comments on whether the asset size threshold should be higher or lower and whether the limit on the number of annual transactions is appropriate.

Additionally, the CFPB is proposing to increase the threshold separating "safe harbor" and "rebuttable presumption" qualified mortgages for small creditors to 3.5 percentage points above the average prime offer rate for first-lien loans to reflect the higher cost of funds for these creditors.

The CFPB also invited comment on how to calculate loan origination compensation, which is part of the points and fees calculation applicable to the "qualified mortgage" criteria. The CFPB expects to issue a rule resolving these additional matters in the Spring of this year, well in advance of the January 10, 2014 effective date.

Additional Provisions

The Final Rule also includes other mortgage-related provisions that implement statutory mandates in the Dodd-Frank Act, including:

- a prohibition on prepayment penalties, except for certain fixed-rate, qualified mortgages where the penalties satisfy certain restrictions and the creditor has offered the consumer an alternative loan without prepayment penalties;
- extension of the record retention requirement to three years to evidence compliance with the ability-to-repay requirement and the prepayment penalty restrictions; and
- a prohibition on inappropriately restructuring a closed-end extension of credit as an open-end plan in order to evade compliance.

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