Auditing
Real Estate Loans Boot Camp
General Topics

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Ability to Repay (Mortgages)

Section 1: Repayment Ability [12 CFR § 1026.43(a)]

Introductory Commentary

Regulatory Discussion

For reference: §1026.25(c)(3) states a creditor shall retain evidence of compliance with §1026.43 of this regulation for three years after consummation of a transaction covered by that section.

Comments 25(c)(3)-1 and -2 state:

Evidence of compliance with repayment ability provisions. A creditor must retain evidence of compliance with §1026.43 for three years after the date of consummation of a consumer credit transaction covered by that section. (See comment 25(c)(3)-2 for guidance on the retention of evidence of compliance with the requirement to offer a consumer a loan without a prepayment penalty under §1026.43(g)(3).) If a creditor must verify and document information used in underwriting a transaction subject to §1026.43, the creditor shall retain evidence sufficient to demonstrate compliance with the documentation requirements of the rule. Although a creditor need not retain actual paper copies of the documentation used in underwriting a transaction subject to §1026.43, to comply with §1026.25(c)(3), the creditor must be able to reproduce such records accurately. For example, if the creditor uses a consumer's Internal Revenue Service (IRS) Form W-2 to verify the consumer's income, the creditor must be able to reproduce the IRS Form W-2 itself, and not merely the income information that was contained in the form.

Dwelling-secured transactions and prepayment penalties. If a transaction covered by §1026.43 has a prepayment penalty, the creditor must maintain records that document that the creditor complied with requirements for offering the consumer an alternative transaction that does not include a prepayment penalty under §1026.43(g)(3), (4), or (5). However, the creditor need not maintain records that document compliance with those provisions if a transaction is consummated without a prepayment penalty or if the creditor and consumer do not consummate a covered transaction. If a creditor offers a transaction with a prepayment penalty to a consumer through a mortgage broker, to evidence compliance with §1026.43(g)(4) the creditor should retain evidence of the alternative covered transaction presented to the mortgage broker, such as a rate sheet, and the agreement with the mortgage broker required by §1026.43(g)(4)(ii).

Regulatory Text

None.

Regulatory Commentary

Section 1026.43—Minimum Standards for Transactions Secured by a Dwelling

*1. **Record retention.** See §1026.25(c)(3) and comments 25(c)(3)-1 and -2 for guidance on the required retention of records as evidence of compliance with §1026.43.*

Scope – 12 CFR § 1026.43(a)

Regulatory Discussion

This section applies to any consumer credit transaction that is secured by a dwelling, including any real property attached to a dwelling. Excluded from these requirements are:

- HELOCs
- Timeshares
- Reverse mortgages
- Temporary or "bridge" loans
- Construction loans (no longer than 12 months
- Other loan types, that most banks do not offer

Regulatory Text

(a) **Scope.** This section applies to any consumer credit transaction that is secured by a dwelling, as defined in §1026.2(a)(19), including any real property attached to a dwelling, other than:

(1) A home equity line of credit subject to §1026.40;

(2) A mortgage transaction secured by a consumer's interest in a timeshare plan, as defined in 11 U.S.C. 101(53(D)); or

(3) For purposes of paragraphs (c) through (f) of this section:

(i) A reverse mortgage subject to §1026.33;

(ii) A temporary or "bridge" loan with a term of 12 months or less, such as a loan to finance the purchase of a new dwelling where the consumer plans to sell a current dwelling within 12 months or a loan to finance the initial construction of a dwelling;

(iii) A construction phase of 12 months or less of a construction-to-permanent loan;

(iv) An extension of credit made pursuant to a program administered by a Housing Finance Agency, as defined under 24 CFR 266.5;

(v) An extension of credit made by:

[Paragraphs A through D Omitted, as these provisions do not impact banks.]

(vi) An extension of credit made pursuant to a program authorized by sections 101 and 109 of the Emergency Economic Stabilization Act of 2008 (12 U.S.C. 5211; 5219);

(vii) Consumer credit transactions that meet the following criteria…

[Paragraphs A through F Omitted, as these provisions do not impact banks.]

Regulatory Commentary

43(a) Scope.

1. ***Consumer credit.*** *In general, §1026.43 applies to consumer credit transactions secured by a dwelling, but certain dwelling-secured consumer credit transactions are exempt or partially exempt from coverage under §1026.43(a)(1) through (3). (See §1026.2(a)(12) for the definition of "consumer credit.") Section 1026.43 does not apply to an extension of credit primarily for a business, commercial, or agricultural purpose, even if it is secured by a dwelling. See §1026.3 and associated commentary for guidance in determining the primary purpose of an extension of credit. In addition, §1026.43 does not apply to any change to an existing loan that is not treated as a refinancing under §1026.20(a).*

2. ***Real property.*** *"Dwelling" means a residential structure that contains one to four units, whether or not the structure is attached to real property. See §1026.2(a)(19). For purposes of §1026.43, the term "dwelling" includes any real property to which the residential structure is attached that also secures the covered transaction. For example, for purposes of §1026.43(c)(2)(i), the value of the dwelling that secures the covered transaction includes the value of any real property to which the residential structure is attached that also secures the covered transaction.*

Paragraph 43(a)(3).

1. ***Renewable temporary or "bridge" loan.*** *Under §1026.43(a)(3)(ii), a temporary or "bridge" loan with a term of 12 months or less is exempt from §1026.43(c) through (f). Examples of such a loan are a loan to finance the purchase of a new dwelling where the consumer plans to sell a current dwelling within 12 months and a loan to finance the initial construction of a dwelling. Where a temporary or "bridge loan" is renewable, the loan term does not include any additional period of time that could result from a renewal provision provided that any renewal possible under the loan contract is for one year or less. For example, if a construction loan has an initial loan term of 12 months but is renewable for another 12-month loan term, the loan is exempt from §1026.43(c) through (f) because the initial loan term is 12 months.*

2. ***Construction phase of a construction-to-permanent loan.*** *Under §1026.43(a)(3)(iii), a construction phase of 12 months or less of a construction-to-permanent loan is exempt from §1026.43(c) through (f). A construction-to-permanent loan is a potentially multiple-advance loan to finance the construction, rehabilitation, or improvement of a dwelling that may be permanently financed by the same creditor. For such a loan, the construction phase and the permanent phase may be treated as separate transactions for the purpose of compliance with §1026.43(c) through (f), and the construction phase of the loan is exempt from §1026.43(c) through (f), provided the initial term is 12 months or less. See §1026.17(c)(6)(ii), allowing similar treatment for disclosures. Where the construction phase of a construction-to-permanent loan is renewable for a period of one year or less, the term of that construction phase does not include any additional period of time that could result from a renewal provision. For example, if the construction phase of a construction-to-permanent loan has an initial term of 12 months but is renewable for another 12-month term before permanent financing begins, the construction phase is exempt from §1026.43(c) through (f) because the initial term is 12 months. Any renewal of one year or less also qualifies for the exemption. The permanent phase of the loan is treated as a separate transaction and is not exempt under §1026.43(a)(3)(iii). It may be a qualified mortgage if it satisfies the appropriate requirements.*

Paragraph 43(a)(3)(iv) through (vii).

[Omitted, as these provisions do not impact banks.]

Section 2: Repayment Ability
12 CFR § 1026.43(c)

General Requirement - 12 CFR § 1026.43(c)(1)

Regulatory Discussion

In general, a creditor cannot extend *credit to a consumer that is secured by a dwelling* (a "covered transaction") unless there is a *reasonable and good faith determination* that the consumer will have a *reasonable ability to repay* the loan.

There are numerous considerations discussed in the commentary.

Regulatory Text

(1) **General 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.

Regulatory Commentary

*1. **Reasonable and good faith determination.***

*i. **General.** Creditors generally are required by §1026.43(c)(1) to make reasonable and good faith determinations of consumers' ability to repay. Section 1026.43(c) and the accompanying commentary describe certain requirements for making this ability-to-repay determination, but do not provide comprehensive underwriting standards to which creditors must adhere. For example, the rule and commentary do not specify how much income is needed to support a particular level of debt or how credit history should be weighed against other factors. So long as creditors consider the factors set forth in §1026.43(c)(2) according to the requirements of §1026.43(c), creditors are permitted to develop their own underwriting standards and make changes to those standards over time in response to empirical information and changing economic and other conditions. Whether a particular ability-to-repay determination is reasonable and in good faith will depend not only on the underwriting standards adopted by the creditor, but on the facts and circumstances of an individual extension of credit and how a creditor's underwriting standards were applied to those facts and circumstances. A consumer's statement or attestation that the consumer has the ability to repay the loan is not indicative of whether the creditor's determination was reasonable and in good faith.*

*ii. **Considerations.***

A. The following may be evidence that a creditor's ability-to-repay determination was reasonable and in good faith:

1. The consumer demonstrated actual ability to repay the loan by making timely payments, without modification or accommodation, for a significant period of time after consummation or, for an adjustable-rate, interest-only, or negative-amortization mortgage, for a significant period of time after recast;

2. The creditor used underwriting standards that have historically resulted in comparatively low rates of delinquency and default during adverse economic conditions; or

3. The creditor used underwriting standards based on empirically derived, demonstrably and statistically sound models.

B. In contrast, the following may be evidence that a creditor's ability-to-repay determination was not reasonable or in good faith:

1. The consumer defaulted on the loan a short time after consummation or, for an adjustable-rate, interest-only, or negative-amortization mortgage, a short time after recast;

2. The creditor used underwriting standards that have historically resulted in comparatively high levels of delinquency and default during adverse economic conditions;

3. The creditor applied underwriting standards inconsistently or used underwriting standards different from those used for similar loans without reasonable justification;

4. The creditor disregarded evidence that the underwriting standards it used are not effective at determining consumers' repayment ability;

5. The creditor disregarded evidence that the consumer may have insufficient residual income to cover other recurring obligations and expenses, taking into account the consumer's assets other than the property securing the loan, after paying his or her monthly payments for the covered transaction, any simultaneous loans, mortgage-related obligations, and any current debt obligations; or

6. The creditor disregarded evidence that the consumer would have the ability to repay only if the consumer subsequently refinanced the loan or sold the property securing the loan.

C. All of the considerations listed in paragraphs (A) and (B) above may be relevant to whether a creditor's ability-to-repay determination was reasonable and in good faith. However, these considerations are not requirements or prohibitions with which creditors must comply, nor are they elements of a claim that a consumer must prove to establish a violation of the ability-to-repay requirements. For example, creditors are not required to validate their underwriting criteria using mathematical models. These considerations also are not absolute in their application; instead they exist on a continuum and may apply to varying degrees. For example, the longer a consumer successfully makes timely payments after consummation or recast the less likely it is that the creditor's determination of ability to repay was unreasonable or not in good faith. Finally, each of these considerations must be viewed in the context of all facts and circumstances relevant to a particular extension of credit. For example, in some cases inconsistent application of underwriting standards may indicate that a creditor is manipulating those standards to approve a loan despite a consumer's inability to repay. The creditor's ability-to-repay determination therefore may be unreasonable or in bad faith. However, in other cases inconsistently applied underwriting standards may be the result of, for example, inadequate training and may nonetheless yield a reasonable and good faith ability-to-repay determination in a particular case. Similarly, although an early payment default on a mortgage will often be persuasive evidence that the creditor did not have a *reasonable and good faith belief in the consumer's ability to repay (and such evidence may even be sufficient to establish a prima facie case of an ability-to-repay violation), a particular ability-to-repay determination may be reasonable and in good faith even though the consumer defaulted shortly after consummation if, for example, the consumer experienced a sudden and unexpected loss of income. In contrast, an ability-to-repay determination may be unreasonable or not in good faith even though the consumer made timely payments for a significant period of time if, for example, the consumer was able to make those payments only by foregoing necessities such as food and heat.*

2. ***Repayment ability at consummation.*** *Section 1026.43(c)(1) requires the creditor to determine, at or before the time the loan is consummated, that a consumer will have a reasonable ability to repay the loan. A change in the consumer's circumstances after consummation (for example, a significant reduction in income due to a job loss or a significant obligation arising from a major medical expense) that cannot be reasonably anticipated from the consumer's application or the records used to determine repayment ability is not relevant to determining a creditor's compliance with the rule. However, if the application or records considered at or before consummation indicate there will be a change in a consumer's repayment ability after consummation (for example, if a consumer's application states that the consumer plans to retire within 12 months without obtaining new employment or that the consumer will transition from full-time to part-time employment), the creditor must consider that information under the rule.*

3. ***Interaction with Regulation B.*** *Section 1026.43(c)(1) does not require or permit the creditor to make inquiries or verifications prohibited by Regulation B, 12 CFR part 1002.*

Basis for Determination - 12 CFR § 1026.43(c)(2)

Regulatory Discussion

- The repayment ability determination requires consideration of the following eight items:
  - Income or assets
  - Employment status
  - Monthly payment on the proposed loan
  - Monthly payment on any simultaneous loan
  - Monthly payment for mortgage-related obligations
  - Other debts and obligations (i.e., alimony and child support)
  - monthly debt-to-income ratio or residual income
  - Consumer's credit history

The commentary provides additional important information on each of the eight items.

Regulatory Text

(2) **Basis for determination.** Except as provided otherwise in paragraphs (d), (e), and (f) of this section, in making the repayment ability determination required under paragraph (c)(1) of this section, a creditor must consider the following:

(i) The consumer's 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;

(ii) If the creditor relies on income from the consumer's employment in determining repayment ability, the consumer's current employment status;

(iii) The consumer's monthly payment on the covered transaction, calculated in accordance with paragraph (c)(5) of this section;

(iv) The consumer's monthly payment on any simultaneous loan that the creditor knows or has reason to know will be made, calculated in accordance with paragraph (c)(6) of this section;

(v) The consumer's monthly payment for mortgage-related obligations;

(vi) The consumer's current debt obligations, alimony, and child support;

(vii) The consumer's monthly debt-to-income ratio or residual income in accordance with paragraph (c)(7) of this section; and

(viii) The consumer's credit history.

Regulatory Commentary

The commentary has been omitted here.

Verification Using Third-Party Records - 12 CFR § 1026.43(c)(3)

Regulatory Discussion

A creditor *must verify* a consumer's repayment ability using reasonably reliable third-party records.

A creditor *must verify* a consumer's income or assets using the techniques discussed in (c)(4).

If a creditor relies on income from a consumer’s employment in determining repayment ability, the creditor *may verify* a consumer's employment status orally if the creditor prepares a record of the information obtained orally.

If a creditor relies on a consumer's credit report to verify a consumer's current debt obligations and a consumer's application states a current debt obligation not shown in the consumer's credit report, the creditor *need not independently verify* such an obligation.

The commentary provides additional guidance on these verifications.

Regulatory Text

(3) **Verification using third-party records.** A creditor must verify the information that the creditor relies on in determining a consumer's repayment ability under §1026.43(c)(2) using reasonably reliable third-party records, except that:

(i) For purposes of paragraph (c)(2)(i) of this section, a creditor must verify a consumer's income or assets that the creditor relies on in accordance with §1026.43(c)(4);

(ii) For purposes of paragraph (c)(2)(ii) of this section, a creditor may verify a consumer's employment status orally if the creditor prepares a record of the information obtained orally; and

(iii) For purposes of paragraph (c)(2)(vi) of this section, if a creditor relies on a consumer's credit report to verify a consumer's current debt obligations and a consumer's application states a current debt obligation not shown in the consumer's credit report, the creditor need not independently verify such an obligation.

Regulatory Commentary

The commentary has been omitted here.

Verification of Income or Assets - 12 CFR § 1026.43(c)(4)

Regulatory Discussion

A creditor *must verify* the amounts of income or assets that the creditor relies on to determine a consumer's ability to repay, using third-party records that provide reasonably reliable evidence of the consumer's income or assets.

A creditor *may verify* the consumer's income using a tax-return transcript issued by the Internal Revenue Service (IRS).

Other examples of items that may be used:

- Copies of tax returns
- IRS Form W-2s
- Payroll statements, including military Leave and Earnings Statements;
- Financial institution records (such as direct deposit information on statements
- Records from the consumer's employer
- Records from a Federal, State, or local government agency stating the consumer's income from benefits or entitlements;
- Receipts from the consumer's use of check cashing services
- Receipts from the consumer's use of a funds transfer service.

Regulatory Text

(4) **Verification of income or assets.** A creditor must verify the amounts of income or assets that the creditor relies on under §1026.43(c)(2)(i) to determine a consumer's ability to repay a covered transaction using third-party records that provide reasonably reliable evidence of the consumer's income or assets. A creditor may verify the consumer's income using a tax-return transcript issued by the Internal Revenue Service (IRS). Examples of other records the creditor may use to verify the consumer's income or assets include:

(i) Copies of tax returns the consumer filed with the IRS or a State taxing authority;

(ii) IRS Form W-2s or similar IRS forms used for reporting wages or tax withholding;

(iii) Payroll statements, including military Leave and Earnings Statements;

(iv) Financial institution records;

(v) Records from the consumer's employer or a third party that obtained information from the employer;

(vi) Records from a Federal, State, or local government agency stating the consumer's income from benefits or entitlements;

(vii) Receipts from the consumer's use of check cashing services; and

(viii) Receipts from the consumer's use of a funds transfer service.

Regulatory Commentary

43(c)(4) Verification of Income or Assets.

1. ***Income or assets relied on.*** *A creditor need consider, and therefore need verify, only the income or assets the creditor relies on to evaluate the consumer's repayment ability. See comment 43(c)(2)(i)-2. For example, if a consumer's application states that the consumer earns a salary and is paid an annual bonus and the creditor relies on only the consumer's salary to evaluate the consumer's repayment ability, the creditor need verify only the salary. See also comments 43(c)(3)-1 and -2.*

2. ***Multiple applicants.*** *If multiple consumers jointly apply for a loan and each lists income or assets on the application, the creditor need verify only the income or assets the creditor relies on in determining repayment ability. See comment 43(c)(2)(i)-5.*

3. ***Tax-return transcript.*** *Under §1026.43(c)(4), a creditor may verify a consumer's income using an Internal Revenue Service (IRS) tax-return transcript, which summarizes the information in a consumer's filed tax return, another record that provides reasonably reliable evidence of the consumer's income, or both. A creditor may obtain a copy of a tax-return transcript or a filed tax return directly from the consumer or from a service provider. A creditor need not obtain the copy directly from the IRS or other taxing authority. See comment 43(c)(3)-2.*

Paragraph 43(c)(4)(vi).

1. ***Government benefits.*** *In verifying a consumer's income, a creditor may use a written or electronic record from a government agency of the amount of any benefit payments or awards, such as a "proof of income letter" issued by the Social Security Administration (also known as a "budget letter," "benefits letter," or "proof of award letter").*

Payment Calculation - 12 CFR § 1026.43(c)(5)

Regulatory Discussion

In general, whether the loan is a fixed-rate, adjustable-rate or step-rate mortgage, the consumer's *monthly payment calculation must be made* using:

- the fully indexed rate or any introductory interest rate, whichever is greater; and
- monthly, fully amortizing payments that are substantially equal.

There are *special rules for*:

- Loans with a balloon payment, the monthly payment calculation *must be made* using:
- The maximum payment scheduled during the first five years for non-HPML
- The maximum payment in the payment schedule, including the balloon payment, for an HPML
- Interest-only loans, the monthly payment calculation *must be made* using:
- The fully indexed rate or any introductory interest rate, whichever is greater
- Substantially equal, monthly payments of principal and interest that will repay the loan amount over the term of the loan remaining as of the date the loan is switches to payments.

Negative amortization loans, the monthly payment calculation *must be made* using:

- The fully indexed rate or any introductory interest rate, whichever is greater
- Substantially equal, monthly payments of principal and interest that will repay the maximum loan amount over the term of the loan remaining as of the date the loan reaches the maximum loan amount.

The commentary provides additional important information on these rules.

Regulatory Text

(5) **Payment calculation**

(i) **General rule.** Except as provided in paragraph (c)(5)(ii) of this section, a creditor must make the consideration required under paragraph (c)(2)(iii) of this section using:

(A) The fully indexed rate or any introductory interest rate, whichever is greater; and

(B) Monthly, fully amortizing payments that are substantially equal.

(ii) **Special rules for loans with a balloon payment, interest-only loans, and negative amortization loans.** A creditor must make the consideration required under paragraph (c)(2)(iii) of this section for:

(A) A loan with a balloon payment, as defined in §1026.18(s)(5)(i), using:

(1) The maximum payment scheduled during the first five years after the date on which the first regular periodic payment will be due for a loan that is not a higher-priced covered transaction; or

(2) The maximum payment in the payment schedule, including any balloon payment, for a higher-priced covered transaction;

(B) An interest-only loan, as defined in §1026.18(s)(7)(iv), using:

(1) The fully indexed rate or any introductory interest rate, whichever is greater; and

(2) Substantially equal, monthly payments of principal and interest that will repay the loan amount over the term of the loan remaining as of the date the loan is recast.

(C) A negative amortization loan, as defined in §1026.18(s)(7)(v), using:

(1) The fully indexed rate or any introductory interest rate, whichever is greater; and

(2) Substantially equal, monthly payments of principal and interest that will repay the maximum loan amount over the term of the loan remaining as of the date the loan is recast.

Regulatory Commentary

The commentary has been omitted here.

Payment Calculation Simultaneous Loans - 12 CFR § 1026.43(c)(6)

Regulatory Discussion

When calculating a consumer's monthly payment in accordance with paragraph (c)(5), a creditor must consider the consumer's payment on any simultaneous loan either:

- For a "covered transaction" (any consumer credit transaction that is secured by a dwelling), by following the rules in paragraph (c)(5); or
- For a HELOC, by using the payment required by the HELOC and the amount of the "covered transaction."

Regulatory Text

(6) **Payment calculation for simultaneous loans.** For purposes of making the evaluation required under paragraph (c)(2)(iv) of this section, a creditor must consider, taking into account any mortgage-related obligations, a consumer's payment on a simultaneous loan that is:

(i) A covered transaction, by following paragraph (c)(5)of this section; or

(ii) A home equity line of credit subject to §1026.40, by using the periodic payment required under the terms of the plan and the amount of credit to be drawn at or before consummation of the covered transaction.

Regulatory Commentary

43(c)(6) Payment calculation for simultaneous loans.

1. **Scope.** *In determining the consumer's repayment ability for a covered transaction under §1026.43(c)(2)(iii), a creditor must include consideration of any simultaneous loan which it knows, or has reason to know, will be made at or before consummation of the covered transaction. For a discussion of the standard "knows or has reason to know," see comment 43(c)(2)(iv)-2. For the meaning of the term "simultaneous loan," see §1026.43(b)(12).*

2. ***Payment calculation—covered transaction.*** *For a simultaneous loan that is a covered transaction, as that term is defined under §1026.43(b)(1), a creditor must determine a consumer's ability to repay the monthly payment obligation for a simultaneous loan as set forth in §1026.43(c)(5), taking into account any mortgage-related obligations required to be considered under §1026.43(c)(2)(v). For the meaning of the term "mortgage-related obligations," see §1026.43(b)(8).*

3. ***Payment calculation—home equity line of credit.*** *For a simultaneous loan that is a home equity line of credit subject to §1026.40, the creditor must consider the periodic payment required under the terms of the plan when assessing the consumer's ability to repay the covered transaction secured by the same dwelling as the simultaneous loan. Under §1026.43(c)(6)(ii), a creditor must determine the periodic payment required under the terms of the plan by considering the actual amount of credit to be drawn by the consumer at consummation of the covered transaction. The amount to be drawn is the amount requested by the consumer; when the amount requested will be disbursed, or actual receipt of funds, is not determinative. Any additional draw against the line of credit that the creditor of the covered transaction does not know or have reason to know about before or during underwriting need not be considered in relation to ability to repay. For example, where the creditor's policies and procedures require the source of down payment to be verified, and the creditor verifies that a simultaneous loan that is a HELOC will provide the source of down payment for the first-lien covered transaction, the creditor must consider the periodic payment on the HELOC by assuming the amount drawn is at least the down payment amount. In general, a creditor should determine the periodic payment based on guidance in the commentary to §1026.40(d)(5) (discussing payment terms).*

Monthly DTI Ratio or Residual Income - 12 CFR § 1026.43(c)(7)

Regulatory Discussion

If a creditor considers the consumer's monthly debt-to-income ratio, the creditor must consider the ratio of the consumer's "total monthly debt obligations" to the consumer's "total monthly income."

If a creditor considers the consumer's monthly residual income the creditor must consider the consumer's remaining income after subtracting the consumer's "total monthly debt obligations" from the "total monthly income."

Definitions are provided for:

- Total monthly debt obligations.
- Total monthly income

The commentary provides additional considerations.

Regulatory Text

(7) **Monthly debt-to-income ratio or residual income**

(i) **Definitions.** For purposes of this paragraph (c)(7), the following definitions apply:

(A) **Total monthly debt obligations.** The term *total monthly debt obligations* means the sum of: the payment on the covered transaction, as required to be calculated by paragraphs (c)(2)(iii) and (c)(5) of this section; simultaneous loans, as required by paragraphs (c)(2)(iv) and (c)(6) of this section; mortgage-related obligations, as required by paragraph (c)(2)(v) of this section; and current debt obligations, alimony, and child support, as required by paragraph (c)(2)(vi) of this section.

(B) **Total monthly income.** The term *total monthly income* means the sum of the consumer's current or reasonably expected income, including any income from assets, as required by paragraphs (c)(2)(i) and (c)(4) of this section.

(ii) **Calculations**

(A) **Monthly debt-to-income ratio.** If a creditor considers the consumer's monthly debt-to-income ratio under paragraph (c)(2)(vii) of this section, the creditor must consider the ratio of the consumer's total monthly debt obligations to the consumer's total monthly income.

(B) **Monthly residual income.** If a creditor considers the consumer's monthly residual income under paragraph (c)(2)(vii) of this section, the creditor must consider the consumer's remaining income after subtracting the consumer's total monthly debt obligations from the consumer's total monthly income.

Regulatory Commentary

43(c)(7) Monthly debt-to-income ratio or residual income.

1. ***Monthly debt-to-income ratio or monthly residual income.*** *Under §1026.43(c)(2)(vii), the creditor must consider the consumer's monthly debt-to-income ratio, or the consumer's monthly residual income, in accordance with the requirements in §1026.43(c)(7). In contrast to the qualified mortgage provisions in §1026.43(e), §1026.43(c) does not prescribe a specific monthly debt-to-income ratio with which creditors must comply. Instead, an appropriate threshold for a consumer's monthly debt-to-income ratio or monthly residual income is for the creditor to determine in making a reasonable and good faith determination of a consumer's ability to repay.*

2. ***Use of both monthly debt-to-income ratio and monthly residual income.*** *If a creditor considers the consumer's monthly debt-to-income ratio, the creditor may also consider the consumer's residual income as further validation of the assessment made using the consumer's monthly debt-to-income ratio.*

3. ***Compensating factors.*** *The creditor may consider factors in addition to the monthly debt-to-income ratio or residual income in assessing a consumer's repayment ability. For example, the creditor may reasonably and in good faith determine that a consumer has the ability to repay despite a higher debt-to-income ratio or lower residual income in light of the consumer's assets other than the dwelling, including any real property attached to the dwelling, securing the covered transaction, such as a savings account. The creditor may also reasonably and in good faith determine that a consumer has the ability to repay despite a higher debt-to-income ratio in light of the consumer's residual income.*

Section 3: Refinancing of Non-Standard Mortgages 12 CFR § 1026.43(d)

Definitions - 12 CFR § 1026.43(d)(1)

Regulatory Discussion

This section begins with the definition of three terms specific to this section.

Non-standard mortgage includes any consumer credit transaction that is secured by a dwelling that is:

- An ARM with an introductory fixed interest rate for a period of one year or longer;
- An interest-only loan
- A negative amortization loan

Standard mortgage includes any consumer credit transaction that is secured by a dwelling:

- That provides for regular periodic payments (*with conditions*)
- For which the total points and fees payable in connection with the transaction do not exceed specified amounts
- For which the term does not exceed 40 years
- For which the interest rate is fixed for at least the first five years after consummation
- For which the proceeds from the loan are used solely for specific purposes

Refinancing is defined in §1026.20(a)

The regulatory text and commentary has been omitted here. It is available, along with the complete manual section, on the web page for this school.

Section 4: Qualified Mortgages
12 CFR § 1026.43(e)

Safe Harbor and Presumption of Compliance - 12 CFR § 1026.43(e)(1)

Regulatory Discussion

A safe harbor with the repayment ability requirements of paragraph (c) (discussed in Section 3, above) is provided to a creditor (or assignee) of:

- a "*qualified mortgage*" that
- is not a "*higher-priced covered transaction*"

A presumption of compliance with the repayment ability requirements of paragraph (c) (discussed in Section 3, above) is provided to a creditor (or assignee) of:

- a "*qualified mortgage*" that
- is a "*higher-priced covered transaction*"

To rebut the presumption of compliance, it must be proven:

- the creditor did not make a reasonable and good faith determination of the consumer's repayment ability,
- by showing that the consumer's income, debt obligations, alimony, child support, and the consumer's monthly payment
- would leave the consumer with insufficient residual income or assets with which to meet living expenses.

Regulatory Text

(1) **Safe harbor and presumption of compliance**

(i) **Safe harbor for loans that are not higher-priced covered transactions.** A creditor or assignee of a qualified mortgage, as defined in paragraphs (e)(2), (e)(4), (e)(5), (e)(6), or (f) of this section, that is not a higher-priced covered transaction, as defined in paragraph (b)(4) of this section, complies with the repayment ability requirements of paragraph (c) of this section.

(ii) **Presumption of compliance for higher-priced covered transactions.**

(A) A creditor or assignee of a qualified mortgage, as defined in paragraph (e)(2), (e)(4), (e)(5), (e)(6), or (f) of this section, that is a higher-priced covered transaction, as defined in paragraph (b)(4) of this section, is presumed to comply with the repayment ability requirements of paragraph (c) of this section.

(B) To rebut the presumption of compliance described in paragraph (e)(1)(ii)(A) of this section, it must be proven that, despite meeting the prerequisites of paragraph (e)(2), (e)(4), (e)(5), (e)(6), or (f) of this section, the creditor did not make a reasonable and good faith determination of the consumer's repayment ability at the time of consummation, by showing that the consumer's income, debt obligations, alimony, child support, and the consumer's monthly payment (including mortgage-related obligations) on the covered transaction and on any simultaneous loans of which the creditor was aware at consummation would leave the consumer with insufficient residual income or assets other than the value of the dwelling (including any real property attached to the dwelling) that secures the loan with which to meet living expenses, including any recurring and material non-debt obligations of which the creditor was aware at the time of consummation.

Regulatory Commentary

The commentary has been omitted here.

Qualified Mortgage Definition - 12 CFR § 1026.43(e)(2)

Regulatory Discussion

In general, "*qualified mortgage*" means a consumer credit transaction that is secured by a dwelling that satisfies the following six conditions:

- That provides for regular periodic payments that are substantially equal (*see additional limitations in (2)(i)(A) through (C)*)
- For which the loan term does not exceed 30 years
- For which the total points and fees payable in connection with the loan do not exceed specified amounts
- For which the creditor underwrites the loan, taking into account the monthly payment for mortgage-related obligations (*see requirements in (2)(iv)(A) and (B)(1) through (2)*)
- For which the creditor considers and verifies, at or before consummation, certain information (*see requirements in (2)(v)(A) and (B)*)
- For which the ratio of the consumer's total monthly debt to total monthly income at the time of consummation does not exceed 43 percent (*see calculation in (2)(vi)(A) and (B)(1) through (2)*)

Note: exceptions to this general definition will be covered in paragraphs (e)(4), (5) and (6) of this Section 5, as well as in paragraph (f) in Section 6.

The commentary provides additional substantial guidance on conditions (i), (ii), (iv), (v) and (vi).

Regulatory Text

(2) **Qualified mortgage defined—general**. Except as provided in paragraph (e)(4), (e)(5), (e)(6), or (f) of this section, a qualified mortgage is a covered transaction:

(i) That provides for regular periodic payments that are substantially equal, except for the effect that any interest rate change after consummation has on the payment in the case of an adjustable-rate or step-rate mortgage, that do not:

(A) Result in an increase of the principal balance;

(B) Allow the consumer to defer repayment of principal, except as provided in paragraph (f) of this section; or

(C) Result in a balloon payment, as defined in §1026.18(s)(5)(i), except as provided in paragraph (f) of this section;

(ii) For which the loan term does not exceed 30 years;

(iii) For which the total points and fees payable in connection with the loan do not exceed the amounts specified in paragraph (e)(3) of this section;

(iv) For which the creditor underwrites the loan, taking into account the monthly payment for mortgage-related obligations, using:

(A) The maximum interest rate that may apply during the first five years after the date on which the first regular periodic payment will be due; and

(B) Periodic payments of principal and interest that will repay either:

(1) The outstanding principal balance over the remaining term of the loan as of the date the interest rate adjusts to the maximum interest rate set forth in paragraph (e)(2)(iv)(A) of this section, assuming the consumer will have made all required payments as due prior to that date; or

(2) The loan amount over the loan term;

(v) For which the creditor considers and verifies at or before consummation the following:

(A) The consumer's 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, in accordance with appendix Q and paragraphs (c)(2)(i) and (c)(4) of this section; and

(B) The consumer's current debt obligations, alimony, and child support in accordance with appendix Q and paragraphs (c)(2)(vi) and (c)(3) of this section; and

(vi) For which the ratio of the consumer's total monthly debt to total monthly income at the time of consummation does not exceed 43 percent. For purposes of this paragraph (e)(2)(vi), the ratio of the consumer's total monthly debt to total monthly income is determined:

(A) Except as provided in paragraph (e)(2)(vi)(B) of this section, in accordance with the standards in appendix Q;

(B) Using the consumer's monthly payment on:

(1) The covered transaction, including the monthly payment for mortgage-related obligations, in accordance with paragraph (e)(2)(iv) of this section; and

(2) Any simultaneous loan that the creditor knows or has reason to know will be made, in accordance with paragraphs (c)(2)(iv) and (c)(6) of this section.

Regulatory Commentary

The commentary has been omitted here.

Limits on Points and Fees for Qualified Mortgages - 12 CFR § 1026.43(e)(3)

Regulatory Discussion

A consumer credit transaction that is secured by a dwelling is not a "*qualified mortgage*" (as defined in (e)(2), above) *unless* the total "*points and fees"* (defined in §1026.32(b)(1)) do not exceed the limits established in (3)(i)(A) through (E) as detailed in the regulatory text.

Note: these limits are adjusted annually on January 1st.

There are special rules for transactions consummated on or before January 10, 2021.

If the creditor (or assignee) determines after consummation that the total points and fees exceed the limits in paragraph (e)(3)(i), the loan *is not precluded* from being a "*qualified mortgage,*" *provided the conditions* in (e)(iii)(A), (B)(1) through (3), and (C) *are satisfied*.

In the event the special rules are applicable, the creditor (or assignee) must pay to the consumer the amount (that is not less than the sum) specified in (e)(iv)(A) and (B).

The commentary provides additional guidance on this information.

Regulatory Text

(3) **Limits on points and fees for qualified mortgages.**

(i) Except as provided in paragraph (e)(3)(iii) of this section, a covered transaction is not a qualified mortgage unless the transaction's total points and fees, as defined in §1026.32(b)(1), do not exceed:

(A) For a loan amount greater than or equal to $100,000 (indexed for inflation): 3 percent of the total loan amount;

(B) For a loan amount greater than or equal to $60,000 (indexed for inflation) but less than $100,000 (indexed for inflation): $3,000 (indexed for inflation);

(C) For a loan amount greater than or equal to $20,000 (indexed for inflation) but less than $60,000 (indexed for inflation): 5 percent of the total loan amount;

(D) For a loan amount greater than or equal to $12,500 (indexed for inflation) but less than $20,000 (indexed for inflation): $1,000 (indexed for inflation);

(E) For a loan amount less than $12,500 (indexed for inflation): 8 percent of the total loan amount.

(ii) The dollar amounts, including the loan amounts, in paragraph (e)(3)(i) of this section shall be adjusted annually on January 1 by the annual percentage change in the Consumer Price Index for All Urban Consumers (CPI-U) that was reported on the preceding June 1. See the official commentary to this paragraph (e)(3)(ii) for the current dollar amounts.

(iii) For covered transactions consummated on or before January 10, 2021, if the creditor or assignee determines after consummation that the transaction's total points and fees exceed the applicable limit under paragraph (e)(3)(i) of this section, the loan is not precluded from being a qualified mortgage, provided:

(A) The loan otherwise meets the requirements of paragraphs (e)(2), (e)(4), (e)(5), (e)(6), or (f) of this section, as applicable;

(B) The creditor or assignee pays to the consumer the amount described in paragraph (e)(3)(iv) of this section within 210 days after consummation and prior to the occurrence of any of the following events:

(1) The institution of any action by the consumer in connection with the loan;

(2) The receipt by the creditor, assignee, or servicer of written notice from the consumer that the transaction's total points and fees exceed the applicable limit under paragraph (e)(3)(i) of this section; or

(3) The consumer becoming 60 days past due on the legal obligation; and

(C) The creditor or assignee, as applicable, maintains and follows policies and procedures for post-consummation review of points and fees and for making payments to consumers in accordance with paragraphs (e)(3)(iii)(B) and (e)(3)(iv) of this section.

(iv) For purposes of paragraph (e)(3)(iii) of this section, the creditor or assignee must pay to the consumer an amount that is not less than the sum of the following:

(A) The dollar amount by which the transaction's total points and fees exceeds the applicable limit under paragraph (e)(3)(i) of this section; and

(B) Interest on the dollar amount described in paragraph (e)(3)(iv)(A) of this section, calculated using the contract interest rate applicable during the period from consummation until the payment described in this paragraph (e)(3)(iv) is made to the consumer.

Regulatory Commentary

The commentary has been omitted here.

Qualified Mortgage Defined – Special Rules - 12 CFR § 1026.43(e)(4)

Regulatory Discussion

As an exception to the general definition of a "*qualified mortgage*" in paragraph (e)(2), above, this paragraph (e)(4) also includes as a "qualified mortgage" transactions that not only satisfy the requirements of paragraphs (e)(2)(i) through (iii) but also satisfies:

One or more of the following criteria, which requires a loan (except with regard to matters wholly unrelated to ability to repay):

- be eligible:
  - to be purchased or guaranteed by the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation; or

  - o to be purchased or guaranteed by any limited-life regulatory entity succeeding the charters of either entity, above;
- be eligible to be insured by the U.S. Department of Housing and Urban Development;
- be eligible to be guaranteed by the U.S. Department of Veteran Affairs;
- be eligible to be guaranteed by the U.S. Department of Agriculture; or
- be eligible to be insured by the Rural Housing Service.

Note: each special rule described above shall expire on the effective date of a rule issued by each respective agency; and, unless otherwise expired as stated herein, these special rules are only available for covered transactions consummated on or before January 10, 2021.

See the commentary for additional information.

Regulatory Text

(4) **Qualified mortgage defined - special rules**

(i) **General.** Notwithstanding paragraph (e)(2) of this section, a qualified mortgage is a covered transaction that satisfies:

(A) The requirements of paragraphs (e)(2)(i) through (iii) of this section; and

(B) One or more of the criteria in paragraph (e)(4)(ii) of this section.

(ii) **Eligible loans.** A qualified mortgage under this paragraph (e)(4) must be one of the following at consummation:

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

(1) To be purchased or guaranteed by the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation operating under the conservatorship or receivership of the Federal Housing Finance Agency pursuant to section 1367(a) of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. 4617(a)); or

(2) To be purchased or guaranteed by any limited-life regulatory entity succeeding the charter of either the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation pursuant to section 1367(i) of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. 4617(i));

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

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

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

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

(iii) **Sunset of special rules.**

(A) Each respective special rule described in paragraph (e)(4)(ii)(B), (C), (D), or (E) of this section shall expire on the effective date of a rule issued by each respective agency pursuant to its authority under TILA section 129C(b)(3)(ii) to define a qualified mortgage.

(B) Unless otherwise expired under paragraph (e)(4)(iii)(A) of this section, the special rules in this paragraph (e)(4) are available only for covered transactions consummated on or before January 10, 2021.

Regulatory Commentary

The commentary has been omitted here.

QM – Small Creditor Portfolio Loans - 12 CFR § 1026.43(e)(5)

Regulatory Discussion

As an exception to the general definition of a "*qualified mortgage*" in paragraph (e)(2), above, this paragraph (e)(5) also includes as a "qualified mortgage" transactions that not only satisfy the requirements of paragraphs of (e)(2) (except for (e)(2)(vi)) but also satisfies the requirements of (e)(5)(i)(B) through (D), below.

Note: a "qualified mortgage" extended under this exception immediately loses its status as such if legal title to the qualified mortgage is sold, assigned, or otherwise transferred to another person (see exceptions in (e)(5)(ii)(A) through (D), below.

See the commentary for additional information.

Regulatory Text

(5) **Qualified mortgage defined—small creditor portfolio loans.**

(i) Notwithstanding paragraph (e)(2) of this section, a qualified mortgage is a covered transaction:

(A) That satisfies the requirements of paragraph (e)(2) of this section other than the requirements of paragraph (e)(2)(vi) and without regard to the standards in appendix Q to this part;

(B) For which the creditor considers at or before consummation the consumer's monthly debt-to-income ratio or residual income and verifies the debt obligations and income used to determine that ratio in accordance with paragraph (c)(7) of this section, except that the calculation of the payment on the covered transaction for purposes of determining the consumer's total monthly debt obligations in paragraph (c)(7)(i)(A) shall be determined in accordance with paragraph (e)(2)(iv) of this section instead of paragraph (c)(5) of this section;

(C) That is not subject, at consummation, to a commitment to be acquired by another person, other than a person that satisfies the requirements of paragraph (e)(5)(i)(D) of this section; and

(D) For which the creditor satisfies the requirements stated in §1026.35(b)(2)(iii)(B) and (C).

(ii) A qualified mortgage extended pursuant to paragraph (e)(5)(i) of this section immediately loses its status as a qualified mortgage under paragraph (e)(5)(i) if legal title to the qualified mortgage is sold, assigned, or otherwise transferred to another person except when:

(A) The qualified mortgage is sold, assigned, or otherwise transferred to another person three years or more after consummation of the qualified mortgage;

(B) The qualified mortgage is sold, assigned, or otherwise transferred to a creditor that satisfies the requirements of paragraph (e)(5)(i)(D) of this section;

(C) The qualified mortgage is sold, assigned, or otherwise transferred to another person pursuant to a capital restoration plan or other action under 12 U.S.C. 1831o, actions or instructions of any person acting as conservator, receiver, or bankruptcy trustee, an order of a State or Federal government agency with jurisdiction to examine the creditor pursuant to State or Federal law, or an agreement between the creditor and such an agency; or

(D) The qualified mortgage is sold, assigned, or otherwise transferred pursuant to a merger of the creditor with another person or acquisition of the creditor by another person or of another person by the creditor.

Regulatory Commentary

The commentary has been omitted here.

QM Balloon Payment Loans - 12 CFR § 1026.43(e)(6)

Regulatory Discussion

Note: this exception only applies to transactions for which the application was received before April 1, 2016.

As an exception to the general definition of a "*qualified mortgage*" in paragraph (e)(2), above, this paragraph (e)(6) also includes as a "qualified mortgage" transactions that not only satisfy the requirements of paragraphs in (e)(2) but also:

- satisfies the requirements of paragraph (f) (in Section 6, below); and
- the creditor satisfies the requirements of §1026.35(b)(2)(iii)(B) and (C)

Regulatory Text

(6) **Qualified mortgage defined - temporary balloon-payment qualified mortgage rules.**

(i) Notwithstanding paragraph (e)(2) of this section, a qualified mortgage is a covered transaction:

(A) That satisfies the requirements of paragraph (f) of this section other than the requirements of paragraph (f)(1)(vi); and

(B) For which the creditor satisfies the requirements stated in §1026.35(b)(2)(iii)(B) and (C).

(ii) The provisions of this paragraph (e)(6) apply only to covered transactions for which the application was received before April 1, 2016.

Regulatory Commentary

None.

Section 5: Balloon Payment Qualified Mortgages 12 CFR § 1026.43(f)

Exemption – 12 CFR § 1026.43(f)(1)

Regulatory Discussion

As an exception to the general definition of a "*qualified mortgage*" in paragraph (e)(2), above, this paragraph (f)(1) also includes as a "qualified mortgage" transactions that not only satisfy the requirements of paragraphs in (e)(2) but also provides for a balloon payment, provided the six conditions in paragraphs (f)(1)(i) through (vi) are satisfied.

The commentary provides additional important information on each of the six conditions.

Regulatory Text

(1) ***Exemption.*** Notwithstanding paragraph (e)(2) of this section, a qualified mortgage may provide for a balloon payment, provided:

(i) The loan satisfies the requirements for a qualified mortgage in paragraphs (e)(2)(i)(A), (e)(2)(ii), (e)(2)(iii), and (e)(2)(v) of this section, but without regard to the standards in appendix Q;

(ii) The creditor determines at or before consummation that the consumer can make all of the scheduled payments under the terms of the legal obligation, as described in paragraph (f)(1)(iv) of this section, together with the consumer's monthly payments for all mortgage-related obligations and excluding the balloon payment, from the consumer's current or reasonably expected income or assets other than the dwelling that secures the loan;

(iii) The creditor considers at or before consummation the consumer's monthly debt-to-income ratio or residual income and verifies the debt obligations and income used to determine that ratio in accordance with paragraph (c)(7) of this section, except that the calculation of the payment on the covered transaction for purposes of determining the consumer's total monthly debt obligations in (c)(7)(i)(A) shall be determined in accordance with paragraph (f)(iv)(A) of this section, together with the consumer's monthly payments for all mortgage-related obligations and excluding the balloon payment;

(iv) The legal obligation provides for:

(A) Scheduled payments that are substantially equal, calculated using an amortization period that does not exceed 30 years;

(B) An interest rate that does not increase over the term of the loan; and

(C) A loan term of five years or longer.

(v) The loan is not subject, at consummation, to a commitment to be acquired by another person, other than a person that satisfies the requirements of paragraph (f)(1)(vi) of this section; and

(vi) The creditor satisfies the requirements stated in §1026.35(b)(2)(iii)(A), (B), and (C).

Regulatory Commentary

The commentary has been omitted here.

Transfer of Balloon Loans - 12 CFR § 1026.43(f)(2)

Regulatory Discussion

This paragraph provides that a balloon-payment "qualified mortgage" will immediately lose its status as such if legal title to the balloon-payment qualified mortgage is sold, assigned, or otherwise transferred to another person (subject to the exceptions in (f)(2)(i) through (iv).

The commentary provides additional information on each of the exceptions.

Regulatory Text

(2) **Post-consummation transfer of balloon-payment qualified mortgage.** A balloon-payment qualified mortgage, extended pursuant to paragraph (f)(1), immediately loses its status as a qualified mortgage under paragraph (f)(1) if legal title to the balloon-payment qualified mortgage is sold, assigned, or otherwise transferred to another person except when:

(i) The balloon-payment qualified mortgage is sold, assigned, or otherwise transferred to another person three years or more after consummation of the balloon-payment qualified mortgage;

(ii) The balloon-payment qualified mortgage is sold, assigned, or otherwise transferred to a creditor that satisfies the requirements of paragraph (f)(1)(vi) of this section;

(iii) The balloon-payment qualified mortgage is sold, assigned, or otherwise transferred to another person pursuant to a capital restoration plan or other action under 12 U.S.C. 1831o, actions or instructions of any person acting as conservator, receiver or bankruptcy trustee, an order of a State or Federal governmental agency with jurisdiction to examine the creditor pursuant to State or Federal law, or an agreement between the creditor and such an agency; or

(iv) The balloon-payment qualified mortgage is sold, assigned, or otherwise transferred pursuant to a merger of the creditor with another person or acquisition of the creditor by another person or of another person by the creditor.

Regulatory Commentary

The commentary has been omitted here.

Section 6: Prepayment Penalties
12 CFR § 1026.43(g)

Prepayment Penalties - 12 CFR § 1026.43(g)

Regulatory Discussion

In general, a consumer credit transaction that is secured by a dwelling *must not include* any *prepayment penalties* unless four conditions are satisfied.

1. The prepayment penalty is otherwise permitted by law;
2. The APR cannot increase after consummation;
3. The transaction meet the definition of a "qualified mortgage;" and
4. The transaction is not a "high-priced mortgage loan."

Regulatory Text

(g) **Prepayment penalties**

(1) **When permitted.** A covered transaction must not include a prepayment penalty unless:

(i) The prepayment penalty is otherwise permitted by law; and

(ii) The transaction:

(A) Has an annual percentage rate that cannot increase after consummation;

(B) Is a qualified mortgage under paragraph (e)(2), (e)(4), (e)(5), (e)(6), or (f) of this section; and

(C) Is not a higher-priced mortgage loan, as defined in §1026.35(a).

Regulatory Commentary

None.

Prepayment Penalty Limits - 12 CFR § 1026.43(g)(2)

Regulatory Discussion

If prepayment penalties are permitted, there are two limitations which must be applied; as detailed in (g)(2)(i) and (i)(A) and (B).

Regulatory Text

(2) **Limits on prepayment penalties.** A prepayment penalty:

(i) Must not apply after the three-year period following consummation; and

(ii) Must not exceed the following percentages of the amount of the outstanding loan balance prepaid:

(A) 2 percent, if incurred during the first two years following consummation; and

(B) 1 percent, if incurred during the third year following consummation.

Regulatory Commentary

43(g)(2) Limits on prepayment penalties.

*1. **Maximum period and amount.** Section 1026.43(g)(2) establishes the maximum period during which a prepayment penalty may be imposed and the maximum amount of the prepayment penalty. A covered transaction may include a prepayment penalty that may be imposed during a shorter period or in a lower amount than provided under §1026.43(g)(2). For example, a covered transaction may include a prepayment penalty that may be imposed for two years after consummation and that equals 1 percent of the amount prepaid in each of those two years.*

Alternative Offer Required - 12 CFR § 1026.43(g)(3)

Regulatory Discussion

If a creditor offers a consumer a credit transaction that is secured by a dwelling that contains a prepayment penalty, the creditor must also offer the consumer an alternative transaction without a prepayment penalty.

The alternative transaction, without a prepayment penalty, is subject to five conditions (as detailed in (g)(3)(i)(A) and (B), and (ii) through (v).

The commentary provides additional guidance on conditions (i), (iv) and (v).

Regulatory Text

(3) **Alternative offer required.** A creditor must not offer a consumer a covered transaction with a prepayment penalty unless the creditor also offers the consumer an alternative covered transaction without a prepayment penalty and the alternative covered transaction:

(i) Has an annual percentage rate that cannot increase after consummation and has the same type of interest rate as the covered transaction with a prepayment penalty; for purposes of this paragraph (g), the term "type of interest rate" refers to whether a transaction:

(A) Is a fixed-rate mortgage, as defined in §1026.18(s)(7)(iii); or

(B) Is a step-rate mortgage, as defined in §1026.18(s)(7)(ii);

(ii) Has the same loan term as the loan term for the covered transaction with a prepayment penalty;

(iii) Satisfies the periodic payment conditions under paragraph (e)(2)(i) of this section;

(iv) Satisfies the points and fees conditions under paragraph (e)(2)(iii) of this section, based on the information known to the creditor at the time the transaction is offered; and

(v) Is a transaction for which the creditor has a good faith belief that the consumer likely qualifies, based on the information known to the creditor at the time the creditor offers the covered transaction without a prepayment penalty.

Regulatory Commentary

The commentary has been omitted here. It is available, along with the complete manual section, on the web page for this school.

Offer Through a Mortgage Broker - 12 CFR § 1026.43(g)(4)

Regulatory Discussion

If a creditor offers a consumer a credit transaction that is secured by a dwelling, *through a mortgage broker*, that contains a prepayment penalty, the creditor must also:

- present the mortgage broker an alternative transaction without a prepayment penalty that satisfies the five conditions of paragraph (g)(3), above; and
- establish an agreement with the broker that the consumer will be presented an alternative transaction without a prepayment penalty offered by either:
  - the creditor; or
  - another creditor.

The commentary provides additional information.

Regulatory Text

(4) **Offer through a mortgage broker.** If the creditor offers a covered transaction with a prepayment penalty to the consumer through a mortgage broker, as defined in §1026.36(a)(2), the creditor must:

(i) Present the mortgage broker an alternative covered transaction without a prepayment penalty that satisfies the requirements of paragraph (g)(3) of this section; and

(ii) Establish by agreement that the mortgage broker must present the consumer an alternative covered transaction without a prepayment penalty that satisfies the requirements of paragraph (g)(3) of this section, offered by:

(A) The creditor; or

(B) Another creditor, if the transaction offered by the other creditor has a lower interest rate or a lower total dollar amount of discount points and origination points or fees.

Regulatory Commentary

The commentary has been omitted here.

Creditor that is a Loan Originator - 12 CFR § 1026.43(g)(5)

Regulatory Discussion

If a creditor is a "loan originator" and presents a consumer a credit transaction that is secured by a dwelling *offered by a person to which the creditor would assign the transaction after consummation, the creditor must*:

- present the consumer an alternative transaction without a prepayment penalty that satisfies the five conditions of paragraph (g)(3), above, offered by:
  - the assignee; or
  - another person.

The commentary provides additional information.

Regulatory Text

(5) **Creditor that is a loan originator.** If the creditor is a loan originator, as defined in §1026.36(a)(1), and the creditor presents the consumer a covered transaction offered by a person to which the creditor would assign the covered transaction after consummation, the creditor must present the consumer an alternative covered transaction without a prepayment penalty that satisfies the requirements of paragraph (g)(3) of this section, offered by:

(i) The assignee; or

(ii) Another person, if the transaction offered by the other person has a lower interest rate or a lower total dollar amount of origination discount points and points or fees.

Regulatory Commentary

43(g)(5) Creditor that is a loan originator.

*1. **Loan originator.** The definition of "loan originator" in §1026.36(a)(1) applies for purposes of §1026.43(g)(5). Thus, a loan originator includes any creditor that satisfies the definition of loan originator but makes use of "table-funding" by a third party. See comment 36(a)-1.i and ii.*

*2. **Lower interest rate.** Under §1026.43(g)(5), a creditor that is a loan originator must present an alternative covered transaction without a prepayment penalty that satisfies the requirements of §1026.43(g)(3) offered by either the assignee for the covered transaction or another person, if that other person offers a transaction with a lower interest rate or a lower total dollar amount of origination points or fees or discount points. See comment 36(e)(3)-3 for guidance in determining which step-rate mortgage has a lower interest rate.*

Applicability - 12 CFR § 1026.43(g)(6)

Regulatory Discussion

This Section only applies if a consumer a credit transaction that is secured by a dwelling:

- is consummated with a prepayment penalty; and is not violated if:
- a transaction without a prepayment penalty is consummated; or
- a transaction is not consummated.

Regulatory Text

(6) **Applicability.** This paragraph (g) applies only if a covered transaction is consummated with a prepayment penalty and is not violated if:

(i) A covered transaction is consummated without a prepayment penalty; or

(ii) The creditor and consumer do not consummate a covered transaction.

Regulatory Commentary

None.

Section 7: Evasion; Open-End Credit
12 CFR § 1026.43(h)

Evasion; Open End Credit - 12 CFR § 1026.43(h)

Regulatory Discussion

This section simply prohibits a creditor from structuring a loan as an open-end plan (HELOC) to evade the requirements of §1026.43.

Regulatory Text

(h) **Evasion; open-end credit**. In connection with credit secured by a consumer's dwelling that does not meet the definition of open-end credit in §1026.2(a)(20), a creditor shall not structure the loan as an open-end plan to evade the requirements of this section.

Regulatory Commentary

43(h) Evasion; open-end credit.

1. ***Subject to closed-end credit rules.*** *Where a creditor documents a loan as open-end credit but the features and terms, or other circumstances, demonstrate that the loan does not meet the definition of open-end credit in §1026.2(a)(20), the loan is subject to the rules for closed-end credit, including §1026.43.*

Section 8: Appendix Q to Part 1026:
Standards for Determining Monthly Debt and Income

. *Introduction*

This section is a direct quote from the regulation. If you are underwriting a standard qualified mortgage under Regulation Z, or if you are underwriting a loan for sale to Freddie Mac or Fannie Mae, these rules must be followed to the letter. Some banks, in the interest of simplicity, will choose to follow these rules regardless of loan type. Make sure that you understand your bank's rules regarding the use of these standards.

Regulatory Text

Section 1026.43(e)(2)(vi) provides that, to satisfy the requirements for a qualified mortgage under § 1026.43(e)(2), the ratio of the consumer's total monthly debt to total monthly income at the time of consummation cannot exceed 43 percent. Section 1026.43(e)(2)(vi)(A) requires the creditor to calculate the ratio of the consumer's total monthly debt to total monthly income using the following standards, with additional requirements for calculating debt and income appearing in § 1026.43(e)(2)(vi)(B).

I. Consumer Eligibility

A. Stability of Income.

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

2. Verifying Employment History.

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

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

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

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

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

3. Analyzing a Consumer's Employment Record.

a. When analyzing the probability of continued employment, creditors must examine:

i. The consumer's past employment record;

ii. The employer's confirmation of continued employment.

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

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

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

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

i. Traditional employment verifications; and/or

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

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

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

B. Salary, Wage and Other Forms of Income.

1. General Policy on Consumer Income Analysis.

a. The income of each consumer who will be obligated for the mortgage debt must be analyzed to determine whether his/her income level can be reasonably expected to continue through at least the first three years of the mortgage loan.

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

Notes:

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

a. Documented retirement benefits;

b. Social Security payments; or

c. Other payments expected to be received in retirement.

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

2. Overtime and Bonus Income.

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

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

3. Establishing an Overtime and Bonus Income Earning Trend.

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

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

4. Qualifying Part-Time Income.

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

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

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

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

5. Income from Seasonal Employment.

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

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

ii. Expects to be rehired the next season.

b. Seasonal employment includes:

i. Umpiring baseball games in the summer; or

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

6. Primary Employment Less Than 40 Hour Work Week.

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

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

7. Commission Income.

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

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

ii. The most recent pay stub.

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

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

ii. Soundly rationalize accepting the commission income.

Notes:

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

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

iii. A tax transcript obtained directly from the IRS may be used in lieu of signed tax returns, and the cost of the transcript may be charged to the consumer.

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

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

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

9. Employer Differential Payments. If the employer subsidizes a consumer's mortgage payment through direct payments, the amount of the payments:

a. Is considered gross income, and

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

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

11. Social Security Income. Social Security income must be verified by the Social Security Administration or on Federal tax returns. If any benefits expire within the first full three years of the loan, the income source may not be used in qualifying.

Notes:

i. The creditor must obtain a complete copy of the current awards letter.

ii. Not all Social Security income is for retirement-aged recipients; therefore, documented continuation is required.

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

12. Automobile Allowances and Expense Account Payments.

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

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

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

ii. Employer verification that the payments will continue.

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

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

i. The consumer's monthly car payment; and

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

C. Consumers Employed by a Family Owned Business.

1. Income Documentation Requirement.

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

a. Copies of signed personal tax returns, or

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

Note: A tax transcript obtained directly from the IRS may be used in lieu of signed tax returns, and the cost of the transcript may be charged to the consumer.

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

1. ***Definition: Self Employed Consumer.*** A consumer with a 25 percent or greater ownership interest in a business is considered self-employed.

2. ***Types of Business Structures.*** There are four basic types of business structures. They include:

   a. Sole proprietorships;

   b. Corporations;

   c. Limited liability or "S" corporations; and

   d.Partnerships.

3. ***Minimum Length of Self Employment.***

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

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

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

4. ***General Documentation Requirements for Self Employed Consumers.*** Self-employed consumers must provide the following documentation:

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

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

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

5. ***Establishing a Consumer's Earnings Trend.***

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

   b. If a consumer:

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

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

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

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

6. Analyzing the Business's Financial Strength:

a. To determine if the business is expected to generate sufficient income for the consumer's needs, the creditor must carefully analyze the business's financial strength, including the:

i. Source of the business's income;

ii. General economic outlook for similar businesses in the area.

b. Annual earnings that are stable or increasing are acceptable, while businesses that show a significant decline in income over the analysis period are not acceptable.

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

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

2. Guidelines for Analyzing IRS Form 1040. The table on the next page contains guidelines for analyzing IRS Form 1040:

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

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

1. ***Description:*** Corporation. A corporation is a State-chartered business owned by its stockholders.

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

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

      i. Corporate tax return IRS Form 1120; and

      ii. Individual tax returns.

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

3. ***Analyzing Corporate Tax Returns.***

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

      i. Be determined; and

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

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

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

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

1. ***Description: "S" Corporation.***

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

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

2. Analyzing "S" Corporation Tax Returns.

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

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

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

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

1. Description: Partnership.

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

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

2. Analyzing Partnership Tax Returns.

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

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

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

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

II. Non-Employment Related Consumer Income

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

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

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

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

   i. Final divorce decree;

   ii. Legal separation agreement;

   iii. Court order; or

iv. Voluntary payment agreement; and

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

i. Cancelled checks;

ii. Deposit slips;

iii. Tax returns; or

iv. Court records.

Notes:

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

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

B. Investment and Trust Income.

1. Analyzing Interest and Dividends.

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

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

2. Trust Income.

a. Income from trusts may be used if guaranteed, constant payments will continue for at least the first three years of the mortgage term.

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

i. Amount of the trust;

ii. Frequency of distribution; and

iii. Duration of payments.

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

3. Notes Receivable Income.

a. In order to include notes receivable income to qualify a consumer, he/she must provide:

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

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

b. If the consumer is not the original payee on the note, the creditor must establish that the consumer is now a holder in due course, and able to enforce the note.

4. Eligible Investment Properties.

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

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

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

1. Military Income.

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

i. Income from variable housing allowances;

ii. Clothing allowances;

iii. Flight or hazard pay;

iv. Rations; and

v. Proficiency pay.

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

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

2. VA Benefits.

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

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

3. Government Assistance Programs.

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

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

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

4. Mortgage Credit Certificates.

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

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

5. Homeownership Subsidies.

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

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

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

d. The assistance payment must be:

i. Paid directly to the servicing creditor; or

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

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

D. Rental Income.

1. Analyzing the Stability of Rental Income.

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

i. A current lease;

ii. An agreement to lease, or

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

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

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

2. Rental Income from Consumer Occupied Property.

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

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

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

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

3. Income from Roommates in a Single Family Property.

a. Income from roommates in a single-family property occupied as the consumer's primary residence is not acceptable. Rental income from boarders however, is acceptable, if the boarders are related by blood, marriage, or law.

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

4. Documentation Required To Verify Rental Income. Analysis of the following required documentation is necessary to verify all consumer rental income:

a. IRS Form 1040 Schedule E; and

b. Current leases/rental agreements.

5. Analyzing IRS Form 1040 Schedule E.

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

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

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

6. Using Current Leases To Analyze Rental Income.

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

b. In order to calculate the rental income:

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

ii. Subtract PITI and any homeowners association dues; and

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

7. Exclusion of Rental Income From Property Being Vacated by the Consumer.

Underwriters may not consider any rental income from a consumer's principal residence that is being vacated in favor of another principal residence, except under the conditions described below:

Notes:

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

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

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

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

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

E. Non Taxable and Projected Income.

1. Types of Non Taxable Income.

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

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

b. Certain types of disability and public assistance payments;

c. Child support;

d. Military allowances; and

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

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

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

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

c. The creditor:

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

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

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

3. Analyzing Projected Income.

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

i. Cost-of-living adjustments;

ii. Performance raises; and

iii. Bonuses.

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

i. Verified in writing by the employer; and

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

4. Project Income for New Job.

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

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

c. The loan is not eligible for endorsement if the loan closes more than 60 days before the consumer starts the new job. To be eligible for endorsement, the creditor must obtain from the consumer a pay stub or other acceptable evidence indicating that he/she has started the new job.

III. Consumer Liabilities: Recurring Obligations

1. Types of Recurring Obligation. Recurring obligations include:

a. All installment loans;

b. Revolving charge accounts;

c. Real estate loans;

d. Alimony;

e. Child support; and

f. Other continuing obligations.

2. Debt to Income Ratio Computation for Recurring Obligations.

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

i. Monthly housing expense; and

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

a. Payments on installment accounts;

b. Child support or separate maintenance payments;

c. Revolving accounts; and

d. Alimony.

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

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

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

a. 5 percent of the balance; or

b. $10.

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

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

IV. Consumer Liabilities: Contingent Liability

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

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

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

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

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

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

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

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

5. Contingent Liability on Cosigned Obligations.

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

i. A car loan;

ii. A student loan;

iii. A mortgage; or

iv. Any other obligation.

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

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

1. Projected Obligations.

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

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

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

2. Obligations Not Considered Debt. Obligations not considered debt, and therefore not subtracted from gross income, include:

a. Federal, State, and local taxes;

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

c. Commuting costs;

d. Union dues;

e. Open accounts with zero balances;

f. Automatic deductions to savings accounts;

g. Child care; and

h. Voluntary deductions.

Section 9: Ability to Repay Audit

Does the loan file contain documentation of ATR? _______________

Did the bank make 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? _______________

In making the ATR decision, did the bank consider the following? _______________

- Income or assets
- Employment status
- Monthly payment on the proposed loan
- Monthly payment on any simultaneous loan
- Monthly payment for mortgage-related obligations
- Other debts and obligations (i.e., alimony and child support)
- monthly debt-to-income ratio or residual income
- Consumer's credit history

Did the bank verify all ATR data using reasonably reliable third-party records? _______________

Did the bank obtain a safe harbor for loans that are not higher-priced covered transactions? _______________

Did the bank obtain a presumption of compliance (for higher-priced covered transactions)? _______________

Did the loan meet the general qualified mortgage standards? _____________

Did the loan meet the points and fees test? _____________

Is the loan being reviewed a qualified mortgage under the special rule provision (generally saleable to the secondary market)? _______________

Is the loan under review a small creditor portfolio loan? ________________

Is this loan a qualified mortgage under the balloon payment qualified mortgage portion standard? _______________

If it is a balloon-payment "qualified mortgage," did it meet the post-consummation transfer of balloon-payment qualified mortgage rule? _______________

Does the loan include a prepayment penalty? _______________

If it does, are the general prepayment penalty rules met? ______________

Were all prepayment penalty limits followed? _______________

If there is a prepayment penalty, did the bank offer the consumer an alternative transaction without a prepayment penalty? _____________

Did the loan avoid the issue of evasion and using open end credit? _______________

Was Appendix Q properly applied? ________________

Reviewing Loan Documents within Your Bank

Section 1: General Discussion

Discussion Questions

1. How much access do you have to legal advice?
2. Do you rely on your software company exclusively?
3. What issues are you encountering within you bank?
4. How do you handle issues that arise?

Reviewing the Right of Rescission

Section 1: Introduction (Commentary)

Regulatory Discussion

This introductory commentary qualifies transactions that are not subject to right-of-rescission.

Regulatory Text

None

Regulatory Commentary

1. ***Transactions not covered.*** *Credit extensions that are not subject to the regulation are not covered by §1026.23 even if a customer's principal dwelling is the collateral securing the credit. For example, the right of rescission does not apply to a business purpose loan, even though the loan is secured by the customer's principal dwelling.*

Section 2: Consumer's Right to Rescind
12 C.F.R. §1026.23(a)

Consumer's Right to Rescind - 12 CFR § 1026.23(a)

Regulatory Discussion

This section answers the questions:

1. **What transactions are subject to rescission?**
   - a credit transaction in which a security interest is or will be retained or acquired in a consumer's *principal dwelling* (see commentary for additional details).
   - Note: there are exemptions that will be discussed in section 7.
2. **Who has the right to rescind?**
   - Each consumer whose ownership interest is or will be subject to the security interest shall have the right to rescind the transaction, except for transactions described in paragraph (f) of this section.
   - When more than one consumer in a transaction has the right to rescind, the exercise of the right by one consumer shall be effective as to all consumers.
3. **How to rescind?**
   - The consumer shall notify the creditor of the rescission by mail, telegram or other means of written communication (see commentary for additional details).
4. **When to rescind?**
   - The consumer may exercise the right to rescind until midnight of the third <u>business day</u> following consummation, delivery of the notice required by paragraph (b) of this section, or delivery of all material disclosures, whichever occurs last.
   - *Business day*, for purposes of rescission, *means all calendar days except Sundays and the legal public holidays* (New Year's Day, the Birthday of Martin Luther King, Jr., Washington's Birthday, Memorial Day, Independence Day, Labor Day, Columbus Day, Veterans Day, Thanksgiving Day, and Christmas Day). See commentary for examples of counting business days.
   - **Exception**: see commentary on *unexpired right of rescission*.

Regulatory Text

(a) **Consumer's right to rescind.**

(1) In a credit transaction in which a security interest is or will be retained or acquired in a consumer's principal dwelling, each consumer whose ownership interest is or will be subject to the security interest shall have the right to rescind the transaction, except for transactions described in paragraph (f) of this section. For purposes of this section, the addition to an existing obligation of a security interest in a consumer's principal dwelling is a transaction. The right of rescission applies only to the addition of the security interest and not the existing obligation. The creditor shall deliver the notice required by paragraph (b) of this section but need not deliver new material disclosures. Delivery of the required notice shall begin the rescission period.

(2) To exercise the right to rescind, the consumer shall notify the creditor of the rescission by mail, telegram or other means of written communication. Notice is considered given when mailed, when filed for telegraphic transmission or, if sent by other means, when delivered to the creditor's designated place of business.

(3)

(i) The consumer may exercise the right to rescind until midnight of the third business day following consummation, delivery of the notice required by paragraph (b) of this section, or delivery of all material disclosures, whichever occurs last. If the required notice or material disclosures are not delivered, the right to rescind shall expire 3 years after consummation, upon transfer of all of the consumer's interest in the property, or upon sale of the property, whichever occurs first. In the case of certain administrative proceedings, the rescission period shall be extended in accordance with section 125(f) of the Act.

(ii) For purposes of this paragraph (a)(3), the term “material disclosures” means the required disclosures of the annual percentage rate, the finance charge, the amount financed, the total of payments, the payment schedule, and the disclosures and limitations referred to in §§1026.32(c) and (d) and 1026.43(g).

(4) When more than one consumer in a transaction has the right to rescind, the exercise of the right by one consumer shall be effective as to all consumers.

Regulatory Commentary

23(a) Consumer's Right to Rescind

Paragraph 23(a)(1)

1. ***Security interest arising from transaction.***

i. In order for the right of rescission to apply, the security interest must be retained as part of the credit transaction. For example:

A. A security interest that is acquired by a contractor who is also extending the credit in the transaction.

B. A mechanic's or materialman's lien that is retained by a subcontractor or supplier of the contractor-creditor, even when the latter has waived its own security interest in the consumer's home.

ii. The security interest is not part of the credit transaction and therefore the transaction is not subject to the right of rescission when, for example:

A. A mechanic's or materialman's lien is obtained by a contractor who is not a party to the credit transaction but is merely paid with the proceeds of the consumer's unsecured bank loan.

B. All security interests that may arise in connection with the credit transaction are validly waived.

C. The creditor obtains a lien and completion bond that in effect satisfies all liens against the consumer's principal dwelling as a result of the credit transaction.

iii. Although liens arising by operation of law are not considered security interests for purposes of disclosure under §1026.2, that section specifically includes them in the definition for purposes of the right of rescission. Thus, even though an interest in the consumer's principal dwelling is not a required disclosure under §1026.18(m), it may still give rise to the right of rescission.

2. ***Consumer.*** *To be a consumer within the meaning of §1026.2, that person must at least have an ownership interest in the dwelling that is encumbered by the creditor's security interest, although that person need not be a signatory to the credit agreement. For example, if only one spouse signs a credit contract, the other spouse is a consumer if the ownership interest of that spouse is subject to the security interest.*

3. ***Principal dwelling.*** *A consumer can only have one principal dwelling at a time. (But see comment 23(a)(1)-4.) A vacation or other second home would not be a principal dwelling. A transaction secured by a second home (such as a vacation home) that is not currently being used as the consumer's principal dwelling is not rescindable, even if the consumer intends to reside there in the future. When a consumer buys or builds a new dwelling that will become the consumer's principal dwelling within one year or upon completion of construction, the new dwelling is considered the principal dwelling if it secures the acquisition or construction loan. In that case, the transaction secured by the new dwelling is a residential mortgage transaction and is not rescindable. For example, if a consumer whose principal dwelling is currently A builds B, to be occupied by the consumer upon completion of construction, a construction loan to finance B and secured by B is a residential mortgage transaction. Dwelling, as defined in §1026.2, includes structures that are classified as personalty under state law. For example, a transaction secured by a mobile home, trailer, or houseboat used as the consumer's principal dwelling may be rescindable.*

4. ***Special rule for principal dwelling.*** *Notwithstanding the general rule that consumers may have only one principal dwelling, when the consumer is acquiring or constructing a new principal dwelling, any loan subject to Regulation Z and secured by the equity in the consumer's current principal dwelling (for example, a bridge loan) is subject to the right of rescission regardless of the purpose of that loan. For example, if a consumer whose principal dwelling is currently A builds B, to be occupied by the consumer upon completion of construction, a construction loan to finance B and secured by A is subject to the right of rescission. A loan secured by both A and B is, likewise, rescindable.*

5. ***Addition of a security interest.*** *Under §1026.23(a), the addition of a security interest in a consumer's principal dwelling to an existing obligation is rescindable even if the existing obligation is not satisfied and replaced by a new obligation, and even if the existing obligation was previously exempt under §1026.3(b). The right of rescission applies only to the added security interest, however, and not to the original obligation. In those situations, only the §1026.23(b) notice need be delivered, not new material disclosures; the rescission period will begin to run from the delivery of the notice.*

Paragraph 23(a)(2)

1. ***Consumer's exercise of right.*** *The consumer must exercise the right of rescission in writing but not necessarily on the notice supplied under §1026.23(b). Whatever the means of sending the notification of rescission—mail, telegram or other written means—the time period for the creditor's performance under §1026.23(d)(2) does not begin to run until the notification has*

been received. The creditor may designate an agent to receive the notification so long as the agent's name and address appear on the notice provided to the consumer under §1026.23(b). Where the creditor fails to provide the consumer with a designated address for sending the notification of rescission, delivering notification to the person or address to which the consumer has been directed to send, payments constitutes delivery to the creditor or assignee. State law determines whether delivery of the notification to a third party other than the person to whom payments are made is delivery to the creditor or assignee, in the case where the creditor fails to designate an address for sending the notification of rescission.

Paragraph 23(a)(3)

1. ***Rescission period.***

- *i. The period within which the consumer may exercise the right to rescind runs for 3 business days from the last of 3 events:*
  - *A. Consummation of the transaction.*
  - *B. Delivery of all material disclosures.*
  - *C. Delivery to the consumer of the required rescission notice.*
- *ii. For example:*
  - *A. If a transaction is consummated on Friday, June 1, and the disclosures and notice of the right to rescind were given on Thursday, May 31, the rescission period will expire at midnight of the third business day after June 1—that is, Tuesday, June 5.*
  - *B. If the disclosures are given and the transaction consummated on Friday, June 1, and the rescission notice is given on Monday, June 4, the rescission period expires at midnight of the third business day after June 4—that is, Thursday, June 7. The consumer must place the rescission notice in the mail, file it for telegraphic transmission, or deliver it to the creditor's place of business within that period in order to exercise the right.*

2. ***Material disclosures.*** *Section 1026.23(a)(3)(ii) sets forth the material disclosures that must be provided before the rescission period can begin to run. Failure to provide information regarding the annual percentage rate also includes failure to inform the consumer of the existence of a variable rate feature. Failure to give the other required disclosures does not prevent the running of the rescission period, although that failure may result in civil liability or administrative sanctions.*

3. ***Unexpired right of rescission.***

- *i. When the creditor has failed to take the action necessary to start the three-business day rescission period running, the right to rescind automatically lapses on the occurrence of the earliest of the following three events:*
  - *A. The expiration of three years after consummation of the transaction.*
  - *B. Transfer of all the consumer's interest in the property.*
  - *C. Sale of the consumer's interest in the property, including a transaction in which the consumer sells the dwelling and takes back a purchase money note and mortgage or retains legal title through a device such as an installment sale contract.*

ii. Transfer of all the consumers' interest includes such transfers as bequests and gifts. A sale or transfer of the property need not be voluntary to terminate the right to rescind. For example, a foreclosure sale would terminate an unexpired right to rescind. As provided in Section 125 of the Act, the three-year limit may be extended by an administrative proceeding to enforce the provisions of this section. A partial transfer of the consumer's interest, such as a transfer bestowing co-ownership on a spouse, does not terminate the right of rescission.

Paragraph 23(a)(4)

1. ***Joint owners.*** *When more than one consumer has the right to rescind a transaction, any of them may exercise that right and cancel the transaction on behalf of all. For example, if both husband and wife have the right to rescind a transaction, either spouse acting alone may exercise the right and both are bound by the rescission.*

Section 3: Notice of Right to Rescind
12 C.F.R. § 1026.23(b)

Notice of Right to Rescind - 12 CFR § 1026.23(b)

Regulatory Discussion

This section answers the questions:

1. **To whom does the creditor provide the notice?**
   - Each consumer entitled to rescind must be given two copies of the rescission notice and the material disclosures.
   - In a transaction involving joint owners, both of whom are entitled to rescind, both must receive the notice of the right to rescind and disclosures. See the commentary for exaples.
2. **What are the format and content requirements of the notice?**
   - The notice must be on a separate piece of paper, but may appear with other information such as the itemization of the amount financed. The material must be clear and conspicuous, but no minimum type size or other technical requirements are imposed.
   - The notice *must include* five pieces of information (see (b)(1)(i) through (v)).
   - The notice *may include additional information* (see commentary).
3. **When must the creditor give the notice?**
   - The notice need not be given before consummation of the transaction.
   - The creditor may deliver the notice after the transaction is consummated, but the rescission period will not begin to run until the notice is given. See commentary for example.

Regulatory Text

(b)

(1) ***Notice of right to rescind.*** In a transaction subject to rescission, a creditor shall deliver two copies of the notice of the right to rescind to each consumer entitled to rescind (one copy to each if the notice is delivered in electronic form in accordance with the consumer consent and other applicable provisions of the E-Sign Act). The notice shall be on a separate document that identifies the transaction and shall clearly and conspicuously disclose the following:

(i) The retention or acquisition of a security interest in the consumer's principal dwelling.

(ii) The consumer's right to rescind the transaction.

(iii) How to exercise the right to rescind, with a form for that purpose, designating the address of the creditor's place of business.

(iv) The effects of rescission, as described in paragraph (d) of this section.

(v) The date the rescission period expires.

(2) ***Proper form of notice.*** To satisfy the disclosure requirements of paragraph (b)(1) of this section, the creditor shall provide the appropriate model form in appendix H of this part or a substantially similar notice.

Regulatory Commentary

23(b)(1) Notice of Right To Rescind

1. ***Who receives notice.*** *Each consumer entitled to rescind must be given two copies of the rescission notice and the material disclosures. In a transaction involving joint owners, both of whom are entitled to rescind, both must receive the notice of the right to rescind and disclosures. For example, if both spouses are entitled to rescind a transaction, each must receive two copies of the rescission notice (one copy to each if the notice is provided in electronic form in accordance with the consumer consent and other applicable provisions of the E-Sign Act) and one copy of the disclosures.*

2. ***Format.*** *The notice must be on a separate piece of paper, but may appear with other information such as the itemization of the amount financed. The material must be clear and conspicuous, but no minimum type size or other technical requirements are imposed. The notices in appendix H provide models that creditors may use in giving the notice.*

3. ***Content.*** *The notice must include all of the information outlined in Section 1026.23(b)(1)(i) through (v). The requirement in §1026.23(b) that the transaction be identified may be met by providing the date of the transaction. The creditor may provide a separate form that the consumer may use to exercise the right of rescission, or that form may be combined with the other rescission disclosures, as illustrated in appendix H. The notice may include additional information related to the required information, such as:*

i. A description of the property subject to the security interest.

ii. A statement that joint owners may have the right to rescind and that a rescission by one is effective for all.

iii. The name and address of an agent of the creditor to receive notice of rescission.

4. ***Time of providing notice.*** *The notice required by §1026.23(b) need not be given before consummation of the transaction. The creditor may deliver the notice after the transaction is consummated, but the rescission period will not begin to run until the notice is given. For example, if the creditor provides the notice on May 15, but disclosures were given and the transaction was consummated on May 10, the 3-business day rescission period will run from May 15.*

Section 4: Delay of Creditor's Performance
12 C.F.R. § 1026.23(c)

Delay of Creditor's Performance - 12 CFR § 1026.23(c)

Regulatory Discussion

The section describes actions the creditor can and cannot take during the rescission period – unless the consumer has waived their right of rescission. The commentary further describes how a creditor can be "reasonably satisfied" the consumer has not rescinded; as well as reminding the creditor to make certain all consumers eligible to rescind have not exercised the right.

Regulatory Text

(c) **Delay of creditor's performance.** Unless a consumer waives the right of rescission under paragraph (e) of this section, no money shall be disbursed other than in escrow, no services shall be performed and no materials delivered until the rescission period has expired and the creditor is reasonably satisfied that the consumer has not rescinded.

Regulatory Commentary

23(c) Delay of Creditor's Performance

1. ***General rule.*** *Until the rescission period has expired and the creditor is reasonably satisfied that the consumer has not rescinded, the creditor must not, either directly or through a third party:*

   i. Disburse loan proceeds to the consumer.

   ii. Begin performing services for the consumer.

   iii. Deliver materials to the consumer.

2. ***Escrow.*** *The creditor may disburse loan proceeds during the rescission period in a valid escrow arrangement. The creditor may not, however, appoint the consumer as "trustee" or "escrow agent" and distribute funds to the consumer in that capacity during the delay period.*

3. ***Actions during the delay period.*** *Section 1026.23(c) does not prevent the creditor from taking other steps during the delay, short of beginning actual performance. Unless otherwise prohibited, such as by state law, the creditor may, for example:*

   i. Prepare the loan check.

   ii. Perfect the security interest.

   iii. Prepare to discount or assign the contract to a third party.

   iv. Accrue finance charges during the delay period.

4. ***Delay beyond rescission period.***

i. The creditor must wait until it is reasonably satisfied that the consumer has not rescinded. For example, the creditor may satisfy itself by doing one of the following:

A. Waiting a reasonable time after expiration of the rescission period to allow for delivery of a mailed notice.

B. Obtaining a written statement from the consumer that the right has not been exercised.

ii. When more than one consumer has the right to rescind, the creditor cannot reasonably rely on the assurance of only one consumer, because other consumers may exercise the right.

Section 5: Effects of Rescission
12 C.F.R. § 1026.23(d)

Effects of Rescission - 12 CFR § 1026.23(d)

Regulatory Discussion

This section describes the actions that must be followed in the effect a transaction is rescinded, and include:

1. Termination of security interest
2. Refunds to consumer; Amounts not refundable to consumer; Reflection of security interest termination
3. Property exchange; Reasonable value
4. Modifications

Regulatory Text

(d) **Effects of rescission.**

(1) When a consumer rescinds a transaction, the security interest giving rise to the right of rescission becomes void and the consumer shall not be liable for any amount, including any finance charge.

(2) Within 20 calendar days after receipt of a notice of rescission, the creditor shall return any money or property that has been given to anyone in connection with the transaction and shall take any action necessary to reflect the termination of the security interest.

(3) If the creditor has delivered any money or property, the consumer may retain possession until the creditor has met its obligation under paragraph (d)(2) of this section. When the creditor has complied with that paragraph, the consumer shall tender the money or property to the creditor or, where the latter would be impracticable or inequitable, tender its reasonable value. At the consumer's option, tender of property may be made at the location of the property or at the consumer's residence. Tender of money must be made at the creditor's designated place of business. If the creditor does not take possession of the money or property within 20 calendar days after the consumer's tender, the consumer may keep it without further obligation.

(4) The procedures outlined in paragraphs (d)(2) and (3) of this section may be modified by court order.

Regulatory Commentary

23(d) Effects of Rescission

Paragraph 23(d)(1)

1. ***Termination of security interest.*** *Any security interest giving rise to the right of rescission becomes void when the consumer exercises the right of rescission. The security interest is* *automatically negated regardless of its status and whether or not it was recorded or perfected. Under §1026.23(d)(2), however, the creditor must take any action necessary to reflect the fact that the security interest no longer exists.*

Paragraph 23(d)(2)

1. ***Refunds to consumer.*** *The consumer cannot be required to pay any amount in the form of money or property either to the creditor or to a third party as part of the credit transaction. Any amounts of this nature already paid by the consumer must be refunded. "Any amount" includes finance charges already accrued, as well as other charges, such as broker fees, application and commitment fees, or fees for a title search or appraisal, whether paid to the creditor, paid directly to a third party, or passed on from the creditor to the third party. It is irrelevant that these amounts may not represent profit to the creditor.*

2. ***Amounts not refundable to consumer.*** *Creditors need not return any money given by the consumer to a third party outside of the credit transaction, such as costs incurred for a building permit or for a zoning variance. Similarly, the term any amount does not apply to any money or property given by the creditor to the consumer; those amounts must be tendered by the consumer to the creditor under §1026.23(d)(3).*

3. ***Reflection of security interest termination.*** *The creditor must take whatever steps are necessary to indicate that the security interest is terminated. Those steps include the cancellation of documents creating the security interest, and the filing of release or termination statements in the public record. In a transaction involving subcontractors or suppliers that also hold security interests related to the credit transaction, the creditor must insure that the termination of their security interests is also reflected. The 20-day period for the creditor's action refers to the time within which the creditor must begin the process. It does not require all necessary steps to have been completed within that time, but the creditor is responsible for seeing the process through to completion.*

Paragraph 23(d)(3)

1. ***Property exchange.*** *Once the creditor has fulfilled its obligations under §1026.23(d)(2), the consumer must tender to the creditor any property or money the creditor has already delivered to the consumer. At the consumer's option, property may be tendered at the location of the property. For example, if lumber or fixtures have been delivered to the consumer's home, the consumer may tender them to the creditor by making them available for pick-up at the home, rather than physically returning them to the creditor's premises. Money already given to the consumer must be tendered at the creditor's place of business.*

2. ***Reasonable value.*** *If returning the property would be extremely burdensome to the consumer, the consumer may offer the creditor its reasonable value rather than returning the property itself. For example, if building materials have already been incorporated into the consumer's dwelling, the consumer may pay their reasonable value.*

Paragraph 23(d)(4)

1. ***Modifications.*** *The procedures outlined in §1026.23(d)(2) and (3) may be modified by a court. For example, when a consumer is in bankruptcy proceedings and prohibited from returning anything to the creditor, or when the equities dictate, a modification might be made. The sequence of procedures under §1026.23(d)(2) and (3), or a court's modification of those procedures under §1026.23(d)(4), does not affect a consumer's substantive right to rescind and to have the loan amount adjusted accordingly. Where the consumer's right to rescind is contested by the creditor, a court would normally determine whether the consumer has a right to rescind and determine the amounts owed before establishing the procedures for the parties to tender any money or property.*

Section 6: Consumer's Waiver of Right to Rescind
12 C.F.R. § 1026.23(e)

Consumer's Waiver of Right to Rescind - 12 CFR § 1026.23(e)

Regulatory Discussion

Caution: waivers of the right to rescind should not be a frequent occurrence.

In the event of a bona fide personal financial emergency, specific procedures must be followed.

Regulatory Text

(e) **Consumer's waiver of right to rescind.** The consumer may modify or waive the right to rescind if the consumer determines that the extension of credit is needed to meet a bona fide personal financial emergency. To modify or waive the right, the consumer shall give the creditor a dated written statement that describes the emergency, specifically modifies or waives the right to rescind, and bears the signature of all the consumers entitled to rescind. Printed forms for this purpose are prohibited.

Regulatory Commentary

23(e) Consumer's Waiver of Right to Rescind

1. ***Need for waiver.*** *To waive the right to rescind, the consumer must have a bona fide personal financial emergency that must be met before the end of the rescission period. The existence of the consumer's waiver will not, of itself, automatically insulate the creditor from liability for failing to provide the right of rescission.*

2. ***Procedure.*** *To waive or modify the right to rescind, the consumer must give a written statement that specifically waives or modifies the right, and also includes a brief description of the emergency. Each consumer entitled to rescind must sign the waiver statement. In a transaction involving multiple consumers, such as a husband and wife using their home as collateral, the waiver must bear the signatures of both spouses.*

Section 7: Exempt Transactions
12 C.F.R. § 1026.23(f)

Exempt Transactions - 12 CFR § 1026.23(f)

Regulatory Discussion

There are five types of transactions that are exempt from the rescission requirements; the most common are *residential mortgage transactions* and *refinancings*. Both of these transactions have specific meanings that must be applied (see the commentary for further detail).

Regulatory Text

(f) **Exempt transactions.** The right to rescind does not apply to the following:

(1) A residential mortgage transaction.

(2) A refinancing or consolidation by the same creditor of an extension of credit already secured by the consumer's principal dwelling. The right of rescission shall apply, however, to the extent the new amount financed exceeds the unpaid principal balance, any earned unpaid finance charge on the existing debt, and amounts attributed solely to the costs of the refinancing or consolidation.

(3) A transaction in which a state agency is a creditor.

(4) An advance, other than an initial advance, in a series of advances or in a series of single-payment obligations that is treated as a single transaction under §1026.17(c)(6), if the notice required by paragraph (b) of this section and all material disclosures have been given to the consumer.

(5) A renewal of optional insurance premiums that is not considered a refinancing under §1026.20(a)(5).

Regulatory Commentary

23(f) Exempt Transactions

1. ***Residential mortgage transaction.*** *Any transaction to construct or acquire a principal dwelling, whether considered real or personal property, is exempt. (See the commentary to §1026.23(a).) For example, a credit transaction to acquire a mobile home or houseboat to be used as the consumer's principal dwelling would not be rescindable.*

2. ***Lien status.*** *The lien status of the mortgage is irrelevant for purposes of the exemption in §1026.23(f)(1); the fact that a loan has junior lien status does not by itself preclude application of this exemption. For example, a home buyer may assume the existing first mortgage and create a second mortgage to finance the balance of the purchase price. Such a transaction would not be rescindable.*

3. ***Combined-purpose transaction.*** *A loan to acquire a principal dwelling and make improvements to that dwelling is exempt if treated as one transaction. If, on the other hand, the loan for the acquisition of the principal dwelling and the subsequent advances for improvements are treated as more than one transaction, then only the transaction that finances the acquisition of that dwelling is exempt.*

4. ***New advances.*** *The exemption in §1026.23(f)(2) applies only to refinancings (including consolidations) by the original creditor. The original creditor is the creditor to whom the written agreement was initially made payable. In a merger, consolidation or acquisition, the successor institution is considered the original creditor for purposes of the exemption in §1026.23(f)(2). If the refinancing involves a new advance of money, the amount of the new advance is rescindable. In determining whether there is a new advance, a creditor may rely on the amount financed, refinancing costs, and other figures stated in the latest Truth in Lending disclosures provided to the consumer and is not required to use, for example, more precise information that may only become available when the loan is closed. For purposes of the right of rescission, a new advance does not include amounts attributed solely to the costs of the refinancing. These amounts would include §1026.4(c)(7) charges (such as attorney's fees and title examination and insurance fees, if bona fide and reasonable in amount), as well as insurance premiums and other charges that are not finance charges. (Finance charges on the new transaction—points, for example—would not be considered in determining whether there is a new advance of money in a refinancing since finance charges are not part of the amount financed.) To illustrate, if the sum of the outstanding principal balance plus the earned unpaid finance charge is $50,000 and the new amount financed is $51,000, then the refinancing would be exempt if the extra $1,000 is attributed solely to costs financed in connection with the refinancing that are not finance charges. Of course, if new advances of money are made (for example, to pay for home improvements) and the consumer exercises the right of rescission, the consumer must be placed in the same position as he or she was in prior to entering into the new credit transaction. Thus, all amounts of money (which would include all the costs of the refinancing) already paid by the consumer to the creditor or to a third party as part of the refinancing would have to be refunded to the consumer. (See the commentary to §1026.23(d)(2) for a discussion of refunds to consumers.) A model rescission notice applicable to transactions involving new advances appears in appendix H. The general rescission notice (model form H-8) is the appropriate form for use by creditors not considered original creditors in refinancing transactions.*

5. ***State creditors.*** *Cities and other political subdivisions of states acting as creditors are not exempted from this section.*

6. ***Multiple advances.*** *Just as new disclosures need not be made for subsequent advances when treated as one transaction, no new rescission rights arise so long as the appropriate notice and disclosures are given at the outset of the transaction. For example, the creditor extends credit for home improvements secured by the consumer's principal dwelling, with advances made as repairs progress. As permitted by §1026.17(c)(6), the creditor makes a single set of disclosures at the beginning of the construction period, rather than separate disclosures for each advance. The right of rescission does not arise with each advance. However, if the advances are treated as separate transactions, the right of rescission applies to each advance.*

7. ***Spreader clauses.*** *When the creditor holds a mortgage or deed of trust on the consumer's principal dwelling and that mortgage or deed of trust contains a "spreader clause," subsequent loans made are separate transactions and are subject to the right of rescission. Those loans are rescindable unless the creditor effectively waives its security interest under the spreader clause with respect to the subsequent transactions.*

8. ***Converting open-end to closed-end credit.*** *Under certain state laws, consummation of a closed-end credit transaction may occur at the time a consumer enters into the initial open-end credit agreement. As provided in the commentary to §1026.17(b), closed-end credit disclosures may be delayed under these circumstances until the conversion of the open-end account to a closed-end transaction. In accounts secured by the consumer's principal dwelling, no new right of rescission arises at the time of conversion. Rescission rights under §1026.15 are unaffected.*

Section 8: Tolerances for Accuracy
12 C.F.R. § 1026.23(g)

Tolerances for Accuracy - 12 CFR § 1026.23(g)

Regulatory Discussion

This section describes the tolerances for accuracy of the finance charge (and other disclosures affected by the finance charge); either one-half of 1 percent, or one percent.

Regulatory Text

(g) **Tolerances for accuracy**

(1) **One-half of 1 percent tolerance.** Except as provided in paragraphs (g)(2) and (h)(2) of this section:

(i) The finance charge and other disclosures affected by the finance charge (such as the amount financed and the annual percentage rate) shall be considered accurate for purposes of this section if the disclosed finance charge:

(A) Is understated by no more than 1⁄2 of 1 percent of the face amount of the note or $100, whichever is greater; or

(B) Is greater than the amount required to be disclosed.

(ii) The total of payments for each transaction subject to § 1026.19(e) and (f) shall be considered accurate for purposes of this section if the disclosed total of payments:

(A) Is understated by no more than 1⁄2 of 1 percent of the face amount of the note or $100, whichever is greater; or

(B) Is greater than the amount required to be disclosed.

(2) **One percent tolerance.** In a refinancing of a residential mortgage transaction with a new creditor (other than a transaction covered by § 1026.32), if there is no new advance and no consolidation of existing loans:

(i) The finance charge and other disclosures affected by the finance charge (such as the amount financed and the annual percentage rate) shall be considered accurate for purposes of this section if the disclosed finance charge:

(A) Is understated by no more than 1 percent of the face amount of the note or $100, whichever is greater; or

(B) Is greater than the amount required to be disclosed.

(ii) The total of payments for each transaction subject to § 1026.19(e) and (f) shall be considered accurate for purposes of this section if the disclosed total of payments:

(A) Is understated by no more than 1 percent of the face amount of the note or $100, whichever is greater; or

(B) Is greater than the amount required to be disclosed.

Regulatory Commentary

23(g) Tolerances for Accuracy

1. ***Example.*** *See comment 38(o)-1 for examples illustrating the interaction of the finance charge and total of payments accuracy requirements for each transaction subject to § 1026.19(e) and (f).*

23(g)(2) One Percent Tolerance

1. ***New advance.*** *The phrase "new advance" has the same meaning as in comment 23(f)-4.*

Section 9: Special Rules for Foreclosure
12 C.F.R. § 1026.23(h)

Special Rules for Foreclosure - 12 CFR § 1026.23(h)

Omitted, as this section covers post origination events.

Section 10: Reviewing Right of Rescission

Is the loan being reviewed subject to the right of rescission? _______________

Was the correct rescission forms used? _______________

Was the rescission form completed correctly? _______________

Did the bank avoid disbursing funds prior to the end of the rescission period? ______________

Did the customer properly waive their right to rescind? _____________

Were all disclosures within the tolerances for accuracy? _______________

Auditing the Requirements for Higher-Priced Mortgage Loans

Section 1: Definitions
12 C.F.R. § 1026.35(a)

Definitions – Higher Priced Mortgage Loan - 12 CFR § 1026.35(a)(1)

Regulatory Discussion

This section defines the term "*higher-priced mortgage*." There are three types; all must be secured by the consumer's principal dwelling:

- Conventional, first lien;
- Jumbo, first lien;
- Either conventional or jumbo, subordinate lien

Regulatory Text

(a) **Definitions.** For purposes of this section:

(1) **"Higher-priced mortgage loan"** means a closed-end 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:

(i) By 1.5 or more percentage points for loans secured by a first lien with a principal obligation at consummation that does not exceed the limit in effect as of the date the transaction's interest rate is set for the maximum principal obligation eligible for purchase by Freddie Mac;

(ii) By 2.5 or more percentage points for loans secured by a first lien with a principal obligation at consummation that exceeds the limit in effect as of the date the transaction's interest rate is set for the maximum principal obligation eligible for purchase by Freddie Mac; or

(iii) By 3.5 or more percentage points for loans secured by a subordinate lien.

Regulatory Commentary

Paragraph 35(a)(1)

*1. **Comparable transaction.** 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 the specified margin. The table of average prime offer rates published by the Bureau indicates how to identify the comparable transaction.*

*2. **Rate set.** A transaction's annual percentage rate is compared to the average prime offer rate as of the date the transaction's interest rate is set (or "locked") before consummation. Sometimes a creditor sets the interest rate initially and then re-sets it at a different level before consummation. The creditor should use the last date the interest rate is set before consummation.*

3. ***Threshold for "jumbo" loans.*** *Section 1026.35(a)(1)(ii) provides a separate threshold for determining whether a transaction is a higher-priced mortgage loan subject to §1026.35 when the principal balance exceeds the limit in effect as of the date the transaction's rate is set for the maximum principal obligation eligible for purchase by Freddie Mac (a "jumbo" loan). The Federal Housing Finance Agency (FHFA) establishes and adjusts the maximum principal obligation pursuant to rules under 12 U.S.C. 1454(a)(2) and other provisions of federal law. Adjustments to the maximum principal obligation made by FHFA apply in determining whether a mortgage loan is a "jumbo" loan to which the separate coverage threshold in §1026.35(a)(1)(ii) applies.*

Definitions - Average Prime Offer Rate - 12 CFR § 1026.35(a)(2)

Regulatory Discussion

This section defines the term "*average prime offer rate*," ("APOR"). The CFPB publishes the APOR on the Internet and is updated at least weekly.

Regulatory Text

(a) **Definitions.** For purposes of this section:

(2) **"Average prime offer rate"** means an annual percentage rate that is derived from average interest rates, points, and other loan pricing terms currently offered to consumers by a representative sample of creditors for mortgage transactions that have low-risk pricing characteristics. The Bureau publishes average prime offer rates for a broad range of types of transactions in a table updated at least weekly as well as the methodology the Bureau uses to derive these rates.

Regulatory Commentary

Paragraph 35(a)(2)

1. ***Average prime offer rate.*** *Average prime offer rates are annual percentage rates derived from average interest rates, points, and other loan pricing terms currently offered to consumers by a representative sample of creditors for mortgage transactions that have low-risk pricing characteristics. Other pricing terms include commonly used indices, margins, and initial fixed-rate periods for variable-rate transactions. Relevant pricing characteristics include a consumer's credit history and transaction characteristics such as the loan-to-value ratio, owner-occupant status, and purpose of the transaction. To obtain average prime offer rates, the Bureau uses a survey of creditors that both meets the criteria of §1026.35(a)(2) and provides pricing terms for at least two types of variable-rate transactions and at least two types of non-variable-rate transactions. An example of such a survey is the Freddie Mac Primary Mortgage Market Survey®.*

2. ***Bureau table.*** *The Bureau publishes on the Internet, in table form, average prime offer rates for a wide variety of transaction types. The Bureau calculates an annual percentage rate, consistent with Regulation Z (see §1026.22 and appendix J), for each transaction type for which pricing terms are available from a survey. The Bureau estimates annual percentage rates for other types of transactions for which direct survey data are not available based on the loan*

pricing terms available in the survey and other information. The Bureau publishes on the Internet the methodology it uses to arrive at these estimates.

*3. **Additional guidance on determination of average prime offer rates.** The average prime offer rate has the same meaning in §1026.35 as in Regulation C, 12 CFR part 1003. See 12 CFR 1003.4(a)(12)(ii). Guidance on the average prime offer rate under §1026.35(a)(2), such as when a transaction's rate is set and determination of the comparable transaction, is provided in the official commentary under Regulation C, the publication entitled "A Guide to HMDA Reporting: Getting it Right!", and the relevant "Frequently Asked Questions" on Home Mortgage Disclosure Act (HMDA) compliance posted on the FFIEC's Web site at http://www.ffiec.gov/hmda.*

Section 2: Escrow Accounts
12 C.F.R. § 1026.35(b)

Escrow Accounts - 12 CFR § 1026.35(b)(1)

Regulatory Discussion

Generally, a *first-lien* higher-priced mortgage requires an escrow account for payment of property taxes and mortgage-related insurance premiums. The escrow account must be established before consummation.

Note the commentary on: Optional insurance items; and Transactions not subject to this section, (b)(1).

Discussion on escrow account exceptions is found in (b)(2), below.

Regulatory Text

(b) Escrow accounts

(1) **Requirement to escrow for property taxes and insurance.** Except as provided in paragraph (b)(2) of this section, a creditor may not extend a higher-priced mortgage loan secured by a first lien on a consumer's principal dwelling unless an escrow account is established before consummation for payment of property taxes and premiums for mortgage-related insurance required by the creditor, such as insurance against loss of or damage to property, or against liability arising out of the ownership or use of the property, or insurance protecting the creditor against the consumer's default or other credit loss. For purposes of this paragraph (b), the term "escrow account" has the same meaning as under Regulation X (12 CFR 1024.17(b)), as amended.

Regulatory Commentary

35(b) Escrow Accounts

*1. **Principal dwelling.** Section 1026.35(b)(1) applies to principal dwellings, including structures that are classified as personal property under State law. For example, an escrow account must be established on a higher-priced mortgage loan secured by a first lien on a manufactured home, boat, or trailer used as the consumer's principal dwelling. See the commentary under §§1026.2(a)(19) and(24), 1026.15, and 1026.23. Section 1026.35(b)(1) also applies to a higher-priced mortgage loan secured by a first lien on a condominium if it is in fact used as the consumer's principal dwelling. But see §1026.35(b)(2) for exemptions from the escrow requirement that may apply to such transactions.*

35(b)(1) Requirement to escrow for property taxes and insurance

1. ***Administration of escrow accounts.*** *Section 1026.35(b)(1) requires creditors to establish an escrow account for payment of property taxes and premiums for mortgage-related insurance required by the creditor before the consummation of a higher-priced mortgage loan secured by a first lien on a principal dwelling. Section 6 of RESPA, 12 U.S.C. 2605, and Regulation X, 12 CFR 1024.17, address how escrow accounts must be administered.*

2. ***Optional insurance items.*** *Section 1026.35(b)(1) does not require that an escrow account be established for premiums for mortgage-related insurance that the creditor does not require in connection with the credit transaction, such as earthquake insurance or credit life insurance, even if the consumer voluntarily obtains such insurance.*

3. ***Transactions not subject to §1026.35(b)(1).*** *Section 1026.35(b)(1) requires a creditor to establish an escrow account before consummation of a first-lien higher-priced mortgage loan. This requirement does not affect a creditor's ability, right, or obligation, pursuant to the terms of the legal obligation or applicable law, to offer or require an escrow account for a transaction that is not subject to §1026.35(b)(1).*

Escrow Accounts - Exemptions - 12 CFR § 1026.35(b)(2)

Regulatory Discussion

There are four categories of escrow account exemptions, as follows:

An escrow account is not required for the following four transaction types (as described in (b)(2)(i)):

- Secured by shares in a cooperative
- Initial construction of a dwelling
- Temporary, or “bridge,” loan with a term of twelve monthes or less
- Reverse mortgage transaction

An escrow account is not required for the following insurance premiums (as described in (b)(2)(ii)):

- For dwellings in condominiums, planned unit developments (PUDs), or other common interest communities in which dwelling ownership requires participation in a governing association and where the governing association maintains a paster policy insuring all dwellings

An escrow account is not required if, at the time of consummation (as described in (b)(2)(iii)):

- A higher-priced mortgage transaction secured by a first lien on a property is located in either a “*rural*” or “*underserved*” area;
- Note the time period:
    - during the preceding calendar year; or
    - if the application was received before April 1 of the current calendar year, during either of the two preceding calendar years

See (b)(2)(iv)(A) through (C) for description and discussion of “*rural*” and “*underserved*” areas.

The creditor (and its affiliates together) extended no more than 2,000 higher-priced mortgage transactions secured by first liens that were sold, assigned, or otherwise transferred to another person, or were subject at consummation to a commitment to be acquired by another person;

- Note the time period:
  - during the preceding calendar year; or
  - if the application was received before April 1 of the current calendar year, during either of the two preceding calendar years

The creditor (and its affiliates together) that regularly extended higher-priced mortgages secured by first liens had total assets of less than $2 billion (adjusted annually); and

- Note the time period:
  - during the preceding December 31st; or
  - if the application was received before April 1 of the current calendar year, during either of the two preceding December 31sts

Neither the creditor nor its affiliates maintains an escrow account for any extension of consumer credit secured by real property or a dwelling that the creditor (or its affiliate) currently services, except for:

- Escrow accounts established first-lien higher-priced mortgage applications received on or after April 1, 2010 and before May 1, 2016; or
- Escrow accounts established after consummation as an accommodation to distressed consumers to avoid default or foreclosure.

NOTE: An escrow account *must be established*, for any first-lien higher-priced mortgage loan that, at the time of consummation, is subject to a commitment to be acquired by a person that does not satisfy the conditions in (b)(2)(iii), unless otherwise exempted by (b)(2) (as described in (b)(2)(v)).

The commentary provides additional substantial information relative to these exemptions.

Regulatory Text

(b) Escrow accounts

(2) **Exemptions.** Notwithstanding paragraph (b)(1) of this section:

(i) An escrow account need not be established for:

(A) A transaction secured by shares in a cooperative;

(B) A transaction to finance the initial construction of a dwelling;

(C) A temporary or "bridge" loan with a loan term of twelve months or less, such as a loan to purchase a new dwelling where the consumer plans to sell a current dwelling within twelve months; or

(D) A reverse mortgage transaction subject to §1026.33.

(ii) Insurance premiums described in paragraph (b)(1) of this section need not be included in escrow accounts for loans secured by dwellings in condominiums, planned unit developments, or other common interest communities in which dwelling ownership requires participation in a governing association, where the governing association has an obligation to the dwelling owners to maintain a master policy insuring all dwellings.

(iii) Except as provided in paragraph (b)(2)(v) of this section, an escrow account need not be established for a transaction if, at the time of consummation:

(A) During the preceding calendar year, or, if the application for the transaction was received before April 1 of the current calendar year, during either of the two preceding calendar years, the creditor extended a covered transaction, as defined by §1026.43(b)(1), secured by a first lien on a property that is located in an area that is either "rural" or "underserved," as set forth in paragraph (b)(2)(iv) of this section;

(B) During the preceding calendar year, or, if the application for the transaction was received before April 1 of the current calendar year, during either of the two preceding calendar years, the creditor and its affiliates together extended no more than 2,000 covered transactions, as defined by §1026.43(b)(1), secured by first liens, that were sold, assigned, or otherwise transferred to another person, or that were subject at the time of consummation to a commitment to be acquired by another person;

(C) As of the preceding December 31st, or, if the application for the transaction was received before April 1 of the current calendar year, as of either of the two preceding December 31sts, the creditor and its affiliates that regularly extended covered transactions, as defined by §1026.43(b)(1), secured by first liens, together, had total assets of less than $2,000,000,000; this asset threshold shall adjust automatically each year, based on the year-to-year change in the average of the Consumer Price Index for Urban Wage Earners and Clerical Workers, not seasonally adjusted, for each 12-month period ending in November, with rounding to the nearest million dollars (see comment 35(b)(2)(iii)-1.iii for the applicable threshold); and

(D) Neither the creditor nor its affiliate maintains an escrow account of the type described in paragraph (b)(1) of this section for any extension of consumer credit secured by real property or a dwelling that the creditor or its affiliate currently services, other than:

(*1*) Escrow accounts established for first-lien higher-priced mortgage loans for which applications were received on or after April 1, 2010, and before May 1, 2016; or

(*2*) Escrow accounts established after consummation as an accommodation to distressed consumers to assist such consumers in avoiding default or foreclosure.

(iv) For purposes of paragraph (b)(2)(iii)(A) of this section:

(A) An area is "rural" during a calendar year if it is:

(*1*) A county that is neither in a metropolitan statistical area nor in a micropolitan statistical area that is adjacent to a metropolitan statistical area, as those terms are defined by the U.S. Office of Management and Budget and as they are applied under currently applicable Urban Influence Codes (UICs), established by the United States Department of Agriculture's Economic Research Service (USDA-ERS);

(*2*) A census block that is not in an urban area, as defined by the U.S. Census Bureau using the latest decennial census of the United States; or

(*3*) A county or a census block that has been designated as rural by the Bureau pursuant to the application process established under section 89002 of the Helping Expand Lending Practices in Rural Communities Act, Public Law 114-94, title LXXXIX (2015). The provisions of this paragraph (b)(2)(iv)(A)(*3*) shall cease to have any force or effect on December 4, 2017.

(B) An area is "underserved" during a calendar year if, according to Home Mortgage Disclosure Act (HMDA) data for the preceding calendar year, it is a county in which no more than two creditors extended covered transactions, as defined in §1026.43(b)(1), secured by first liens on properties in the county five or more times.

(C) A property shall be deemed to be in an area that is rural or underserved in a particular calendar year if the property is:

(1) Located in a county that appears on the lists published by the Bureau of counties that are rural or underserved, as defined by §1026.35(b)(2)(iv)(A)(1) or §1026.35(b)(2)(iv)(B), for that calendar year,

(2) Designated as rural or underserved for that calendar year by any automated tool that the Bureau provides on its public Web site, or

(3) Not designated as located in an urban area, as defined by the most recent delineation of urban areas announced by the Census Bureau, by any automated address search tool that the U.S. Census Bureau provides on its public Web site for that purpose and that specifically indicates the urban or rural designations of properties.

(v) Notwithstanding paragraph (b)(2)(iii) of this section, an escrow account must be established pursuant to paragraph (b)(1) of this section for any first-lien higher-priced mortgage loan that, at consummation, is subject to a commitment to be acquired by a person that does not satisfy the conditions in paragraph (b)(2)(iii) of this section, unless otherwise exempted by this paragraph (b)(2).

Regulatory Commentary

35(b)(2) Exemptions.

Paragraph 35(b)(2)(i).

1. ***Construction-permanent loans.*** *Under §1026.35(b)(2)(ii)(B), §1026.35 does not apply to a transaction to finance the initial construction of a dwelling. Section 1026.35 may apply, however, to permanent financing that replaces a construction loan, whether the permanent financing is extended by the same or a different creditor. When a construction loan may be permanently financed by the same creditor, §1026.17(c)(6)(ii) permits the creditor to give either one combined disclosure for both the construction financing and the permanent financing, or a separate set of disclosures for each of the two phases as though they were two separate transactions. See also comment 17(c)(6)-2. Section 1026.17(c)(6)(ii) addresses only how a creditor may elect to disclose a construction-permanent transaction. Which disclosure option a creditor elects under §1026.17(c)(6)(ii) does not affect the determination of whether the permanent phase of the transaction is subject to §1026.35. When the creditor discloses the two* *phases as separate transactions, the annual percentage rate for the permanent phase must be compared to the average prime offer rate for a transaction that is comparable to the permanent financing to determine whether the transaction is a higher-priced mortgage loan under §1026.35(a). When the creditor discloses the two phases as a single transaction, a single annual percentage rate, reflecting the appropriate charges from both phases, must be calculated for the transaction in accordance with §1026.22(a)(1) and appendix D to part 1026. This annual percentage rate must be compared to the average prime offer rate for a transaction that is comparable to the permanent financing to determine the transaction is a higher-priced mortgage loan under §1026.35(a). If the transaction is determined to be a higher-priced mortgage loan, only the permanent phase is subject to the requirement of §1026.35(b)(1) to establish and maintain an escrow account, and the period for which the escrow account must remain in place under §1026.35(b)(3) is measured from the time the conversion to the permanent phase financing occurs.*

Paragraph 35(b)(2)(ii).

1. ***Limited exemption.*** *A creditor is required to escrow for payment of property taxes for all first-lien higher-priced mortgage loans secured by condominium, planned unit development, or similar dwellings or units regardless of whether the creditor escrows for insurance premiums for such dwellings or units.*

2. ***Planned unit developments.*** *Planned unit developments (PUDs) are a form of property ownership often used in retirement communities, golf communities, and similar communities made up of homes located within a defined geographical area. PUDs usually have a homeowners' association or some other governing association, analogous to a condominium association and with similar authority and obligations. Thus, as with condominiums, PUDs often have master insurance policies that cover all units in the PUD. Under §1026.35(b)(2)(ii), if a PUD's governing association is obligated to maintain such a master insurance policy, an escrow account required by §1026.35(b)(1) for a transaction secured by a unit in the PUD need not include escrows for insurance. This exemption applies not only to condominiums and PUDs but also to any other type of property ownership arrangement that has a governing association with an obligation to maintain a master insurance policy.*

3. ***More than one governing association associated with a dwelling.*** *The limited exemption provided pursuant to §1026.35(b)(2)(ii) applies to each master insurance policy for properties with multiple governing associations, to the extent each governing association has an obligation to maintain a master insurance policy.*

Paragraph 35(b)(2)(iii).

1. ***Requirements for exemption.*** *Under §1026.35(b)(2)(iii), except as provided in §1026.35(b)(2)(v), a creditor need not establish an escrow account for taxes and insurance for a higher-priced mortgage loan, provided the following four conditions are satisfied when the higher-priced mortgage loan is consummated:*

   i. During the preceding calendar year, or during either of the two preceding calendar years if the application for the loan was received before April 1 of the current calendar year, a creditor extended a first-lien covered transaction, as defined in §1026.43(b)(1), secured by a property located in an area that is either "rural" or "underserved," as set forth in §1026.35(b)(2)(iv).

   A. In general, whether the rural-or-underserved test is satisfied depends on the creditor's activity during the preceding calendar year. However, if the application for the loan in *question was received before April 1 of the current calendar year, the creditor may instead meet the rural-or-underserved test based on its activity during the next-to-last calendar year. This provides creditors with a grace period if their activity meets the rural-or-underserved test (in §1026.35(b)(2)(iii)(A)) in one calendar year but fails to meet it in the next calendar year.*

B. *A creditor meets the rural-or-underserved test for any higher-priced mortgage loan consummated during a calendar year if it extended a first-lien covered transaction in the preceding calendar year secured by a property located in a rural-or-underserved area. If the creditor does not meet the rural-or-underserved test in the preceding calendar year, the creditor meets this condition for a higher-priced mortgage loan consummated during the current calendar year only if the application for the loan was received before April 1 of the current calendar year and the creditor extended a first-lien covered transaction during the next-to-last calendar year that is secured by a property located in a rural or underserved area. The following examples are illustrative:*

1. *Assume that a creditor extended during 2016 a first-lien covered transaction that is secured by a property located in a rural or underserved area. Because the creditor extended a first-lien covered transaction during 2016 that is secured by a property located in a rural or underserved area, the creditor can meet this condition for exemption for any higher-priced mortgage loan consummated during 2017.*

2. *Assume that a creditor did not extend during 2016 a first-lien covered transaction secured by a property that is located in a rural or underserved area. Assume further that the same creditor extended during 2015 a first-lien covered transaction that is located in a rural or underserved area. Assume further that the creditor consummates a higher-priced mortgage loan in 2017 for which the application was received in November 2017. Because the creditor did not extend during 2016 a first-lien covered transaction secured by a property that is located in a rural or underserved area, and the application was received on or after April 1, 2017, the creditor does not meet this condition for exemption. However, assume instead that the creditor consummates a higher-priced mortgage loan in 2017 based on an application received in February 2017. The creditor meets this condition for exemption for this loan because the application was received before April 1, 2017, and the creditor extended during 2015 a first-lien covered transaction that is located in a rural or underserved area.*

ii. *The creditor and its affiliates together extended no more than 2,000 covered transactions, as defined in §1026.43(b)(1), secured by first liens, that were sold, assigned, or otherwise transferred by the creditor or its affiliates to another person, or that were subject at the time of consummation to a commitment to be acquired by another person, during the preceding calendar year or during either of the two preceding calendar years if the application for the loan was received before April 1 of the current calendar year. For purposes of §1026.35(b)(2)(iii)(B), a transfer of a first-lien covered transaction to "another person" includes a transfer by a creditor to its affiliate.*

A. *In general, whether this condition is satisfied depends on the creditor's activity during the preceding calendar year. However, if the application for the loan in question is received before April 1 of the current calendar year, the creditor may instead meet this condition based on activity during the next-to-last calendar year. This provides creditors with a grace period if their activity falls at or below the threshold in one calendar year but exceeds it in the next calendar year.*

B. For example, assume that in 2015 a creditor and its affiliates together extended 1,500 loans that were sold, assigned, or otherwise transferred by the creditor or its affiliates to another person, or that were subject at the time of consummation to a commitment to be acquired by another person, and 2,500 such loans in 2016. Because the 2016 transaction activity exceeds the threshold but the 2015 transaction activity does not, the creditor satisfies this condition for exemption for a higher-priced mortgage loan consummated during 2017 if the creditor received the application for the loan before April 1, 2017, but does not satisfy this condition for a higher-priced mortgage loan consummated during 2017 if the application for the loan was received on or after April 1, 2017.

C. For purposes of §1026.35(b)(2)(iii)(B), extensions of first-lien covered transactions, during the applicable time period, by all of a creditor's affiliates, as "affiliate" is defined in §1026.32(b)(5), are counted toward the threshold in this section. "Affiliate" is defined in §1026.32(b)(5) as "any company that controls, is controlled by, or is under common control with another company, as set forth in the Bank Holding Company Act of 1956 (12 U.S.C. 1841 et seq.)." Under the Bank Holding Company Act, a company has control over a bank or another company if it "directly or indirectly or acting through one or more persons owns, controls, or has power to vote 25 per centum or more of any class of voting securities of the bank or company"; it "controls in any manner the election of a majority of the directors or trustees of the bank or company"; or the Federal Reserve Board "determines, after notice and opportunity for hearing, that the company directly or indirectly exercises a controlling influence over the management or policies of the bank or company." 12 U.S.C. 1841(a)(2).

iii. As of the end of the preceding calendar year, or as of the end of either of the two preceding calendar years if the application for the loan was received before April 1 of the current calendar year, the creditor and its affiliates that regularly extended covered transactions secured by first liens, together, had total assets that are less than the applicable annual asset threshold.

A. For purposes of §1026.35(b)(2)(iii)(C), in addition to the creditor's assets, only the assets of a creditor's "affiliate" (as defined by §1026.32(b)(5)) that regularly extended covered transactions (as defined by §1026.43(b)(1)) secured by first liens, are counted toward the applicable annual asset threshold. See comment 35(b)(2)(iii)-1.ii.C for discussion of definition of "affiliate."

B. Only the assets of a creditor's affiliate that regularly extended first-lien covered transactions during the applicable period are included in calculating the creditor's assets. The meaning of "regularly extended" is based on the number of times a person extends consumer credit for purposes of the definition of "creditor" in §1026.2(a)(17). Because covered transactions are "transactions secured by a dwelling," consistent with §1026.2(a)(17)(v), an affiliate regularly extended covered transactions if it extended more than five covered transactions in a calendar year. Also consistent with §1026.2(a)(17)(v), because a covered transaction may be a high-cost mortgage subject to §1026.32, an affiliate regularly extends covered transactions if, in any 12-month period, it extends more than one covered transaction that is subject to the requirements of §1026.32 or one or more such transactions through a mortgage broker. Thus, if a creditor's affiliate regularly extended first-lien covered transactions during the preceding calendar year, the creditor's assets as of the end of the preceding calendar year, for purposes of the asset limit, take into account the assets of that affiliate. If the creditor, together with its affiliates that regularly extended first-lien covered transactions, exceeded the asset limit in the preceding calendar year—to be eligible to *operate as a small creditor for transactions with applications received before April 1 of the current calendar year—the assets of the creditor's affiliates that regularly extended covered transactions in the year before the preceding calendar year are included in calculating the creditor's assets.*

C. *If multiple creditors share ownership of a company that regularly extended first-lien covered transactions, the assets of the company count toward the asset limit for a co-owner creditor if the company is an "affiliate," as defined in §1026.32(b)(5), of the co-owner creditor. Assuming the company is not an affiliate of the co-owner creditor by virtue of any other aspect of the definition (such as by the company and co-owner creditor being under common control), the company's assets are included toward the asset limit of the co-owner creditor only if the company is controlled by the co-owner creditor, "as set forth in the Bank Holding Company Act." If the co-owner creditor and the company are affiliates (by virtue of any aspect of the definition), the co-owner creditor counts all of the company's assets toward the asset limit, regardless of the co-owner creditor's ownership share. Further, because the co-owner and the company are mutual affiliates the company also would count all of the co-owner's assets towards its own asset limit. See comment 35(b)(2)(iii)-1.ii.C for discussion of the definition of "affiliate."*

D. *A creditor satisfies the criterion in §1026.35(b)(2)(iii)(C) for purposes of any higher-priced mortgage loan consummated during 2016, for example, if the creditor (together with its affiliates that regularly extended first-lien covered transactions) had total assets of less than the applicable asset threshold on December 31, 2015. A creditor that (together with its affiliates that regularly extended first-lien covered transactions) did not meet the applicable asset threshold on December 31, 2015 satisfies this criterion for a higher-priced mortgage loan consummated during 2016 if the application for the loan was received before April 1, 2016 and the creditor (together with its affiliates that regularly extended first-lien covered transactions) had total assets of less than the applicable asset threshold on December 31, 2014.*

E. *Under §1026.35(b)(2)(iii)(C), the $2,000,000,000 asset threshold adjusts automatically each year based on the year-to-year change in the average of the Consumer Price Index for Urban Wage Earners and Clerical Workers, not seasonally adjusted, for each 12-month period ending in November, with rounding to the nearest million dollars. The Bureau will publish notice of the asset threshold each year by amending this comment. For calendar year 2016, the asset threshold is $2,052,000,000. A creditor that together with the assets of its affiliates that regularly extended first-lien covered transactions during calendar year 2015 has total assets of less than $2,052,000,000 on December 31, 2015, satisfies this criterion for purposes of any loan consummated in 2016 and for purposes of any loan consummated in 2017 for which the application was received before April 1, 2017. For historical purposes:*

1. *For calendar year 2013, the asset threshold was $2,000,000,000. Creditors that had total assets of less than $2,000,000,000 on December 31, 2012, satisfied this criterion for purposes of the exemption during 2013.*

2. *For calendar year 2014, the asset threshold was $2,028,000,000. Creditors that had total assets of less than $2,028,000,000 on December 31, 2013, satisfied this criterion for purposes of the exemption during 2014.*

3. *For calendar year 2015, the asset threshold was $2,060,000,000. Creditors that had total assets of less than $2,060,000,000 on December 31, 2014, satisfied this criterion for purposes of any loan consummated in 2015 and, if the creditor's assets together*

with the assets of its affiliates that regularly extended first-lien covered transactions during calendar year 2014 were less than that amount, for purposes of any loan consummated in 2016 for which the application was received before April 1, 2016.

iv. *The creditor and its affiliates do not maintain an escrow account for any mortgage transaction being serviced by the creditor or its affiliate at the time the transaction is consummated, except as provided in §1026.35(b)(2)(iii)(D)(1) and (2). Thus, the exemption applies, provided the other conditions of §1026.35(b)(2)(iii) are satisfied, even if the creditor previously maintained escrow accounts for mortgage loans, provided it no longer maintains any such accounts except as provided in §1026.35(b)(2)(iii)(D)(1) and (2). Once a creditor or its affiliate begins escrowing for loans currently serviced other than those addressed in §1026.35(b)(2)(iii)(D)(1) and (2), however, the creditor and its affiliate become ineligible for the exemption in §1026.35(b)(2)(iii) on higher-priced mortgage loans they make while such escrowing continues. Thus, as long as a creditor (or its affiliate) services and maintains escrow accounts for any mortgage loans, other than as provided in §1026.35(b)(2)(iii)(D)(1) and (2), the creditor will not be eligible for the exemption for any higher-priced mortgage loan it may make. For purposes of §1026.35(b)(2)(iii), a creditor or its affiliate "maintains" an escrow account only if it services a mortgage loan for which an escrow account has been established at least through the due date of the second periodic payment under the terms of the legal obligation.*

Paragraph 35(b)(2)(iii)(D)(1).

1. ***Exception for certain accounts.*** *Escrow accounts established for first-lien higher-priced mortgage loans for which applications were received on or after April 1, 2010, and before May 1, 2016, are not counted for purposes of §1026.35(b)(2)(iii)(D). For applications received on and after May 1, 2016, creditors, together with their affiliates, that establish new escrow accounts, other than those described in §1026.35(b)(2)(iii)(D)(2), do not qualify for the exemption provided under §1026.35(b)(2)(iii). Creditors, together with their affiliates, that continue to maintain escrow accounts established for first-lien higher-priced mortgage loans for which applications were received on or after April 1, 2010, and before May 1, 2016, still qualify for the exemption provided under §1026.35(b)(2)(iii) so long as they do not establish new escrow accounts for transactions for which they received applications on or after May 1, 2016, other than those described in §1026.35(b)(2)(iii)(D)(2), and they otherwise qualify under §1026.35(b)(2)(iii).*

Paragraph 35(b)(2)(iii)(D)(2).

1. ***Exception for post-consummation escrow accounts for distressed consumers.*** *An escrow account established after consummation for a distressed consumer does not count for purposes of §1026.35(b)(2)(iii)(D). Distressed consumers are consumers who are working with the creditor or servicer to attempt to bring the loan into a current status through a modification, deferral, or other accommodation to the consumer. A creditor, together with its affiliates, that establishes escrow accounts after consummation as a regular business practice, regardless of whether consumers are in distress, does not qualify for the exception described in §1026.35(b)(2)(iii)(D)(2).*

Paragraph 35(b)(2)(iv).

1. ***Requirements for "rural" or "underserved" status.*** *An area is considered to be "rural" or "underserved" during a calendar year for purposes of §1026.35(b)(2)(iii)(A) if it satisfies either the definition for "rural" or the definition for "underserved" in §1026.35(b)(2)(iv). A creditor's extensions of covered transactions, as defined by §1026.43(b)(1), secured by first liens on properties located in such areas are considered in determining whether the creditor satisfies the condition in §1026.35(b)(2)(iii)(A). See comment 35(b)(2)(iii)-1.*

i. Under §1026.35(b)(2)(iv)(A), an area is rural during a calendar year if it is: A county that is neither in a metropolitan statistical area nor in a micropolitan statistical area that is adjacent to a metropolitan statistical area; a census block that is not in an urban area, as defined by the U.S. Census Bureau using the latest decennial census of the United States; or a county or a census block that has been designated as "rural" by the Bureau pursuant to the application process established in 2016. See Application Process for Designation of Rural Area under Federal Consumer Financial Law; Procedural Rule, 81 FR 11099 (Mar. 3, 2016). Metropolitan statistical areas and micropolitan statistical areas are defined by the Office of Management and Budget and applied under currently applicable Urban Influence Codes (UICs), established by the United States Department of Agriculture's Economic Research Service (USDA-ERS). For purposes of §1026.35(b)(2)(iv)(A)(1), "adjacent" has the meaning applied by the USDA-ERS in determining a county's UIC; as so applied, "adjacent" entails a county not only being physically contiguous with a metropolitan statistical area but also meeting certain minimum population commuting patterns. A county is a "rural" area under §1026.35(b)(2)(iv)(A)(1) if the USDA-ERS categorizes the county under UIC 4, 6, 7, 8, 9, 10, 11, or 12. Descriptions of UICs are available on the USDA-ERS Web site at http://www.ers.usda.gov/data-products/urban-influence-codes/documentation.aspx. A county for which there is no currently applicable UIC (because the county has been created since the USDA-ERS last categorized counties) is a rural area only if all counties from which the new county's land was taken are themselves rural under currently applicable UICs.

ii. Under §1026.35(b)(2)(iv)(B), an area is underserved during a calendar year if, according to Home Mortgage Disclosure Act (HMDA) data for the preceding calendar year, it is a county in which no more than two creditors extended covered transactions, as defined in §1026.43(b)(1), secured by first liens, five or more times on properties in the county. Specifically, a county is an "underserved" area if, in the applicable calendar year's public HMDA aggregate dataset, no more than two creditors have reported five or more first-lien covered transactions, with HMDA geocoding that places the properties in that county. For purposes of this determination, because only covered transactions are counted, all first-lien originations (and only first-lien originations) reported in the HMDA data are counted except those for which the owner-occupancy status is reported as "Not owner-occupied" (HMDA code 2), the property type is reported as "Multifamily" (HMDA code 3), the applicant's or co-applicant's race is reported as "Not applicable" (HMDA code 7), or the applicant's or co-applicant's sex is reported as "Not applicable" (HMDA code 4). The most recent HMDA data are available at http://www.ffiec.gov/hmda.

iii.

A. Each calendar year, the Bureau applies the "underserved" area test and the "rural" area test to each county in the United States. If a county satisfies either test, the Bureau will include the county on a published list of counties that are rural or underserved as defined by §1026.35(b)(2)(iv)(A)(1) or §1026.35(b)(2)(iv)(B) for a particular calendar year, even if the county contains census blocks that are designated by the Census Bureau as urban. To facilitate compliance with appraisal requirements in §1026.35(c), the Bureau also creates a list of those counties that are rural under the Bureau's definition without regard to whether the counties are underserved. To the extent that U.S. territories are treated by the Census Bureau as counties and are neither metropolitan statistical areas nor micropolitan statistical areas adjacent to metropolitan statistical areas, such territories will be included on these lists as rural areas in their entireties. The Bureau will post on its public Web site the applicable lists for each calendar year by the end of that year and publish such lists in the FEDERAL REGISTER, to assist creditors in ascertaining the availability to them of *the exemption during the following year. Any county that the Bureau includes on its published lists of counties that are rural or underserved under the Bureau's definitions for a particular year is deemed to qualify as a rural or underserved area for that calendar year for purposes of §1026.35(b)(2)(iv), even if the county contains census blocks that are designated by the Census Bureau as urban. A property located in such a listed county is deemed to be located in a rural or underserved area, even if the census block in which the property is located is designated as urban.*

B. A property is deemed to be in a rural or underserved area according to the definitions in §1026.35(b)(2)(iv) during a particular calendar year if it is identified as such by an automated tool provided on the Bureau's public Web site. A printout or electronic copy from the automated tool provided on the Bureau's public Web site designating a particular property as being in a rural or underserved area may be used as "evidence of compliance" that a property is in a rural or underserved area, as defined in §1026.35(b)(2)(iv)(A) and (B), for purposes of the record retention requirements in §1026.25.

C. The U.S. Census Bureau may provide on its public Web site an automated address search tool that specifically indicates if a property is located in an urban area for purposes of the Census Bureau's most recent delineation of urban areas. For any calendar year that began after the date on which the Census Bureau announced its most recent delineation of urban areas, a property is deemed to be in a rural area if the search results provided for the property by any such automated address search tool available on the Census Bureau's public Web site do not designate the property as being in an urban area. A printout or electronic copy from such an automated address search tool available on the Census Bureau's public Web site designating a particular property as not being in an urban area may be used as "evidence of compliance" that the property is in a rural area, as defined in §1026.35(b)(2)(iv)(A), for purposes of the record retention requirements in §1026.25.

D. For a given calendar year, a property qualifies for a safe harbor if any of the enumerated safe harbors affirms that the property is in a rural or underserved area or not in an urban area. For example, the Census Bureau's automated address search tool may indicate a property is in an urban area, but the Bureau's rural or underserved counties list indicates the property is in a rural or underserved county. The property in this example is in a rural or underserved area because it qualifies under the safe harbor for the rural or underserved counties list. The lists of counties published by the Bureau, the automated tool on its public Web site, and the automated address search tool available on the Census Bureau's public Web site, are not the exclusive means by which a creditor can demonstrate that a property is in a rural or underserved area as defined in §1026.35(b)(2)(iv)(A) and (B). However, creditors are required to retain "evidence of compliance" in accordance with §1026.25, including determinations of whether a property is in a rural or underserved area as defined in §1026.35(b)(2)(iv)(A) and (B).

*2. **Examples.***

i. An area is considered "rural" for a given calendar year based on the most recent available UIC designations by the USDA-ERS and the most recent available delineations of urban areas by the U.S. Census Bureau that are available at the beginning of the calendar year. These designations and delineations are updated by the USDA-ERS and the U.S. Census Bureau respectively once every ten years. As an example, assume a creditor makes first-lien covered transactions in Census Block X that is located in County Y during calendar year 2017. As of January 1, 2017, the most recent UIC designations were published in the second *quarter of 2013, and the most recent delineation of urban areas was announced in the FEDERAL REGISTER in 2012, see U.S. Census Bureau, Qualifying Urban Areas for the 2010 Census, 77 FR 18652 (Mar. 27, 2012). To determine whether County Y is rural under the Bureau's definition during calendar year 2017, the creditor can use USDA-ERS's 2013 UIC designations. If County Y is not rural, the creditor can use the U.S. Census Bureau's 2012 delineation of urban areas to determine whether Census Block X is rural and is therefore a "rural" area for purposes of §1026.35(b)(2)(iv)(A). In addition, an area is considered "rural" if it is a county or a census block that has been designated as rural by the Bureau using the application process established in 2016. See Application Process for Designation of Rural Area under Federal Consumer Financial Law; Procedural Rule, 81 FR 11099 (Mar. 3, 2016). Designations under this process are time-limited and expire on December 4, 2017.*

ii. A county is considered an "underserved" area for a given calendar year based on the most recent available HMDA data. For example, assume a creditor makes first-lien covered transactions in County Y during calendar year 2016, and the most recent HMDA data are for calendar year 2015, published in the third quarter of 2016. The creditor will use the 2015 HMDA data to determine "underserved" area status for County Y in calendar year 2016 for the purposes of qualifying for the "rural or underserved" exemption for any higher-priced mortgage loans consummated in calendar year 2017 or for any higher-priced mortgage loan consummated during 2018 for which the application was received before April 1, 2018.

Paragraph 35(b)(2)(v).

*1. **Forward commitments.** A creditor may make a mortgage loan that will be transferred or sold to a purchaser pursuant to an agreement that has been entered into at or before the time the loan is consummated. Such an agreement is sometimes known as a "forward commitment." Even if a creditor is otherwise eligible for the exemption in §1026.35(b)(2)(iii), a first-lien higher-priced mortgage loan that will be acquired by a purchaser pursuant to a forward commitment is subject to the requirement to establish an escrow account under §1026.35(b)(1) unless the purchaser is also eligible for the exemption in §1026.35(b)(2)(iii) or the transaction is otherwise exempt under §1026.35(b)(2). The escrow requirement applies to any such transaction, whether the forward commitment provides for the purchase and sale of the specific transaction or for the purchase and sale of mortgage obligations with certain prescribed criteria that the transaction meets. For example, assume a creditor that qualifies for the exemption in §1026.35(b)(2)(iii) makes a higher-priced mortgage loan that meets the purchase criteria of an investor with which the creditor has an agreement to sell such mortgage obligations after consummation. If the investor is ineligible for the exemption in §1026.35(b)(2)(iii), an escrow account must be established for the transaction before consummation in accordance with §1026.35(b)(1) unless the transaction is otherwise exempt (such as a reverse mortgage or home equity line of credit).*

Escrow Accounts - Cancellation - 12 CFR § 1026.35(b)(3)

Regulatory Discussion

The section describes the conditions which must be satisfied in order for the creditor to cancel an escrow account. Generally, an escrow account may be cancelled upon the earlier of:

- Termination of the debt; or

- Receipt of a consumer's request to cancel (no earlier than five years after consummation of the debt).

Except: an escrow account shall not be cancelled pursuant to a consumer's request unless:

- The unpaid principal balance is less than 80% of the "*original value*" (see commentary for definition) of the property securing the debt; and
- The consumer currently is not delinquent or in default on the debt.

Regulatory Text

(b) Escrow accounts

(3) **Cancellation**

(i) **General.** Except as provided in paragraph (b)(3)(ii) of this section, a creditor or servicer may cancel an escrow account required in paragraph (b)(1) of this section only upon the earlier of:

(A) Termination of the underlying debt obligation; or

(B) Receipt no earlier than five years after consummation of a consumer's request to cancel the escrow account.

(ii) **Delayed cancellation.** Notwithstanding paragraph (b)(3)(i) of this section, a creditor or servicer shall not cancel an escrow account pursuant to a consumer's request described in paragraph (b)(3)(i)(B) of this section unless the following conditions are satisfied:

(A) The unpaid principal balance is less than 80 percent of the original value of the property securing the underlying debt obligation; and

(B) The consumer currently is not delinquent or in default on the underlying debt obligation.

Regulatory Commentary

35(b)(3) Cancellation.

*1. **Termination of underlying debt obligation.** Section 1026.35(b)(3)(i) provides that, in general, an escrow account required by §1026.35(b)(1) may not be cancelled until the underlying debt obligation is terminated or the consumer requests cancellation at least five years after consummation. Methods by which an underlying debt obligation may be terminated include, among other things, repayment, refinancing, rescission, and foreclosure.*

*2. **Minimum durations**. Section 1026.35(b)(3) establishes minimum durations for which escrow accounts established pursuant to §1026.35(b)(1) must be maintained. This requirement does not affect a creditor's right or obligation, pursuant to the terms of the legal obligation or applicable law, to offer or require an escrow account thereafter.*

*3. **Less than eighty percent unpaid principal balance**. The term "original value" in §1026.35(b)(3)(ii)(A) means the lesser of the sales price reflected in the sales contract for the property, if any, or the appraised value of the property at the time the transaction was consummated. In determining whether the unpaid principal balance has reached less than 80* *percent of the original value of the property securing the underlying debt, the creditor or servicer shall count any subordinate lien of which it has reason to know. If the consumer certifies in writing that the equity in the property securing the underlying debt obligation is unencumbered by a subordinate lien, the creditor or servicer may rely upon the certification in making its determination unless it has actual knowledge to the contrary.*

Section 3: Appraisals
12 C.F.R. § 1026.35(c)

Appraisals - Definitions - 12 CFR § 1026.35(c)(1)

Regulatory Discussion

This section defines seven specific terms associated with appraisals with respect to higher-priced mortgage transactions.

Regulatory Text

(c) Appraisals.

(1) **Definitions.** For purposes of this section:

(i) **Certified or licensed appraiser** means a person who is certified or licensed by the State agency in the State in which the property that secures the transaction is located, and who performs the appraisal in conformity with the Uniform Standards of Professional Appraisal Practice and the requirements applicable to appraisers in title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, as amended (12 U.S.C. 3331 *et seq.*), and any implementing regulations in effect at the time the appraiser signs the appraiser's certification.

(ii) **Credit risk** means the financial risk that a consumer will default on a loan.

(iii) **Manufactured home** has the same meaning as in 24 CFR 3280.2.

(iv) **Manufacturer's invoice** means a document issued by a manufacturer and provided with a manufactured home to a retail dealer that separately details the wholesale (base) prices at the factory for specific models or series of manufactured homes and itemized options (large appliances, built-in items and equipment), plus actual itemized charges for freight from the factory to the dealer's lot or the homesite (including any rental of wheels and axles) and for any sales taxes to be paid by the dealer. The invoice may recite such prices and charges on an itemized basis or by stating an aggregate price or charge, as appropriate, for each category.

(v) **National Registry** means the database of information about State certified and licensed appraisers maintained by the Appraisal Subcommittee of the Federal Financial Institutions Examination Council.

(vi) **New manufactured home** means a manufactured home that has not been previously occupied.

(vii) **State agency** means a “State appraiser certifying and licensing agency” recognized in accordance with section 1118(b) of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3347(b)) and any implementing regulations.

Regulatory Commentary

35(c)(1)(i) Certified or Licensed Appraiser

1. ***USPAP.*** *The Uniform Standards of Professional Appraisal Practice (USPAP) are established by the Appraisal Standards Board of the Appraisal Foundation (as defined in 12 U.S.C. 3350(9)). Under §1026.35(c)(1)(i), the relevant USPAP standards are those found in the edition of USPAP and that are in effect at the time the appraiser signs the appraiser's certification.*

2. ***Appraiser's certification.*** *The appraiser's certification refers to the certification that must be signed by the appraiser for each appraisal assignment. This requirement is specified in USPAP Standards Rule 2-3.*

3. ***FIRREA title XI and implementing regulations.*** *The relevant regulations are those prescribed under section 1110 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), as amended (12 U.S.C. 3339), that relate to an appraiser's development and reporting of the appraisal in effect at the time the appraiser signs the appraiser's certification. Paragraph (3) of FIRREA section 1110 (12 U.S.C. 3339(3)), which relates to the review of appraisals, is not relevant for determining whether an appraiser is a certified or licensed appraiser under §1026.35(c)(1)(i).*

Appraisals - Exemptions - 12 CFR § 1026.35(c)(2)

Regulatory Discussion

This section describes eight specific transactions that are exempt from the appraisal requirements for higher-priced mortgage transactions.

The exemptions in items (i) through (vi) are relatively straightforward; the exemptions in items (vii) and (viii) are more complex.

The commentary provides important additional information for the exemptions in items (i), (ii), (iii), (iv), (vii), and (viii).

Regulatory Text

(c) Appraisals.

(2) **Exemptions.** Unless otherwise specified, the requirements in paragraph (c)(3) through (6) of this section do not apply to the following types of transactions:

(i) A loan that satisfies the criteria of a qualified mortgage as defined pursuant to 15 U.S.C. 1639c;

(ii) An extension of credit for which the amount of credit extended is equal to or less than the applicable threshold amount, which is adjusted every year to reflect increases in the Consumer Price Index for Urban Wage Earners and Clerical Workers, as applicable, and published in the official staff commentary to this paragraph (c)(2)(ii);

(iii) A transaction secured by a mobile home, boat, or trailer.

(iv) A transaction to finance the initial construction of a dwelling.

(v) A loan with a maturity of 12 months or less, if the purpose of the loan is a "bridge" loan connected with the acquisition of a dwelling intended to become the consumer's principal dwelling.

(vi) A reverse-mortgage transaction subject to 12 CFR 1026.33(a).

(vii) An extension of credit that is a refinancing secured by a first lien, with refinancing defined as in §1026.20(a) (except that the creditor need not be the original creditor or a holder or servicer of the original obligation), provided that the refinancing meets the following criteria:

(A) Either

(1) The credit risk of the refinancing is retained by the person that held the credit risk of the existing obligation and there is no commitment, at consummation, to transfer the credit risk to another person; or

(2) The refinancing is insured or guaranteed by the same Federal government agency that insured or guaranteed the existing obligation;

(B) The regular periodic payments under the refinance loan do not

(1) Cause the principal balance to increase;

(2) Allow the consumer to defer repayment of principal; or

(3) Result in a balloon payment, as defined in §1026.18(s)(5)(i); and

(C) The proceeds from the refinancing are used solely to satisfy the existing obligation and amounts attributed solely to the costs of the refinancing; and

(viii) A transaction secured by:

(A) A new manufactured home and land, but the exemption shall only apply to the requirement in paragraph (c)(3)(i) of this section that the appraiser conduct a physical visit of the interior of the new manufactured home; or

(B) A manufactured home and not land, for which the creditor obtains one of the following and provides a copy to the consumer no later than three business days prior to consummation of the transaction—

(1) For a new manufactured home, the manufacturer's invoice for the manufactured home securing the transaction, provided that the date of manufacture is no earlier than 18 months prior to the creditor's receipt of the consumer's application for credit;

(2) A cost estimate of the value of the manufactured home securing the transaction obtained from an independent cost service provider; or

(3) A valuation, as defined in §1026.42(b)(3), of the manufactured home performed by a person who has no direct or indirect interest, financial or otherwise, in the property or transaction for which the valuation is performed and has training in valuing manufactured homes.

Regulatory Commentary

35(c)(2) Exemptions

1. ***Compliance with title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA).*** *Section 1026.35(c)(2) provides exemptions solely from the requirements of section 1026.35(c)(3) through (6). Institutions subject to the requirements of FIRREA and its implementing regulations that make a loan qualifying for an exemption under section 1026.35(c)(2) must still comply with appraisal and evaluation requirements under FIRREA and its implementing regulations.*

Paragraph 35(c)(2)(i)

1. ***Qualified mortgage criteria.*** *Under §1026.35(c)(2)(i), a loan is exempt from the appraisal requirements of §1026.35(c) if either:*

   i. The loan is

   (1) subject to the Bureau's ability-to-repay requirements in §1026.43 as a "covered transaction" (defined in §1026.43(b)(1)) and (2) a qualified mortgage pursuant to the Bureau's rules or, for loans insured, guaranteed, or administered by the U.S. Department of Housing and Urban Development (HUD), U.S. Department of Veterans Affairs (VA), U.S. Department of Agriculture (USDA), or Rural Housing Service (RHS), a qualified mortgage pursuant to applicable rules prescribed by those agencies (but only once such rules are in effect; otherwise, the Bureau's definition of a qualified mortgage applies to those loans); or

   ii. The loan is

   (1) not subject to the Bureau's ability-to-repay requirements in §1026.43 as a "covered transaction" (defined in §1026.43(b)(1)), but (2) meets the criteria for a qualified mortgage in the Bureau's rules or, for loans insured, guaranteed, or administered by HUD, VA, USDA, or RHS, meets the criteria for a qualified mortgage in the applicable rules prescribed by those agencies (but only once such rules are in effect; otherwise, the Bureau's criteria for a qualified mortgage applies to those loans). To explain further, loans enumerated in §1026.43(a) are not "covered transactions" under the Bureau's ability-to-repay requirements in §1026.43, and thus cannot be qualified mortgages (entitled to a rebuttable presumption or safe harbor of compliance with the ability-to-repay requirements of §1026.43, see, e.g., §1026.43(e)(1)). These include an extension of credit made pursuant to a program administered by a Housing Finance Agency, as defined under 24 CFR 266.5, or pursuant to a program authorized by sections 101 and 109 of the Emergency Economic Stabilization Act of 2008. See §1026.43(a)(3)(iv) and (vi). They also include extensions of credit made by a creditor identified in §1026.43(a)(3)(v). However, these loans are eligible for the exemption in §1026.35(c)(2)(i) if they meet the Bureau's qualified mortgage criteria in §1026.43(e)(2), (4), (5), or (6) or §1026.43(f) (including limits on when loans must be consummated) or, for loans that

are insured, guaranteed, or administered by HUD, VA, USDA, or RHS, in applicable rules prescribed by those agencies (but only once such rules are in effect; otherwise, the Bureau's criteria for a qualified mortgage applies to those loans). For example, assume that HUD has prescribed rules to define loans insured under its programs that are qualified mortgages and those rules are in effect. Assume further that a creditor designated as a Community Development Financial Institution, as defined under 12 CFR 1805.104(h), originates a loan insured by the Federal Housing Administration, which is a part of HUD. The loan is not a "covered transaction" and thus is not a qualified mortgage. See §1026.43(a)(3)(v)(A) and (b)(1). Nonetheless, the transaction is eligible for an exemption from the appraisal requirements of §1026.35(c) if it meets the qualified mortgage criteria in HUD's rules. Nothing in §1026.35(c)(2)(i) alters the definition of a qualified mortgage under regulations of the Bureau, HUD, VA, USDA, or RHS.

Paragraph 35(c)(2)(ii)

1. ***Threshold amount.*** *For purposes of §1026.35(c)(2)(ii), the threshold amount in effect during a particular one-year period is the amount stated below for that period. The threshold amount is adjusted effective January 1 of every year by the percentage increase in the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W) that was in effect on the preceding June 1. Every year, this comment will be amended to provide the threshold amount for the upcoming one-year period after the annual percentage change in the CPI-W that was in effect on June 1 becomes available. Any increase in the threshold amount will be rounded to the nearest $100 increment. For example, if the percentage increase in the CPI-W would result in a $950 increase in the threshold amount, the threshold amount will be increased by $1,000. However, if the percentage increase in the CPI-W would result in a $949 increase in the threshold amount, the threshold amount will be increased by $900.*

   i. through iii. Omitted.

   iv. From January 1, 2018, through December 31, 2018, the threshold amount is $26,000.

2. ***Qualifying for exemption - in general.*** *A transaction is exempt under §1026.35(c)(2)(ii) if the creditor makes an extension of credit at consummation that is equal to or below the threshold amount in effect at the time of consummation.*

3. ***Qualifying for exemption - subsequent changes.*** *A transaction does not meet the condition for an exemption under §1026.35(c)(2)(ii) merely because it is used to satisfy and replace an existing exempt loan, unless the amount of the new extension of credit is equal to or less than the applicable threshold amount. For example, assume a closed-end loan that qualified for a §1026.35(c)(2)(ii) exemption at consummation in year one is refinanced in year ten and that the new loan amount is greater than the threshold amount in effect in year ten. In these circumstances, the creditor must comply with all of the applicable requirements of §1026.35(c) with respect to the year ten transaction if the original loan is satisfied and replaced by the new loan, unless another exemption from the requirements of §1026.35(c) applies. See §1026.35(c)(2) and §1026.35(c)(4)(vii).*

Paragraph 35(c)(2)(iii)

1. ***Secured by a mobile home.*** *For purposes of the exemption in §1026.35(c)(2)(iii), a mobile home does not include a manufactured home, as defined in §1026.35(c)(1)(ii).*

Paragraph 35(c)(2)(iv)

1. ***Construction-to-permanent loans.*** *Section 1026.35(c) does not apply to a transaction to finance the initial construction of a dwelling. This exclusion applies to a construction-only loan as well as to the construction phase of a construction-to-permanent loan. Section 1026.35(c) does apply, however, to permanent financing that replaces a construction loan, whether the permanent financing is extended by the same or a different creditor, unless the permanent financing is otherwise exempt from the requirements of §1026.35(c). See §1026.35(c)(2). When a construction loan may be permanently financed by the same creditor, the general disclosure requirements for closed-end credit (§1026.17) provide that the creditor may give either one combined disclosure for both the construction financing and the permanent financing, or a separate set of disclosures for each of the two phases as though they were two separate transactions. See §1026.17(c)(6)(ii) and comment 17(c)(6)-2. Section 1026.17(c)(6)(ii) addresses only how a creditor may elect to disclose a construction-to-permanent transaction. Which disclosure option a creditor elects under §1026.17(c)(6)(ii) does not affect the determination of whether the permanent phase of the transaction is subject to §1026.35(c). When the creditor discloses the two phases as separate transactions, the annual percentage rate for the permanent phase must be compared to the average prime offer rate for a transaction that is comparable to the permanent financing to determine coverage under §1026.35(c). When the creditor discloses the two phases as a single transaction, a single annual percentage rate, reflecting the appropriate charges from both phases, must be calculated for the transaction in accordance with §1026.35 and appendix D to part 1026. The annual percentage rate must be compared to the average prime offer rate for a transaction that is comparable to the permanent financing to determine coverage under §1026.35(c). If the transaction is determined to be a higher-priced mortgage loan not otherwise exempt under §1026.35(c)(2), only the permanent phase is subject to the requirements of §1026.35(c).*

2. ***Financing initial construction***. *The exemption for construction loans in §1026.35(c)(2)(iv) applies to temporary financing of the construction of a dwelling that will be replaced by permanent financing once construction is complete. The exemption does not apply, for example, to loans to finance the purchase of manufactured homes that have not been or are in the process of being built when the financing obtained by the consumer at that time is permanent. See §1026.35(c)(2)(viii).*

Paragraph 35(c)(2)(vii)(A)(1)

1. ***Same credit risk holder.*** *The requirement that the holder of the credit risk on the existing obligation and the refinancing be the same applies to situations in which an entity bears the financial responsibility for the default of a loan by either holding the loan in its portfolio or guaranteeing payments of principal and any interest to investors in a mortgage-backed security in which the loan is pooled. See §1026.35(c)(1)(ii) (defining "credit risk"). For example, a credit risk holder could be a bank that bears the credit risk on the existing obligation by holding the loan in the bank's portfolio. Another example of a credit risk holder would be a government-sponsored enterprise that bears the risk of default on a loan by guaranteeing the payment of principal and any interest on a loan to investors in a mortgage-backed security. The holder of credit risk under §1026.35(c)(2)(vii)(A)(1) does not mean individual investors in a mortgage-backed security or providers of private mortgage insurance.*

2. ***Same credit risk holder - illustrations***. *Illustrations of the credit risk holder of the existing obligation continuing to be the credit risk holder of the refinancing include, but are not limited to, the following:*

   i. The existing obligation is held in the portfolio of a bank, thus the bank holds the credit risk. The bank arranges to refinance the loan and also will hold the refinancing in its portfolio. If the refinancing otherwise meets the requirements for an exemption under §1026.35(c)(2)(vii), the transaction will qualify for the exemption because the credit risk holder is the same for the existing obligation and the refinance transaction. In this case, the exemption would apply regardless of whether the bank arranged to refinance the loan directly or indirectly, such as through the servicer or subservicer on the existing obligation.

   ii. The existing obligation is held in the portfolio of a government-sponsored enterprise (GSE), thus the GSE holds the credit risk. The existing obligation is then refinanced by the servicer of the loan and immediately transferred to the GSE. The GSE pools the refinancing in a mortgage-backed security guaranteed by the GSE, thus the GSE holds the credit risk on the refinance loan. If the refinance transaction otherwise meets the requirements for an exemption under §1026.35(c)(2)(vii), the transaction will qualify for the exemption because the credit risk holder is the same for the existing obligation and the refinance transaction. In this case, the exemption would apply regardless of whether the existing obligation was refinanced by the servicer or subservicer on the existing obligation (acting as a "creditor" under §1026.2(a)(17)) or by a different creditor.

3. ***Forward commitments.*** *A creditor may make a mortgage loan that will be sold or otherwise transferred pursuant to an agreement that has been entered into at or before the time the transaction is consummated. Such an agreement is sometimes known as a "forward commitment." A refinance loan does not satisfy the requirement of §1026.35(c)(2)(vii)(A)(1) if the loan will be acquired pursuant to a forward commitment, such that the credit risk on the refinance loan will transfer to a person who did not hold the credit risk on the existing obligation.*

Paragraph 35(c)(2)(vii)(B)

1. ***Regular periodic payments.*** *Under §1026.35(c)(2)(vii)(B), the regular periodic payments on the refinance loan must not: result in an increase of the principal balance (negative amortization); allow the consumer to defer repayment of principal (see comment 43(e)(2)(i)-2); or result in a balloon payment. Thus, the terms of the legal obligation must require the consumer to make payments of principal and interest on a monthly or other periodic basis that will repay the loan amount over the loan term. Except for payments resulting from any interest rate changes after consummation in an adjustable-rate or step-rate mortgage, the periodic payments must be substantially equal. For an explanation of the term "substantially equal," see comment 43(c)(5)(i)-4. In addition, a single-payment transaction is not a refinancing meeting the requirements of §1026.35(c)(2)(vii) because it does not require "regular periodic payments."*

Paragraph 35(c)(2)(vii)(C)

1. ***Permissible use of proceeds.*** *The exemption for a refinancing under §1026.35(c)(2)(vii) is available only if the proceeds from the refinancing are used exclusively for the existing obligation and amounts attributed solely to the costs of the refinancing. The existing obligation includes the unpaid principal balance of the existing first lien loan, any earned unpaid finance charges, and any other lawful charges related to the existing loan. For guidance on the meaning of refinancing costs, see comment 23(f)-4. If the proceeds of a refinancing are used for other purposes, such as to pay off other liens or to provide additional cash to the consumer for*

discretionary spending, the transaction does not qualify for the exemption for a refinancing under §1026.35(c)(2)(vii) from the appraisal requirements in §1026.35(c).

For applications received on or after July 18, 2015

Paragraph 35(c)(2)(viii)(A)

1. ***Secured by new manufactured home and land - physical visit of the interior.*** *A transaction secured by a new manufactured home and land is subject to the requirements of §1026.35(c)(3) through (6) except for the requirement in §1026.35(c)(3)(i) that the appraiser conduct a physical inspection of the interior of the property. Thus, for example, a creditor of a loan secured by a new manufactured home and land could comply with §1026.35(c)(3)(i) by obtaining an appraisal conducted by a state-certified or -licensed appraiser based on plans and specifications for the new manufactured home and an inspection of the land on which the property will be sited, as well as any other information necessary for the appraiser to complete the appraisal assignment in conformity with the Uniform Standards of Professional Appraisal Practice and the requirements of FIRREA and any implementing regulations.*

Paragraph 35(c)(2)(viii)(B)

1. ***Secured by a manufactured home and not land.*** *Section 1026.35(c)(2)(viii)(B) applies to a higher-priced mortgage loan secured by a manufactured home and not land, regardless of whether the home is titled as realty by operation of state law.*

Paragraph 35(c)(2)(viii)(B)(2)

1. ***Independent.*** *A cost service provider from which the creditor obtains a manufactured home unit cost estimate under §1026.35(c)(2)(viii)(B)(2) is "independent" if that person is not affiliated with the creditor in the transaction, such as by common corporate ownership, and receives no direct or indirect financial benefits based on whether the transaction is consummated.*

2. ***Adjustments.*** *The requirement that the cost estimate be from an independent cost service provider does not prohibit a creditor from providing a cost estimate that reflects adjustments to account for factors such as special features, condition or location. However, the requirement that the estimate be obtained from an independent cost service provider means that any adjustments to the estimate must be based on adjustment factors available as part of the independent cost service used, with associated values that are determined by the independent cost service.*

Paragraph 35(c)(2)(viii)(C)(3)

1. ***Interest in the property.*** *A person has a direct or indirect in the property if, for example, the person has any ownership or reasonably foreseeable ownership interest in the manufactured home. To illustrate, a person who seeks a loan to purchase the manufactured home to be valued has a reasonably foreseeable ownership interest in the property.*

2. ***Interest in the transaction.*** *A person has a direct or indirect interest in the transaction if, for example, the person or an affiliate of that person also serves as a loan officer of the creditor or otherwise arranges the credit transaction, or is the retail dealer of the manufactured home. A person also has a prohibited interest in the transaction if the person is compensated or otherwise receives financial or other benefits based on whether the transaction is consummated.*

3. ***Training in valuing manufactured homes.*** *Training in valuing manufactured homes includes, for example, successfully completing a course in valuing manufactured homes offered by a state or national appraiser association or receiving job training from an employer in the business of valuing manufactured homes.*

4. ***Manufactured home valuation - example.*** *A valuation in compliance with §1026.35(c)(2)(viii)(B)(3) would include, for example, an appraisal of the manufactured home in accordance with the appraisal requirements for a manufactured home classified as personal property under the Title I Manufactured Home Loan Insurance Program of the U.S. Department of Housing and Urban Development, pursuant to section 2(b)(10) of the National Housing Act, 12 U.S.C. 1703(b)(10).*

Appraisals - Appraisals Required - 12 CFR § 1026.35(c)(3)

Regulatory Discussion

This section states, in general, a creditor shall not extend a higher-priced mortgage loan without obtaining (prior to consummation) a written appraisal of the property to be mortgaged. Subject, of course, to the eight specific exemptions discussed previously under (c)(2)(i) through (viii).

In addition, the appraisal must be performed by a certified or licensed appraiser (defined in (c)(1)(i)) who conducts a physical visit of the interior of the collateral property.

Note the safe harbor protections.

Regulatory Text

(c) Appraisals.

(3) **Appraisals required**

(i) **In general.** Except as provided in paragraph (c)(2) of this section, a creditor shall not extend a higher-priced mortgage loan to a consumer without obtaining, prior to consummation, a written appraisal of the property to be mortgaged. The appraisal must be performed by a certified or licensed appraiser who conducts a physical visit of the interior of the property that will secure the transaction.

(ii) **Safe harbor.** A creditor obtains a written appraisal that meets the requirements for an appraisal required under paragraph (c)(3)(i) of this section if the creditor:

(A) Orders that the appraiser perform the appraisal in conformity with the Uniform Standards of Professional Appraisal Practice and title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, as amended (12 U.S.C. 3331 *et seq.*), and any implementing regulations in effect at the time the appraiser signs the appraiser's certification;

(B) Verifies through the National Registry that the appraiser who signed the appraiser's certification was a certified or licensed appraiser in the State in which the appraised property is located as of the date the appraiser signed the appraiser's certification;

(C) Confirms that the elements set forth in appendix N to this part are addressed in the written appraisal; and

(D) Has no actual knowledge contrary to the facts or certifications contained in the written appraisal.

Regulatory Commentary

35(c)(3) Appraisals Required

35(c)(3)(i) In General

1. ***Written appraisal - electronic transmission.*** *To satisfy the requirement that the appraisal be "written," a creditor may obtain the appraisal in paper form or via electronic transmission.*

35(c)(3)(ii) Safe Harbor.

1. ***Safe harbor.*** *A creditor that satisfies the safe harbor conditions in §1026.35(c)(3)(ii)(A) through (D) complies with the appraisal requirements of §1026.35(c)(3)(i). A creditor that does not satisfy the safe harbor conditions in §1026.35(c)(3)(ii)(A) through (D) does not necessarily violate the appraisal requirements of §1026.35(c)(3)(i).*

2. ***Appraiser's certification.*** *For purposes of §1026.35(c)(3)(ii), the appraiser's certification refers to the certification specified in item 9 of appendix N. See also comment 35(c)(1)(i)-2.*

Paragraph 35(c)(3)(ii)(C)

1. ***Confirming elements in the appraisal.*** *To confirm that the elements in appendix N to this part are included in the written appraisal, a creditor need not look beyond the face of the written appraisal and the appraiser's certification.*

Appraisals - Additional Appraisal for Certain HPMLs - 12 CFR § 1026.35(c)(4)

Regulatory Discussion

In the event either of the two circumstances described under (c)(4)(i)(A) or (B) occurs, two written appraisals are required. Items (c)(4)(ii) through (v) include additional requirements relative to the two appraisal requirement.

Item (c)(4)(vi) discusses a *potential exemption* if the creditor can can *demonstrate by exercising reasonable diligence* that the requirement to obtain two appraisals does not apply

Item (c)(4)(vii)(A) through (H) provides *eight actual exemptions* from the two appraisal requirement.

The commentary provides additional important information on every item, (i) through (vii).

Regulatory Text

(c) Appraisals.

(4) **Additional appraisal for certain higher-priced mortgage loans**

(i) **In general.** Except as provided in paragraphs (c)(2) and (c)(4)(vii) of this section, a creditor shall not extend a higher-priced mortgage loan to a consumer to finance the acquisition of the consumer's principal dwelling without obtaining, prior to consummation, two written appraisals, if:

(A) The seller acquired the property 90 or fewer days prior to the date of the consumer's agreement to acquire the property and the price in the consumer's agreement to acquire the property exceeds the seller's acquisition price by more than 10 percent; or

(B) The seller acquired the property 91 to 180 days prior to the date of the consumer's agreement to acquire the property and the price in the consumer's agreement to acquire the property exceeds the seller's acquisition price by more than 20 percent.

(ii) **Different certified or licensed appraisers.** The two appraisals required under paragraph (c)(4)(i) of this section may not be performed by the same certified or licensed appraiser.

(iii) **Relationship to general appraisal requirements.** If two appraisals must be obtained under paragraph (c)(4)(i) of this section, each appraisal shall meet the requirements of paragraph (c)(3)(i) of this section.

(iv) **Required analysis in the additional appraisal.** One of the two required appraisals must include an analysis of:

(A) The difference between the price at which the seller acquired the property and the price that the consumer is obligated to pay to acquire the property, as specified in the consumer's agreement to acquire the property from the seller;

(B) Changes in market conditions between the date the seller acquired the property and the date of the consumer's agreement to acquire the property; and

(C) Any improvements made to the property between the date the seller acquired the property and the date of the consumer's agreement to acquire the property.

(v) **No charge for the additional appraisal.** If the creditor must obtain two appraisals under paragraph (c)(4)(i) of this section, the creditor may charge the consumer for only one of the appraisals.

(vi) **Creditor's determination of prior sale date and price**

(A) **Reasonable diligence.** A creditor must obtain two written appraisals under paragraph (c)(4)(i) of this section unless the creditor can demonstrate by exercising reasonable diligence that the requirement to obtain two appraisals does not apply. A creditor acts with reasonable diligence if the creditor bases its determination on information contained in written source documents, such as the documents listed in Appendix O to this part.

(B) **Inability to determine prior sale date or price - modified requirements for**

additional appraisal. If, after exercising reasonable diligence, a creditor cannot determine whether the conditions in paragraphs (c)(4)(i)(A) and (c)(4)(i)(B) are present and therefore must obtain two written appraisals in accordance with paragraphs (c)(4)(i) through (v) of this section, one of the two appraisals shall include an analysis of the factors in paragraph (c)(4)(iv) of this section only to the extent that the information necessary for the appraiser to perform the analysis can be determined.

(vii) **Exemptions from the additional appraisal requirement.** The additional appraisal required under paragraph (c)(4)(i) of this section shall not apply to extensions of credit that finance a consumer's acquisition of property:

(A) From a local, State or Federal government agency;

(B) From a person who acquired title to the property through foreclosure, deed-in-lieu of foreclosure, or other similar judicial or non-judicial procedure as a result of the person's exercise of rights as the holder of a defaulted mortgage loan;

(C) From a non-profit entity as part of a local, State, or Federal government program under which the non-profit entity is permitted to acquire title to single-family properties for resale from a seller who acquired title to the property through the process of foreclosure, deed-in-lieu of foreclosure, or other similar judicial or non-judicial procedure;

(D) From a person who acquired title to the property by inheritance or pursuant to a court order of dissolution of marriage, civil union, or domestic partnership, or of partition of joint or marital assets to which the seller was a party;

(E) From an employer or relocation agency in connection with the relocation of an employee;

(F) From a servicemember, as defined in 50 U.S.C. App. 511(1), who received a deployment or permanent change of station order after the servicemember purchased the property;

(G) Located in an area designated by the President as a federal disaster area, if and for as long as the Federal financial institutions regulatory agencies, as defined in 12 U.S.C. 3350(6), waive the requirements in title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, as amended (12 U.S.C. 3331 *et seq.*), and any implementing regulations in that area; or

(H) Located in a rural county, as defined in 12 CFR 1026.35(b)(2)(iv)(A).

Regulatory Commentary

35(c)(4) Additional Appraisal for Certain Higher-Priced Mortgage Loans

1. ***Acquisition.*** *For purposes of §1026.35(c)(4), the terms "acquisition" and "acquire" refer to the acquisition of legal title to the property pursuant to applicable State law, including by purchase.*

35(c)(4)(i) In General

1. ***Appraisal from a previous transaction.*** *An appraisal that was previously obtained in connection with the seller's acquisition or the financing of the seller's acquisition of the property*

does not satisfy the requirements to obtain two written appraisals under §1026.35(c)(4)(i).

2. ***90-day, 180-day calculation.*** *The time periods described in §1026.35(c)(4)(i)(A) and (B) are calculated by counting the day after the date on which the seller acquired the property, up to and including the date of the consumer's agreement to acquire the property that secures the transaction. For example, assume that the creditor determines that date of the consumer's acquisition agreement is October 15, 2012, and that the seller acquired the property on April 17, 2012. The first day to be counted in the 180-day calculation would be April 18, 2012, and the last day would be October 15, 2012. In this case, the number of days from April 17 would be 181, so an additional appraisal is not required.*

3. ***Date seller acquired the property.*** *For purposes of §1026.35(c)(4)(i)(A) and (B), the date on which the seller acquired the property is the date on which the seller became the legal owner of the property pursuant to applicable State law.*

4. ***Date of the consumer's agreement to acquire the property.*** *For the date of the consumer's agreement to acquire the property under §1026.35(c)(4)(i)(A) and (B), the creditor should use the date on which the consumer and the seller signed the agreement provided to the creditor by the consumer. The date on which the consumer and the seller signed the agreement might not be the date on which the consumer became contractually obligated under State law to acquire the property. For purposes of §1026.35(c)(4)(i)(A) and (B), a creditor is not obligated to determine whether and to what extent the agreement is legally binding on both parties. If the dates on which the consumer and the seller signed the agreement differ, the creditor should use the later of the two dates.*

5. ***Price at which the seller acquired the property.*** *The price at which the seller acquired the property refers to the amount paid by the seller to acquire the property. The price at which the seller acquired the property does not include the cost of financing the property.*

6. ***Price the consumer is obligated to pay to acquire the property.*** *The price the consumer is obligated to pay to acquire the property is the price indicated on the consumer's agreement with the seller to acquire the property. The price the consumer is obligated to pay to acquire the property from the seller does not include the cost of financing the property. For purposes of §1026.35(c)(4)(i)(A) and (B), a creditor is not obligated to determine whether and to what extent the agreement is legally binding on both parties. See also comment 35(c)(4)(i)-4.*

35(c)(4)(ii) Different Certified or Licensed Appraisers

1. ***Independent appraisers.*** *The requirements that a creditor obtain two separate appraisals under §1026.35(c)(4)(i), and that each appraisal be conducted by a different licensed or certified appraiser under §1026.35(c)(4)(ii), indicate that the two appraisals must be conducted independently of each other. If the two certified or licensed appraisers are affiliated, such as by being employed by the same appraisal firm, then whether they have conducted the appraisal independently of each other must be determined based on the facts and circumstances of the particular case known to the creditor.*

35(c)(4)(iii) Relationship to General Appraisal Requirements

1. ***Safe harbor.*** *When a creditor is required to obtain an additional appraisal under §1026(c)(4)(i), the creditor must comply with the requirements of both §1026.35(c)(3)(i) and §1026.35(c)(4)(ii) through (v) for that appraisal. The creditor complies with the requirements of §1026.35(c)(3)(i) for the additional appraisal if the creditor meets the safe harbor conditions in §1026.35(c)(3)(ii) for that appraisal.*

35(c)(4)(iv) Required Analysis in the Additional Appraisal

1. ***Determining acquisition dates and prices used in the analysis of the additional appraisal.*** *For guidance on identifying the date on which the seller acquired the property, see comment 35(c)(4)(i)-3. For guidance on identifying the date of the consumer's agreement to acquire the property, see comment 35(c)(4)(i)-4. For guidance on identifying the price at which the seller acquired the property, see comment 35(c)(4)(i)-5. For guidance on identifying the price the consumer is obligated to pay to acquire the property, see comment 35(c)(4)(i)-6.*

35(c)(4)(v) No Charge for Additional Appraisal

1. ***Fees and mark-ups.*** *The creditor is prohibited from charging the consumer for the performance of one of the two appraisals required under §1026.35(c)(4)(i), including by imposing a fee specifically for that appraisal or by marking up the interest rate or any other fees payable by the consumer in connection with the higher-priced mortgage loan.*

35(c)(4)(vi) Creditor's Determination of Prior Sale Date and Price

35(c)(4)(vi)(A) In General

1. ***Estimated sales price.*** *If a written source document describes the seller's acquisition price in a manner that indicates that the price described is an estimated or assumed amount and not the actual price, the creditor should look at an alternative document to satisfy the reasonable diligence standard in determining the price at which the seller acquired the property.*

2. ***Reasonable diligence - oral statements insufficient.*** *Reliance on oral statements of interested parties, such as the consumer, seller, or mortgage broker, does not constitute reasonable diligence under §1026.35(c)(4)(vi)(A).*

3. ***Lack of information and conflicting information - two appraisals required.*** *If a creditor is unable to demonstrate that the requirement to obtain two appraisals under §1026.35(c)(4)(i) does not apply, the creditor must obtain two written appraisals before extending a higher-priced mortgage loan subject to the requirements of §1026.35(c). See also comment 35(c)(4)(vi)(B)-1. For example:*

   i. *Assume a creditor orders and reviews the results of a title search, which shows that a prior sale occurred between 91 and 180 days ago, but not the price paid in that sale. Thus, based on the title search, the creditor would not be able to determine whether the price the consumer is obligated to pay under the consumer's acquisition agreement is more than 20 percent higher than the seller's acquisition price, pursuant to §1026.35(c)(4)(i)(B). Before extending a higher-priced mortgage loan subject to the appraisal requirements of §1026.35(c), the creditor must either: (1) Perform additional diligence to ascertain the seller's acquisition price and, based on this information, determine whether two written appraisals are required; or (2) obtain two written appraisals in compliance with §1026.35(c)(4). See also comment 35(c)(4)(vi)(B)-1.*

   ii. *Assume a creditor reviews the results of a title search indicating that the last recorded purchase was more than 180 days before the consumer's agreement to acquire the property. Assume also that the creditor subsequently receives a written appraisal indicating that the seller acquired the property between 91 and 180 days before the consumer's agreement to acquire the property. In this case, unless one of these sources is clearly wrong on its face, the creditor would not be able to determine whether the seller acquired the property within 180 days of the date of the consumer's agreement to acquire the property from the seller, pursuant to §1026.35(c)(4)(i)(B). Before extending a higher-priced mortgage loan subject to* *the appraisal requirements of §1026.35(c), the creditor must either: perform additional diligence to ascertain the seller's acquisition date and, based on this information, determine whether two written appraisals are required; or obtain two written appraisals in compliance with §1026.35(c)(4). See also comment 35(c)(4)(vi)(B)-1.*

35(c)(4)(vi)(B) Inability To Determine Prior Sales Date or Price - Modified Requirements for Additional Appraisal

1. ***Required analysis.*** *In general, the additional appraisal required under §1026.35(c)(4)(i) should include an analysis of the factors listed in §1026.35(c)(4)(iv)(A) through (C). However, if, following reasonable diligence, a creditor cannot determine whether the conditions in §1026.35(c)(4)(i)(A) or (B) are present due to a lack of information or conflicting information, the required additional appraisal must include the analyses required under §1026.35(c)(4)(iv)(A) through (C) only to the extent that the information necessary to perform the analyses is known. For example, assume that a creditor is able, following reasonable diligence, to determine that the date on which the seller acquired the property occurred between 91 and 180 days prior to the date of the consumer's agreement to acquire the property. However, the creditor is unable, following reasonable diligence, to determine the price at which the seller acquired the property. In this case, the creditor is required to obtain an additional written appraisal that includes an analysis under §1026.35(c)(4)(iv)(B) and (c)(4)(iv)(C) of the changes in market conditions and any improvements made to the property between the date the seller acquired the property and the date of the consumer's agreement to acquire the property. However, the creditor is not required to obtain an additional written appraisal that includes analysis under §1026.35(c)(4)(iv)(A) of the difference between the price at which the seller acquired the property and the price that the consumer is obligated to pay to acquire the property.*

35(c)(4)(vii) Exemptions From the Additional Appraisal Requirement

Paragraph 35(c)(4)(vii)(C)

1. ***Non-profit entity.*** *For purposes of §1026.35(c)(4)(vii)(C), a "non-profit entity" is a person with a tax exemption ruling or determination letter from the Internal Revenue Service under section 501(c)(3) of the Internal Revenue Code of 1986 (26 U.S.C. 501(c)(3)).*

Paragraph 35(c)(4)(vii)(H)

1. ***Bureau table of rural counties.*** *The Bureau publishes on its Web site a table of rural counties under §1026.35(c)(4)(vii)(H) for each calendar year by the end of that calendar year. See comment 35(b)(2)(iv)-1. A property securing an HPML subject to §1026.35(c) is in a rural county under §1026.35(c)(4)(vii)(H) if the county in which the property is located is on the table of rural counties most recently published by the Bureau. For example, for a transaction occurring in 2015, assume that the Bureau most recently published a table of rural counties at the end of 2014. The property securing the transaction would be located in a rural county for purposes of §1026.35(c)(4)(vii)(H) if the county is on the table of rural counties published by the Bureau at the end of 2014.*

Appraisals - Required Disclosure - 12 CFR § 1026.35(c)(5)

Regulatory Discussion

In general (except as provided in (c)(2), above), a specific disclosure must be provided, in writing, to a consumer who applies for a higher-priced mortgage loan.

In general, the disclosure must be delivered or placed in the mail no later than the third business day after the creditor receives the consumer's application (or is thereafter determined to be) for a higher-priced mortgage loan.

NOTE: compliance with the disclosure requirements in Regulation B will also satisfy the requirements of this section.

Regulatory Text

(c) Appraisals.

(5) **Required disclosure**

(i) **In general.** Except as provided in paragraph (c)(2) of this section, a creditor shall disclose the following statement, in writing, to a consumer who applies for a higher-priced mortgage loan: "We may order an appraisal to determine the property's value and charge you for this appraisal. We will give you a copy of any appraisal, even if your loan does not close. You can pay for an additional appraisal for your own use at your own cost." Compliance with the disclosure requirement in Regulation B, 12 CFR 1002.14(a)(2), satisfies the requirements of this paragraph.

(ii) **Timing of disclosure.** The disclosure required by paragraph (c)(5)(i) of this section shall be delivered or placed in the mail no later than the third business day after the creditor receives the consumer's application for a higher-priced mortgage loan subject to paragraph (c) of this section. In the case of a loan that is not a higher-priced mortgage loan subject to paragraph (c) of this section at the time of application, but becomes a higher-priced mortgage loan subject to paragraph (c) of this section after application, the disclosure shall be delivered or placed in the mail not later than the third business day after the creditor determines that the loan is a higher-priced mortgage loan subject to paragraph (c) of this section.

Regulatory Commentary

35(c)(5) Required Disclosure

35(c)(5)(i) In General

*1. **Multiple applicants.** When two or more consumers apply for a loan subject to this section, the creditor is required to give the disclosure to only one of the consumers.*

*2. **Appraisal independence requirements not affected.** Nothing in the text of the consumer notice required by §1026.35(c)(5)(i) should be construed to affect, modify, limit, or supersede the operation of any legal, regulatory, or other requirements or standards relating to independence in the conduct of appraisers or restrictions on the use of borrower-ordered appraisals by creditors.*

Appraisals – Copy of Appraisals - 12 CFR § 1026.35(c)(6)

Regulatory Discussion

This section requires the creditor to provide (at no cost) the consumer a copy (in electronic form subject to E-Sign Act) of any written appraisal associated with a higher-priced mortgage loan. The appraisal(s) must be provided no later than three business days prior to consummation; or in the event the loan is not consummated, no later than 30 days after it is know the loan will not be consummated.

Regulatory Text

(c) Appraisals.

(6) **Copy of appraisals**

(i) **In general.** Except as provided in paragraph (c)(2) of this section, a creditor shall provide to the consumer a copy of any written appraisal performed in connection with a higher-priced mortgage loan pursuant to paragraphs (c)(3) and (c)(4) of this section.

(ii) ***Timing.*** A creditor shall provide to the consumer a copy of each written appraisal pursuant to paragraph (c)(6)(i) of this section:

(A) No later than three business days prior to consummation of the loan; or

(B) In the case of a loan that is not consummated, no later than 30 days after the creditor determines that the loan will not be consummated.

(iii) **Form of copy.** Any copy of a written appraisal required by paragraph (c)(6)(i) of this section may be provided to the applicant in electronic form, subject to compliance with the consumer consent and other applicable provisions of the Electronic Signatures in Global and National Commerce Act (E-Sign Act) (15 U.S.C. 7001 *et seq*.).

(iv) **No charge for copy of appraisal.** A creditor shall not charge the consumer for a copy of a written appraisal required to be provided to the consumer pursuant to paragraph (c)(6)(i) of this section.

Regulatory Commentary

35(c)(6) Copy of Appraisals

35(c)(6)(i) In General

*1. **Multiple applicants.** When two or more consumers apply for a loan subject to this section, the creditor is required to give the copy of each required appraisal to only one of the consumers.*

35(c)(6)(ii) Timing

*1. **"Provide."** For purposes of the requirement to provide a copy of the appraisal within a specified time under §1026.35(c)(6)(ii), "provide" means "deliver." Delivery occurs three business days after mailing or delivering the copies to the last-known address of the applicant, or when evidence indicates actual receipt by the applicant (which, in the case of electronic receipt, must be based upon consent that complies with the E-Sign Act), whichever is earlier.*

2. ***No waiver.*** *Regulation B, 12 CFR 1002.14(a)(1), allowing the consumer to waive the requirement that the appraisal copy be provided three business days before consummation, does not apply to higher-priced mortgage loans subject to §1026.35(c). A consumer of a higher-priced mortgage loan subject to §1026.35(c) may not waive the timing requirement to receive a copy of the appraisal under §1026.35(c)(6)(i).*

35(c)(6)(iv) No Charge for Copy Of Appraisal

1. ***Fees and mark-ups.*** *The creditor is prohibited from charging the consumer for any copy of an appraisal required to be provided under §1026.35(c)(6)(i), including by imposing a fee specifically for a required copy of an appraisal or by marking up the interest rate or any other fees payable by the consumer in connection with the higher-priced mortgage loan.*

Appraisals - Relation to Other Rules - 12 CFR § 1026.35(c)(7)

Regulatory Discussion

This section simply states the appraisal rules are consistent among the various supervisory agencies.

Regulatory Text

(c) Appraisals.

(7) **Relation to other rules**. The rules in this paragraph (c) were adopted jointly by the Federal Reserve Board (Board), the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Federal Housing Finance Agency, and the Bureau. These rules are substantively identical to the Board's and the OCC's higher-priced mortgage loan appraisal rules published separately in 12 CFR 226.43 (for the Board) and in 12 CFR part 34, subpart G and 12 CFR part 164, subpart B (for the OCC).

Regulatory Commentary

None.

Section 4: Evasion; Open End Credit
12 C.F.R. § 1026.35(d)

Evasion; Open End Credit - 12 CFR § 1026.35(d)

Regulatory Discussion

This section simply states a creditor shall not structure a home-secured loan as an open-end plan to evade the higher-priced mortgage transaction requirements of this section.

Regulatory Text

(d) **Evasion; open-end credit.** In connection with credit secured by a consumer's principal dwelling that does not meet the definition of open-end credit in §1026.2(a)(20), a creditor shall not structure a home-secured loan as an open-end plan to evade the requirements of this section.

Regulatory Commentary

None.

Section 5: Auditing Higher Priced Mortgage Loans

Does the loan under review meet the definition of an HPML? _______________

If the loan is an HPML, does it meet the requirements for an escrow account, and was the escrow account established before consummation? _______________.

Does the loan meet the requirements for an escrow exemption? _______________

If the loan is an HPML, does it meet the HPML appraisal requirements? ______________

Does the loan meet the requirements for an appraisal exemption? _______________

Does the HPML loan require an additional appraisal due to a seller "flip?" ________________

Was the requirement for a second "flip" appraisal met? _______________

Was the required appraisal disclosure given (duplication of the Regulation B requirement? _______________

Was the required appraisal copy given (duplication of the Regulation B requirement? _______________

Did the bank avoid structuring the loan to evade the higher-priced mortgage transaction requirements? ________________

Auditing PMI

Introduction

This law has never been reduced to regulation. Therefore, we are presenting the law in its entirety.

Attendees should be aware that we are not attorneys, and if any interpretation of the law is required, competent legal counsel should be consulted.

The Law

PUBLIC LAW 105–216—JULY 29, 1998 112 STAT. 897

Public Law 105–216 105th Congress

An Act:

To require automatic cancellation and notice of cancellation rights with respect to private mortgage insurance which is required as a condition for entering into a residential mortgage transaction, to abolish the Thrift Depositor Protection Oversight Board, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE; TABLE OF CONTENTS.

(a) SHORT TITLE.—This Act may be cited as the "Homeowners Protection Act of 1998".

(b) TABLE OF CONTENTS.—The table of contents for this Act is as follows:

Sec. 1. Short title; table of contents.

Sec. 2. Definitions.

Sec. 3. Termination of private mortgage insurance.

Sec. 4. Disclosure requirements.

Sec. 5. Notification upon cancellation or termination.

Sec. 6. Disclosure requirements for lender paid mortgage insurance.

Sec. 7. Fees for disclosures.

Sec. 8. Civil liability.

Sec. 9. Effect on other laws and agreements.

Sec. 10. Enforcement.

Sec. 11. Construction.

Sec. 12. Amendment to Higher Education Act of 1965.

Sec. 13. Effective date.

Sec. 14. Abolishment of the Thrift Depositor Protection Oversight Board.

SEC. 2. DEFINITIONS.

In this Act, the following definitions shall apply:

(1) ADJUSTABLE RATE MORTGAGE. - The term "adjustable rate mortgage" means a residential mortgage that has an interest rate that is subject to change.

(2) CANCELLATION DATE. - The term "cancellation date" means -

(A) with respect to a fixed rate mortgage, at the option of the mortgagor, the date on which the principal balance of the mortgage -

(i) based solely on the initial amortization schedule for that mortgage, and irrespective of the outstanding balance for that mortgage on that date, is first scheduled to reach 80 percent of the original value of the property securing the loan; or

(ii) based solely on actual payments, reaches 80 percent of the original value of the property securing the loan; and

(B) with respect to an adjustable rate mortgage, at the option of the mortgagor, the date on which the principal balance of the mortgage -

(i) based solely on amortization schedules for that mortgage, and irrespective of the outstanding balance for that mortgage on that date, is first scheduled to reach 80 percent of the original value of the property securing the loan; or

(ii) based solely on actual payments, first reaches 80 percent of the original value of the property securing the loan.

(3) FIXED RATE MORTGAGE. - The term "fixed rate mortgage" means a residential mortgage that has an interest rate that is not subject to change.

(4) GOOD PAYMENT HISTORY. - The term "good payment history" means, with respect to a mortgagor, that the mortgagor has not -

(A) made a mortgage payment that was 60 days or longer past due during the 12-month period beginning 24 months before the date on which the mortgage reaches the cancellation date; or

(B) made a mortgage payment that was 30 days or longer past due during the 12-month period preceding the date on which the mortgage reaches the cancellation date.

(5) INITIAL AMORTIZATION SCHEDULE. - The term "initial amortization schedule" means a schedule established at the time at which a residential mortgage transaction is consummated with respect to a fixed rate mortgage, showing -

(A) the amount of principal and interest that is due at regular intervals to retire the principal balance and accrued interest over the amortization period of the loan; and

(B) the unpaid principal balance of the loan after each scheduled payment is made.

(6) MORTGAGE INSURANCE. - The term "mortgage insurance" means insurance, including any mortgage guaranty insurance, against the nonpayment of, or default on, an individual mortgage or loan involved in a residential mortgage transaction.

(7) MORTGAGE INSURER. - The term "mortgage insurer" means a provider of private mortgage insurance, as described in this Act, that is authorized to transact such business in the State in which the provider is transacting such business.

(8) MORTGAGEE. - The term "mortgagee" means the holder of a residential mortgage at the time at which that mortgage transaction is consummated.

(9) MORTGAGOR. - The term "mortgagor" means the original borrower under a residential mortgage or his or her successors or assignees.

(10) ORIGINAL VALUE. - The term "original value", with respect to a residential mortgage, means the lesser of the sales price of the property securing the mortgage, as reflected in the contract, or the appraised value at the time at which the subject residential mortgage transaction was consummated.

(11) PRIVATE MORTGAGE INSURANCE. - The term "private mortgage insurance" means mortgage insurance other than mortgage insurance made available under the National Housing Act, title 38 of the United States Code, or title V of the Housing Act of 1949.

(12) RESIDENTIAL MORTGAGE. - The term "residential mortgage" means a mortgage, loan, or other evidence of a security interest created with respect to a single-family dwelling that is the primary residence of the mortgagor.

(13) RESIDENTIAL MORTGAGE TRANSACTION. - The term "residential mortgage transaction" means a transaction consummated on or after the date that is 1 year after the date of enactment of this Act, in which a mortgage, deed of trust, purchase money security interest arising under an installment sales contract, or equivalent consensual security interest is created or retained against a single-family dwelling that is the primary residence of the mortgagor to finance the acquisition, initial construction, or refinancing of that dwelling.

(14) SERVICER. - The term "servicer" has the same meaning as in section 6(i)(2) of the Real Estate Settlement Procedures Act of 1974, with respect to a residential mortgage.

(15) SINGLE-FAMILY DWELLING. - The term "single-family dwelling" means a residence consisting of 1 family dwelling unit.

(16) TERMINATION DATE. - The term "termination date" means -

(A) with respect to a fixed rate mortgage, the date on which the principal balance of the mortgage, based solely on the initial amortization schedule for that mortgage, and irrespective of the outstanding balance for that mortgage on that date, is first scheduled to reach 78 percent of the original value of the property securing the loan; and

(B) with respect to an adjustable rate mortgage, the date on which the principal balance of the mortgage, based solely on amortization schedules for that mortgage, and irrespective of the outstanding balance for that mortgage on that date, is first scheduled to reach 78 percent of the original value of the property securing the loan.

SEC. 3. TERMINATION OF PRIVATE MORTGAGE INSURANCE.

(a) BORROWER CANCELLATION. - A requirement for private mortgage insurance in connection with a residential mortgage transaction shall be canceled on the cancellation date, if the mortgagor -

(1) submits a request in writing to the servicer that cancellation be initiated;

(2) has a good payment history with respect to the residential mortgage; and

(3) has satisfied any requirement of the holder of the mortgage (as of the date of a request under paragraph (1)) for -

(A) evidence (of a type established in advance and made known to the mortgagor by the servicer promptly upon receipt of a request under paragraph (1)) that the value of the property securing the mortgage has not declined below the original value of the property; and

(B) certification that the equity of the mortgagor in the residence securing the mortgage is unencumbered by a subordinate lien.

(b) AUTOMATIC TERMINATION. - A requirement for private mortgage insurance in connection with a residential mortgage transaction shall terminate with respect to payments for that mortgage insurance made by the mortgagor -

(1) on the termination date if, on that date, the mortgagor is current on the payments required by the terms of the residential mortgage transaction; or

(2) on the date after the termination date on which the mortgagor becomes current on the payments required by the terms of the residential mortgage transaction.

(c) FINAL TERMINATION. - If a requirement for private mortgage insurance is not otherwise canceled or terminated in accordance with subsection (a) or (b), in no case may such a requirement be imposed beyond the first day of the month immediately following the date that is the midpoint of the amortization period of the loan if the mortgagor is current on the payments required by the terms of the mortgage.

(d) NO FURTHER PAYMENTS. - No payments or premiums may be required from the mortgagor in connection with a private mortgage insurance requirement terminated or canceled under this section -

(1) in the case of cancellation under subsection (a), more than 30 days after the later of -

(A) the date on which a request under subsection (a)(1) is received; or

(B) the date on which the mortgagor satisfies any evidence and certification requirements under subsection (a)(3);

(2) in the case of termination under subsection (b), more than 30 days after the termination date or the date referred to in subsection (b)(2), as applicable; and

(3) in the case of termination under subsection (c), more than 30 days after the final termination date established under that subsection.

(e) RETURN OF UNEARNED PREMIUMS.—

(1) IN GENERAL. - Not later than 45 days after the termination or cancellation of a private

mortgage insurance requirement under this section, all unearned premiums for private mortgage insurance shall be returned to the mortgagor by the servicer.

(2) TRANSFER OF FUNDS TO SERVICER. - Not later than 30 days after notification by the servicer of termination or cancellation of private mortgage insurance under this Act with respect to a mortgagor, a mortgage insurer that is in possession of any unearned premiums of that mortgagor shall transfer to the servicer of the subject mortgage an amount equal to the amount of the unearned premiums for repayment in accordance with paragraph (1).

(f) EXCEPTIONS FOR HIGH RISK LOANS. -

(1) IN GENERAL. - The termination and cancellation provisions in subsections (a) and (b) do not apply to any residential mortgage or mortgage transaction that, at the time at which the residential mortgage transaction is consummated, has high risks associated with the extension of the loan -

(A) as determined in accordance with guidelines published by the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation, in the case of a mortgage loan with an original principal balance that does not exceed the applicable annual conforming loan limit for the secondary market established pursuant to section 305(a)(2) of the Federal Home Loan Mortgage Corporation Act, so as to require the imposition or continuation of a private mortgage insurance requirement beyond the terms specified in subsection (a) or (b) of section 3; or

(B) as determined by the mortgagee in the case of any other mortgage, except that termination shall occur -

(i) with respect to a fixed rate mortgage, on the date on which the principal balance of the mortgage, based solely on the initial amortization schedule for that mortgage, and irrespective of the outstanding balance for that mortgage on that date, is first scheduled to reach 77 percent of the original value of the property securing the loan; and

(ii) with respect to an adjustable rate mortgage, on the date on which the principal balance of the mortgage, based solely on amortization schedules for that mortgage, and irrespective of the outstanding balance for that mortgage on that date, is first scheduled to reach 77 percent of the original value of the property securing the loan.

(2) TERMINATION AT MIDPOINT. - A private mortgage insurance requirement in connection with a residential mortgage or mortgage transaction described in paragraph (1) shall terminate in accordance with subsection (c).

(3) RULE OF CONSTRUCTION. - Nothing in this subsection may be construed to require a mortgage or mortgage transaction described in paragraph (1)(A) to be purchased by the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation.

(4) GAO REPORT. - Not later than 2 years after the date of the enactment of this Act, the Comptroller General of the United States shall submit to the Congress a report describing the volume and characteristics of residential mortgages and residential mortgage transactions that, pursuant to paragraph (1) of this subsection, are exempt from the application of subsections (a) and (b). The report shall -

(A) determine the number or volume of such mortgages and transactions compared to residential mortgages and residential mortgage transactions that are not classified as high-risk for purposes of paragraph (1); and

(B) identify the characteristics of such mortgages and transactions that result in their classification (for purposes of paragraph (1)) as having high risks associated with the extension of the loan and describe such characteristics, including -

(i) the income levels and races of the mortgagors involved;

(ii) the amount of the downpayments involved and the downpayments expressed as percentages of the acquisition costs of the properties involved;

(iii) the types and locations of the properties involved;

(iv) the mortgage principal amounts; and

(v) any other characteristics of such mortgages and transactions that may contribute to their classification as high risk for purposes of paragraph (1), including whether such mortgages are purchase-money mortgages or refinancings and whether and to what extent such loans are low-documentation loans.

SEC. 4. DISCLOSURE REQUIREMENTS.

(a) DISCLOSURES FOR NEW MORTGAGES AT TIME OF TRANSACTION. -

(1) DISCLOSURES FOR NON-EXEMPTED TRANSACTIONS. – In any case in which private mortgage insurance is required in connection with a residential mortgage or mortgage transaction (other than a mortgage or mortgage transaction described in section 3(f)(1)), at the time at which the transaction is consummated, the mortgagee shall provide to the mortgagor -

(A) if the transaction relates to a fixed rate mortgage -

(i) a written initial amortization schedule; and

(ii) written notice -

(I) that the mortgagor may cancel the requirement in accordance with section 3(a) of this Act indicating the date on which the mortgagor may request cancellation, based solely on the initial amortization schedule;

(II) that the mortgagor may request cancellation in accordance with section 3(a) of this Act earlier than provided for in the initial amortization schedule, based on actual payments;

(III) that the requirement for private mortgage insurance will automatically terminate on the termination date in accordance with section 3(b) of this Act, and what that termination date is with respect to that mortgage; and

(IV) that there are exemptions to the right to cancellation and automatic termination of a requirement for private mortgage insurance in accordance with section 3(f) of this Act, and whether such an exemption applies at that time to that transaction; and

(B) if the transaction relates to an adjustable rate mortgage, a written notice that -

(i) the mortgagor may cancel the requirement in accordance with section 3(a) of this Act on the cancellation date, and that the servicer will notify the mortgagor when the cancellation date is reached;

(ii) the requirement for private mortgage insurance will automatically terminate on the termination date, and that on the termination date, the mortgagor will be notified of the termination or that the requirement will be terminated as soon as the mortgagor is current on loan payments; and

(iii) there are exemptions to the right of cancellation and automatic termination of a requirement for private mortgage insurance in accordance with section 3(f) of this Act, and whether such an exemption applies at that time to that transaction.

(2) DISCLOSURES FOR EXCEPTED TRANSACTIONS. - In the case of a mortgage or mortgage transaction described in section 3(f)(1), at the time at which the transaction is consummated, the mortgagee shall provide written notice to the mortgagor that in no case may private mortgage insurance be required beyond the date that is the midpoint of the amortization period of the loan, if the mortgagor is current on payments required by the terms of the residential mortgage.

(3) ANNUAL DISCLOSURES. - If private mortgage insurance is required in connection with a residential mortgage transaction, the servicer shall disclose to the mortgagor in each such transaction in an annual written statement -

(A) the rights of the mortgagor under this Act to cancellation or termination of the private mortgage insurance requirement; and

(B) an address and telephone number that the mortgagor may use to contact the servicer to determine whether the mortgagor may cancel the private mortgage insurance.

(4) APPLICABILITY. - Paragraphs (1) through (3) shall apply with respect to each residential mortgage transaction consummated on or after the date that is 1 year after the date of enactment of this Act.

(b) DISCLOSURES FOR EXISTING MORTGAGES. - If private mortgage insurance was required in connection with a residential mortgage entered into at any time before the effective date of this Act, the servicer shall disclose to the mortgagor in each such transaction in an annual written statement -

(1) that the private mortgage insurance may, under certain circumstances, be canceled by the mortgagor (with the consent of the mortgagee or in accordance with applicable State law); and

(2) an address and telephone number that the mortgagor may use to contact the servicer to determine whether the mortgagor may cancel the private mortgage insurance.

(c) INCLUSION IN OTHER ANNUAL NOTICES. - The information and disclosures required under subsection (b) and paragraphs (1)(B) and (3) of subsection (a) may be provided on the annual disclosure relating to the escrow account made as required under the Real Estate Settlement Procedures Act of 1974, or as part of the annual disclosure of interest payments made pursuant to Internal Revenue Service regulations, and on a form promulgated by the Internal Revenue Service for that purpose.

(d) STANDARDIZED FORMS. - The mortgagee or servicer may use standardized forms for the provision of disclosures required under this section.

SEC. 5. NOTIFICATION UPON CANCELLATION OR TERMINATION.

(a) IN GENERAL. - Not later than 30 days after the date of cancellation or termination of a private mortgage insurance requirement in accordance with this Act, the servicer shall notify the mortgagor in writing -

(1) that the private mortgage insurance has terminated and that the mortgagor no longer has private mortgage insurance; and

(2) that no further premiums, payments, or other fees shall be due or payable by the mortgagor in connection with the private mortgage insurance.

(b) NOTICE OF GROUNDS. -

(1) IN GENERAL. - If a servicer determines that a mortgage did not meet the requirements for termination or cancellation of private mortgage insurance under subsection (a) or (b) of section 3, the servicer shall provide written notice to the mortgagor of the grounds relied on to make the determination (including the results of any appraisal used to make the determination).

(2) TIMING. - Notice required by paragraph (1) shall be provided -

(A) with respect to cancellation of private mortgage insurance under section 3(a), not later than 30 days after the later of -

(i) the date on which a request is received under section 3(a)(1); or

(ii) the date on which the mortgagor satisfies any evidence and certification requirements under section 3(a)(3); and

(B) with respect to termination of private mortgage insurance under section 3(b), not later than 30 days after the scheduled termination date.

SEC. 6. DISCLOSURE REQUIREMENTS FOR LENDER PAID MORTGAGE INSURANCE.

(a) DEFINITIONS. - For purposes of this section -

(1) the term “borrower paid mortgage insurance” means private mortgage insurance that is required in connection with a residential mortgage transaction, payments for which are made by the borrower;

(2) the term “lender paid mortgage insurance” means private mortgage insurance that is required in connection with a residential mortgage transaction, payments for which are made by a person other than the borrower; and

(3) the term “loan commitment” means a prospective mortgagee’s written confirmation of its approval, including any applicable closing conditions, of the application of a prospective mortgagor for a residential mortgage loan.

(b) EXCLUSION. - Sections 3 through 5 do not apply in the case of lender paid mortgage insurance.

(c) NOTICES TO MORTGAGOR. - In the case of lender paid mortgage insurance that is required in connection with a residential mortgage or a residential mortgage transaction -

(1) not later than the date on which a loan commitment is made for the residential mortgage transaction, the prospective mortgagee shall provide to the prospective mortgagor a written notice -

(A) that lender paid mortgage insurance differs from borrower paid mortgage insurance, in that lender paid mortgage insurance may not be canceled by the mortgagor, while borrower paid mortgage insurance could be cancelable by the mortgagor in accordance with section 3(a) of this Act, and could automatically terminate on the termination date in accordance with section 3(b) of this Act;

(B) that lender paid mortgage insurance -

(i) usually results in a residential mortgage having a higher interest rate than it would in the case of borrower paid mortgage insurance; and

(ii) terminates only when the residential mortgage is refinanced, paid off, or otherwise terminated; and

(C) that lender paid mortgage insurance and borrower paid mortgage insurance both have benefits and disadvantages, including a generic analysis of the differing costs and benefits of a residential mortgage in the case lender paid mortgage insurance versus borrower paid mortgage insurance over a 10-year period, assuming prevailing interest and property appreciation rates;

(D) that lender paid mortgage insurance may be tax-deductible for purposes of Federal income taxes, if the mortgagor itemizes expenses for that purpose; and

(2) not later than 30 days after the termination date that would apply in the case of borrower paid mortgage insurance, the servicer shall provide to the mortgagor a written notice indicating that the mortgagor may wish to review financing options that could eliminate the requirement for private mortgage insurance in connection with the residential mortgage.

(d) STANDARD FORMS. - The servicer of a residential mortgage may develop and use a standardized form or forms for the provision of notices to the mortgagor, as required under subsection (c).

SEC. 7. FEES FOR DISCLOSURES.

No fee or other cost may be imposed on any mortgagor with respect to the provision of any notice or information to the mortgagor pursuant to this Act.

SEC. 8. CIVIL LIABILITY.

(a) IN GENERAL. - Any servicer, mortgagee, or mortgage insurer that violates a provision of this Act shall be liable to each mortgagor to whom the violation relates for -

(1) in the case of an action by an individual, or a class action in which the liable party is not subject to section 10, any actual damages sustained by the mortgagor as a result of the violation, including interest (at a rate determined by the court) on the amount of actual damages, accruing from the date on which the violation commences;

(2) in the case of -

(A) an action by an individual, such statutory damages as the court may allow, not to exceed $2,000; and

(B) in the case of a class action -

(i) in which the liable party is subject to section 10, such amount as the court may allow, except that the total recovery under this subparagraph in any class action or series of class actions arising out of the same violation by the same liable party shall not exceed the lesser of $500,000 or 1 percent of the net worth of the liable party, as determined by the court; and

(ii) in which the liable party is not subject to section 10, such amount as the court may allow, not to exceed $1,000 as to each member of the class, except that the total recovery under this subparagraph in any class action or series of class actions arising out of the same violation by the same liable party shall not exceed the lesser of $500,000 or 1 percent of the gross revenues of the liable party, as determined by the court;

(3) costs of the action; and

(4) reasonable attorney fees, as determined by the court.

(b) TIMING OF ACTIONS. - No action may be brought by a mortgagor under subsection (a) later than 2 years after the date of the discovery of the violation that is the subject of the action.

(c) LIMITATIONS ON LIABILITY. -

(1) IN GENERAL. - With respect to a residential mortgage transaction, the failure of a servicer to comply with the requirements of this Act due to the failure of a mortgage insurer or a mortgagee to comply with the requirements of this Act, shall not be construed to be a violation of this Act by the servicer.

(2) RULE OF CONSTRUCTION. - Nothing in paragraph (1) shall be construed to impose any additional requirement or liability on a mortgage insurer, a mortgagee, or a holder of a residential mortgage.

SEC. 9. EFFECT ON OTHER LAWS AND AGREEMENTS.

(a) EFFECT ON STATE LAW. -

(1) IN GENERAL. - With respect to any residential mortgage or residential mortgage transaction consummated after the effective date of this Act, and except as provided in paragraph (2), the provisions of this Act shall supersede any provisions of the law of any State relating to requirements for obtaining or maintaining private mortgage insurance in connection with residential mortgage transactions, cancellation or automatic termination of such private mortgage insurance, any disclosure of information addressed by this Act, and any other matter specifically addressed by this Act.

(2) PROTECTION OF EXISTING STATE LAWS. -

(A) IN GENERAL. - The provisions of this Act do not supersede protected State laws, except to the extent that the protected State laws are inconsistent with any provision of this Act, and then only to the extent of the inconsistency.

(B) INCONSISTENCIES. - A protected State law shall not be considered to be inconsistent with a provision of this Act if the protected State law -

(i) requires termination of private mortgage insurance or other mortgage guaranty insurance -

(I) at a date earlier than as provided in this Act; or

(II) when a mortgage principal balance is achieved that is higher than as provided in this Act; or

(ii) requires disclosure of information -

(I) that provides more information than the information required by this Act; or

(II) more often or at a date earlier than is required by this Act.

(C) PROTECTED STATE LAWS. - For purposes of this paragraph, the term "protected State law" means a State law –

(i) regarding any requirements relating to private mortgage insurance in connection with residential mortgage transactions;

(ii) that was enacted not later than 2 years after the date of the enactment of this Act; and

(iii) that is the law of a State that had in effect, on or before January 2, 1998, any State law described in clause (i).

(b) EFFECT ON OTHER AGREEMENTS. - The provisions of this Act shall supersede any conflicting provision contained in any agreement relating to the servicing of a residential mortgage loan entered into by the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, or any private investor or note holder (or any successors thereto).

SEC. 10. ENFORCEMENT.

(a) IN GENERAL. - Compliance with the requirements imposed under this Act shall be enforced under -

(1) section 8 of the Federal Deposit Insurance Act -

(A) by the appropriate Federal banking agency (as defined in section 3(q) of the Federal Deposit Insurance Act) in the case of insured depository institutions (as defined in section 3(c)(2) of such Act);

(B) by the Federal Deposit Insurance Corporation in the case of depository institutions described in clause (i), (ii), or (iii) of section 19(b)(1)(A) of the Federal Reserve Act that are not insured depository institutions (as defined in section 3(c)(2) of the Federal Deposit Insurance Act); and

(C) by the Director of the Office of Thrift Supervision in the case of depository institutions described in clause (v) and or (vi) of section 19(b)(1)(A) of the Federal Reserve Act that are not insured depository institutions (as defined in section 3(c)(2) of the Federal Deposit Insurance Act);

(2) the Federal Credit Union Act, by the National Credit Union Administration Board in the case of depository institutions described in clause (iv) of section 19(b)(1)(A) of the Federal Reserve Act; and

(3) part C of title V of the Farm Credit Act of 1971 (12 U.S.C. 2261 et seq.), by the Farm Credit Administration in the case of an institution that is a member of the Farm Credit System.

(b) ADDITIONAL ENFORCEMENT POWERS. -

(1) VIOLATION OF THIS ACT TREATED AS VIOLATION OF OTHER ACTS. - For purposes

of the exercise by any agency referred to in subsection (a) of such agency's powers under any Act referred to in such subsection, a violation of a requirement imposed under this Act shall be deemed to be a violation of a requirement imposed under that Act.

(2) ENFORCEMENT AUTHORITY UNDER OTHER ACTS. - In addition to the powers of any agency referred to in subsection (a) under any provision of law specifically referred to in such subsection, each such agency may exercise, for purposes of enforcing compliance with any requirement imposed under this Act, any other authority conferred on such agency by law.

(c) ENFORCEMENT AND REIMBURSEMENT. - In carrying out its enforcement activities under this section, each agency referred to in subsection (a) shall -

(1) notify the mortgagee or servicer of any failure of the mortgagee or servicer to comply with 1 or more provisions of this Act;

(2) with respect to each such failure to comply, require the mortgagee or servicer, as applicable, to correct the account of the mortgagor to reflect the date on which the mortgage insurance should have been canceled or terminated under this Act; and

(3) require the mortgagee or servicer, as applicable, to reimburse the mortgagor in an amount equal to the total unearned premiums paid by the mortgagor after the date on which the obligation to pay those premiums ceased under this Act.

SEC. 11. CONSTRUCTION.

(a) PMI NOT REQUIRED. - Nothing in this Act shall be construed to impose any requirement for private mortgage insurance in connection with a residential mortgage transaction.

(b) NO PRECLUSION OF CANCELLATION OR TERMINATION AGREEMENTS. - Nothing in this Act shall be construed to preclude cancellation or termination, by agreement between a mortgagor and the holder of the mortgage, of a requirement for private mortgage insurance in connection with a residential mortgage transaction before the cancellation or termination date established by this Act for the mortgage.

SEC. 12. AMENDMENT TO HIGHER EDUCATION ACT OF 1965.

Omitted, as having no impact on today's discussion.

SEC. 13. EFFECTIVE DATE.

This Act, other than section 14, shall become effective 1 year after the date of enactment of this Act.

SEC. 14. ABOLISHMENT OF THE THRIFT DEPOSITOR PROTECTION OVERSIGHT BOARD.

Omitted, as having no impact on today's discussion.

Section 2: Auditing the PMI Law

Did the bank give the appropriate PMI Disclosure? _______________

If the transaction relates to a fixed rate mortgage, did the bank give a written initial amortization schedule? _______________

If the transaction relates to a variable rate mortgage, were appropriate disclosures made? _______________

If the loan involved "lender paid mortgage insurance," were appropriate PMI disclosures made? _______________

Did the bank avoid requiring a fee for PMI disclosures? _______________

Reviewing Kickbacks

Section 1: Kickbacks and Unearned Fees [12 C.F.R. § 1024.14]

Section 8 Violations and Penalties

Regulatory Discussion

Any violation of this section is a violation of section 8 of RESPA and is subject to enforcement by the CFPB. Any person who violates this section will be sanctioned accordingly.

The enforcement provisions of RESPA were formerly included in § 1024.19. Effective January 10, 2014, these provisions were removed and reserved.

No Referral Fees

No person shall give and no person shall accept any fee, kickback, or other thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or part of a settlement service involving a federally related mortgage loan shall be referred to any person. Any referral of a settlement service is not a compensable service, except as set forth in section 1024.14(g)(1). A business entity (whether or not in an affiliate relationship) may not pay any other business entity or the employees of any other business entity for the referral of settlement service business.

No Split of Charges Except for Actual Services Performed

No person may give and no person may accept any portion, split, or percentage of any charge made or received for the rendering of a settlement service in connection with a transaction involving a federally related mortgage loan other than for services actually performed. A charge by a person for which no or nominal services are performed or for which duplicative fees are charged is an unearned fee and violates this section. The source of the payment does not determine whether or not a service is compensable. The prohibitions of this part may not be avoided by creating an arrangement wherein the purchaser of services splits the fee.

Thing of Value

This term is broadly defined in RESPA. It includes, without limitation, the following:

- Money
- Things
- Discounts
- Salaries
- Commissions
- Fees

- Duplicate payments of a charge
- Stock
- Dividends
- Distributions of partnership profits
- Franchise royalties
- Credits representing monies that may be paid at a future date
- Opportunity to participate in a money-making program
- Retained or increased earnings
- Increased equity in a parent or subsidiary entity
- Special bank deposits or accounts
- Special or unusual banking terms
- Services of all types at special or free rates
- Sales or rentals at special prices or rates
- Lease or rental payments based in whole or in part on the amount of business referred
- Trips and payment of another person's expenses
- Reduction in credit against an existing obligation

The term "payment" is used throughout sections 1024.14 and 1024.15 synonymously with the giving or receiving of any "thing of value" and does not require transfer of money.

Agreement or Understanding

An agreement or understanding for the referral of business incident to or part of a settlement service does not need to be written or verbalized but may be established by a practice, pattern, or course of conduct. When a thing of value is received repeatedly and is connected in any way with the volume or value of the business referred, the receipt of the thing of value is evidence that it is made pursuant to an agreement or understanding for the referral of business.

Referral

A referral includes any oral or written action directed to a person which has the effect of affirmatively influencing the selection by any person of a provider of a settlement service or business incident to or part of a settlement service when such person will pay for such settlement service or business incident thereto or pay a charge attributable in whole or in part to such settlement service or business.

A referral also occurs whenever a person paying for a settlement service or business incident thereto is required to use a particular provider of a settlement service or business incident thereto.

Exemptions for Fees, Salaries, Compensation, or Other Payments

The following are permissible:

- A payment to an attorney for services actually rendered.
- A payment by a title company to its duly appointed agent for services actually performed in the issuance of a policy of title insurance.
- A payment by a lender to its duly appointed agent or contractor for services actually performed in the origination, processing, or funding of a loan.
- A payment to any person of a bona fide salary or compensation or other payment for goods or facilities actually furnished or for services actually performed.
- A payment pursuant to cooperative brokerage and referral arrangements or agreements between real estate agents and real estate brokers. (The statutory exemption restated in this paragraph refers only to fee divisions within real estate brokerage arrangements when all parties are acting in a real estate brokerage capacity, and has no applicability to any fee arrangements between real estate brokers and mortgage brokers or between mortgage brokers.)
- Normal promotional and educational activities that are not conditioned on the referral of business and do not involve the defraying of expenses that otherwise would be incurred by persons in a position to refer settlement services or business incident thereto.
- A payment by an employer to its own bona fide employee for generating business for that employer.
- A payment by an employer to its bona fide employee for the referral of settlement service business to a settlement service provider that has an affiliate relationship with the employer or in which the employer has a direct or beneficial ownership interest of more than 1.0 percent, if the following conditions are met:
    - The employee does not perform settlement services in any transaction, and
    - Before the referral, the employee provides to the person being referred a written disclosure (Affiliated Business Arrangement).
    - The marketing of a settlement service or product of an affiliated entity, including the collection and conveyance of information or the taking of an application or order for an affiliated entity, does not constitute the performance of a settlement service.
    - The marketing of a settlement service or product may include incidental communications with the consumer after the application or order, such as providing the consumer with information about the status of an application or order.
- Marketing shall not include serving as the ongoing point of contact for coordinating the delivery and provision of settlement services.

The CFPB may investigate high prices to see if they are the result of a referral fee or a split of a fee. If the payment of a thing of value bears no reasonable relationship to the market value of the goods or services provided, then the excess is not for services or goods actually performed or provided. These facts may be used as evidence of a violation of section 8 and may serve as a basis for a RESPA investigation. High prices standing alone are not proof of a RESPA violation.

The value of a referral (i.e., the value of any additional business obtained thereby) is not to be taken into account in determining whether the payment exceeds the reasonable value of such goods, facilities, or services. The fact that the transfer of the thing of value does not result in an increase in any charge made by the person giving the thing of value is irrelevant in determining whether the act is prohibited.

Multiple Services

When a person in a position to refer settlement service business, such as an attorney, mortgage lender, real estate broker or agent, or developer or builder, receives a payment for providing additional settlement services as part of a real estate transaction, such payment must be for services that are actual, necessary, and distinct from the primary services provided by such person.

For example, for an attorney of the buyer or seller to receive compensation as a title agent, the attorney must perform core title agent services (for which liability arises) separate from attorney services, including the evaluation of the title search to determine the insurability of the title, the clearance of underwriting objections, the actual issuance of the policy or policies on behalf of the title insurance company, and, where customary, issuance of the title commitment, conducting of the title search, and closing.

Recordkeeping

Any documents required by this section shall be retained for five (5) years from the date of execution.

Regulatory Text - Prohibition against Kickbacks and Unearned Fees [12 CFR § 1024.14]

(a) **Section 8 violation.** Any violation of this section is a violation of section 8 of RESPA (12 U.S.C. 2607).

(b) **No referral fees**. No person shall give and no person shall accept any fee, kickback or other thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or part of a settlement service involving a federally related mortgage loan shall be referred to any person. Any referral of a settlement service is not a compensable service, except as set forth in §1024.14(g)(1). A company may not pay any other company or the employees of any other company for the referral of settlement service business.

(c) **No split of charges except for actual services performed**. No person shall give and no person shall accept any portion, split, or percentage of any charge made or received for the rendering of a settlement service in connection with a transaction involving a federally related mortgage loan other than for services actually performed. A charge by a person for which no or nominal services are performed or for which duplicative fees are charged is an unearned fee and violates this section. The source of the payment does not determine whether or not a service is compensable. Nor may the prohibitions of this part be avoided by creating an arrangement wherein the purchaser of services splits the fee.

(d) **Thing of value**. This term is broadly defined in section 3(2) of RESPA (12 U.S.C. 2602(2)). It includes, without limitation, monies, things, discounts, salaries, commissions, fees, duplicate payments of a charge, stock, dividends, distributions of partnership profits, franchise royalties, credits representing monies that may be paid at a future date, the opportunity to participate in a money-making program, retained or increased earnings, increased equity in a parent or subsidiary entity, special bank deposits or accounts, special or unusual banking terms, services of all types at special or free rates, sales or rentals at special prices or rates, lease or rental payments based in whole or in part on the amount of business referred, trips and payment of another person's expenses, or reduction in credit against an existing obligation. The term "payment" is used throughout §§1024.14 and 1024.15 as synonymous with the giving or receiving of any "thing of value" and does not require transfer of money.

(e) **Agreement or understanding**. An agreement or understanding for the referral of business incident to or part of a settlement service need not be written or verbalized but may be established by a practice, pattern or course of conduct. When a thing of value is received repeatedly and is connected in any way with the volume or value of the business referred, the receipt of the thing of value is evidence that it is made pursuant to an agreement or understanding for the referral of business.

(f) **Referral**.

(1) A referral includes any oral or written action directed to a person which has the effect of affirmatively influencing the selection by any person of a provider of a settlement service or business incident to or part of a settlement service when such person will pay for such settlement service or business incident thereto or pay a charge attributable in whole or in part to such settlement service or business.

(2) A referral also occurs whenever a person paying for a settlement service or business incident thereto is required to use (see §1024.2, "required use") a particular provider of a settlement service or business incident thereto.

(g) **Fees, salaries, compensation, or other payments.**

(1) Section 8 of RESPA permits:

(i) A payment to an attorney at law for services actually rendered;

(ii) A payment by a title company to its duly appointed agent for services actually performed in the issuance of a policy of title insurance;

(iii) A payment by a lender to its duly appointed agent or contractor for services actually performed in the origination, processing, or funding of a loan;

(iv) A payment to any person of a bona fide salary or compensation or other payment for goods or facilities actually furnished or for services actually performed;

(v) A payment pursuant to cooperative brokerage and referral arrangements or agreements between real estate agents and real estate brokers. (The statutory exemption restated in this paragraph refers only to fee divisions within real estate brokerage arrangements when all parties are acting in a real estate brokerage capacity, and has no applicability to any fee arrangements between real estate brokers and mortgage brokers or between mortgage brokers.);

(vi) Normal promotional and educational activities that are not conditioned on the referral of business and that do not involve the defraying of expenses that otherwise would be incurred by persons in a position to refer settlement services or business incident thereto; or

(vii) An employer's payment to its own employees for any referral activities.

(2) The Bureau may investigate high prices to see if they are the result of a referral fee or a split of a fee. If the payment of a thing of value bears no reasonable relationship to the market value of the goods or services provided, then the excess is not for services or goods actually performed or provided. These facts may be used as evidence of a violation of section 8 and may serve as a basis for a RESPA investigation. High prices standing alone are not proof of a RESPA violation. The value of a referral (i.e., the value of any additional business obtained thereby) is not to be taken into account in determining whether the payment exceeds the reasonable value of such goods, facilities or services. The fact that the transfer of the thing of value does not result in an increase in any charge made by the person giving the thing of value is irrelevant in determining whether the act is prohibited.

(3) **Multiple services**. When a person in a position to refer settlement service business, such as an attorney, mortgage lender, real estate broker or agent, or developer or builder, receives a payment for providing additional settlement services as part of a real estate transaction, such payment must be for services that are actual, necessary and distinct from the primary services provided by such person. For example, for an attorney of the buyer or seller to receive compensation as a title agent, the attorney must perform core title agent services (for which liability arises) separate from attorney services, including the evaluation of the title search to determine the insurability of the title, the clearance of underwriting objections, the actual issuance of the policy or policies on behalf of the title insurance company, and, where customary, issuance of the title commitment, and the conducting of the title search and closing.

(h) **Recordkeeping**. Any documents provided pursuant to this section shall be retained for five (5) years from the date of execution.

(i) **Appendix B of this part**. Illustrations in Appendix B of this part demonstrate some of the requirements of this section.

Regulatory Commentary - Prohibition against Kickbacks and Unearned Fees [12 CFR § 1024.14]

The regulation does not offer any commentary on this section.

Appendix B to Part 1024: Illustrations of Requirements of RESPA

The following section is a direct quote of Appendix B, which discusses the issue of kickbacks and other illegal activities. We have made no changes to the text, however, we have chosen to number the illustrations for ease of presentation. The appendix language is as follows:

The following illustrations provide additional guidance on the meaning and coverage of the provisions of RESPA. Other provisions of Federal or state law may also be applicable to the practices and payments discussed in the following illustrations.

Scenario 1:

Facts: A 1 Homes, a provider of settlement services, provides settlement services at abnormally low rates or at no charge at all to John Smith, a builder, in connection with a subdivision being developed by John Smith. John Smith agrees to refer purchasers of the completed homes in the subdivision to A 1 Homes for the purchase of settlement services in connection with the sale of individual lots by John Smith.

Comments: The rendering of services by A 1 Homes to John Smith at little or no charge constitutes a thing of value given by A 1 Homes to John Smith in return for the referral of settlement services business and both A 1 Homes and John Smith are in violation of section 8 of RESPA.

Scenario 2:

Facts**:** Home Bank, a lender, encourages persons who receive federally related mortgage loans from it to employ Jane Jones, an attorney, to perform title searches and related settlement services in connection with their transaction. Home Bank and Jane Jones have an understanding that in return for the referral of this business Jane Jones provides legal services to Home Bank or Home Bank's officers or employees at abnormally low rates or for no charge.

Comments: Both Jane Jones and Home Bank are in violation of section 8 of RESPA. Similarly, if an attorney gives a portion of his or her fees to another attorney, a lender, a real estate broker, or any other provider of settlement services who had referred prospective clients to the attorney, section 8 would be violated by both persons.

Scenario 3:

Facts**:** Acme, a real estate broker, obtains all necessary licenses under state law to act as a title insurance agent. Acme refers individuals who are purchasing homes in transactions in which Acme participates as a broker to Smith & Jones, an unaffiliated title company, for the purchase of title insurance services. Acme performs minimal, if any, title services in connection with the issuance of the title insurance policy (such as placing an application with the title company). Smith & Jones pays Acme a commission (or Acme retains a portion of the title insurance premium) for the transactions or alternatively Smith & Jones receives a portion of the premium paid directly from the purchaser.

Comments: The payment of a commission or portion of the title insurance premium by Smith & Jones to Acme, or receipt of a portion of the payment for title insurance under circumstances where no substantial services are being performed by Acme, is a violation of section 8 of RESPA. It makes no difference whether the payment comes from Smith & Jones or the purchaser. The amount of the payment must bear a reasonable relationship to the services rendered. Here Acme really is being compensated for a referral of business to Smith & Jones.

Scenario 4:

***Facts*:** John Johnson is an attorney who, as a part of his legal representation of clients in residential real estate transactions, orders and reviews title insurance policies for his clients. John Johnson enters into a contract with SmithCo, a title company, to be an agent of SmithCo under a program set up by SmithCo. Under the agreement, John Johnson agrees to prepare and forward title insurance applications to SmithCo, to re-examine the preliminary title commitment for accuracy, and, if he chooses, to attempt to clear exceptions to the title policy before closing. John Johnson agrees to assume liability for waiving certain exceptions to title, but never exercises this authority. SmithCo performs the necessary title search and examination work, determines insurability of title, prepares documents containing substantive information in title commitments, handles closings for John Johnson's clients, and issues title policies. John Johnson receives a fee from his client for legal services and an additional fee for his title agent "services" from the client's title insurance premium to SmithCo.

***Comments*:** John Johnson and SmithCo are violating section 8 of RESPA. Here, John Johnson's clients are being double-billed because the work John Johnson performs as a "title agent" is that which he already performs for his client in his capacity as an attorney. For John Johnson to receive a separate payment as a title agent, John Johnson must perform necessary core title work and may not contract out the work. To receive additional compensation as a title agent for this transaction, John Johnson must provide his client with core title agent services for which he assumes liability and which include, at a minimum, the evaluation of the title search to determine insurability of the title and the issuance of a title commitment where customary, the clearance of underwriting objections, and the actual issuance of the policy or policies on behalf of the title company. John Johnson may not be compensated for the mere re- examination of work performed by SmithCo. Here, John Johnson is not performing these services and may not be compensated as a title agent under section 8(c)(1)(B). Referral fees or splits of fees may not be disguised as title agent commissions when the core title agent work is not performed. Further, because SmithCo created the program and gave John Johnson the opportunity to collect fees (a thing of value) in exchange for the referral of settlement service business, it has violated section 8 of RESPA.

Scenario 5:

Facts: HomeMakers, a "mortgage originator," receives loan applications, funds the loans with its own money or with a wholesale line of credit for which HomeMakers is liable, and closes the loans in HomeMakers' own name. Subsequently, SmithCo, a mortgage lender, purchases the loans and compensates HomeMakers for the value of the loans, as well as for any mortgage servicing rights.

Comments: Compensation for the sale of a mortgage loan and servicing rights constitutes a secondary market transaction, rather than a referral fee, and is beyond the scope of section 8 of RESPA. For purposes of section 8, in determining whether a bona fide transfer of the loan obligation has taken place, HUD examines the real source of funding and the real interest of the named settlement lender.

Scenario 6:

Facts: Acme, a credit reporting company, places a facsimile transmission machine (fax) in the office of HomeHelpers, a mortgage lender, so that HomeHelpers can easily transmit requests for credit reports and Acme can respond. Acme supplies the fax machine at no cost or at a reduced rental rate based on the number of credit reports ordered.

Comments: Either situation violates section 8 of RESPA. The fax machine is a thing of value that Acme provides in exchange for the referral of business from HomeHelpers. Copying machines, computer terminals, printers, or other like items which have general use to the recipient and which are given in exchange for referrals of business also violate RESPA.

Scenario 7:

***Facts*:** A 1 Homes, a real estate broker, refers title business to JonesInc, a company that is a licensed title agent for SmithCo, a title insurance company. A 1 Homes owns more than 1.0 percent of JonesInc. JonesInc performs the title search and examination, makes determinations of insurability, issues the commitment, clears underwriting objections, and issues a policy of title insurance on behalf of SmithCo, for which SmithCo pays JonesInc a commission. JonesInc pays annual dividends to its owners, including A 1 Homes, based on the relative amount of business each of its owners refers to JonesInc.

***Comments*:** The facts involve an affiliated business arrangement. The payments of a commission by SmithCo to JonesInc is not a violation of section 8 of RESPA if the amount of the commission constitutes reasonable compensation for the services performed by JonesInc for SmithCo. The payment of a dividend or the giving of any other thing of value by JonesInc to A 1 Homes that is based on the amount of business referred to JonesInc by A 1 Homes does not meet the affiliated business agreement exemption provisions, and such actions violate section 8. Similarly, if the amount of stock held by A 1 Homes in JonesInc (or, if JonesInc were a partnership, the distribution of partnership profits by JonesInc to A 1 Homes) varies based on the amount of business referred or expected to be referred, or if JonesInc retained any funds for subsequent distribution to A 1 Homes where such funds were generally in proportion to the amount of business A 1 Homes referred to JonesInc relative to the amount referred by other owners, such arrangements would violate section 8. The exemption for affiliated business arrangements would not be available because the payments here would not be considered returns on ownership interests. Further, the required disclosure of the affiliated business arrangement and estimated charges have not been provided.

Scenario 8:

***Facts*:** Same as illustration 7, but JonesInc pays annual dividends in proportion to the amount of stock held by its owners, including A 1 Homes, and the distribution of annual dividends is not based on the amount of business referred or expected to be referred.

Comments: If A 1 Homes and JonesInc meet the requirements of the affiliated business arrangement exemption, there is not a violation of RESPA. Since the payment is a return on ownership interests, A 1 Homes and JonesInc will be exempt from section 8 if (1) A 1 Homes also did not require anyone to use the services of JonesInc and (2) A 1 Homes disclosed its ownership interest in JonesInc on a separate disclosure form and provided an estimate of JonesInc's charges to each person referred by A 1 Homes to JonesInc and (3) JonesInc makes no payment (nor is there any other thing of value exchanged) to A 1 Homes other than dividends.

Scenario 9:

***Facts*:** SmithCo, a franchisor for franchised real estate brokers, owns True Blue, a provider of settlement services. HomeMakers, a franchisee of SmithCo, refers business to True Blue.

Comments: This is an affiliated business arrangement. SmithCo, True Blue, and HomeMakers will all be exempt from section 8 if HomeMakers discloses its franchise relationship with the owner of True Blue on a separate disclosure form and provides an estimate of True Blue's charges to each person referred to True Blue; HomeMakers does not require anyone to use True Blue's services; SmithCo gives nothing of value to HomeMakers under the franchise agreement (such as an adjusted level of franchise payment based on the referrals); and True Blue makes no payments to SmithCo other than dividends representing a return on ownership interest (rather than, e.g., an adjusted level of payment being based on the referrals). Nor may True Blue pay HomeMakers anything of value for the referral.

Scenario 10:

Facts: XYZ Homes is a real estate broker who refers business to its affiliate title company Smith Title. XYZ Homes makes all required written disclosures to the home buyer of the arrangement and estimated charges, and the home buyer is not required to use Smith Title. Smith Title refers or contracts out business to JonesInc, who does all the title work and splits the fee with Smith Title. Smith Title passes its fee to XYZ Homes in the form of dividends, a return on ownership interest.

Comments: The relationship between XYZ Homes and Smith Title is an affiliated business arrangement. However, the affiliated business arrangement exemption does not provide exemption between an affiliated entity, Smith Title, and a third-party, JonesInc. Here, Smith Title is a mere "shell" and provides no substantive services for its portion of the fee. The arrangement between Smith Title and JonesInc would be in violation of section 8(a) and (b). Even if Smith Title had an affiliate relationship with JonesInc, the required exemption criteria have not been met and the relationship would be subject to section 8.

Scenario 11:

Facts: Acme, a mortgage lender, is affiliated with Titles R Us, a title company, and Ess Cro, an escrow company, and offers consumers a package of mortgage, title, and escrow services at a discount from the prices at which such services would be sold if purchased separately. Acme, Titles R Us, and Ess Cro are subsidiaries of BrownCo, a holding company, which also controls a retail stock brokerage firm, StockUp. None of Acme, Titles R Us, or Ess Cro requires consumers to purchase the services of its sister companies, and each company sells such services separately and as part of the package. Acme also pays an employee, Tim Taylor, a full-time bank teller who does not perform settlement services, a bonus for each loan, title insurance binder, or closing that Tim Taylor generates for Acme, Titles R Us, or Ess Cro. Acme pays Tim Taylor these bonuses out of Acme's own funds and receives no reimbursements for these bonuses from Titles R Us, Ess Cro, or BrownCo. At the time that Tim Taylor refers customers to Titles R Us and Ess Cro, Tim Taylor provides the customers with a disclosure using the Affiliated Business Arrangement Disclosure format. Also, Sandra Sanders, a stockbroker employee of StockUp, occasionally refers her customers to Acme, Titles R Us, or Ess Cro; gives a statement in the Affiliated Business Arrangement Disclosure format; and receives a payment from StockUp for each referral.

Comments: Selling a package of settlement services at a discount is not prohibited by RESPA, consistent with the definition of "required use" in 12 C.F.R. § 1024.2. Also, Acme is always allowed to compensate its own employees for business generated for Acme's company. Here, Acme may also compensate Tim Taylor, an employee who does not perform settlement services in this or any transaction, for referring business to a business entity in an affiliate relationship with Acme. Sandra Sanders, who does not perform settlement services in this or any transaction, can also be compensated by StockUp, but not by anyone else. Employees who perform settlement services cannot be compensated for referrals to other settlement service providers. None of the entities in an affiliated relationship with each other may pay for referrals received from an affiliate's employees. Sections 1024.15(b)(3)(i)(A) and (B) set forth the permissible exchanges of funds between controlled business entities. In all circumstances described a statement in the Affiliated Business Arrangement Disclosure format must be provided to a potential consumer at or before the time that the referral is made.

Scenario 12:

Facts: DandyDeals, a real estate broker, is affiliated with Smith Title, a mortgage lender, and JonesInc, a title agency. DandyDeals employs Ron Rogers to advise and assist any customers of DandyDeals who have executed sales contracts regarding mortgage loans and title insurance. Ron Rogers collects and transmits (by computer, fax, mail, or other means) loan applications or other information to Smith Title and JonesInc for processing. DandyDeals pays Ron Rogers a small salary and a bonus for every loan closed with Smith Title or title insurance issued with JonesInc. Ron Rogers furnishes the Affiliated Business Arrangement Disclosure to consumers at the time of each referral. Ron Rogers receives no other compensation from the real estate or mortgage transaction and performs no settlement services in any transaction. At the end of each of DandyDeals's fiscal years, Sandra Sanders, a managerial employee of DandyDeals, receives a $1,000 bonus if 20 percent of the consumers who purchase a home through DandyDeals close a loan on the home with Smith Title and have the title issued by JonesInc. During the year, Sandra Sanders acted as a real estate agent for her neighbor and received a real estate sales commission for selling her neighbor's home.

***Comments*:** Employers may pay their own bona fide employees for generating business for their employer (1024.14(g)(1)(vii)). Employers may also pay their own bona fide employees for generating business for their affiliate business entities (1024.14(g)(1)(ix)), as long as the employees do not perform settlement services in any transaction and disclosure is made. This permits a company to employ a person whose primary function is to market the employer's or its affiliate's settlement services (frequently referred to as a financial services representative, or FSR). An FSR may not perform any settlement services including, for example, those services of a real estate agent, loan processor, settlement agent, attorney, or mortgage broker. In accordance with the terms of the exemption at 1024.14(g)(1)(ix), the marketing of a settlement service or product of an affiliated entity, including the collection and conveyance of information or the taking of an application or order for the services of an affiliated entity, does not constitute the performance of a settlement service. Under the exemption, marketing of a settlement service or product also may include incidental communications with the consumer after the application or order, such as providing the consumer with information about the status of an application or order; marketing may not include serving as the ongoing point of contact for coordinating the delivery and provision of settlement services.

Thus, in the circumstances described, Ron Rogers and Sandra Sanders may receive the additional compensation without violating RESPA. Also, employers may pay managerial employees compensation in the form of bonuses based on a percentage of transactions completed by an affiliated company (frequently called a "capture rate"), as long as the payment is not directly calculated as a multiple of the number or value of the referrals. 12 C.F.R. § 1024.14(g)(1)(viii). A managerial employee who receives compensation for performing settlement services in three or fewer transactions in any calendar year "does not routinely" deal directly with the consumer and is not precluded from receiving managerial compensation.

Scenario 13:

Facts: Xenith is a mortgage broker who provides origination services to submit a loan to a lender for approval. The mortgage broker charges the borrower a uniform fee for the total origination services, as well as a direct up-front charge for reimbursement of credit reporting, appraisal services, or similar charges.

Comments: The mortgage broker's fee must be itemized in the Good Faith Estimate and on the HUD-1 Settlement Statement. Other charges which are paid for by the borrower and paid in advance are listed as "P.O.C." on the HUD-1 Settlement Statement, and they reflect the actual provider charge for such services. Also, any other fee or payment received by the mortgage broker from either the lender or the borrower arising from the initial funding transaction, including a servicing release premium or yield spread premium, is to be noted on the Good Faith Estimate and listed in the 800 series of the HUD-1 Settlement Statement.

Scenario 14:

Facts: Handy Helpers is a dealer in home improvements who has established funding arrangements with several lenders. Customers for home improvements receive a proposed contract from Handy Helpers. The proposal requires that customers both execute forms authorizing a credit check and employment verification and, frequently, execute a dealer consumer credit contract secured by a lien on the customer's (borrower's) one to four family residential property. Simultaneously with the completion and certification of the home improvement work, the note is assigned by the dealer to a funding lender.

***Comments*:** The loan that is assigned to the funding lender is a loan covered by RESPA, when a lien is placed on the borrower's one- to four family residential structure. The dealer loan or consumer credit contract originated by a dealer is also a RESPA-covered transaction, except when the dealer is not a "creditor" under the definition of "federally related mortgage loan" in 1024.2. The lender to whom the loan will be assigned is responsible for assuring that the lender or the dealer delivers to the borrower a Good Faith Estimate of closing costs consistent with Regulation X, and that the HUD-1 or HUD-1A Settlement Statement is used in conjunction with the settlement of the loan to be assigned. A dealer who, under 1024.2, is covered by RESPA as a creditor is responsible for the Good Faith Estimate of closing costs and the use of the appropriate settlement statement in connection with the loan.

Section 2: Reviewing Kickbacks

For this issue, there is basically only one question:

Did any information in the file indicate that there was any violation of the anti-kickback rule?

Reviewing CIP

Section 1: Customer Identification Program

[31 C.F.R. § 1020.220]

Introduction

On May 1, 2003, the final rule of the Customer Identification Program was issued by the Financial Crimes Enforcement Network (FinCEN), United States Department of the Treasury; Office of the Comptroller of the Currency, Treasury; Board of Governors of the Federal Reserve System; Federal Deposit Insurance Corporation; Office of Thrift Supervision, Treasury; and the National Credit Union Administration (hereafter, the "Agencies"). Together, these Agencies jointly adopted a final rule to implement section 326 of the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT) Act of 2001 (the Act).

The substantive requirements of the joint final rule were codified as part of Treasury's BSA regulations located in 31 C.F.R. § Chapter X. In addition, each of the Agencies concurrently published a provision in its own regulations to cross-reference this final rule in order to clarify the applicability of the final rule to the banks subject to its jurisdiction.

Section 2: Definitions [31 C.F.R § 1020.100]

Account [31 C.F.R § 1020.100(a)]

Account means a formal banking relationship established to provide or engage in services, dealings, or other financial transactions.\

The balance of the definition is omitted, as it is not relevant to our current discussion.

Bank [31 C.F.R § 1020.100(b)]

Bank means a bank, as that term is defined in § 1010.100(d), that is subject to regulation by a Federal Functional Regulator; and a credit union, private bank, and trust company, as set forth in § 1010.100(d), that does not have a Federal Functional Regulator.

Customer [31 C.F.R § 1020.100(c)]

Customer means:

- a person that opens a new account; and
- an individual who opens a new account for an individual who lacks legal capacity, such as a minor; or an entity that is not a legal person, such as a civic club.

Customer *does not* include:

- a financial institution regulated by a Federal Functional Regulator;
- a bank regulated by a state bank regulator;
- companies that are publicly traded described in § 1020.315(b)(2) through (b)(4); or
- a person that has an existing account with the bank, provided that the bank has a reasonable belief that it knows the true identity of the person.

Financial Institution [31 C.F.R § 1020.100(d)]

- For the purposes of § 1020.210, a financial institution defined in 31 U.S.C. 5312(a)(2) or (c)(1) that is subject to regulation by a Federal functional regulator or a self-regulatory organization.
- For the purposes of § 1020.220, financial institution is defined at 31 U.S.C. 5312(a)(2) and (c)(1).

Section 3: Customer Identification Program [31 C.F.R § 1020.220]

Minimum Requirements [31 C.F.R § 1020.220(a)]

In General [31 C.F.R § 1020.220(a)(1)]

A bank must implement a written Customer Identification Program (CIP) appropriate for its size and type of business that, at a minimum, includes each of the requirements of paragraphs (a)(1) through (5) of this section. If a bank is required to have an anti-money laundering compliance program under the regulations implementing 31 U.S.C. 5318(h), 12 U.S.C. 1818(s), or 12 U.S.C. 1786(q)(1), then the CIP must be a part of the anti-money laundering compliance program.

Discussion:

The rule requires each bank to maintain a CIP that is appropriate given the bank's size, location, and type of business. The rule also requires a bank's CIP to contain the statutorily prescribed procedures, describe these procedures, and detail certain minimum elements that each of the procedures must contain. In addition, the rule requires that the CIP be written and that it be approved by the bank's board of directors or a committee of the board.

The CIP must be incorporated into the bank's BSA compliance program and should not be a separate program. A bank's BSA compliance program must be written, approved by the board, and noted in the bank's minutes.

The board of directors' responsibility to oversee bank compliance with section 326 of the Act is a part of a board's conventional supervisory BSA compliance responsibilities that cannot be delegated to bank management. Therefore, a bank's board of directors must be responsible for approving a CIP described in detail sufficient for the board to determine that:

1. the bank's CIP contains the minimum requirements of this final rule; and
2. the bank's identity verification procedures are designed to enable the bank to form a reasonable belief that it knows the true identity of the customer.

Responsibility for the development, implementation, and day-to-day administration of the CIP may be delegated to bank management.

The rule requires that the CIP be a part of a bank's anti-money laundering program once a bank becomes subject to an anti-money laundering compliance program requirement.

Identity Verification Procedures [31 C.F.R § 1020.220(a)(2)]

The CIP must include risk-based procedures for verifying the identity of each customer to the extent reasonable and practical. The procedures must enable the bank to form a reasonable belief that it knows the true identity of each customer. These procedures must be based on the bank's assessment of the relevant risks, including those presented by the various types of accounts maintained by the bank, the various methods of opening accounts provided by the bank, the various types of identifying information available, and the bank's size, location, and customer base. At a minimum, these procedures must contain the elements described in this paragraph (a)(2).

Customer information required [31 C.F.R § 1020.220(a)(2)(i)]

(A) In general. The CIP must contain procedures for opening an account that specify the identifying information that will be obtained from each customer. Except as permitted by paragraphs (a)(2)(i)(B) and (C) of this section, the bank must obtain, at a minimum, the following information from the customer prior to opening an account:

1. Name;
2. Date of birth, for an individual;
3. Address, which shall be:
    a. For an individual, a residential or business street address;
    b. For an individual who does not have a residential or business street address, an Army Post Office (APO) or Fleet Post Office (FPO) box number, or the residential or business street address of next of kin or of another contact individual; or
    c. For a person other than an individual (such as a corporation, partnership, or trust), a principal place of business, local office, or other physical location; and
4. Identification number, which shall be:
    a. For a U.S. person, a taxpayer identification number; or
    b. For a non-U.S. person, one or more of the following:
        i a taxpayer identification number;
        ii passport number and country of issuance;
        iii alien identification card number; or
        iv number and country of issuance of any other government-issued document evidencing nationality or residence and bearing a photograph or similar safeguard.

When opening an account for a foreign business or enterprise that does not have an identification number, the bank must request alternative government-issued documentation certifying the existence of the business or enterprise.

(B) Exception for persons applying for a taxpayer identification number. Instead of obtaining a taxpayer identification number from a customer prior to opening the account, the CIP may include procedures for opening an account for a customer that has applied for, but has not received, a taxpayer identification number. In this case, the CIP must include procedures to confirm that the application was filed before the customer opens the account and to obtain the taxpayer identification number within a reasonable period of time after the account is opened.

(C) Credit card accounts. In connection with a customer who opens a credit card account, a bank may obtain the identifying information about a customer required under paragraph (a)(2)(i)(A) by acquiring it from a third-party source prior to extending credit to the customer.

The rule includes an exception for credit card accounts only, which would allow a bank broader latitude to obtain some information from the customer opening a credit card account, and the remaining information from a third party source, such as a credit reporting agency, prior to extending credit to a customer.

Customer Verification [31 C.F.R § 1020.220(a)(2)(ii)]

The CIP must contain procedures for verifying the identity of the customer, using information obtained in accordance with paragraph (a)(2)(i) of this section, within a reasonable time after the account is opened. The procedures must describe when the bank will use documents, non-documentary methods, or a combination of both methods as described in this paragraph (a)(2)(ii).

(A) Verification through documents. For a bank relying on documents, the CIP must contain procedures that set forth the documents that the bank will use. These documents may include:

- (1) For an individual, unexpired government-issued identification evidencing nationality or residence and bearing a photograph or similar safeguard, such as a driver's license or passport; and
- (2) For a person other than an individual (such as a corporation, partnership, or trust), documents showing the existence of the entity, such as certified articles of incorporation, a government-issued business license, a partnership agreement, or trust instrument.

(B) Verification through non-documentary methods. For a bank relying on non-documentary methods, the CIP must contain procedures that describe the non-documentary methods the bank will use.

- (1) These methods may include contacting a customer; independently verifying the customer's identity through the comparison of information provided by the customer with information obtained from a consumer reporting agency, public database, or other source; checking references with other financial institutions; and obtaining a financial statement.
- (2) The bank's non-documentary procedures must address situations where an individual is unable to present an unexpired government-issued identification document that bears a photograph or similar safeguard; the bank is not familiar with the documents presented; the account is opened without obtaining documents; the customer opens the account without appearing in person at the bank; and where the bank is otherwise presented with circumstances that increase the risk that the bank will be unable to verify the true identity of a customer through documents.

Discussion

Recognizing that some accounts are opened by telephone, by mail, and over the Internet, the rule provides that a bank's CIP also must contain procedures describing what non-documentary methods the bank will use to verify identity and when the bank will use these methods (whether in addition to, or instead of, relying on documents).

Non-documentary verification methods that a bank may use include contacting a customer after the account is opened; obtaining a financial statement; comparing the identifying information provided by the customer against fraud and bad check databases to determine whether any of the information is associated with known incidents of fraudulent behavior (negative verification); comparing the identifying information with information available from a trusted third party source, such as a credit report from a consumer reporting agency (positive verification); and checking references with other financial institutions. The bank also may wish to analyze whether there is logical consistency between the identifying information provided, such as the customer's name, street address, ZIP code, telephone number, date of birth, and social security number (logical verification).

The rule adopts general principles plus examples. Therefore, the final rule states that for a bank relying on non-documentary verification methods, the CIP must contain procedures that describe the non-documentary methods the bank will use. One method is "independently verifying the customer's identity through the comparison of information provided by the customer with information obtained from a consumer reporting agency, public database, or other source," rather than verifying "documentary information" through such sources.

(C) Additional verification for certain customers. The CIP must address situations where, based on the bank's risk assessment of a new account opened by a customer that is not an individual, the bank will obtain information about individuals with authority or control over such account, including signatories, in order to verify the customer's identity. This verification method applies only when the bank cannot verify the customer's true identity using the verification methods described in paragraphs (a)(2)(ii)(A) and (B) of this section.

Lack of Verification [31 C.F.R § 1020.220(a)(2)(iii)]

The CIP must include procedures for responding to circumstances in which the bank cannot form a reasonable belief that it knows the true identity of a customer. These procedures should describe:

(A) When the bank should not open an account;

(B) The terms under which a customer may use an account while the bank attempts to verify the customer's identity;

(C) When the bank should close an account, after attempts to verify a customer's identity have failed; and

(D) When the bank should file a Suspicious Activity Report in accordance with applicable law and regulation.

Discussion

A bank's CIP should include procedures for responding to circumstances in which the bank cannot form a reasonable belief that it knows the true identity of the customer. There are some exceptions to this basic rule. For example, a bank may maintain an account at the direction of a law enforcement or intelligence agency, even though the bank does not know the true identity of the customer. However, the rule text itself states that the procedures should describe the following:

- When a bank should not open an account for a potential customer;
- The terms under which a customer may use an account while the bank attempts to verify the customer's identity; when the bank should close an account after attempts to verify a customer's identity have failed; and
- When the bank should file a Suspicious Activity Report in accordance with applicable law and regulation.

The rule does not specifically require a bank to close the account of a customer whose identity the bank cannot verify, but instead leaves this determination to the discretion of the bank. There is no statutory basis to create a safe harbor that would shield banks from state regulatory or borrower liability if a bank should choose to close a customer's account. Any such closure should be consistent with the bank's existing procedures for closing accounts in accordance with its risk management practices.

A bank must also comply with other applicable laws and regulations, such as the adverse action provisions under ECOA and the FCRA, when determining not to open an account because it cannot establish a reasonable belief that it knows the true identity of the customer.

Recordkeeping [31 C.F.R § 1020.220(a)(3)]

The CIP must include procedures for making and maintaining a record of all information obtained under the procedures implementing paragraph (a) of this section.

(i) ***Required records.*** At a minimum, the record must include:

(A) All identifying information about a customer obtained under paragraph (a)(2)(i) of this section;

(B) A description of any document that was relied upon under paragraph (a)(2)(ii)(A) of this section 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;

(C) A description of the methods and the results of any measures undertaken to verify the identity of the customer under paragraph (a)(2)(ii)(B) or (C) of this section; and

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

Nothing in the rule modifies, limits, or supersedes section 101 of the Electronic Signatures in Global and National Commerce Act, Pub. L. 106-229, 114 Stat. 464 (15 U.S.C. 7001) (E-Sign Act). Thus, a bank may use electronic records to satisfy the requirements of this final rule, as long as the records are accurate and remain accessible in accordance with 31 C.F.R. § 1010.430(d).

(ii) ***Retention of Records.*** The bank must retain the information in paragraph (a)(3)(i)(A) of this section for five years after the date the account is closed or, in the case of credit card accounts, five years after the account is closed or becomes dormant. The bank must retain the information in paragraphs (a)(3)(i)(B), (C), and (D) of this section for five years after the record is made.

Comparison with Government Lists [31 C.F.R § 1020.220(a)(4)]

The CIP must include procedures for determining whether the customer appears on any list of known or suspected terrorists or terrorist organizations issued by any Federal government agency and designated as such by Treasury in consultation with the Federal functional regulators. The procedures must require the bank to make such a determination within a reasonable period of time after the account is opened, or earlier, if required by another Federal law or regulation or Federal directive issued in connection with the applicable list. The procedures must also require the bank to follow all Federal directives issued in connection with such lists.

At this time, there are no designated lists. Banks will receive notification by way of separate guidance regarding the lists that must be consulted for purposes of this provision.

Customer Notice [31 C.F.R § 1020.220(a)(5)]

(i) **Customer Notice.** The CIP must include procedures for providing bank customers with adequate notice that the bank is requesting information to verify their identities.

(ii) **Adequate Notice.** Notice is adequate if the bank generally describes the identification requirements of this section and provides the notice in a manner reasonably designed to ensure that a customer is able to view the notice, or is otherwise given notice, before opening an account. For example, depending upon the manner in which the account is opened, a bank may post a notice in the lobby or on its Web site, include the notice on its account applications, or use any other form of written or oral notice.

(iii) **Sample Notice.** If appropriate, a bank may use the following sample language to provide notice to its customers:

Important Information About Procedures for Opening a New Account

To help the government fight the funding of terrorism and money laundering activities, Federal law requires all financial institutions to obtain, verify, and record information that identifies each person who opens an account.

What this means for you: When you open an account, 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.

Reliance on another Financial Institution [31 C.F.R § 1020.220(a)(6)]

The CIP may include procedures specifying when a bank will rely on the performance by another financial institution (including an affiliate) of any procedures of the bank's CIP, with respect to any customer of the bank that is opening, or has opened, an account, or has established a similar formal banking or business relationship with the other financial institution to provide or engage in services, dealings, or other financial transactions, provided that:

a. Such reliance is reasonable under the circumstances;
b. The other financial institution is subject to a rule implementing 31 U.S.C. 5318(h) and is regulated by a Federal functional regulator; and
c. The other financial institution enters into a contract requiring it to certify annually to the bank that it has implemented its anti-money laundering program, and that it will perform (or its agent will perform) the specified requirements of the bank's CIP.

Exemptions [31 C.F.R § 1020.220(b)]

The appropriate Federal functional regulator, with the concurrence of the Secretary, may, by order or regulation, exempt any bank or type of account from the requirements of this section. The Federal functional regulator and the Secretary shall consider whether the exemption is consistent with the purposes of the Bank Secrecy Act and with safe and sound banking, and may consider other appropriate factors. The Secretary will make these determinations for any bank or type of account that is not subject to the authority of a Federal functional regulator.

Other Requirements Unaffected [31 C.F.R § 1020.220(c)]

Nothing in this section relieves a bank of its obligation to comply with any other provision in this part, including provisions concerning information that must be obtained, verified, or maintained in connection with any account or transaction.

Discussion

The proposal provided that nothing in § 1020.220 shall be construed to relieve a bank of its obligations to obtain, verify, or maintain information in connection with an account or transaction that is required by another provision in part 1020. For example, if an account is opened with a deposit of more than $10,000 in cash, the bank opening the account must comply with the customer identification requirements in § 1020.220, as well as with the provisions of § 1010.311, which require that certain information concerning the transaction be reported by filing a Currency Transaction Report (CTR).

Section 4: Auditing Customer Identification Program

Question for this section include:

Did the bank follow the bank-approved CIP procedures for verifying the identity of each customer? _______________

Were the following pieces of information collected for each customer?

- Name
- Date of birth, for an individual
- Address
- Identification number

Was verification made through documents? _______________

Were non-documentary versification methods used? _______________

Were all recordkeeping rules met? ______________

Reviewing OFAC

Section 1: OFAC Review

Introduction

We have elected to omit any lengthy discussion of this rule. The requirements are simple: No one gets any money through the bank unless the bank is sure they are not on the various OFAC lists. Each bank has their own risk-based rules about compliance. The rules should cover (at a minimum), all service providers, the customer(s), and the seller(s).

Once you understand your bank's requirements, answer this question:

Reviewing Selected FCRA Requirements

Section 1: 12 CFR §§ 1022.30 – 1022.32
Subpart D – Limits for Medical Information

Scope and Definitions – 12 CFR § 1022.30(a) and (b)

Regulatory Discussion

Paragraph (a) discusses the scope of the rule, which includes all financial institutions and lenders.

Paragraph (b) discusses the general prohibition on obtaining or using medical information. A creditor may not obtain or use medical information pertaining to a consumer in connection with any determination of the consumer's eligibility, or continued eligibility, for credit, except as provided under the regulation. Paragraph (b) also includes definitions directly related to this topic.

Regulatory Text - 12 CFR § 1022.30(a) and (b)

(b) General prohibition on obtaining or using medical information

(1) In general. A creditor may not obtain or use medical information pertaining to a consumer in connection with any determination of the consumer's eligibility, or continued eligibility, for credit, except as provided in this section.

(2) Definitions.

(i) **Credit** has the same meaning as in section 702 of the Equal Credit Opportunity Act, 15 U.S.C. 1691a.

(ii) **Creditor** has the same meaning as in section 702 of the Equal Credit Opportunity Act, 15 U.S.C. 1691a.

(iii) **Eligibility, or continued eligibility,** for credit means the consumer's qualification or fitness to receive, or continue to receive, credit, including the terms on which credit is offered. The term does not include:

(A) Any determination of the consumer's qualification or fitness for **employment, insurance** (other than a credit insurance product), or other non-credit products or services;

(B) **Authorizing, processing, or documenting a payment** or transaction on behalf of the consumer in a manner that does not involve a determination of the consumer's eligibility, or continued eligibility, for credit; or

(C) **Maintaining or servicing the consumer's account** in a manner that does not involve a determination of the consumer's eligibility, or continued eligibility, for credit.

Rule of Construction – 12 CFR § 1022.30(c)

Regulatory Discussion

This paragraph discusses the rule of construction for obtaining and using unsolicited medical information. For instance, there is no violation if the creditor receives medical information pertaining to a consumer in connection with any determination of the consumer's eligibility, or continued eligibility, for credit, even though the information was not requested (unsolicited).

The regulation offers examples of situations in which the financial institution or lender may obtain medical information without being in violation of the regulation. They are quoted as follows:

Regulatory Text - 12 CFR § 1022.30(c)

(c) Rule of construction for obtaining and using unsolicited medical information

(1) In general. A creditor does not obtain medical information in violation of the prohibition if it receives medical information pertaining to a consumer in connection with any determination of the consumer's eligibility, or continued eligibility, for credit **without specifically requesting medical information.**

(2) Use of unsolicited medical information. A creditor that receives unsolicited medical information in the manner described in paragraph (c)(1) of this section may use that information in connection with any determination of the consumer's eligibility, or continued eligibility, for credit to the extent the creditor can rely on at least one of the exceptions in §1022.30(d) or (e).

(3) Examples. A creditor does not obtain medical information in violation of the prohibition if, for example:

(i) In response to a **general question regarding a consumer's debts or expenses,** the creditor receives information that the consumer owes a debt to a hospital.

(ii) In a conversation with the creditor's loan officer, **the consumer informs the creditor that the consumer has a particular medical condition.**

(iii) In connection with a consumer's application for an extension of credit, the **creditor requests a consumer report from a consumer reporting agency** and receives medical information in the consumer report furnished by the agency even though the creditor did not specifically request medical information from the consumer reporting agency.

Financial Information Exception – 12 CFR § 1022.30(d)

Regulatory Discussion

There is a specific exception for financial information. A creditor may obtain and use a consumer’s medical information in connection with any credit decision as long as the information is limited to creditworthiness, such as debts, expenses, income, benefits, assets, collateral, or the purpose of the loan, including the use of proceeds. The creditor must treat the information no differently than any other credit information.

The regulation gives numerous examples regarding this issue.

Regulatory Text - 12 CFR § 1022.30(d)

(d) Financial information exception for obtaining and using medical information

(1) In general. A creditor may obtain and use medical information pertaining to a consumer in connection with any determination of the consumer's eligibility, or continued eligibility, for credit so long as:

(i) The information is the **type of information routinely used** in making credit eligibility determinations, such as information relating to debts, expenses, income, benefits, assets, collateral, or the purpose of the loan, including the use of proceeds;

(ii) The creditor uses the medical information in a manner and to an extent **that is no less favorable** than it would use comparable information that is not medical information in a credit transaction; and

(iii) The creditor **does not take** the consumer's physical, mental, or behavioral health, condition or history, type of treatment, or prognosis into account as part of any such determination.

(2) Examples.

(i) Examples of the types of information routinely used in making credit eligibility determinations. Paragraph (d)(1)(i) of this section permits a creditor, for example, to obtain and use information about:

(A) **The dollar amount, repayment terms, repayment history,** and similar information regarding medical debts to calculate, measure, or verify the repayment ability of the consumer, the use of proceeds, or the terms for granting credit;

(B) The **value, condition, and lien status of a medical device** that may serve as collateral to secure a loan;

(C) The **dollar amount and continued eligibility for disability income,** workers' compensation income, or other benefits related to health or a medical condition that is relied on as a source of repayment; or

(D) The identity of in connection with an application for credit, including but not limited to, a transaction involving the consolidation of medical debts.

(ii) Examples of uses of medical information consistent with the exception.

(A) A consumer includes on an application for credit information about two $20,000 debts. One debt is to a hospital; the other debt is to a retailer. The creditor contacts the hospital and the retailer to verify the amount and payment status of the debts. The creditor learns that both debts are more than 90 days past due. Any two debts of this size that are more than 90 days past due would disqualify the consumer under the creditor's established underwriting criteria. The creditor denies the application on the basis that the consumer has a poor repayment history on outstanding debts. The creditor has used medical information in a manner and to an extent no less favorable than it would use comparable non-medical information.

(B) A consumer indicates on an application for a $200,000 mortgage loan that she receives $15,000 in long-term disability income each year from her former employer and has no other income. Annual income of $15,000, regardless of source, would not be sufficient to support the requested amount of credit. The creditor denies the application on the basis that the projected debt-to-income ratio of the consumer does not meet the creditor's underwriting criteria. The creditor has used medical information in a manner and to an extent that is no less favorable than it would use comparable non-medical information.

(C) A consumer includes on an application for a $10,000 home equity loan that he has a $50,000 debt to a medical facility that specializes in treating a potentially terminal disease. The creditor contacts the medical facility to verify the debt and obtain the repayment history and current status of the loan. The creditor learns that the debt is current. The applicant meets the income and other requirements of the creditor's underwriting guidelines. The creditor grants the application. The creditor has used medical information in accordance with the exception.

(iii) Examples of uses of medical information inconsistent with the exception.

(A) A consumer applies for $25,000 of credit and includes on the application information about a $50,000 debt to a hospital. The creditor contacts the hospital to verify the amount and payment status of the debt, and learns that the debt is current and that the consumer has no delinquencies in her repayment history. If the existing debt were instead owed to a retail department store, the creditor would approve the application and extend credit based on the amount and repayment history of the outstanding debt. The creditor, however, denies the application because the consumer is indebted to a hospital. The creditor has used medical information, here the identity of the medical creditor, in a manner and to an extent that is less favorable than it would use comparable non-medical information.

(B) A consumer meets with a loan officer of a creditor to apply for a mortgage loan. While filling out the loan application, the consumer informs the loan officer orally that she has a potentially terminal disease. The consumer meets the creditor's established requirements for the requested mortgage loan. The loan officer recommends to the credit committee that the consumer be denied credit because the consumer has that disease. The credit committee follows the loan officer's recommendation and denies the application because the consumer has a potentially terminal disease. The creditor has used medical information in a manner inconsistent with the exception by taking into account the consumer's physical, mental, or behavioral health, condition, or history, type of treatment, or prognosis as part of a determination of eligibility or continued eligibility for credit.

(C) A consumer who has an apparent medical condition, such as a consumer who uses a wheelchair or an oxygen tank, meets with a loan officer to apply for a home equity loan. The consumer meets the creditor's established requirements for the requested home equity loan and the creditor typically does not require consumers to obtain a debt cancellation contract, debt suspension agreement, or credit insurance product in connection with such loans. However, based on the consumer's apparent medical condition, the loan officer recommends to the credit committee that credit be extended to the consumer only if the consumer obtains a debt cancellation contract, debt suspension agreement, or credit insurance product from a nonaffiliated third party. The credit committee agrees with the loan officer's recommendation. The loan officer informs the consumer that the consumer must obtain a debt cancellation contract, debt suspension agreement, or credit insurance product from a nonaffiliated third party to qualify for the loan. The consumer obtains one of these products and the creditor approves the loan. The creditor has used medical information in a manner inconsistent with the exception by taking into account the consumer's physical, mental, or behavioral health, condition, or history, type of treatment, or prognosis in setting conditions on the consumer's eligibility for credit.

Exceptions for Obtaining/Using Medical Information – 12 CFR § 1022.30(e)

Regulatory Discussion

A creditor may obtain and use medical information pertaining to a consumer in connection with any determination of the consumer's eligibility, or continued eligibility, for credit in very specific circumstances.

Regulatory Text - *12 CFR* § 1022.30(e)

(e) Specific exceptions for obtaining and using medical information

(1) In general. A creditor may obtain and use medical information pertaining to a consumer in connection with any determination of the consumer's eligibility, or continued eligibility, for credit:

"(i) To determine whether the use of a **power of attorney or legal representative** that is triggered by a medical condition or event is necessary and appropriate or whether the consumer has the legal capacity to contract when a person seeks to exercise a power of attorney or act as legal representative for a consumer based on an asserted medical condition or event;

(ii) To comply with applicable **requirements of local, state, or Federal laws;**

(iii) To determine, **at the consumer's request**, whether the consumer qualifies for a legally permissible special credit program or credit-related assistance program that is:

(A) Designed to meet the special needs of consumers with medical conditions; and

(B) Established and administered pursuant to a written plan that:

(1) Identifies the class of persons that the program is designed to benefit; and

(2) Sets forth the procedures and standards for extending credit or providing other credit-related assistance under the program;

(iv) To the extent necessary for purposes of **fraud prevention or detection;**

(v) In the case of credit for the purpose of financing medical products or services, to **determine and verify the medical purpose** of a loan and the use of proceeds;

(vi) Consistent with safe and sound practices, **if the consumer or the consumer's legal**

representative specifically requests that the creditor use medical information in determining the consumer's eligibility, or continued eligibility, for credit, to accommodate the consumer's particular circumstances, and such request is documented by the creditor;

(vii) Consistent with safe and sound practices, to determine whether the **provisions of a forbearance practice** or program that is triggered by a medical condition or event apply to a consumer;

(viii) To determine the consumer's eligibility for, the **triggering of, or the reactivation of a debt cancellation contract** or debt suspension agreement if a medical condition or event is a triggering event for the provision of benefits under the contract or agreement; or

(ix) To determine the consumer's eligibility for, the **triggering of, or the reactivation of a credit insurance product** if a medical condition or event is a triggering event for the provision of benefits under the product.

(2) Example of determining eligibility for a special credit program or credit assistance program. A not-for-profit organization establishes a credit assistance program pursuant to a written plan that is designed to assist disabled veterans in purchasing homes by subsidizing the down payment for the home purchase mortgage loans of qualifying veterans. The organization works through mortgage lenders and requires mortgage lenders to obtain medical information about the disability of any consumer that seeks to qualify for the program, use that information to verify the consumer's eligibility for the program, and forward that information to the organization. A consumer who is a veteran applies to a creditor for a home purchase mortgage loan. The creditor informs the consumer about the credit assistance program for disabled veterans and the consumer seeks to qualify for the program. Assuming that the program complies with all applicable law, including applicable fair lending laws, the creditor may obtain and use medical information about the medical condition and disability, if any, of the consumer to determine whether the consumer qualifies for the credit assistance program.

(3) Examples of verifying the medical purpose of the loan or the use of proceeds.

(i) If a consumer applies for $10,000 of credit for the purpose of financing vision correction surgery, the creditor may verify with the surgeon that the procedure will be performed. If the surgeon reports that surgery will not be performed on the consumer, the creditor may use that medical information to deny the consumer's application for credit, because the loan would not be used for the stated purpose.

(ii) If a consumer applies for $10,000 of credit for the purpose of financing cosmetic surgery, the creditor may confirm the cost of the procedure with the surgeon. If the surgeon reports that the cost of the procedure is $5,000, the creditor may use that medical information to offer the consumer only $5,000 of credit.

(iii) A creditor has an established medical loan program for financing particular elective surgical procedures. The creditor receives a loan application from a consumer requesting $10,000 of credit under the established loan program for an elective surgical procedure. The consumer indicates on the application that the purpose of the loan is to finance an elective surgical procedure not eligible for funding under the guidelines of the established loan program. The creditor may deny the consumer's application because the purpose of the loan is not for a particular procedure funded by the established loan program.

(4) Examples of obtaining and using medical information at the request of the consumer.

(i) If a consumer applies for a loan and specifically requests that the creditor consider the consumer's medical disability at the relevant time as an explanation for adverse payment history information in his credit report, the creditor may consider such medical information in evaluating the consumer's willingness and ability to repay the requested loan to accommodate the consumer’s particular circumstances, consistent with safe and sound practices. The creditor may also decline to consider such medical information to accommodate the consumer, but may evaluate the consumer's application in accordance with its otherwise applicable underwriting criteria. The creditor may not deny the consumer's application or otherwise treat the consumer less favorably because the consumer specifically requested a medical accommodation, if the creditor would have extended the credit or treated the consumer more favorably under the creditor's otherwise applicable underwriting criteria.

(ii) If a consumer applies for a loan by telephone and explains that his income has been and will continue to be interrupted on account of a medical condition and that he expects to repay the loan by liquidating assets, the creditor may, but is not required to, evaluate the application using the sale of assets as the primary source of repayment, consistent with safe and sound practices, provided that the creditor documents the consumer's request by recording the oral conversation or making a notation of the request in the consumer's file.

(iii) If a consumer applies for a loan and the application form provides a space where the consumer may provide any other information or special circumstances, whether medical or non-medical, that the consumer would like the creditor to consider in evaluating the consumer's application, the creditor may use medical information provided by the consumer in that space on that application to accommodate the consumer's application for credit, consistent with safe and sound practices, or may disregard that information.

(iv) If a consumer specifically requests that the creditor use medical information in determining the consumer's eligibility, or continued eligibility, for credit and provides the creditor with medical information for that purpose, and the creditor determines that it needs additional information regarding the consumer's circumstances, the creditor may request, obtain, and use additional medical information about the consumer as necessary to verify the information provided by the consumer or to determine whether to make an accommodation for the consumer. The consumer may decline to provide additional information, withdraw the request for an accommodation, and have the application considered under the creditor's otherwise applicable underwriting criteria.

(v) If a consumer completes and signs a credit application that is not for medical purpose credit and the application contains boilerplate language that routinely requests medical information from the consumer or that indicates that by applying for credit the consumer authorizes or consents to the creditor obtaining and using medical information in connection with a determination of the consumer's eligibility, or continued eligibility, for credit, the consumer has not specifically requested that the creditor obtain and use medical information to accommodate the consumer's particular circumstances.

(5) Example of a forbearance practice or program. After an appropriate safety and soundness review, a creditor institutes a program that allows consumers who are or will be hospitalized to defer payments as needed for up to three months, without penalty, if the credit account has been open for more than one year and has not previously been in default, and the consumer provides confirming documentation at an appropriate time. A consumer is hospitalized and does not pay her bill for a particular month. This consumer has had a credit account with the creditor for more than one year and has not previously been in default. The creditor attempts to contact the consumer and speaks with the consumer's adult child, who is not the consumer's legal representative. The adult child informs the creditor that the consumer is hospitalized and is unable to pay the bill at that time. The creditor defers payments for up to three months, without penalty, for the hospitalized consumer and sends the consumer a letter confirming this practice and the date on which the next payment will be due. The creditor has obtained and used medical information to determine whether the provisions of a medically-triggered forbearance practice or program apply to a consumer."

Limits on Re-disclosure of Medical Information – 12 CFR § 1022.31

Regulatory Discussion

This paragraph begins with a scope section, which still includes all financial institutions.

This paragraph (a) also contains scope information, which is of little value. However, section (b) states that if a financial institution receives medical information about a consumer from a consumer reporting agency or its affiliate, the person must not disclose that information to any other person, except as necessary to carry out the purpose for which the information was initially disclosed, or as otherwise permitted by statute, regulation, or order.

Regulatory Text- 12 CFR § 1022.31

(a) **Scope.** This section applies to any person, except for a person excluded from coverage of this part by section 1029 of the Consumer Financial Protection Act of 2010, title X of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203, 124 Stat. 137.

(b) Limits on redisclosure. If a person described in paragraph (a) of this section receives medical information about a consumer from a consumer reporting agency or its affiliate, the person must not disclose that information to any other person, except as necessary to carry out the purpose for which the information was initially disclosed, or as otherwise permitted by statute, regulation, or order.

Sharing Medical Information with Affiliates – 12 CFR § 1022.32

Regulatory Discussion

The exclusions from the term "consumer report" in the Act that allow the sharing of information with affiliates do not apply to a financial institution if the institution communicates to an affiliate medical information; payment transactions of the consumer for medical products or services; or an aggregate list of identified consumers based on payment transactions for medical products or services.

There are exceptions to this rule. You may rely on the exclusions from the term "consumer report" to communicate the information listed above, when sharing with an affiliate. Section (a) discusses scope, which is the same as many previous "scope" paragraphs. Sections (b) and (c) discuss the exclusions and exceptions.

Regulatory Text - 12 CFR § 1022.32

(a) **Scope**. This section applies to any person, except for a person excluded from coverage of this part by section 1029 of the Consumer Financial Protection Act of 2010, title X of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203, 124 Stat. 137.

(b) In general. The **exclusions from the term "consumer report"** in section 603(d)(2) of the Act that allow the sharing of information with affiliates do not apply to a person described in paragraph (a) of this section if that person **communicates to an affiliate:**

(1) **Medical information**;

(2) An individualized list or description **based on the payment transactions** of the consumer for medical products or services; or

(3) **An aggregate list** of identified consumers based on payment transactions for medical products or services.

(c) Exceptions. A person described in paragraph (a) of this section may rely on the exclusions from the term "consumer report" in section 603(d)(2) of the Act to communicate the information in paragraph (b) of this section to an affiliate:

(1) In connection with **the business of insurance or annuities** (including the activities described in section 18B of the model Privacy of Consumer Financial and Health Information Regulation issued by the National Association of Insurance Commissioners, as in effect on January 1, 2003);

(2) For any purpose permitted without authorization under the regulations promulgated by the Department of Health and Human Services pursuant to the **Health Insurance Portability and Accountability Act of 1996** (HIPAA);

(3) For any purpose referred to in section 1179 of **HIPAA**;

(4) For any purpose described in section 502(e) of the **Gramm-Leach-Bliley Act**;

(5) In connection with a **determination of the consumer's eligibility**, or continued eligibility, for credit consistent with §1022.30 of this part; or

(6) As otherwise **permitted by order of the Bureau**.

Section 2: 12 CFR §§ 1022.70 – 1022.75

Subpart H - Duties of Users Regarding Risk-Based Pricing

Scope and Enforcement - 12 CFR § 1022.70(a) and (b)

Regulatory Discussion

As in previous subparts, Subpart H is directed at certain financial institutions. The covered institutions must use consumer reports and negatively change pricing on the basis of the reports. Business credit is excluded.

Paragraph (b) indicates the enforcement mechanism.

Regulatory Text and Commentary

We have chosen to omit the 20 pages of regulation and commentary, and focus on the required forms as they appear in Appendix H, which begins on the next page.

Appendix H to Part 1022—Appendix H—Model Forms for Risk-Based Pricing and Credit Score Disclosure Exception Notices

1. This appendix contains four model forms for risk-based pricing notices and three model forms for use in connection with the credit score disclosure exceptions. Each of the model forms is designated for use in a particular set of circumstances as indicated by the title of that model form.

2. Model form H–1 is for use in complying with the general risk-based pricing notice requirements in Sec. 1022.72 if a credit score is not used in setting the material terms of credit. Model form H–2 is for risk-based pricing notices given in connection with account review if a credit score is not used in increasing the annual percentage rate. Model form H–3 is for use in connection with the credit score disclosure exception for loans secured by residential real property. Model form H–4 is for use in connection with the credit score disclosure exception for loans that are not secured by residential real property. Model form H–5 is for use in connection with the credit score disclosure exception when no credit score is available for a consumer. Model form H–6 is for use in complying with the general risk-based pricing notice requirements in Sec. 1022.72 if a credit score is used in setting the material terms of credit. Model form H–7 is for risk- based pricing notices given in connection with account review if a credit score is used in increasing the annual percentage rate. All forms contained in this appendix are models; their use is optional.

3. A person may change the forms by rearranging the format or by making technical modifications to the language of the forms, in each case without modifying the substance of the disclosures. Any such rearrangement or modification of the language of the model forms may not be so extensive as to materially affect the substance, clarity, comprehensibility, or meaningful sequence of the forms. Persons making revisions with that effect will lose the benefit of the safe harbor for appropriate use of Appendix H model forms. A person is not required to conduct consumer testing when rearranging the format of the model forms.

   a. Acceptable changes include, for example:

      i. Corrections or updates to telephone numbers, mailing addresses, or Web site addresses that may change over time.

      ii. The addition of graphics or icons, such as the person's corporate logo.

      iii. Alteration of the shading or color contained in the model forms.

      iv. Use of a different form of graphical presentation to depict the distribution of credit scores.

      v. Substitution of the words "credit" and "creditor" or "finance" and "finance company" for the terms "loan" and "lender."

      vi. Including pre-printed lists of the sources of consumer reports or consumer reporting agencies in a "check-the-box" format.

      vii. Including the name of the consumer, transaction identification numbers, a date, and other information that will assist in identifying the transaction to which the form pertains.

      viii. Including the name of an agent, such as an auto dealer or other party, when providing the "Name of the Entity Providing the Notice."

ix. Until January 1, 2013, substituting "For more information about credit reports and your rights under Federal law, visit the Federal Reserve Board's Web site at www.federalreserve.gov, or the Federal Trade Commission's Web site at www.ftc.gov." for "For more information about credit reports and your rights under Federal law, visit the Consumer Financial Protection Bureau's Web site at www.consumerfinance.gov/learnmore."

b. Unacceptable changes include, for example:

i. Providing model forms on register receipts or interspersed with other disclosures.

ii. Eliminating empty lines and extra spaces between sentences within the same section.

4. If a person uses an appropriate Appendix H model form, or modifies a form in accordance with the above instructions, that person shall be deemed to be acting in compliance with the provisions of §1022.73 or §1022.74, as applicable, of this part. It is intended that appropriate use of Model Form H–3 also will comply with the disclosure that may be required under section 609(g) of the FCRA. Optional language in model forms H–6 and H–7 may be used to direct the consumer to the entity (which may be a consumer reporting agency or the creditor itself, for a proprietary score that meets the definition of a credit score) that provided the credit score for any questions about the credit score, along with the entity's contact information. Creditors may use or not use the additional language without losing the safe harbor, since the language is optional.

H–1 Model form for risk-based pricing notice.

H–2 Model form for account review risk- based pricing notice.

H–3 Model form for credit score disclosure exception for credit secured by one to four units of residential real property.

H–4 Model form for credit score disclosure exception for loans not secured by residential real property.

H–5 Model form for credit score disclosure exception for loans where credit score is not available.

H–6 Model form for risk-based pricing notice with credit score information.

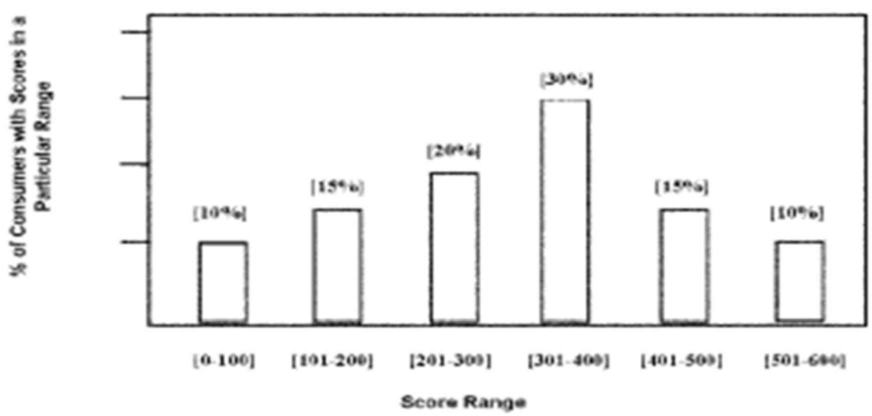
H–7 Model form for account review risk- based pricing notice with credit score information.

NOTE: We are only showing the forms below that relate to mortgage loans.

H-3. Model form for credit score disclosure exception for loans secured by one to four units of residential real property

[Name of Entity Providing the Notice]
Your Credit Score and the Price You Pay for Credit

Your Credit Score	
Your credit score	**[Insert credit score]** Source: **[Insert source]** Date: **[Insert date score was created]**

Understanding Your Credit Score	
What you should know about credit scores	Your credit score is a number that reflects the information in your credit report. Your credit report is a record of your credit history. It includes information about whether you pay your bills on time and how much you owe to creditors. Your credit score can change, depending on how your credit history changes.
How we use your credit score	Your credit score can affect whether you can get a loan and how much you will have to pay for that loan.
The range of scores	Scores range from a low of **[Insert bottom number in the range]** to a high of **[Insert top number in the range]**. Generally, the higher your score, the more likely you are to be offered better credit terms.
How your score compares to the scores of other consumers	 **[or]** [Your credit score ranks higher than [X] percent of U.S. consumers.]

Understanding Your Credit Score (continued)	
Key factors that adversely affected your credit score	**[Insert first factor]** **[Insert second factor]** **[Insert third factor]** **[Insert fourth factor]** **[Insert fifth factor, if applicable]**

Checking Your Credit Report	
What if there are mistakes in your credit report?	You have a right to dispute any inaccurate information in your credit report. If you find mistakes on your credit report, contact the consumer reporting agency. It is a good idea to check your credit report to make sure the information it contains is accurate.
How can you obtain a copy of your credit report?	Under Federal law, you have the right to obtain a free copy of your credit report from each of the nationwide consumer reporting agencies once a year. To order your free annual credit report— *By telephone:* Call toll-free: 1-877-322-8228 *On the web:* Visit www.annualcreditreport.com *By mail:* Mail your completed Annual Credit Report Request Form (which you can obtain from the Federal Trade Commission's website at http://www.ftc.gov/bcp/conline/include/requestformfinal.pdf) to: Annual Credit Report Request Service P.O. Box 105281 Atlanta, GA 30348-5281
How can you get more information?	For more information about credit reports and your rights under Federal law, visit the Consumer Financial Protection Bureau's website at www.consumerfinance.gov/learnmore.

Notice to the Home Loan Applicant

In connection with your application for a home loan, the lender must disclose to you the score that a consumer reporting agency distributed to users and the lender used in connection with your home loan, and the key factors affecting your credit scores.

The credit score is a computer generated summary calculated at the time of the request and based on information that a consumer reporting agency or lender has on file. The scores are based on data about your credit history and payment patterns. Credit scores are important because they are used to assist the lender in determining whether you will obtain a loan. They may also be used to determine what interest rate you may be offered on the mortgage. Credit scores can change over time, depending on your conduct, how your credit history and payment patterns change, and how credit scoring technologies change.

Because the score is based on information in your credit history, it is very important that you review the credit-related information that is being furnished to make sure it is accurate. Credit records may vary from one company to another.

If you have questions about your credit score or the credit information that is furnished to you, contact the consumer reporting agency at the address and telephone number provided with this notice, or contact the lender, if the lender developed or generated the credit score. The consumer reporting agency plays no part in the decision to take any action on the loan application and is unable to provide you with specific reasons for the decision on a loan application.

If you have questions concerning the terms of the loan, contact the lender.

H-5. Model form for loans where credit score is not available

[Name of Entity Providing the Notice]
Credit Scores and the Price You Pay for Credit

Your Credit Score	
Your credit score	Your credit score is not available from **[insert name of CRA]**, which is a consumer reporting agency, because they may not have enough information about your credit history to calculate a score.
What you should know about credit scores	A credit score is a number that reflects the information in a credit report. A credit report is a record of your credit history. It includes information about whether you pay your bills on time and how much you owe to creditors. A credit score can change, depending on how a consumer's credit history changes.
Why credit scores are important	Credit scores are important because consumers who have higher credit scores generally will get more favorable credit terms. Not having a credit score can affect whether you can get a loan and how much you will have to pay for that loan.
Checking Your Credit Report	
What if there are mistakes in your credit report?	You have a right to dispute any inaccurate information in your credit report. If you find mistakes on your credit report, contact the consumer reporting agency. It is a good idea to check your credit report to make sure the information it contains is accurate.
How can you obtain a copy of your credit report?	Under Federal law, you have the right to obtain a free copy of your credit report from each of the nationwide consumer reporting agencies once a year. To order your free annual credit report— *By telephone:* Call toll-free: 1-877-322-8228 *On the web:* Visit www.annualcreditreport.com *By mail:* Mail your completed Annual Credit Report Request

Section 3: Reviewing FCRA Selected Subjects

Questions for this area include:

Did the bank avoid obtaining or using medical information pertaining to a consumer in connection with any determination of the consumer's eligibility, or continued eligibility, for credit? _______________

Did the bank follow the rules of construction for obtaining and using unsolicited medical information? _______________

Did the bank follow all rules under the financial information exception for obtaining and using medical information? _______________

Did the bank obtain and use medical information pertaining to a consumer in connection with any determination of the consumer's eligibility, or continued eligibility, as permitted by the regulation? _______________

Did the bank provide the appropriate risk based pricing notice(s)? _______________

Were the risk based pricing notices correct and complete? _______________