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DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

24 CFR Parts 201, 203, 1005, and 1007

[Docket No. FR 5707-F-02]
RIN 2502-AJ18

Qualified Mortgage Definition for HUD Insured and Guaranteed Single Family Mortgages

AGENCY: Office of Secretary, HUD.

ACTION: Final rule.

SUMMARY: Through this final rule, HUD establishes a definition of "qualified mortgage" for the single family residential loans that HUD insures, guarantees, or administers that aligns with the statutory ability-to-repay criteria of the Truth-in-Lending Act (TILA) and the regulatory criteria of the definition of "qualified mortgage" promulgated by the Consumer Financial Protection Bureau (CFPB). The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) created new section 129C in TILA, which establishes minimum standards for considering a consumer's repayment ability for creditors originating certain closed-end, dwelling-secured mortgages, and generally prohibits a creditor from making a residential mortgage loan unless the creditor makes a reasonable and good-faith determination of a consumer's ability to repay the loan according to its terms. Section 129C authorizes the agency with responsibility for compliance with TILA, which is CFPB, to issue a rule implementing these requirements, and the CFPB has issued its rule implementing these requirements.

The Dodd-Frank Act also charges HUD and three other Federal agencies with prescribing regulations defining the types of loans that these Federal agencies insure, guarantee, or administer, as may be applicable, that are qualified mortgages. Through this rule, HUD complies

with this statutory directive for the single family residential loans that HUD insures, guarantees, or administers.

DATES: Effective Date: January 10, 2014.

FOR FURTHER INFORMATION CONTACT: Michael P. Nixon, Office of Housing, Department of Housing and Urban Development, 451 7th Street, SW, Room 9278, Washington, DC 20410; telephone number 202-402-5216, ext. 3094 (this is not a toll-free number). Persons with hearing or speech impairments may access this number through TTY by calling the Federal Relay Service at 800-877-8339 (this is a toll-free number).

SUPPLEMENTARY INFORMATION

I. Executive Summary

A. Purpose of the Regulatory Action.

This rule meets HUD's charge under TILA, as amended by the Dodd-Frank Act, to define, in regulation, the term "qualified mortgage" for the single family residential mortgages and loans that HUD insures, guarantees, or otherwise administers. While the CFPB, in accordance with statutory direction, has promulgated regulations that define "qualified mortgage" for the broader single family mortgage market, HUD, through this rule, promulgates regulations that define this term for HUD's single family insured or guaranteed mortgage programs.

The statutory purpose of defining "qualified mortgage," whether for the conventional mortgage market or for specific Federal programs, as specified in the Dodd-Frank Act, is to identify single family residential mortgages that take into consideration a borrower's ability to repay the loan and provide certain protections for the lender from liability. During the years preceding the mortgage crisis, too many mortgages in the conventional mortgage market were made to borrowers without regard to their ability to repay the loan and included risky features such as "no doc" loans or "interest only" loans. As a result, many homeowners defaulted on these loans and faced foreclosure, contributing to the collapse in the housing market in 2008 and leading to the Nation's most serious financial crisis since the Great Depression.

In developing its definition of "qualified mortgage", HUD reviewed its mortgage insurance and loan guarantee programs and determined that all of the single family residential mortgage and loan products offered under HUD programs should be defined as "qualified mortgages"; that is, they exclude risky features and are designed so that the borrower can repay the loan. For certain of its mortgage products, HUD establishes qualified mortgage standards similar to those established by the CFPB in its definition of "qualified mortgage." HUD has always required lenders to determine a borrower's ability to repay a mortgage in its insured and guaranteed single family mortgage programs. With ability-to-repay and qualified mortgage standards now in place for conventional mortgage loans, HUD determined that all HUD loans should be qualified mortgages and it could adjust its existing standards to more closely align with the standards promulgated by the CFPB, lessening future differences in standards for HUD's single family residential insured mortgages and those governing conventional mortgages to be designated qualified mortgage, but maintaining standards that continue to support the mission of HUD's programs.

B. <u>Summary of the Major Provisions of the Regulatory Action</u>.

In defining "qualified mortgage" in its rulemaking, the CFPB established both a safe harbor and a rebuttable presumption of compliance for transactions that are qualified mortgages. The label of safe harbor qualified mortgage applies to those mortgages that are not higher-priced covered transactions (that is the annual percentage rate does not exceed the average prime offer rate by 1.5 percent). These are considered to be the least risky loans and presumed to have conclusively met the ability-to-repay requirements of TILA. The label of rebuttable presumption qualified mortgage is applied to those mortgages that are higher-priced transactions.

In this final rule, the definition of "qualified mortgage," as provided in HUD's September 30, 2013, proposed rule, published at 78 FR 59890, is retained with certain clarifications and exceptions HUD is making in response to public comments. As proposed by HUD in the September 30, 2013, proposed rule, this final rule designates Title I (property improvement loans and manufactured home loans), Section 184 (Indian housing loans), and Section 184A (Native Hawaiian housing loans) insured mortgages and guaranteed loans covered by this rule as safe harbor qualified mortgages and no changes to the current underwriting requirements of these mortgage and loan products are made by this final rule. To this list, FHA adds manufactured housing insured under Title II of the National Housing Act (Title II) and clarifies that the Title I Manufactured Home Loan program is included in the Title I exemption. However, for its largest volume of mortgage products, those insured under Title II of the National Housing Act, with certain exceptions, HUD retains the two categories of qualified mortgages similar to the two categories created in the CFPB final rule — a safe harbor qualified mortgage and a rebuttable presumption qualified mortgage. HUD continues to exempt reverse mortgages insured under section 255 of Title II from the "qualified mortgage" definition. HUD has also added to the list of exempted transactions Title II insured mortgages made by housing finance agencies and certain other governmental or nonprofit organizations providing home financing under programs designed for low- and moderate-income individuals and families, and discussed in more detail later in this preamble.

For the remaining Title II insured mortgages, this final rule, consistent with the proposed rule, defines safe harbor qualified mortgage as a mortgage insured under Title II of the National Housing Act that meets the points and fees limit adopted by the CFPB in its regulation at 12 CFR 1026.43(e)(3), and that has an annual percentage rate for a first-lien mortgage relative to the average prime offer rate that is no more than the sum of the annual mortgage insurance premium and 1.15 percentage points. This final rule defines a rebuttable presumption qualified mortgage as a single family mortgage insured under Title II of the National Housing Act that meets the points and fees limit adopted by the CFPB in its regulation at 12 CFR 1026.43(e)(3), but has an annual percentage rate that exceeds the average prime offer rate for a comparable mortgage, as of the date the interest rate is set, by more than the sum of the annual mortgage insurance premium and 1.15 percentage points for a first-lien mortgage.

HUD requires that all loans, subject to the exceptions noted, be insured under Title II of the National Housing Act and meet the CFPB's points and fees limit at 12 CFR 1026.43(e)(3) in order to be either a rebuttable presumption or safe harbor qualified mortgage. The CFPB set a three percent points and fees limit for its definition of qualified mortgage and allowed for adjustments of this limit to facilitate the presumption of compliance for smaller loans.

As more fully discussed in HUD's September 30, 2013, proposed rule, HUD establishes two categories of qualified mortgages for the majority of National Housing Act mortgages to maintain consistency with the TILA statutory criteria defining qualified mortgage, as well as the CFPB's definition, to the extent consistent with the National Housing Act.

While the final rule makes no significant changes to HUD's proposed core definition of qualified mortgage, as noted above, HUD is making certain clarifications and exceptions.

For example, commenters stated that compliance with HUD regulations would necessitate further and immediate system changes and that the lending industry lacked sufficient time to make such changes by January 2014. HUD clarifies that HUD's definition of safe harbor qualified mortgage incorporates CFPB's requirements for a safe harbor qualified mortgage under the special provision for loans insured under the National Housing Act while allowing for a higher APR threshold, so compliance with HUD regulations does not necessitate immediate industry changes for lenders to identify safe harbor qualified mortgages under HUD's definition by January 2014. In other words, compared to the CFPB's regulations, this rule allows more FHA mortgages to qualify as safe harbor qualified mortgages; every FHA loan that would have qualified as a safe harbor qualified mortgage under the CFPB regulations for loans insured under the National Housing Act would qualify as a safe harbor qualified mortgage under this HUD rule. Since the lending industry must comply with CFPB's regulations by January 2014, and were given a full year to prepare for compliance with the CFPB regulations, this clarification should ease concerns about additional immediate compliance costs and the need for additional time to comply with HUD's qualified mortgage regulations.

C. Costs and Benefits.

HUD's final rule, in effect, reclassifies a sizeable group (about 19 percent) of Title II loans insured under the National Housing Act from rebuttable presumption qualified mortgages under the CFPB regulations to safe harbor qualified mortgages under HUD's regulation, less than one percent would remain a rebuttable presumption qualified mortgage. A small number (about 7 percent) of Title II loans would continue to not qualify as qualified mortgage based on their exceeding the points and fees limit, while the remaining FHA loans (about 74 percent) would qualify for qualified mortgage status with a safe harbor presumption of compliance with the ability to repay requirements under both the CFPB's rule and HUD's rule. The Title II loans that would be non-qualified mortgages under the CFPB's rule would remain non-qualified mortgage under the proposed rule. The difference is that HUD, through this rule, will no longer insure loans with points and fees above the CFPB level for qualified mortgage, but expects that most of these loans will adapt to meet the points and fees to be insured.

In addition, HUD classifies all Title I, Title II manufactured housing and Section 184 and Section 184A insured mortgages and guaranteed loans as safe harbor qualified mortgages that would have most likely been non-qualified mortgages under the CFPB's rule. Classifying these programs as safe harbor recognizes the unique nature of these loans. For these programs, HUD believes that providing safe harbor status to these programs will not increase market share but instead maintain availability of these products to the underserved borrowers targeted, and allow HUD additional time to further examine these programs and whether they should be covered by a definition of "qualified mortgage" similar to the definition provided in this rule for Title II mortgages.

As a result of these reclassifications, HUD expects the following economic impacts:

Table 1, Summary of Economic Effects: Changing the Rebuttable Presumption Standard for Title I, Title II, Section 184, and Section 184A Loans

Effect	**Distribution**	**Effect Size**
Benefits		
Lower legal costs through an increase in the number of safe harbor loans	Lenders (transfers to borrowers via lower interest rates)	$12.2 to $40.7 million
Costs		
Foregone benefits from ability-to-pay lawsuits through incremental	Borrowers	Unquantified (the likelihood of such lawsuits has been

Effect	Distribution	Effect Size
decrease in rebuttable presumption loans		reduced greatly by changes in lending practices stemming from the Dodd-Frank Act and the lawsuits initiated by Federal and State governments)
Operational costs through the programming of a new HUD standard	Lenders (potential transfers to borrowers through increased loan costs for borrowers)	De minimus
Transfers		
Lower interest rates for FHA mortgages due to the increased legal benefits for lenders with the HUD rule vs. CFPB patch	Lenders to Borrowers	Unquantified but will be capped by legal benefits to lenders
Potential increase in the volume of loans due to greater legal benefits to lenders for HUD rule relative to CFPB patch	Borrowers to FHA	Unquantified as this theoretical increase in volume is expected to be minimal. (The observable impact of both the CFPB patch and the HUD rule will be a decrease in volume relative to HUD volume of loans today).
Potential increase in the net present value of premium revenues minus mortgage insurance claims	Borrowers to FHA	De minimus

Table 2, Summary of Economic Effects: Eliminating the Points and Fee Limit for Title I, Section 184, Section 184A, and Title II Manufactured Housing Loans (All Designated as Safe Harbor Qualified Mortgages)

Effect	Distribution	Size
Benefits		
Maintained Homeownership benefits for underserved populations as loans	Borrowers (Indian and Native Hawaiian borrowers, home improvement and	Positive but unquantified. Under the CFPB patch, there could be a slight decrease in loans to these populations as lenders would

Effect	Distribution	Size
Benefits		
continue to be made	manufactured housing borrowers)	be making non-QM loans that are nevertheless guaranteed/insured by HUD.
Lower legal costs	Lenders	Positive but unquantified.
Costs		
Foregone benefits from ability-to-pay lawsuits	Borrowers	Unquantified but expected to be minimal (the likelihood of such lawsuits has been reduced greatly by changes in lending practices stemming from the Dodd-Frank Act and the lawsuits initiated by Federal and State governments)
Transfers		
Potential increase in the volume of loans through greater legal protection for HUD rule relative to CFPB patch	Borrowers to FHA	Unquantified but expected to be minimal
Potential increase in the net present value of premium revenues minus mortgage insurance claims	Borrowers to FHA	De minimus

II. Background

As noted in the Summary of this preamble, it is the Dodd-Frank Act that charges HUD and other Federal agencies to define "qualified mortgage" for the single family residential loans that meet statutory ability-to-repay requirements. New section 129C(a) of TILA, added by section 1411 of subtitle B of Title XIV of the Dodd-Frank Act (Pub. L. 111-203, 124 Stat. 1736, approved July 21, 2010), provides minimum standards for considering a consumer's ability to repay a residential mortgage. New section 129C(b), added by section 1412 of the Dodd-Frank Act, establishes the presumption that the ability-to-repay requirements of section 129C(a) are satisfied if a mortgage is a "qualified mortgage," and authorizes, initially, the Federal Reserve Board and, ultimately, the CFPB[1], to prescribe regulations that revise, add to, or subtract from the criteria in TILA that define a "qualified mortgage."

Section 129C(b)(2)(A) defines qualified mortgage as a mortgage that meets the following requirements: (i) the transaction must have regular periodic payments; (ii) the terms of the mortgage must not result in a balloon payment; (iii) the income and financial resources of the mortgagor are verified and documented; (iv) for a fixed rate loan, the underwriting process fully amortizes the loan over the loan term; (v) for an adjustable rate loan, the underwriting is based on the maximum rate permitted under the loan during the first 5 years and includes a payment schedule that fully amortizes the loan over the loan term; (vi) the transaction must comply with any regulations established by the CFPB relating to ratios of total monthly debt to total monthly income; (vii) the total points and fees payable in connection with the loan must not exceed 3 percent of the total loan amount; and (viii) the mortgage must not exceed 30 years, except in specific areas.[2]

New section 129C(b)(3)(B)(ii) of TILA, also added by section 1412 of the Dodd-Frank Act, requires that HUD, the Department of Veterans Affairs (VA), and the Department of

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[1] On July 21, 2011, rulemaking authority under TILA transferred from the Federal Reserve Board to the CFPB.

[2] Section 129C also provides for a reverse mortgage to be a qualified mortgage if the mortgage meets the CFPB's standards for a qualified mortgage except to the extent that reverse mortgages are statutorily exempted altogether from the ability-to-repay requirements. The CFPB's regulations provide that the ability-to-repay requirements of section 129C(a) do not apply to reverse mortgages. In the preamble to its final rule published on January 30, 2013, the CPFB states: "The Bureau notes that the final rule does not define a 'qualified' reverse mortgage. As described above, TILA section 129C(a)(8) excludes reverse mortgages from the repayment ability requirements. See section-by-section analysis of § 1026.43(a)(3)(i). However, TILA section 129C(b)(2)(ix) provides that the term 'qualified mortgage' may include a 'residential mortgage loan' that is 'a reverse mortgage which meets the standards for a qualified mortgage, as set by the Bureau in rules that are consistent with the purposes of this subsection.' The Board's proposal did not include reverse mortgages in the definition of a 'qualified mortgage.'" See 78 FR 6516.

Agriculture (USDA)prescribe rules in consultation with the Federal Reserve Board[3] to define the types of loans they insure, guarantee, or administer, as the case may be, that are "qualified mortgages," and revise, add to, or subtract from the statutory criteria used to define a qualified mortgage.

The CFPB published a final rule on January 30, 2013, at 78 FR 6408, entitled, "Ability-to-Repay and Qualified Mortgage Standards under the Truth in Lending Act (Regulation Z)," which is referred to in this preamble as the CFPB final rule. The CFPB final rule implemented section 129C(b) by defining "qualified mortgage" with two degrees of protections for creditors and assignees of a qualified mortgage. The CFPB's regulations implementing section 129C(b) are codified at 12 CFR part 1026. The CFPB regulations establish both a safe harbor and a rebuttable presumption of compliance for transactions that are "qualified mortgages."

Under the CFPB's regulation, a qualified mortgage falls into the safe harbor category and is conclusively presumed to have met the ability-to-repay requirements if it is not a "higher-priced covered transaction."[4] A qualified mortgage that is a higher-priced covered transaction has only a rebuttable presumption of compliance with the ability-to-repay requirement, even though each element of the "qualified mortgage" definition is met. See 12 CFR 1026.43(e)(1)(ii)(B). The CFPB's rule is intended to provide greater protection for borrowers by providing only a rebuttable presumption of compliance for higher-priced covered transactions.

The preamble to HUD's September 30, 2013, proposed rule discussed the CFPB's qualified mortgage regulations in more detail. Members of the public interested in more detail

[3] Rulemaking authority under TILA was transferred to the CFPB.
[4] A "higher-priced covered transaction" is a transaction that has an annual percentage rate (APR) that exceeds the average prime offer rate (APOR) for a comparable transaction as of the date the interest rate is set by 1.5 or more percentage points for a first-lien covered transaction, or by 3.5 or more percentage points for a subordinate-lien covered transaction.

about the CFPB's regulations may refer to the preamble of HUD's September 30, 2013, proposed rule (see 78 FR 59892-59893) but more importantly should refer to the preamble to the CFPB's final rule published in the Federal Register on January 30, 2013, at 78 FR 6409.[5]

III. HUD's September 30, 2013, Proposed Rule

In its September 30, 2013, proposed rule, HUD submitted for public comment regulations defining qualified mortgage for its insured and guaranteed single family loan programs. The covered programs consist of single family loans insured under the National Housing Act (12 U.S.C. 1701 et seq.), and section 184 loans for Indian housing under the Housing and Community Development Act of 1992 (12 U.S.C. 1715z-13a) (Section 184 guaranteed loans) and section 184A loans for Native Hawaiian housing under the Housing and Community Development Act of 1992 (1715z-13b) (Section 184A guaranteed loans). Of these programs, the single family loans insured under Title II of the National Housing Act (12 U.S.C. 1701 et seq.) (Title II) present the largest volume of mortgages insured by HUD, through FHA.

In the September 30, 2013, proposed rule, HUD proposed to define all FHA-insured single family mortgages to be qualified mortgages, except for reverse mortgages insured under HUD's Home Equity Conversion Mortgage (HECM) program (section 255 of the National Housing Act (12 U.S.C. 1715z-20)), which are exempt from the ability-to-repay requirements. Mortgages insured under the Title I Property Improvement Loan Insurance program and Manufactured Home Loan program (Title I), authorized by section 2 of the National Housing Act (12 U.S.C. 1703), and Section 184 guaranteed loans and Section 184A guaranteed loans,

[5] Various provisions of CFPB's January 2013, final rule were amended by rules published in the Federal Register on June 13, 2013, at 78 FR 35430, July 24, 2013, at 78 FR 44686, July 30, 2013, at 78 FR 45842, October 1, 2013, at 78 FR 60382, and October 23, 2013, at 78 FR 62993.

would be designated safe harbor qualified mortgages, with no specific points and fees limits and with no annual percentage rate (APR) limits. See 78 FR 59895 and 59897.

Similar to the CFPB's regulations, HUD proposed to provide for two types of qualified mortgages for FHA Title II mortgages: (1) a safe harbor qualified mortgage and (2) a rebuttable presumption qualified mortgage. For the Title II mortgages, HUD proposed to modify the APR limit used in the "higher-priced covered transaction" element as defined by the CFPB to distinguish between HUD's safe harbor qualified mortgages and rebuttable presumption qualified mortgages.

For Title II mortgages, HUD proposed to add a new § 203.19 to its regulations in 24 CFR part 203[6] that would require, through the proposed definition of "qualified mortgage," all FHA-insured single family mortgages, except for HECMs, to be "qualified mortgages." HUD proposed to incorporate the safe harbor and rebuttable presumption standards within the definition of a "qualified mortgage" rather than create subsets based on defining whether a mortgage is a higher-priced covered transaction, as provided in the CFPB's regulations. HUD also proposed to adopt the CFPB's points and fees limitations at 12 CFR 1026.43(e)(3). HUD advised, in the proposed rule, that it considered the adoption of the points and fees limit as established by statute and adopted by the CFPB in its final rule to be appropriate.[7]

HUD's proposed rule defined "safe harbor qualified mortgage" for Title II mortgages as one that meets the requirements for insurance under the National Housing Act, meets the CFPB's points and fees limit, and has an APR for a first-lien mortgage relative to the average prime offer rate (APOR) that does not exceed the combined annual mortgage insurance premium (MIP) and

[6] All single family mortgages insured by FHA under the National Housing Act are governed by regulations in 24 CFR part 203 except for property improvement and manufactured home loans under Title I and the HECM program.
[7] As noted in the proposed rule, HUD's upfront mortgage insurance premium (UFMIP) is not included in the points and fees.

1.15 percentage points. HUD's proposed definition of "safe harbor qualified mortgage" for Title II mortgages provides a different APR relative to APOR threshold than under the CFPB's regulation. The APR relative to APOR threshold is higher than CFPB's and fluctuates according to the product's MIP. The CFPB's construct for determining a higher-priced covered transaction captured a number of FHA loans as a result of the MIP which HUD believes needs to be addressed.

As provided in the preamble to HUD's proposed rule, because all FHA-insured mortgages include a MIP that may vary from time to time to address HUD's financial soundness responsibilities, including the MIP as an element of the threshold that distinguishes safe harbor from rebuttable presumption allows the threshold to "float" in a manner that allows HUD to fulfill its responsibilities that would not be feasible if HUD adopted a threshold based only on the amount that APR exceeds APOR. As noted in the proposed rule, if a straight APR over APOR threshold were adopted by HUD, every time HUD would change the MIP to ensure the financial soundness of its insurance fund and reduce risk to the fund or to reflect a more positive market, HUD would also have to consider changing the threshold APR limit. HUD also provides for a higher overall APR relative to APOR to remove the impact of the MIP on the designation of "safe harbor qualified mortgage" and "rebuttable presumption qualified mortgage" definitions.

In the September 30, 2013, proposed rule, HUD proposed to define a "rebuttable presumption qualified mortgage" for Title II mortgages as a single family mortgage that is insured under the National Housing Act, does not exceed the CFPB's limits on points and fees, and has an APR that exceeds the APOR for a comparable mortgage, as of the date the interest rate is set, by more than the combined annual MIP and 1.15 percentage points for a first-lien mortgage. HUD's proposed rule provided that a mortgage that meets the requirements for a rebuttable presumption qualified mortgage would be presumed to comply with the ability to repay requirements in 15 U.S.C. 1639c(a). The proposed rule further provided that any rebuttal of such presumption of compliance must show that despite meeting the "rebuttable presumption qualified mortgage" requirements, the mortgagee did not make a reasonable and good-faith determination of the mortgagor's repayment ability at the time of consummation when underwriting the mortgage in accordance with HUD requirements.

In the September 30, 2013, proposed rule, HUD proposed to require FHA streamlined refinances to comply with HUD's qualified mortgage rule; that is, to require streamlined refinances to meet the points and fees requirements. Section 129C(a)(5) of TILA grants HUD the authority to exempt streamlined refinancing from the income verification requirements of section 129C(a)(4), subject to certain conditions. In the proposed rule, HUD advised that it did not consider it necessary to exercise this authority because HUD's qualified mortgage definition results in an exemption similar to the one contemplated under section 129C(a)(5). HUD requirements only exempt lenders from verifying income if the loan is originated consistent with the FHA-streamlined refinancing requirements, which means that the mortgage must be current, the loan is designed to lower the monthly principal and interest payment, and the loan involves no cash back to the borrower except for minor adjustments.[8]

HUD's proposed rule provided a detailed description of the policy and factors that HUD considered in developing a definition of "qualified mortgage" for the mortgages that it insures, guarantees, or otherwise administers. HUD is not repeating such description in the preamble to

[8] Handbook 4155.1, Ch. 6, Sec. C (Mortgage Credit Analysis for Mortgage Insurance on One-to-Four Unit Mortgage Loans – Streamline Refinances) http://portal.hud.gov/hudportal/HUD?src=/program_offices/administration/hudclips/handbooks/hsgh/4155.1.

this final rule, and refers interested parties to the preamble of the September 30, 2013, proposed rule, for more detailed information about the proposed rule choices.

IV. This Final Rule

As noted earlier in this preamble, HUD retains its core definition of qualified mortgage, as provided in the September 30, 2013, proposed rule. However, in response to public comments, HUD makes certain clarifications and provides certain exemptions to compliance with HUD's qualified mortgage regulations in this final rule. Changes to the regulatory text made by this final rule and certain clarifications are as follows:

- Compliance timeframe. As HUD notes in greater detail in the responses to public comments below, this rule should allow lenders to make the same number of insured safe harbor qualified mortgages, using systems they have already been putting in place, than if HUD had taken no action. By taking the action of issuing this rule, HUD also provides an opportunity for lenders to modify their systems further on their own timetable to take full advantage of the potential increase in the number of insured safe harbor qualified mortgages allowed by this rule. HUD expects in accordance with a lender's own timetable and allocation of resources a lender will update its systems to increase the number of HUD-insured safe harbor qualified mortgages so to track any future revisions to HUD's MIP.
- Designation of manufactured home mortgages as FHA safe harbor qualified mortgages. HUD designates mortgages on manufactured homes insured under Title I and Title II to be safe harbor qualified mortgages with no changes, at this time, to the underwriting requirements for this category of housing. HUD's proposed rule was silent on the treatment of Title II manufactured housing, but HUD's intention was to exempt Title II

manufactured housing mortgages from meeting the points and fees requirements of HUD's definition of qualified mortgage. HUD's designation of Title I loans as safe harbor qualified mortgages was also meant to encompass not only the Title I property improvement loans but also the Title I Manufactured Home Loan program. Similar to HUD's approach to Title I, HUD insurance of manufactured housing under Title II is a specialized product that necessitates further study.

- <u>Transactions exempted from compliance with HUD's qualified mortgage definition</u>. HUD is exempting certain mortgage transactions from compliance with HUD's qualified mortgage definition, which means that unlike all other FHA-insured mortgages, these mortgages are not subject to the requirements in § 203.19(b). These exemptions are the same exemptions provided by the CFPB in its regulations (see 12 CFR 1026.43(a)(3)). In exempting some of these transactions, the CFPB stated that the institutions involved in these transactions employ a traditional model of relationship lending that did not succumb to the general deterioration in lending standards that contributed to the financial crisis, they have particularly strong incentives to maintain positive reputations in their communities, and they often keep the loans they make in their own portfolios in order to pay appropriate attention to the borrower's ability to repay the loan. Therefore, consistent with the CFPB, HUD exempts from compliance with its definition of qualified mortgage the following insured mortgages::

  (1) a reverse mortgage subject to 12 CFR 1026.33;

  (2) a temporary or "bridge" loan with a term of 12 months or less;

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

  (4) a mortgage made by:

(a) a housing finance agency (HFA), as defined in HUD's regulations at 24 CFR 266.5;
(b) a creditor designated as a Community Development Financial Institution, as defined in the regulations of the Department of Treasury's Community Development Financial Institutions program at 12 CFR 1805.104(h);
(c) a creditor designated as a Downpayment Assistance through Secondary Financing Provider, pursuant to HUD's regulations in 24 CFR 200.194(a), operating in accordance with HUD regulations as applicable to such creditors;
(d) a creditor designated as a Community Housing Development Organization provided that the creditor has entered into a commitment with a participating jurisdiction and is undertaking a project under the HOME Investment Partnerships (HOME) program, pursuant to HUD's regulations at 24 CFR 92.300(a);
(e) a creditor 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); 26 CFR 1.501(c)(3)-1), provided that:

(i) during the calendar year preceding receipt of the consumer's application, the creditor extended credit secured by a dwelling no more than 200 times;

(ii) during the calendar year preceding receipt of the consumer's application, the creditor extended credit secured by a dwelling only to consumers with income that did not exceed the low- and moderate-income household limit as established pursuant to section 102 of the Housing and Community Development Act of 1974 (42 U.S.C. 5302(a)(20)) and amended from time to time by HUD pursuant to HUD's regulations at 24 CFR 570.3;

(iii) the extension of credit is to a consumer with income that does not exceed the household limit specified in the applicable FHA program; and

(iv) the creditor determines, in accordance with written procedures, that the consumer has a reasonable ability to repay the extension of credit; and

(5) 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).

All of these mortgages were exempt by the CFPB from compliance with its ability to repay regulations and HUD agrees that the single family mortgages with which these governmental and nonprofit organizations are involved, many under HUD programs as noted above, should be exempt from compliance with HUD's qualified mortgage regulations while otherwise meeting HUD requirements.

- <u>Adoption of the CFPB's guidance definitions for APR, APOR, and points and fees</u>. For purposes of clarity, this final rule adopts, through cross-reference, the CFPB's definitions of APOR, APR, and points and fees. The CFPB defines APOR at 12 CFR 1026.35, APR at 1026.22, and points and fees at 12 CFR 1026.32(b)(1). In addition to these definitions, the CFPB provides guidance for APR calculations in Appendix J to 12 CFR part 1026; guidance for points and fees is provided in Paragraph 32(b) of CFPB's Official Interpretation, which is Supplement I to 12 CFR part 1026; and guidance for APOR is provided in Paragraph 35 of Supplement I to 12 CFR part 1026. HUD adopts this guidance for consistency with the CFPB.
- <u>Adoption of CFPB's definition of points and fees and clarification on non-affiliated fees.</u> HUD clarifies the points and fees calculation that applies in this final rule by incorporating the CFPB's points and fees definition at 12 CFR 1026.32(b). In adopting the CFPB's points and fees definition, HUD clarifies for commenters that housing

counseling fees and rehabilitation consultant fees under HUD's 203(k) program may be excluded from points and fees if made by a third-party and is not retained by the creditor, loan originator, or an affiliate of either. HUD-approved housing counseling for borrowers seeking FHA-insured mortgages, whether such counseling is voluntary or required, is not part of the points and fees calculation. HUD-approved housing counseling agencies are not permitted to be affiliated with either a creditor or loan originator and, therefore, fees that were paid for counseling would be exempt from the points and fees calculation for the transaction. Additionally, exempt from the points and fees calculation are consultant fees for ensuring program compliance and for drafting the required architectural exhibits for the 203(k) program by non-affiliated entities. HUD requires the use of a HUD consultant to ensure 203(k) program compliance and strongly encourages the use of an independent consultant to prepare the required architectural exhibits. Both types of consultation fees, if obtained by non-affiliated entities on the 203(k) consultant list, are not included in the points and fees calculation, and therefore adoption of the CFPB points and fees definition should not reduce access to the 203(k) program

- Clarification of the rebuttable presumption standard. HUD amends the rebuttable presumption standard to clarify the elements of such standard are consistent with HUD's existing underwriting requirements for rebutting the presumption. The proposed rule stated that to rebut the presumption a borrower must prove that "the mortgage exceeded the points and fees limit in paragraph (b)(1) of this section or that, despite the mortgage being insured under the National Housing Act, the mortgagee did not make a reasonable and good-faith determination of the mortgagor's repayment ability at the time of consummation, by failing to consider the mortgagor's income, debt obligations, alimony, child support, monthly payment on any simultaneous loans, and monthly payment (including mortgage-related obligations) on the mortgage, as applicable to the type of mortgage, when underwriting the mortgage in accordance with HUD requirements." HUD adopted the list of the CFPB's factors (mortgagor's income, debt obligations, alimony, child support, monthly payment on any simultaneous loans, and monthly payment) to remain consistent with the CFPB's rebuttable presumption standard, but intended those factors to harmonize with HUD's existing underwriting requirements. In response to commenters, HUD believes listing HUD's specific underwriting categories is more helpful than solely citing to the list provided by the CFPB. HUD replaces the CFPB's list with FHA's "income, credit and assets" underwriting categories, found in FHA's Underwriting Handbook. Additionally, HUD clarifies that the entity is required to do more than consider the list of ability to repay indicators for the borrower, but evaluate the mortgagor's income, credit, and assets in accordance with HUD underwriting requirements.

- <u>Clarification of relationship between indemnification and qualified mortgage status</u>. HUD adds at this final rule stage a section clarifying that a demand for indemnification or the occurrence of indemnification does not per se remove qualified mortgage status. The final rule includes an indemnification clause for both Title I and Title II loans, which clarifies that an indemnification demand or resolution of a demand that relates to whether the loan satisfied relevant eligibility and underwriting requirements at time of consummation may result from facts that could allow a change in qualified mortgage status, but the existence of an indemnification does not per se remove qualified mortgage status.

- Flexibility to respond to lender or borrower needs consistent with the FHA mission. HUD also adds language to its qualified mortgage regulations to give FHA flexibility to make adjustments, including to the points and fees definition and the list of exempted transactions, that may be necessary to address situations where the FHA Commissioner determines such adjustments are necessary, including in times of significant decrease of available credit, increase in foreclosures, or disaster situations that adversely affect the availability of housing finance. The changes would provide for notice and the opportunity for comment prior to implementing any changes, and HUD contemplates that changes made through this notice process would be temporary not permanent changes. For example, the housing mortgage crisis that emerged late in 2008 resulted in mortgage products designed to keep homeowners from losing their homes. These mortgage products were largely temporary without a permanent regulatory structure. In a situation such as this, the notice process provided in this rule would allow the Commissioner to determine whether such products would be subject to FHA's qualified mortgage definition or be exempt. The notice process would not, however, apply to the rebuttable presumption/safe harbor thresholds in § 203.19(b)(2) and (3).

In the preamble to the September 30, 2013, proposed rule, HUD committed to further study the parameters for distinguishing between a safe harbor qualified mortgage and a rebuttable presumption qualified mortgage for the Title I, Section 184 and Section 184A loans, and makes this same commitment for Title II loans that are subject to HUD's qualified mortgage regulations in this final rule. HUD will monitor how the two subsets of qualified mortgages work for FHA Title II loans subject to these regulations, primarily in relationship to the two subset approach provided for the conventional mortgage market. Given current and expected MIPs, HUD also reiterates that a mortgage that is a safe harbor qualified mortgage under the CFPB's special rules for HUD loans as a safe harbor qualified mortgage would satisfy HUD's regulations.

V. HUD's Responses to Key Issues Raised by Public Commenters

This section of the preamble discusses the key issues raised by the comments submitted in response to the September 30, 2013, proposed rule. All public comments can be viewed at the following website, www.regulations.gov, under docket number HUD-2013-0093.

Comment: Delay implementation of HUD's rule: The majority of commenters expressed support for HUD's proposed rule but the majority also stated that an implementation date of January 2014 was too soon and would not allow sufficient time for lenders to modify their systems to include the specific features of HUD requirements for qualified mortgages. Commenters stated that industry would find it extremely challenging to be ready to originate loans without a robust compliance infrastructure in place. Commenters suggested that if HUD is intent in implementing qualified mortgage regulations by January 2014, HUD should do so through a staged approach. Commenters suggested that HUD begin with all HUD insured and guaranteed single family mortgages being designated as safe harbor qualified mortgages and provide for implementation of HUD rebuttable presumption qualified mortgages at a later date. Another commenter requested that HUD withdraw its rule until HUD had taken more time to assess the impacts of its proposed rule.

Response: HUD understands that the lending industry may need more time to adjust systems to fully implement HUD's qualified mortgage regulations. However, HUD considers that all lenders will be in a position to substantially implement HUD's regulations immediately because of system modifications that were already required under CFPB's regulations and which lenders have been given a full year to implement. If HUD had taken no action at all, lenders making FHA-insured loans that are qualified mortgages would have to have systems in place to account for loans that 1) have regular periodic payments and do not have certain risky features, 2) do not exceed a term of 30 years, and 3) do not exceed certain specified limits on points and fees. HUD's rule is not changing any of these requirements and, therefore, no system changes to address any of these requirements because of HUD's rule should be necessary. Further, systems that lenders have put in place to identify safe harbor qualified mortgages under the CFPB's 1.5 percent APR threshold should also identify the substantial majority of safe harbor qualified mortgages under HUD's APR threshold. A loan that meets the 1.5 percent threshold will also be in compliance with the HUD threshold. Only HUD safe harbor loans that exceed the 1.5 percent threshold would not be picked up by such systems. Thus, lenders are no worse off under HUD's rule in terms of making safe harbor qualified mortgages, using systems already required to be in place, than they would be if HUD had taken no action. To the extent that lenders take steps to conform their systems to identify the higher APR safe harbor threshold allowed under the HUD rule, they will be better off in terms of making safe harbor qualified mortgages than they would have been if HUD had taken no action. The HUD rule provides an immediate opportunity for lenders to increase the number of HUD-insured safe harbor qualified mortgages they make in accordance with a timetable and allocation of resources of their choosing, but HUD does not consider it necessary for any lender to change systems immediately to adapt to HUD's requirements in order to make the same number of insured safe harbor qualified mortgages as a lender would otherwise make.

Comment: Unnecessary to establish two types of qualified mortgages for FHA loans: Designate all FHA loans as safe harbor qualified mortgages to reduce burden and costs: Commenters stated that bifurcation between qualified mortgage safe harbor loans and qualified mortgage rebuttable presumption loans under CFPB's rule is intended to provide greater protection for borrowers with higher-priced mortgage loans. The commenters stated that unlike the CFPB's rule, which governs the wider market of private prime and higher-priced lending, HUD's rule covers only FHA loans. The commenters stated that this protection is unnecessary in the context of FHA loans, which are subject to strict oversight, control, and regulation. Commenters stated that FHA's sound underwriting process ensures consumer access to safe mortgage loans and the recent steps FHA has undertaken to strengthen its underwriting standards have reduced risks.

A commenter similarly stated that its view is that there are safeguards and practices in place, unique to FHA lending and its mission, to lessen the need to copy the CFPB's two-tiered qualified mortgage approach and HUD should instead classify all FHA loans as safe harbor qualified mortgages. The commenter stated that other than a desire to mirror the CFPB's final rule, HUD's proposed rule provides no basis that such a distinction is needed for the FHA market. The commenter stated that HUD acknowledges (in the costs and benefits discussion of the preamble to the proposed rule) that the vast majority of FHA loans will meet the proposed safe harbor parameters; and for most of those that do not, it would be attributable to the limit on points and fees. The commenter stated that this suggests that there are no market indications that the two-tiered approach is warranted

Another commenter stated that HUD defended its proposal to adopt the same points/fees measure for FHA-insured loans as the CFPB qualified mortgage final rule on the basis that it would not give a lender an incentive to choose on the basis of a different (and perhaps higher) points/fees measure for FHA-insured loans. The commenter stated that HUD should consider the potential loss of additional price, product, and service choices for the borrower that might be reduced by the use of a different qualified mortgage standard.

A few commenters stated that FHA's mission is to correct, not create, market failure. The commenter stated that HUD's proposed rule establishes a materially different qualified mortgage standard for FHA insured mortgages than the CFPB qualified mortgage standard for conventional mortgage loans. The commenters stated that HUD seems to rely upon an overly expansive "mission" justification for creating a different qualified mortgage rule than the one established by the CFPB. The commenters stated that to the extent the mission of FHA is to ensure credit access to under-served people, such a distinction may be appropriate, but that the great majority of FHA-insured lending in recent years has been related to a different purpose, which is to provide backstop countercyclical liquidity in a housing market decline. The commenters stated this countercyclical activity is not discussed in the proposed rule, so it is unclear how this activity relates to the mission justification cited. The commenter stated that substantially different qualified mortgage rules distort markets and delay the return of FHA to its primary mission.

Commenters stated that HUD's proposed qualified mortgage structure for FHA loans adds significant regulatory burden and cost to the lender and borrower. Commenters stated that differentiating safe harbor from rebuttable presumption loans for only 3 percent of the current FHA market would require extensive system changes, staff training and monitoring and compliance systems, which will be an expense that saddles the 97 percent of FHA borrowers, whereas, treating all loans as safe harbors will present little compliance cost or regulatory burden. The industry is already burdened with extensive and significant changes that are estimated to increase origination costs.

Response: HUD's position is that in addition to prospective borrowers of FHA-insured mortgages the overall mortgage market benefits from FHA loans being closely aligned with the statutory criteria applicable to a borrower's ability to repay, and the regulations promulgated by the CFPB. Section 1402 of the Dodd-Frank Act states that Congress created new section 129C of TILA upon a finding that "economic stabilization would be enhanced by the protection, limitation, and regulation of the terms of residential mortgage credit and the practices related to such credit, while ensuring that responsible, affordable mortgage credit remains available to consumers."[9] Section 1402 of the Dodd-Frank Act further states that the purpose of section 129C of TILA is to "assure that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay the loans." The CFPB, in its regulations, distinguishes between a safe harbor qualified mortgage and a rebuttable presumption qualified mortgage based on whether the mortgages are prime loans (safe harbor) or subprime loans (rebuttable presumption).[10]

Although section 129C(b)(3)(B)(ii) of TILA authorizes HUD to revise, add to, or subtract from the statutory criteria used to define a qualified mortgage in defining "qualified mortgage" for the mortgages that HUD insures, guarantees or otherwise administers, HUD respects the analysis that the CFPB undertook in defining "qualified mortgage" for the conventional mortgage market, and sees value in having a safe harbor qualified mortgage and a rebuttable

[9] See TILA section 129B(a)(1), 15 U.S.C. 1639b(a)(1).
[10] See 78 FR 6408.

presumption qualified mortgage as established in regulation by the CFPB. HUD's regulation differs from the CFBP's regulation in distinguishing between the two types of qualified mortgages for FHA Title II mortgages based on the mortgage's APR. HUD incorporates the APR as an internal element of HUD's definition of qualified mortgages to distinguish safe harbor qualified mortgages from the rebuttable presumption qualified mortgages. The CFPB's "higher-priced covered transaction" is an external element that is applied to a single definition of "qualified mortgage."

As proposed in HUD's September 30, 2013, proposed rule, HUD's "safe harbor qualified mortgage" provides a different APR relative to APOR threshold than the CFPB's requirement that a first-lien covered transaction have an APR of less than 1.5 percentage points above the APOR. Under this final rule, for a Title II FHA mortgage to meet the "safe harbor qualified mortgage" definition, the mortgage is required to have an APR that does not exceed the APOR for a comparable mortgage by more than the combined annual mortgage insurance premium (MIP) and 1.15 percentage points. HUD adopts the higher APR to remediate the fact that some FHA loans would fall under the CFPB's "higher-priced covered transaction" as a result of the MIP. The MIP by itself should not be the factor that determines whether a loan is a higher-priced transaction.

Because all FHA-insured mortgages include a MIP that may vary from time to time to address HUD's financial soundness responsibilities, including the MIP as an element of the threshold that distinguishes safe harbor from rebuttable presumption allows the threshold to "float" in a manner that allows HUD to fulfill its responsibilities that would not be feasible if HUD adopted a threshold based only on the amount that APR exceeds APOR. If a straight APR over APOR threshold were adopted by HUD, every time HUD would change the MIP to ensure the financial soundness of its insurance fund and reduce risk to the fund or to reflect a more positive market, HUD would also have to consider changing the threshold APR limit.

In addition to the benefit of having a construct similar to the CFPB's construct, HUD expects that a rebuttable presumption category could place downward pressure on the APRs of FHA mortgages. This downward pressure would result in transfers from some FHA lenders to some FHA borrowers, and would also provide social benefits (more sustainable homeowners due to lower rates) in the aggregate. These transfers from lenders arise from legal protections they receive from achieving safe harbor rather than rebuttable presumption status under the HUD rule. Moreover, HUD, through proposing its own rebuttable presumption standard keeps conventional lenders from sending loans to HUD to take advantage of what would otherwise be no APR threshold and forces conventional lenders to keep APR within the limit for the CFPB's standard or HUD's standard for safe harbor. For example, a consumer who applies for a higher risk conventional loan may not meet the CFPB's qualified mortgage on the basis of high points and fees, or if the points and fees are reduced to 3 percent, the APR may become too high for safe harbor under the CFPB rules. However, the consumer might instead be offered a higher interest rate FHA loan in return for lower points and fees, and the lender could achieve qualified mortgage with safe harbor status as an FHA loan with a very high APR in the absence of an FHA rebuttable presumption standard. Additionally, HUD believes that the loans that require a higher APR should be treated with more caution and borrowers should retain the right to challenge on ability-to-repay grounds. HUD's rule attempts to strike a balance between providing lenders legal protections and providing borrowers with access to redress when a loan is more risky.

HUD carefully reviewed the public comments requesting that HUD adopt a single standard – a safe harbor standard, but for the reasons presented in this response and in the preamble to HUD's September 30, 2013, proposed rule, HUD maintains that this is the right approach.

Comment: Designate all FHA loans rebuttable presumption qualified mortgages: A few comments opposed the establishment of a safe harbor for most FHA loans. The commenters stated that the proposed rule provides less protection to consumers than the CFPB's rule. The commenters expressed concern that a consequence would be the reemergence of abusive FHA lending. The commenters stated that a rebuttable presumption means that a homeowner can hold a lender to the basic promise of the CFPB's rule, which is that lenders will reasonably assess a person's ability to afford a loan before that loan is made. A commenter stated that only a rebuttable presumption standard can provide consumers with the legal protection needed to preempt unforeseen predatory practices.

Another commenter stated that those who support a safe harbor emphasize the additional cost associated with a rebuttable presumption. The commenter stated that an examination of the structure of TILA and the litigation facts associated with claims under TILA makes clear these claims are unfounded. The commenter stated that TILA's pre-existing general rules on liability already carefully calibrate the interests of the industry and its customers, and are applicable even where there is a rebuttable presumption for ability-to-pay claims. The commenter disputed that there are substantial legal costs associated with defending rebuttable presumption loans. The commenter stated that most homeowners will not have counsel to seek redress, the remedy is circumscribed, the amount of proof is substantial and the objective amount of litigation in this area is very small. The commenter urged HUD to look behind claims of substantial compliance costs associated with a rebuttable presumption.

Response: HUD disagrees that that the inclusion of a safe harbor qualified mortgage, as opposed to making all FHA-insured loans rebuttable presumption mortgages, will result in "abusive FHA lending." The inclusion of a safe harbor qualified mortgage offers lenders an incentive to make qualified mortgages while maintaining the borrower protections required by the Dodd-Frank Act. HUD further notes that a safe harbor qualified mortgage is not exempt from any legal challenge. A borrower can continue to file a legal claim against a lender if the borrower finds or believes that the lender did not meet statutory or regulatory requirements applicable to a mortgage. However, for a safe harbor mortgage, the bar in challenging a lender meeting ability to repay requirements will be higher. Additionally, the borrower benefits from lower loan costs because lender's face lower legal risk with a safe harbor qualified mortgage and, as a result, the lender does not need to build in the cost of the higher legal risk associated with a rebuttable presumption loan. HUD believes, therefore, that the loans labeled safe harbor have met the ability-to-repay requirements and that HUD's structure, that is consistent with CFPB's structure, is appropriate for FHA-insured loans.

Comment: HUD's adoption of the CFPB's points and fees features will adversely affect the FHA mortgage market and reduce available credit for the very populations FHA was established to serve: Commenters stated that HUD's cap on points and fees will destroy the lending options for the exact group FHA and HUD were intended to assist. Commenters stated that lenders are not likely to adapt to meet the points and fees requirements to insure the loan, but instead the points and fees threshold will result in preventing some borrowers from obtaining loans. Commenters requested that HUD increase the 3 percent limit on points and fees to ensure that low- and moderate-income borrowers can continue to access a variety of affordable loan products.

A commenter expressed support for protecting borrowers from excessive and unnecessary fees, but stated that the proposed cap was too low and could make ineligible for FHA-insurance many responsibly underwritten loans that are in the borrowers' best interest. A few commenters stated that HUD's adoption of points and fees is contrary to other FHA actions. The commenters stated that HUD is returning to an age where discount points were controlled and limitations were placed on origination points and this is contrary to action taken by FHA a year ago when FHA decided to "deactivate the 1% ceiling to what was prudent and customary in our region." Another commenter stated that HUD should exclude MIP from the points and fees calculation.

Response: In developing the September 30, 2013, proposed rule, HUD gave careful consideration to the percentage limit that should be placed on points and fees. The 3 percent points and fees limit is one of the statutory criteria used to define a qualified mortgage, and the CFPB retained this criterion in its regulatory definition with adjustments to facilitate the presumption of compliance for smaller loans. HUD considers the proposed adoption of the points and fees limit, as established by statute and adopted by the CFPB in its rule, to be appropriate for FHA Title II loans that HUD has identified as subject to its qualified mortgage definition. In this final rule, HUD has clarified the points and fees are applicable to FHA-approved lenders by adopting, through cross-reference, the CFPB's definition of "points and fees." Included in the definition is the exclusion of "any premium or other charge imposed in connection with any Federal or State agency program for any guaranty or insurance that protects the creditor against the consumer's default or other credit loss." 12 CFR 1026.32(b)(1)(i)(B).

As stated in the preamble to HUD's September 30, 2013, proposed rule, HUD's practice prior to this rule was that points and fees would be individually negotiated.[11] Although HUD has not established a firm cap for points and fees for HUD-insured mortgages, they have been limited to reasonable and customary amounts not to exceed the actual costs of specific items and reasonable and customary charges as may be approved by the Federal Housing Commissioner (see 24 CFR 203.27(a)).

As stated in HUD's September 30, 2013, proposed rule, as the market adopts the CFPB's 3-percent cap on points and fees for qualified mortgages, FHA lenders would be required to cap points and fees at about 3 percent, as a result of HUD's existing reasonable and customary standard. However, if HUD simply maintained its existing reasonable and customary standard for FHA lenders, FHA lenders would be forced to determine if charging an amount a little over 3-percent points and fees would mean the loan is a qualified mortgage, which could result in higher litigation costs to prove that the loan was a qualified mortgage based solely on whether the points and fees of the loan were reasonable and customary. By HUD adopting the cap of 3-percent points and fees, lenders would not be forced to determine what is reasonable and customary, thereby, providing certainty in the market and setting a clear enforcement standard. Many commenters argued for a bright line test and the points and fees cap adopted from CFPB accommodates that request. Additionally, the 3-percent points and fees cap is consistent with the conventional market's qualified mortgage definition and adopting the same will provide consistency for FHA lenders. HUD believes that if it did not adopt the same 3-percent points and fees caps for the majority of HUD's portfolio FHA could see an increase of market share.

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[11] Generally, the term "points" refers to points charged against interest so that a higher up-front payment results in a lower interest rate or vice versa.

With respect to concerns about loss of access to mortgage credit by low- and moderate-income borrowers that FHA has traditionally served, HUD submits that the exemption of certain transactions from compliance with HUD's qualified mortgage definition (transactions made on behalf of entities with missions similar to HUD which assist low- and moderate-income borrowers in obtaining homeownership financing) helps ensure that low- and moderate-income borrowers can continue to access a variety of affordable loan products. HUD also takes the opportunity at the final rule stage to clarify that HUD-approved housing counseling fees and rehabilitation consultant fees that are required by HUD and provided by non-affiliated entities are third party charges, and as such, would not be included in points and fees under the CFPB's exemption of bona fide third-party charges at 24 CFR 1026.32(b)(1)(i)(D).[12]

HUD also adds language to its qualified mortgage regulations to give FHA flexibility to make any adjustments to the points and fees calculation where the FHA Commissioner determines such adjustments are necessary.

<u>Comment: The inclusion of mortgage broker's and affiliate's fees in the cap on point and fees limits consumer choice and makes it difficult for small lenders and mortgage brokers to compete in the mortgage market</u>: Several commenters stated that HUD's rule will limit the number of lenders who can offer mortgage products to borrowers. The primary objection was the inclusion of mortgage broker fees or affiliate fees in the points and fees cap in the CFPB's definition of points and fees. Commenters stated that applying the 3 percent points and fees cap to mortgage brokers creates a distinct and unfair competitive advantage to the banks and large

[12] Exceptions to this exemption include when the charge is for a guaranty or insurance that is not in connection with any Federal or State agency program, is a real-estate related fee, or is a premium or other charge for insurance for which the creditor is the beneficiary. 12 CFR 1026.32(b)(1)(i)(D).

lenders. Commenters stated that the points and fees cap limit adversely impacts lenders with affiliates without apparent reason.

Commenters stated that the 3 percent cap is too low, and makes it unprofitable for lenders and brokers to engage in mortgage business. The commenters stated that, by including compensation paid by a creditor to any loan originator other than an employee (e.g., a mortgage brokerage company or a lender acting as a mortgage broker) in the points and fees calculation, non-depository direct lenders and other bank owned companies are given a distinct and arguably unfair competitive advantage over those in the wholesale channel. The commenters stated that the retail lender can build compensation into its loan, where the broker and a direct lender cannot, by effect making a double-standard. Commenters stated that inclusion of the lender-paid compensation in the 3 percent cap will all but eliminate broker participation in small loans. The adverse treatment of affiliated fees has a disproportionate effect on lower dollar transactions, and consequently, the availability of lower dollar mortgages will be somewhat limited, which goes against the mission of FHA lending.

One commenter stated that it is important to remember that the largest third-party fee, often provided by an affiliated title agent, is title insurance. The commenter stated that the cost for title insurance to the consumer does not vary from title agent to title agent whether there is or is not an affiliation because agents are bound by their title insurance underwriter's filed rates for the state where the property is located. The commenter stated that the title agent charges the rate filed by the underwriter. Nonetheless, the current definition would include the title insurance charge in the points and fees if the title agent is an affiliate.

One commenter stated that in place of the inclusion of mortgage broker's and affiliate's fees in the cap on points and fees, HUD could limit adverse selection by including in its regulation that "any lender participating in the FHA program may not pay or compensate a loan originator or broker differently for originating an FHA loan than any other loan type, through any compensation mechanism, whether such compensation is paid directly or indirectly to the originator."

Response: HUD recognizes that this issue, which was raised in the CFPB's rulemaking on the definition of "qualified mortgage," remains an issue among industry commenters. This issue was discussed by CFPB in the preamble to its January 2013 final rule. CFPB responded to comments submitted on the May 11, 2011, proposed rule of the Federal Reserve Board, which had initial responsibility for proposing regulations to implement section 129C of TILA,[13] As explained by the CFPB in the preamble to the final rule, TILA, as amended by the Dodd-Frank Act, contemplates that compensation paid to mortgage brokers and other loan originators after consummation of a loan transaction is to be counted toward the points and fees threshold.

The CFPB noted that the Dodd-Frank Act removed the phrase "payable at or before closing" from the high-cost mortgage points and fees test and did not apply the "payable at or before closing" limitation to the points and fees cap for qualified mortgages. See 78 FR 6432 and sections 103(bb)(1)(A)(ii) and 129C(b)(2)(A)(vii), (b)(2)(C) of TILA. The CFPB stated that in light of evident concern by Congress with loan originator compensation practices, it would not be appropriate to waive the statutory requirement that loan originator compensation be included in points and fees, but that the CFPB would provide detailed guidance to clarify what compensation must be included in points and fees. See 78 FR 6434-6435. Additionally, CFPB stated that throughout the Dodd-Frank Act amendments Congress made clear that affiliate fees should be treated the same way as fees paid to loan originators. See 78 FR 6439.

Given the detailed response that CFBP provided in its rule on this issue, the submission of these same comments in response to HUD's rulemaking does not adequately rebut CFPB's justification for the differing treatment, which focuses on potential competition issues. At this final rule stage, HUD will not take a position that differs from that taken by the CFPB, which was based on direction from Congress that loan origination compensation and affiliated fees are to be included in points and fees. HUD needs time to examine this issue further, and see whether HUD has discretion to take action that differs from the position taken by CFPB and whether a departure from CFPB on this issue would be in the interest of promoting HUD's mission.

<u>Comment: Failure to meet the point and fee structure disqualifies a loan from insurance and requires a more careful analysis</u>: Commenters stated that if HUD will not insure non-qualified mortgages, HUD's regulation should provide for adjustment of the points and fees limits for lower balances. One of the commenters expressed support for a higher percentage for lower balance loans and wrote that the threshold of 3 percent for FHA becomes a problem at the $100,000 range. The commenter recommended amending the cap to allow loans between $100,000 and $150,000, up to $4,500 in points and fees. The commenter stated that the additional rate would "more accurately reflect the fixed costs of originating these smaller balance loans," and avoid the denial of loans to otherwise qualified FHA borrowers.

Another commenter stated that HUD's rule provides that a failure to meet the points and fees limit and for any of the qualified mortgage requirements not only disqualifies a loan from qualified mortgage status but also disqualifies a loan from qualifying for FHA insurance. The commenter stated that if FHA does go in this direction it is important for FHA to ensure that qualified mortgage requirements are appropriately adjusted in light of their role as program requirements. The commenter urged HUD to adjust the points and fees limit for lower balance

FHA-insured loans. Another commenter stated that, as a result of only being able to originate qualified mortgage loans lenders will likely leave the market place and that will disproportionately hurt underserved populations.

Response: As addressed above, HUD believes aligning with the CFPB's limit on points and fees is appropriate. TILA section 129C(b)(2) defined the points and fees limit for a qualified mortgage at 3 percent and tasked the CFPB to come up with adjustments to the limit for smaller loans. The CFPB analyzed the differences between loan amounts to determine that a $100,000 loan cap was the appropriate place to limit the definition for a smaller loan for the points and fees threshold. See 78 FR 6531-6532. HUD does not currently have data on points and fees to determine whether a different threshold would be appropriate for defining smaller loans for FHA loans. HUD needs time to examine this issue further, and determine whether HUD has discretion to take action that differs from the position taken by CFPB and whether a departure from CFPB on this issue would be in the interest of promoting HUD's mission.

Comment: Capping points and fees is irrelevant to a borrower's ability to repay a mortgage: A few commenters stated that capping points and fees does not have a direct connection to whether a borrower can repay a mortgage loan. A commenter stated that the APOR and APR have nothing to do with the actual ability of the borrower to repay the loan.

Response: The 3 percent points and fees limit is one of the statutory criteria used to define a qualified mortgage. As the CFPB noted in the preamble to its January 2013 final rule, Congressional intent in amending TILA was not solely to require lenders to take the necessary steps to try and ensure that a borrower can repay a residential mortgage loan but that a qualified mortgage is a products with limited fees and safe features which preserves the availability of affordable credit to consumers. See the CFPB's final rule at 78 FR 6426.

Comment: Replace HUD's proposed 1.15 percentage point with the CFPB's 1.5 percentage point: Several commenters recommended that HUD's safe harbor APR standard for FHA be adopted with the standard 1.5 percentage point in place of the proposed 1.15 percentage point. The commenters stated that such a change would bring consistency with the CFPB's regulation, reduce confusion in the lending community, and broaden the scope of loans that meet the safe harbor definition. Other commenters stated that this "structure will more adequately address the needs of low- and moderate- income borrowers, borrowers from underserved areas, and minority borrowers." A commenter stated that adopting the 1.5 percentage point ratio would allow lenders more flexibility to offer lender credits to help first time and underserved buyers without exceeding the qualified mortgage limits.

A commenter questioned HUD's basis for the APR for FHA safe harbor's to exceed the APR of the CFPB's safe harbor standard. The commenter stated that HUD's first justification seems to rest on lower lender compliance costs and lower litigation costs which will pass on savings to borrowers. The commenter stated that the second factor that HUD points to is the perceived need to allow its APR to APOR spread rate to float with the MIP rate. The commenter stated that the overall purpose of Dodd-Frank ability-to-repay requirements, of which the CFPB and HUD qualified mortgage rules are subsets, is to strike a balance between providing lenders with legal protection when making relatively safe loans that the borrower reasonably can be expected to repay, and providing borrowers with appropriate legal recourse when lenders do not do so. The commenter stated that while HUD's mission to facilitate lending to traditionally underserved borrowers is relevant here, so too must be preserving the legal rights of borrowers where lenders fail to meet their obligations to ensure the borrower's reasonable ability to repay the loan. The commenter further stated that while the inclusion of the MIP may be a legitimate concern it can be included within the calculation already provided by the CFPB's safe harbor definition.

Response: As stated in HUD's September 30, 2013, proposed rule, and accompanying regulatory impact analysis, HUD's qualified mortgage standard increases the number of FHA-insured mortgages that are safe harbor. As provided in the proposed rule and maintained in this final rule, FHA's MIP is explicitly included in the APR to APOR spread calculation but the limit on the spread itself, prior to the addition of the MIP, is reduced from 150 basis points (in the CFPB final rule) to 115 basis points (in HUD's rule). The inclusion of the MIP and the reduction in basis points results in a reduction of the pool of FHA-insured mortgages that would be designated rebuttable presumption under the CFPB's standard while increasing the number of FHA-insured mortgages that would be designated safe harbor. As noted in the regulatory impact analysis that accompanied HUD's September 30, 2013, proposed rule, HUD estimated that there were 129,500 (about 19 percent) FHA-insured mortgages (with relatively high APRs) insured between July 2012 and December 2012 that would have been rebuttable presumption under the CFPB's qualified mortgage standard but qualify as safe harbor qualified mortgages under HUD's regulation. If HUD adopted a basis point metric higher than 115 percent plus MIP more loans would be designated safe harbor. HUD's analysis shows that adoption of a higher initial basis point, such as 150 percent, would result in only a few additional loans being designated a safe harbor qualified mortgage, but that the loans that would are the ones that HUD believes would receive greater benefit from having access to the protections afforded a rebuttable presumption loan. Therefore, HUD maintains that the 115 basis points plus MIP is the appropriate standard.

HUD reiterates that the compliance mechanisms to identify a safe harbor qualified mortgage under the special rules for HUD loans will similarly identify a safe harbor qualified mortgage for FHA insured loans under HUD's final rule.

Comment: Provide a clear distinction between safe harbor and rebuttable presumption: Some commenters expressed support for HUD's proposal to adopt an APR relative to the APOR that accounts for the annual MIP. Other commenters, however, requested that HUD clarify how the threshold between FHA's safe harbor qualified mortgage and rebuttable presumption would work, specifically what the MIP is and how it is to be incorporated. The commenters stated that it is not entirely clear how lenders would combine the annual MIP with 1.15% to calculate the FHA safe harbor threshold. The commenters stated that it appears that HUD intends the lender to calculate the sum of the annual MIP rate and 1.15% (e.g., 1.35 + 1.15 = 2.50) and then determine whether the loan's APR exceeds the applicable APOR by that amount.

Several commenters suggested that the distinction between an FHA safe harbor qualified mortgage and a rebuttable presumption qualified mortgage should be keyed to a bright line standard, not a rate cut-off that incorporates a floating MIP component. The commenters stated that HUD should consider moving from a floating threshold incorporating any of several MIP premiums to the CFPB standard of 150 bps with the addition of 135 bps to reflect the maximum MIP for FHA loans, or 285 bps over APOR. The commenters stated that this standard would be pegged to the CFPB threshold and FHA's maximum MIP going forward so it could be adjusted as needed for all loans but it would not float or vary depending on the individual loan. The commenter stated that this approach has the benefit of employing a widely known and widely programmed standard—the CFPB threshold between safe harbor and rebuttable presumption loans. The commenter stated that taking such an approach would especially be helpful for smaller lenders, as the rule would be simpler and consequently less costly. It will also negate the necessity for the HUD to change its qualified mortgage rule every time FHA changes its maximum allowable MIP. Another commenter recommended that HUD establish a fixed threshold of 2.5 percentage points, which would include the annual MIP at approximately 135 basis points. The commenter stated that FHA loans would receive the safe harbor if the loan APR is no more than the 2.5 percentage points. The commenter stated that this would alleviate the complexities of complying with a fluctuating MIP.

Commenters stated that clear standards without a floating component will simplify lender implementation as well as compliance oversight and accountability. Other commenters encouraged HUD to adopt a simpler approach that uses a single percentage point amount (while still taking the MIP into consideration), similar to the CFPB's approach. A commenter stated that it will be hard for lenders to know when to use the FHA standard and when to use the CFPB standard. A simpler approach that is also consistent with the CFPB’s qualified mortgage regulations would minimize confusion and make it easier for both lenders and the FHA to oversee. Another set of commenters, however, stated that allowing the threshold for an FHA safe harbor qualified mortgage to potentially fluctuate in relation to the MIP could result in errors by lenders attempting to comply with the HUD’s requirements. Some of the commenters stated that when a change in the threshold were to occur, then a certain period of time would be required to amend policies and procedures, re-program hardware and software systems, and re-train staff on the new threshold requirements and calculations. Several commenters suggested that HUD should provide at least 6 months advance notice prior to the effective date of any MIP change. Commenters also stated that industry needs more clarity and guidance from HUD about how the changes to MIP rates will be instituted going forward.

Similar to comments pertaining to points and fees, a commenter recommended that the APR over APOR calculation, if retained, should increase for lower balance loans that have fixed costs. A commenter stated that, specifically, for loans between $100,000 and $150,000, an additional 50 basis points spread should be added to CFPB's points and fees basis of 150 basis points (1.5 percent)- resulting in a standard of 200 basis points over the APOR, plus the MIP; and for loans below $100,000, a further additional 50 basis points spread should be added to the CFPB's points and fees basis of 150 basis points - resulting in a standard of 250 basis points over the APOR, plus the MIP. The commenter stated that this tiered system would prevent many otherwise qualified FHA borrowers from being denied a loan because of the inability of a lender to meet the APOR standard in the proposed rule.

One commenter suggested that HUD grant safe harbor designation to FHA loans that receive approval through FHA's TOTAL Scorecard. Related to this comment, another suggested that HUD update FHA's Total Scorecard system to allow lenders to use the FHA system, rather than their own, to determine at the front end if a loan qualifies as a safe harbor or rebuttable presumption qualified mortgage.

Another commenter stated that a clear distinction between an FHA safe harbor qualified mortgage and an FHA rebuttable presumption qualified mortgage can be achieved by establishing a clear definition for each term. The commenter stated that HUD should define safe harbor qualified mortgages as loans with APRs equal to or less than APOR + 115bps + on-going MIP, and define rebuttable presumption qualified mortgages as loans with an APR greater than APOR + 115 basis points (bps) + on-going MIP. Similar to this comment, another commenter stated that it is essential that HUD's qualified mortgage rule define the applicable MIP.

<u>Response</u>: HUD's qualified mortgage standard is structured to recognize FHA's mission to serve a population that is somewhat riskier than the market in general and that the cost of providing mortgage insurance to this population is higher as well. This is accomplished by

including FHA’s MIP in the calculation. Without such accommodation, a high share of FHA-insured mortgages would be considered “higher-priced covered transactions” and, under the CFPB’s standard, would be designated as rebuttable presumption qualified mortgages.

As discussed in the regulatory impact analysis that accompanied HUD’s proposed rule, under the CFPB’s qualified mortgage regulations, a portion of FHA-insured mortgages would not qualify as qualified mortgages based on their exceeding the points and fees limit in the CFPB’s regulation. As the regulatory impact analysis stated, a larger portion would be designated as qualified mortgages under the CFPB’s regulation, but about 20 percent would only meet the CFPB’s standard as a rebuttable presumption qualified mortgage. These FHA-insured mortgages would not qualify for safe harbor status under CFPB’s regulations because of the 150 basis point limitation on the spread between APR and APOR, in large part because this spread for FHA-insured mortgages includes FHA’s annual MIP that is currently135 basis points for most loans.

HUD recognizes concerns of some commenters that a standard which is tied to FHA’s MIP, resulting in a floating threshold, may cause operational difficulties and delay the ability of lenders’ to comply with FHA’s qualified mortgage standards. As HUD stated in the preamble to its proposed rule, if a straight APR over APOR threshold were adopted by HUD, in lieu of inclusion of the MIP, then every time FHA changes the MIP, for purposes of ensuring the financial soundness of its insurance fund and reducing risk to the fund or to reflect a more positive market, FHA would also have to consider changing the threshold APR limit. This would be a less dynamic approach than that proposed by HUD in its September 30, 2013, proposed rule. HUD believes that the qualified mortgage standard proposed in the September 30, 2013, proposed rule and adopted as final in this rule will be, when systems have been adjusted, easy to administer, and HUD is providing the time for lenders to adjust their systems. Again, a mortgage that would be designated a safe harbor qualified mortgage under the special rules for eligible loans under the National Housing Act in the CFPB's regulations receives the same designated under HUD's definition if insured by HUD.

Comment: The APOR is not an appropriate metric: A few commenters stated that the APOR is not the appropriate metric for FHA to use to determine what constitutes a baseline for the safe harbor/rebuttable presumption distinction, and that an APOR, derived from the Freddie Mac Primary Mortgage Market Survey (PMMS), is not the best metric for determining the dichotomy for FHA. The commenter stated that "The PMMS index contains only conventional conforming loans; no government insured loans are included. Additionally, in recent quarters the PMMS has fallen well below [the Mortgage Bankers Association] survey rates, at times by as much as 20 basis points." The commenter suggested additional study on what is the most useful index for FHA loans.

Response: The Dodd-Frank Act provides for use of the APOR in calculating points and fees and has been adopted by the CFPB in its qualified mortgage regulation. As HUD stated in its September 30, 2013, proposed rule and in this rule, it is HUD's objective to establish qualified mortgage standards that align to the statutory ability-to-repay criteria of TILA and the regulatory criteria of the CFPB's qualified mortgage standard to the extent feasible without departing from FHA's statutory mission. HUD recognizes that the APOR is a 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, and that the representative sample may not include government-insured loans. However, as a result of the ability-to-repay requirements and enhanced consumer protections of the Dodd-Frank Act, the differences between conventional mortgage products and the government mortgage products are lessened.

Comment: Clarify the APR and APOR calculation: A commenter stated that HUD's final rule should specify the APR being examined. The commenter asked HUD to clarify that the APR is the actual APR on the loan and not the high cost APR calculation used for purposes of "Section 32 High Cost testing." The commenter also stated that the final rule should clarify the effective date of the APOR to be used for testing. The commenter asked whether or not this is the APOR in effect at the time the lock is set (which is consistent with the Section 32 High Cost and Section 35 higher-priced mortgage loans (HPML) testing), or HUD expects the test to use the APOR in effect at the time of case number assignment, or some other time frame. The commenter also asked that HUD's final rule clarify that if the APR is calculated to three or more places, HUD will require a specific rounding or truncation method for the purposes of this test. The commenter asked, for instance, if the APR is 6.225 and the APOR is 2.860 would the difference between them be calculated at 3.36 (the result truncated) or would the result be 3.370 (the result using standard rounding)?

Response: As noted earlier in this preamble, the final rule adopts the CFPB's definition of APR and APOR, and therefore the CFPB's guidance on the determination of each of these rates is applicable to FHA's qualified mortgage regulation. The CFPB provides detailed guidance on each of these calculations. Appendix J to the CFPB's regulations in 12 CFR part 1026 provides guidance on the APR computations for closed-end credit transactions. The guidance notes that the CFPB's regulation at 12 CFR 1026.22(a) provides that the APR for other than open-end credit transactions shall be determined in accordance with either the actuarial method or the United States Rule method, and provides that Appendix J contains an explanation of the actuarial method as well as equations, instructions and examples of how this method applies to single advance and multiple advance transactions. Supplement I (Official Interpretations) to the CFPB's part 1026 regulations, provides guidance on calculation of APOR, under the heading for Section 1026.35. By following the CFPB with respect to the APR and APOR calculations, HUD eliminates any inconsistency between APR/APOR calculations to be undertaken by FHA-approved lenders originating FHA qualified mortgages and lenders originating conventional qualified mortgages in accordance with the CFPB's regulations.

Comment: Exclusion of debt-to-income could increase the number of riskier borrowers coming to FHA – a residual income test should be included: The majority of commenters, commenting on debt-to-income (DTI) limits, stated that HUD's proposal to use its existing underwriting and income verification requirements and to not adopt the CFPB's 43 percent total monthly debt-to-income ratio requirements is the right approach. The commenters stated that HUD's underwriting standards have historically been the industry bench mark for documenting a consumer's ability to repay a mortgage debt. A commenter stated that a fixed DTI would only further limit credit availability especially to borrowers living in high-cost underserved communities.

Another commenter stated that HUD's decision to not include a DTI limit in its qualified mortgage regulations could increase the number of riskier credit quality borrowers to the FHA in an origination environment where conventional loans must meet the more stringent CFPB qualified mortgage standard. The commenter stated that this result is inconsistent with HUD's stated goal to foster private market, not FHA, activity as steps are taken to reduce Fannie Mae and Freddie Mac's position in the market.

Other commenters stated that adoption of a residual income test would substantially improve the sustainability of FHA lending, particularly for low-income borrowers. The commenter stated that it understands that the purposes of FHA differ from those of the CFPB and the adoption of the DTI requirement would likely restrict opportunities for credit for many of the FHA constituencies specifically mentioned in its statute. The commenter urged HUD to work with the Department of Veterans Affairs and the CFPB to develop a residual income test that would be uniform across these agencies. The commenter stated that such a test, clear and easily integrated into automated systems, would permit good loans to be made to FHA's constituencies at DTIs of 43 percent or higher. The commenter stated that if such a rule were also adopted by the CFPB, then all loans above DTIs or 43 percent would not flow to FHA, thereby satisfying another accepted public policy goal.

Response: HUD appreciates the commenters' suggestions about a residual income test that would be adopted by all agencies, and this may well be something to further examine. For this final rule, HUD retains the approach provided in the proposed rule. However, HUD will add this issue to HUD's plan for retrospective review of regulatory actions.[14]

Comment: Treat certain other loans similarly to proposed treatment of Title I and Sections 184 and 184A loans: The majority of commenters expressed support for HUD's decision to designate all Title 1, Section 184 and Section 184A mortgages as safe harbor qualified mortgages, without any change in underwriting requirements for these loan products. One commenter, however, stated that loans without points and fees caps encourage the assessment of junk fees and these incentives should not be part of loan programs meant to shore

[14] See HUD's plan at
http://portal.hud.gov/hudportal/HUD?src=/program_offices/general_counsel/Review_of_Regulations,

up needs in vulnerable communities. The commenter stated that the Title I loan program in particular has had a long history of abusive lending, primarily in low-income communities.

Other commenters, however, identified various loan products that they stated should be treated by HUD similarly to the proposed treatment of Title I, Sections 184, and Section 184A loans. Commenters recommended that HUD automatically make Section 203(k) repair and rehabilitation loans, energy efficient mortgages, and mortgages involving real estate-owned (REO) properties safe harbor qualified mortgages. One of the commenters stated that these types of loans, especially 203(k) loans, require more work for the lender, and consequently, the lender is compensated more. The commenter stated that this higher compensation could jeopardize the qualified mortgage status of the loan if the rule does not permit a higher points and fees threshold for such loans. Another commenter stated that housing finance agencies (HFAs) often use 203(k) loans "to support the purchase of affordable homes in need of repair or modernization for traditionally underserved consumers." The commenter stated that because of the increased costs associated with these loans, HFAs often pay lenders higher levels of compensation for originating them and also have to charge higher fees to borrowers. The commenter stated that "if these loans are subject to HUD's proposed qualified mortgage requirements, it would become cost-prohibitive for HFAs, or other lenders, to continue originating these loans."

Response: HUD's final rule will continue to designate Title I, Section 184 and Section 184A loans as safe harbor qualified mortgages. HUD believes that the final rule HUD published on November 7, 2001, entitled, "Strengthening the Title I Property Improvement and Manufactured Home Loan Insurance Programs and Title I Lender/Title II Mortgagee Approval Requirements" (66 FR 56410) strengthened the Title I program and that the Title I program is sound. The Title I loan program insures maximum loan amounts of $25,000 for single family home loans to finance the light or moderate rehabilitation of properties, as well as the construction of nonresidential buildings on the property. Additionally, Title I covers the Manufactured Home Loan program which provides a source of financing for buyers of manufactured homes and allows buyers to finance their home purchase at a longer term and lower interest rate than with conventional loans. Considering the small size of the Title I property improvement loans and the limited access to conventional financing otherwise available to manufactured home loans, HUD believes these loans should be designated as safe harbor qualified mortgages until further study can be conducted on how to apply the qualified mortgage definition.

HUD declines to designate Section 203(k) repair and rehabilitation loans as safe harbor qualified mortgages. HUD does clarify that non-affiliated consultation fees authorized under the Section 203(k) program are exempt from the CFPB's points and fees calculation, adopted by HUD. Section 203(k) mortgages cover both the acquisition of a property and its rehabilitation. While Section 203(k) loans involve minimal financing amounts, Section 203(k) mortgages can cover the virtual reconstruction of a property. For example, a home that has been demolished or will be razed as part of rehabilitation is eligible for financing under FHA's Section 203(k) mortgage program provided that the existing foundation remains in place. HUD also declines to designate an FHA-insured mortgage on property acquired by a borrower through FHA's REO process as a safe harbor qualified mortgage. An FHA-insured mortgage on a REO property is a standard single family-insured mortgage, and therefore would need to meet the qualifications for either a safe harbor qualified mortgage or a rebuttable presumption qualified mortgage. In addition, HUD exempts housing finance agencies from the qualified mortgage rule, consistent with the CFPB's rule, as explained further in Section IV of the preamble.

Comment: Provide an exemption for HFAs as exempted under CFPB's rule: With respect to loans originated by HFAs, certain commenters requested that HFAs should be exempt from ability-to-repay requirements and FHA should classify all HFAs loans as safe harbor qualified mortgages. The commenters stated that HFAs have a consistent record of providing good lending for affordable housing, have never engaged in subprime or other risky lending, and the revenues generated are reinvested in furtherance of their affordable housing mission. The commenter stated that recently, 75 percent of HFA mortgages funded by tax-exempt Mortgage Revenue Bonds have been FHA-insured.

Another commenter stated that the proposed safe harbor qualified mortgage APR to APOR rate of 1.15 percentage points plus MIP would hinder the ability of an HFA to finance FHA-insured loans. The commenter stated many lenders are reluctant to finance HFA loans because the HFA requirements already add extra costs to HFA loans. Some of the extra costs which lenders might try to pass onto borrowers with slightly higher interest rates reflect a legitimate business expense incurred by the lender but could cause a loan to exceed the safe harbor APR cap. As a result, HFA lending could be curtailed, particularly when the CFPB allows for a more flexible APR limit on conventional loans.

Response: As noted earlier in this preamble, HUD agrees with the commenters and has exempted HFAs from the requirement to comply with FHA's qualified mortgage regulations, consistent with the CFPB.

Comment: Exempt FHA streamlined refinancing from qualified mortgage requirements: Commenters stated that streamlined refinances should be excluded from the higher-priced mortgage loan limitations or the APR threshold increased to meet the unique needs of refinancing. The commenter stated that the rates on streamlined refinances are higher because lenders include the closing cost in the rate and may, therefore, result in some streamlined refinances losing safe harbor qualified mortgage status.

A commenter stated that under TILA, HUD has been granted the authority to exempt streamlined refinancings from the income verification requirements of the ability-to-repay rule, as long as the refinancings meet certain requirements. The commenter stated that HUD, however, intimates that including streamlined refinancings in the proposed qualified mortgage requirements would meet similar objectives of a broader exemption, as the proposed qualified mortgage definition would still require these types of loans to meet the three percent points and fees requirements and HUD's existing requirements for streamlined refinances.

In contrast to these commenters, a commenter expressed support for HUD's inclusion of the points and fees cap in the FHA qualified mortgage definition for streamline refinancings and for all Title II loans. The commenter stated that this will help ensure that FHA borrowers obtain loans in a more fair and transparent market while discouraging price gouging. The commenter stated that the points and fees cap ensures that homeowners are not subject to inflated costs and junk fees associated with the initial making of the loan. The commenter stated that while the streamlined refinance program provides needed access to capital for many homeowners, HUD's guidelines assume that a borrower making payments on the previous loan can actually afford those payments. The commenter stated that the program does not account for instances where the previous loan's payments were paid out of proceeds from that loan (and therefore out of equity from the property).

Response: HUD declines to exempt streamlined refinances from the safe harbor and rebuttable presumption qualified mortgage definition. As HUD stated in the proposed rule, HUD advised that it did not consider it necessary to exercise this authority because HUD's qualified mortgage definition results in an exemption similar to the one contemplated under section 129C(a)(5) of TILA. HUD also believes that the points and fees requirement is appropriate for streamlined refinances just as it is for other Title II products, and that the revised APR to APOR threshold will benefit refinances the same as other Title II products. While HUD maintains that subjecting streamlined refinances to the qualified mortgage definition is appropriate now, HUD recognizes that in times of stress, the current qualified mortgage definition may inhibit access to streamlined refinancing, and if this were to occur, HUD will reexamine whether streamlined refinances should be exempt.

Comment: Establish clear criteria for rebutting the presumption of a rebuttable presumption loan: Several commenters stated that HUD needs to establish clear criteria on the basis for a borrower rebutting the presumption of one's ability to repay a mortgage. A commenter stated that the proposed rule appears to significantly change the requirements for a borrower to rebut the presumption of compliance from the CFPB's relatively narrow focus on whether the borrower had sufficient residual income to one that is a far broader inquiry of whether the general ability to repay test was satisfied. The commenter stated that a qualified mortgage is designed to provide a means for a lender, by meeting product and underwriting standards, to gain a presumption that the lender has satisfied the ability to repay requirements without undergoing the statute's factor by factor analysis and demonstrating that the borrower had a "reasonable ability to repay." The commenter stated that HUD's rebuttable presumption definition, however, appears to render the presumption nearly meaningless by returning the inquiry to whether the lender made a reasonable and good faith determination that the borrower had the ability to repay the loan. The commenter stated that if the proposed rule goes forward, it is unlikely that lenders that participate in the FHA program will be willing to assume the greater liability that comes with a relatively unbounded rebuttable presumption. The commenter stated that lenders are more likely to confine their lending to safe harbor loans and in some cases will choose to operate well within qualified mortgage’s safe harbor standards to avoid liability.

Another commenter stated that it understood that the CFPB’s rebuttable presumption standard is not appropriate for FHA because residual income calculations are not currently required by FHA, but nevertheless, it is important for HUD to establish a limited, objective and clear inquiry into the presumption. In a similar vein, a commenter stated that FHA underwriting requirements do not contain a residual income requirement and do not require that a creditor assess a consumer's residual income on an FHA loan. The commenter stated that, therefore, a consumer cannot challenge the creditor's assessment of their ability to repay on an FHA loan based on a claim of insufficient residual income, even if that loan is a higher priced mortgage as defined under Regulation Z. The commenter stated that to avoid any possible confusion among creditors and to ensure the greatest number of creditworthy consumers are served by FHA, the commenter asked that HUD confirm this understanding is accurate in the final rule.

A commenter stated that under HUD’s rebuttable presumption standard, the borrower may prove the lender did not make a reasonable and good faith determination of the borrower’s repayment ability. The commenter stated that it is not clear, however, whether this requires the lender to show it followed the specific HUD requirements or whether the borrower can use other evidence to prove the lender did not consider the borrower’s ability to repay, even if the lender followed HUD requirements.

Another commenter stated that HUD needs to elaborate on what is meant by a reasonable and good faith determination of the borrower’s ability to repay.

A few commenters stated that HUD's rebuttable presumption standard appears to permit rebuttal of the presumption of compliance based on lending standards that are in addition to FHA underwriting requirements, and therefore HUD is establishing new underwriting requirements. The commenters stated that, as proposed, the presumption of compliance could be rebutted in two ways: one relates to points and fees and the other basis is a showing that, "despite the mortgage being insured under the National Housing Act, the mortgagee did not make a reasonable and good-faith determination of the mortgagor's repayment ability at the time of consummation, by failing to consider the mortgagor's income, debt obligations, alimony, child support, monthly payment on any simultaneous loans, and monthly payment (including mortgage-related obligations) on the mortgage, as applicable to the type of mortgage, when underwriting the mortgage in accordance with HUD requirements."

The commenters stated that if underwriting in accordance with HUD's requirements is insufficient to establish sufficient repayment ability under TILA, and if FHA does not revise its requirements to correct that problem, then this language appears to create a new FHA underwriting requirement for rebuttable presumption FHA loans. The commenters stated that the quoted language in the rule differs from FHA underwriting standards, yet this aspect of the rebuttal standard can only apply to loans that are FHA-insured. The commenters stated that the list of factors in HUD's qualified mortgage rule differs from the list in the FHA Handbook monthly housing expense as defined in section 4155.1 4.C.4.b of the Handbook. The commenters stated that HUD uses, in its rule, mortgage-related obligations, which is undefined in FHA's Handbook. The commenters stated that all the types of income and all the types of obligations that are relevant to rebutting the presumption need to be clearly defined, and mortgagees need to know how and be able to quantify them. The commenters suggested that HUD use standards that do not differ from existing FHA loan underwriting requirements.

A commenter suggested that HUD establish a clear standard for rebutting the presumption by adopting the following language: "The mortgagee did not make a reasonable and good-faith determination of the mortgagor's repayment ability at the time of consummation, by failing to consider, to the extent required by applicable HUD requirements, the mortgagor's income, debt obligations, alimony, child support, monthly payment on any simultaneous loans and monthly payment (including mortgage-related obligations) on the mortgage, as applicable to the type of mortgage."

Other commenters stated that HUD proposed to permit rebuttal of the presumption by showing points and fees. The commenters stated that such a standard is meaningless because, under HUD's regulation, any loan with points and fees above the cap cannot be an FHA loan or a qualified mortgage loan. One of the commenters stated that even if HUD's regulations were to apply to a non-FHA loan, a showing of points and fees above the qualified mortgage cap cannot establish a violation of the ability-to-repay requirement. The commenter requested that HUD clarify that it did not intend to imply that points and fees above the cap, without more, could establish a violation of TILA's ability-to-repay requirement.

Another commenter stated that HUD should establish a "materiality" standard by which only uncured underwriting errors that make a material difference to a borrower's ability to repay a loan should be a permissible basis for rebutting a presumption of compliance with the ability-to-repay requirement.

<u>Response</u>: In response to the comments, HUD has sought to clarify the rebuttable presumption language in this final rule. As addressed above in Section IV, HUD adopted the list

of the CFPB's factors, mortgagor's income, debt obligations, alimony, child support, monthly payment on any simultaneous loans, and monthly payment, to remain consistent with the CFPB's rebuttable presumption standard, but intended those factors to harmonize with HUD's existing underwriting requirements. In response to the comments, HUD will reference FHA's underwriting categories as the applicable categories and believes that this better clarifies that HUD-specific underwriting requirements shall be used for rebutting the presumption, rather than the list provided by CFPB. The applicable categories can be found in FHA Handbook 4155.1, Mortgage Credit Analysis for Mortgage Insurance on One-to-Four Unit Mortgage Loans. Additionally, HUD clarifies that instead of merely considering the factors listed, the mortgagee must evaluate the factors as required by HUD underwriting requirements for each applicable transaction.

Comment: HUD's rule will delay lender compliance with foreclosure timeframes during prolonged rebuttable presumption litigation: A commenter suggested that protracted litigation resulting from the rebuttable presumption could result in the curtailment of an interest claim by a lender because "lenders are required to meet 'reasonable diligence' timeframes in prosecuting foreclosure proceedings and acquiring title as set forth in 24 C.F.R. 203.356." The commenter stated that it is unclear whether litigation resulting from a rebuttable presumption challenge would be viewed as lender error and thus lenders would be ineligible for a timeframe extension.

Response: Litigation resulting from a rebuttable presumption challenge will not in and of itself make a lender ineligible for timeframe extension for submission of a claim. The existence of a challenge to rebuttable presumption does not necessarily indicate lender error rendering the lender ineligible for an extension of the deadline. However, where the presumption is successfully rebutted, FHA will not entertain requests for extensions of foreclosures and claim deadlines.

Comment: Rule needs a cure provision; indemnification demand is not dispositive of loan's qualified mortgage status: Several commenters requested that HUD establish a mechanism by which lenders can cure loans where there was a miscalculation in points and fees or any other failure to satisfy the qualified mortgage test. The commenters stated that a "cure provision" is necessary for those situations when technical violations are discovered by lenders and can be easily corrected. The commenters stated that this is particularly important if qualified mortgage status is to equate with FHA eligibility. The commenters stated that these types of procedures encourage early action by lenders and foster more advantageous loans for borrowers. One of the commenters stated that if HUD does not create a mechanism to cure loans where there are qualified mortgage defects, such loans will simply become uninsurable by FHA in the short run and cause greater caution and lack of credit to consumers over the long term. A commenter asked whether FHA would allow lenders to correct a points and fees violation by refunding the excess costs to bring the loan in compliance.

Another commenter requested that HUD continue to insure mortgages which were originated as qualified mortgage loans, but through audit or self-discovery were later found to have certain errors. The commenter stated, for example, if the 3 percent threshold of fees was exceeded, that in lieu of requiring indemnification, HUD allow for the lender to cure the overage. The commenter stated that this would allow the loan to maintain its qualified mortgage status. The commenter requested that if the error was related to an alternative matter (i.e., income/asset related) it would request that HUD allow a lender to indemnify a loan, and through that indemnification, allow for the loan to maintain its qualified mortgage status. The commenter stated that this would allow lenders to continue to treat the loan as a qualified mortgage to avoid unnecessary secondary market ramifications.

Another commenter suggested that HUD should adopt an approach similar to that adopted by Fannie Mae which was that, during the initial roll-out of its qualified mortgage standard, at least during an initial twelve month roll-out period, Fannie Mae would allow the industry to adjust systems and take corrective actions to comply. Without this leniency, the commenter stated that it is concerned that the consumers served will be faced with increased costs, extensive delays and, unfortunately, may find they are unable to obtain the financing they need to secure the American dream.

A commenter stated that recently, the CFPB explained that a defect under the underwriting procedures of the government-sponsored enterprises (GSEs) that is unrelated to the ability to repay should not affect qualified mortgage status.

Another commenter requested clarification of the impact on qualified mortgage status if FHA insurance of a loan is subsequently revoked. The commenter requested that as such revocation may be wholly unrelated to the applicant's ability to repay the loan or to the creditor's compliance with the underwriting requirements, the commenter requested that HUD include in its final rule a statement that such a loan will retain qualified mortgage status following revocation of FHA insurance, provided that all pertinent underwriting criteria had been met.

To address the qualified mortgage status concerns, one commenter requested that § 203.19 include a new paragraph (b)(4) to read as follows: "(b)(4) Indemnification Demands-An indemnification demand by HUD is not dispositive of qualified mortgage status. Qualified mortgage status depends on whether a loan is guaranteed or insured, provided that other requirements under this section are satisfied. Even where an indemnification demand relates to whether the loan satisfied relevant eligibility requirements at time of consummation, the mere fact that a demand has been made, or even resolved, between a creditor and HUD is not dispositive for purposes of establishing a loan's qualified mortgage status."

Response: As addressed above in Section IV, HUD adds at the final rule stage a section clarifying that a demand for indemnification or an indemnification does not per se remove qualified mortgage status in the regulations for Title I and Title II.

Requested clarifications: The final rule needs to provide clarification in a number of areas: Several commenters requested that HUD clarify its position in certain areas.

Clarify that this rule preempts CFPB's rule in its entirety for FHA loans:

Response: Except to the extent that FHA's regulation cross-references to terms defined by CFPB, FHA's underwriting requirements and qualified mortgage definition govern FHA insurance of single family mortgages.

Clarify the presumption afforded a safe harbor qualified mortgage:

Response: A safe harbor qualified mortgage is one that provides a conclusive presumption of compliance with the ability to repay requirements for loans that satisfy the definition of a safe harbor qualified mortgage.

Clarify eligibility for insurance versus actual insurance: A commenter stated that HUD's proposed rule appears to base qualified mortgage status on whether a loan is actually insured by FHA, rather than whether the loan is eligible for insurance. The commenter stated that if the commenter is understanding HUD correctly, HUD's position is inconsistent with the transitional qualified mortgage category created by the CFPB in § 1026.43(e)(4) of Regulation Z for loans eligible for purchase, guarantee or insurance by various government agencies and government-sponsored enterprises. The commenter stated that the FHA guidelines impose a variety of requirements relating not only to underwriting, but to the procedures of sale, guarantee, and insurance, as well as to post-consummation activities, which may be wholly unrelated to the applicant's ability to repay. The commenter stated that to avoid basing qualified mortgage status on the actual insurance status of a loan, the commenter requested that HUD clarify in its final rule that the qualified mortgage status of a loan is based on whether the loan is eligible for insurance by FHA. Other commenters also supported that HUD provide qualified mortgage status for FHA Title II loans eligible for FHA insurance. One of the commenters requested that the qualified mortgage coverage be based on whether the loan qualifies or is eligible for FHA insurance so that any transaction defects that are not related to "ability to repay" would not affect qualified mortgage coverage.

Response: The commenters' understanding is correct. Under HUD's regulations, as promulgated through this final rule, qualified mortgage status for FHA Title II loans is provided only for loans that FHA insures. FHA's responsibility and oversight is only for the mortgages that it insures, not for those that may be eligible for FHA insurance but have not been insured by FHA.

Clarify that there is no preemption of State fair lending laws: Two commenters requested that HUD make clear that it does not preempt State claims for fair lending abuses. The commenters stated that State enforcement of fair and responsible lending is essential to prevent unintended consequences.

Response: This final rule does not preempt any claims a borrower may bring for violation of fair lending laws.

Clarify that FHA's regulatory framework is unchanged: Commenters asked that the final rule specify that the regulatory framework of current FHA programs would remain the same with the addition of the "qualified mortgage" definition applied, specifically in reference to ability-to-repay.

Response: The commenters are correct that HUD is not changing the regulatory framework for its FHA programs with regard to ability to repay other than to establish the requirements for designation of a safe harbor qualified mortgage or rebuttable presumption qualified mortgage. It should be noted, however, that FHA will not insure a mortgage that is not a qualified mortgage but this is not a departure from existing standards since FHA has always had ability to repay standards and mortgages insured by FHA were based on these standards.

Clarify which FHA loans are covered by HUD's qualified mortgage regulations when the regulations become effective: A commenter requested that HUD clarify if the intended January 10, 2014 effective date will apply to loans with an application date on or after January 10th (consistent with the CFPB effective date for ability-to-repay/qualified mortgage applicability) or with case number assignment dates on or after January 10, 2014.

Response: This rule applies to all case numbers assigned on or after the effective date of this rule.

Clarify whether escrows for taxes and insurance are included in the points and fees limitation: Another commenter stated that there is considerable confusion about whether escrows for taxes and insurance are included in the points and fees limitation. The commenter stated that these are just pass-through amounts that have no risk of imposing excessive costs on consumers, and they should not be included. The commenter stated that the CFPB was not clear on this matter. The commenter urged HUD to clarify that it will interpret the definition of points and fees to exclude escrows for taxes and insurance.

Response: HUD is adopting the CFPB's definition of points and fees, and defers to CFPB's interpretations and guidance on that definition. The CFPB's regulation at 12 CFR 1026.32(b)(1) excludes amounts held for future payment of taxes from the calculation of points and fees. See 12 CFR 1026.32(b)(1)(iii). The CFPB also excludes from the calculation of points and fees any premium or other charge imposed in connection with any Federal or State agency program for any guaranty or insurance that protects the creditor against the consumer's default or other credit loss, and any guaranty or insurance that protects the creditor against the consumer's default or other credit loss and that is not in connection with any Federal or State agency program. See 12 CFR 1026.32(b)(1)(i)(B) and (C). However, the CFPB includes in the calculation of points and fees any premiums or other charges payable at or before consummation for any credit life, credit disability, credit unemployment, or credit property insurance, or any other life, accident, health, or loss-of-income insurance for which the creditor is a beneficiary, or any payments directly or indirectly for any debt cancellation or suspension agreement or contract. See 12 CFR 1026.32(b)(1)(iv).

Clarify meaning of reasonable ability to repay: A commenter stated that HUD's rule includes a statement that "the monthly payments on a mortgage must not be in excess of a borrower's reasonable ability to repay." The commenter stated that this is too vague and subject to subjective interpretation. The commenter stated that what is reasonable for one person may not be reasonable for another in a similar financial position. The commenter stated that there would be almost no "safe harbor" for lenders on FHA loans. The commenter requested that HUD clarify the meaning of "reasonable" in this context.

Response: The guiding basis for whether a determination has been made of a borrower's reasonable ability to repay a mortgage is by the lender following the underwriting guidelines in

FHA Handbook 4155.1, Mortgage Credit Analysis for Mortgage Insurance on One-to-Four Unit Mortgage Loans, or subsequent handbook.

Recommendations: Several commenters offered recommendations for additional provisions to be included in HUD's rule:

Mandate prepurchase counseling: A commenter stated that "pre-purchase counseling by a HUD-certified housing counselor should become a mandatory component of all FHA qualified mortgage loans. The commenter stated that housing counseling has proven to be an invaluable tool for creating successful homeowners. The commenter stated that a study of counseling programs found that prepurchase counseling can help reduce the likelihood of default and foreclosures from the start by helping prospective homeowners determine if they are ready to buy."

Response: As a result of changes made to HUD's housing counseling program by the Dodd-Frank Act, and counseling requirements, HUD is examining a variety of counseling issues, several of which will be addressed through separate rulemaking.

Enforce loss mitigation requirements: Two commenters stated that rigorous loss mitigation requirements and compliance with those rules is essential to a sustainable system. The commenters stated that HUD should fully review its loss mitigation options and compliance programs to maximize beneficial outcomes for homeowners, communities, investors and the FHA insurance fund.

Response: FHA has strong loss mitigation requirements and undertakes periodic review of them. HUD invites the commenters to view the following website which identifies mortgagee letters addressing the subject of loss mitigation, recently and previously issued by FHA. See http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/sfh/nsc/lmmltrs.

Prohibit prepayment penalties: A commenter stated that under the CFPB's regulation, covered transactions, including FHA loans that are covered transactions, "must not include a prepayment penalty" unless the loan is a qualified mortgage loan, and prepayment penalties are payable only during the first three years after consummation. The commenter urged FHA to amend its notes to be clear that they do not permit any interest charge for any time after a loan is fully paid, even for a partial month.

Response: HUD is developing a proposed rule that addresses prepayment penalties for an FHA-insured loan.

Provide better lending oversight: A commenter stated the industry does not need more restrictions. The commenter stated that instead of rewarding institutions that have always adhered to the HUD regulations, HUD is treating the good the same as the bad actors. Other commenters stated that government enforcement is a key component to securing widespread industry compliance with regulation. One of the commenters stated that HUD should engage in active oversight of FHA lending, including direct endorsement lenders, with aggressive consequences for non-compliance. The commenter stated that oversight should include proactive resolution of consumer complaints, including requirements for lenders and servicers to document answers to HUD in response to consumer complaints. Another commenter stated that HUD must adopt strong compliance and enforcement provisions to ensure that the required minimum standards are being met in practice and to ensure borrowers have appropriate recourse when these standards are not actually complied with.

Another commenter recommended that HUD avoid unnecessary regulation of FHA lending and that it rely on its existing standards to continue to ensure that FHA loans are appropriate and affordable. The commenter stated that it does not believe another layer of ability-to-repay regulation similar to existing FHA underwriting standards would improve or even alter the quality of FHA loans. The commenter stated that, instead, it would run the risk of constraining lending unless the additional standard is substantially clearer than the proposed rebuttable presumption standard.

Response: FHA continually strives to strengthen its oversight of FHA-approved lenders. HUD values the input of its FHA-approved lenders and other interested parties and members of the public and is considering recommendations offered by the commenters on this notice. HUD also believes that implementation of the final rule improves the quality of FHA loans, which protects borrowers from higher priced loans.

HUD questions in the preamble – feedback offered by commenters

The preamble to HUD's September 30, 2013, proposed rule included several questions for which HUD specifically sought comment. One question which received the most feedback was HUD's question of whether lenders participating in FHA's mortgage insurance and loan guarantee programs would lower the APR relative to the APOR such that the lenders in essence always opt for the safe harbor qualified mortgage and never make a rebuttable presumption qualified mortgage. HUD asked if commenters thought that was the case, and welcomed comments on the effect this incentive may have on lenders, borrowers, and the broader economy.

Feedback: Several stated that it would be extremely difficult to find lenders to make rebuttable presumption mortgages for the 7 percent[15] of Title II loans that will not qualify as safe harbor qualified mortgages. The commenter stated that mortgage professionals will favor safe harbor qualified mortgages and will avoid the potential legal risk associated with rebuttable

[15] The 7 percent referred to by the commenter is in fact the number of loans that would not be considered a qualified mortgage under FHA's rule or eligible for insurance as a result of the points and fees. Only 1 percent of Title II loans would be designated rebuttable presumption under the proposed and final rule.

presumption qualified mortgages. This will result in disparate impact of homeownership throughout the country. Another commenter agreed that lenders are likely to elect only to offer safe harbor qualified mortgages due to the uncertainty surrounding lending outside of the safe harbor qualified mortgage category. The commenter stated that if this occurs, the result will mean less available credit.

Another commenter stated that due to the high legal fees related to making a rebuttable presumption loan, lenders are more likely not to make loans that would be rebuttable presumption. The commenter stated that the result will be that some borrowers are prevented from obtaining loans due to the risk aversion of lenders.

A commenter stated that the consequences of the 1.15% threshold set by FHA is that loans above that amount will not be made and or will have a disparate impact on minorities who often present somewhat higher risks.

A commenter stated that, after polling its members, the consensus was that, at least in the beginning, members would not make rebuttable presumption loans because of the risk of substantial liability if the courts interpreted rebuttable presumption in an adverse manner. As for lowering the APR to be a safe harbor loan, the commenter stated that a small number may be in the margins, but for a substantially larger number, especially small balance loans, it will not be profitable to lower the APR and lenders will simply not make the loans to an otherwise qualified borrower.

A commenter stated that it believes the majority of FHA qualified mortgages made will qualify for the safe harbor due to the pricing of the loan and the level of protection that such status provides, much the same as under the CFPB's qualified mortgage rule. The commenter also stated that it is possible that lenders may make a small reduction in the APR if that is the only requirement standing in the way of a loan qualifying as a safe harbor.

Another commenter expressed disagreement with HUD's hypothesis that the APR standard would put pressure on the conventional market because HUD's MIP is so high in relation to conventional private mortgage insurance (PMI) or loans without PMI. The commenter stated that FHA's market share is likely to decrease and only people who could not obtain conventional insurance will turn to FHA, presenting danger to the fund. The commenter further stated that HUD's lower threshold for exceeding the safe harbor is also a negative incentive for originating an FHA loan versus a conventional loan and is compounded by excluding the annual MIP in the APOR calculation.

Another commenter stated that, with respect to interest rates, FHA is a relatively competitive market, and the purported benefits of the dichotomy is marginal at best and less effective than FHA's current protections. The commenter stated that it will, however, have the result of limiting some otherwise eligible borrowers from receiving an FHA loan.

Response: HUD appreciates all the feedback provided in response to this question. As HUD stated in the preamble to its September 30, 2013, proposed rule and reiterates in this final rule, HUD will carefully monitor how HUD's definition of safe harbor qualified mortgage and rebuttable presumption qualified mortgage for the majority of its Title II programs works. HUD will also study, as it has committed to do so, the HUD mortgage insurance and guarantee programs whose mortgages have been designated safe harbor qualified mortgage, and the appropriateness of such designation. HUD recognized that there may be a transition period before the one percent of rebuttable presumption loans in FHA portfolio are made, but HUD's changes to the rebuttable presumption definition should clarify for lenders and borrowers the standard that applies for rebuttable presumption qualified mortgage loans. The transition period should be similar to that of the conventional market where the market will assess the legal risk and costs of making a rebuttable presumption loan before proceeding. Additionally, as provided in HUD's accompanying regulatory impact analysis, while there may be programming changes needed to comply with HUD's definition of qualified mortgage, HUD estimates that the costs are de minimis.

Procedural Issues: A few commenters raised concerns with certain procedural issues pertaining to the rule:

Comment: Additional public comment should be provided: A few commenters stated that the 30-day comment period was too short to fully identify and compare policy alternatives and the likely consequences, especially when compared to the time used by the CFPB to explore the issues involved in creating a qualified mortgage rule. The commenters requested HUD extend the comment period for at least 60 days after the CFPB issues its final integrated disclosure rule and clarifies the APR calculation.

Response: HUD recognizes that the comment period provided for its qualified mortgage rule was an abbreviated one. However, since HUD strived to closely align its definition of safe harbor qualified mortgage and rebuttable presumption qualified mortgage, HUD had the advantage of reviewing the comments submitted to the CFPB on issues and approaches that HUD considered in its proposed rule, and the benefit of reviewing the CFPB's analysis of such issues. As HUD stated in its proposed rule, HUD accepted and reviewed comments submitted after the 30-day public comment period closed.

Comment: HUD's regulatory impact analysis did not support the policy taken in HUD's rule: A few commenters stated that HUD's assessment of the probable effects of its rule on important mortgage market stakeholders is not well supported. The commenter stated that borrowers, lenders, U.S. taxpayers, and other private market participants have important interests that have not been analyzed within a robust cost/benefit framework.

Another commenter stated that HUD's supporting economic analysis did not consider the broader mortgage market context, the interaction between HUD's proposed rule and the CFPB qualified mortgage rule, and lender incentives to minimize litigation risk. The commenter suggested that HUD examine the likely credit risk management and loan performance consequences to FHA of reduced conventional access to higher loan-to-value (LTV) loans, combined with the more expansive qualified mortgage standard included in HUD's proposed rule.

A commenter stated that significant questions remain unanswered regarding the likely effect of HUD's rule on the size and allocation of the insured low down-payment market. HUD should examine those questions before issuing a final rule.

Another commenter stated that the economic analysis in the preamble to HUD's rule posits that lenders will have an incentive to keep their costs low to minimize the number of loans that would be ineligible for FHA insurance, in light of lower compliance and litigation costs under the FHA program that HUD expects to result from its proposal. The commenter stated that it believes that lenders are likely to reduce the points and fees to 3 percent or less in more cases, further minimizing the impact even on the 7 percent. The commenter stated that if the APOR or 3 percent cap tests turn out to have onerous effects on first-time homebuyers and other potential FHA borrowers, it trusts HUD will reconsider the rule and take action to eliminate such unintended consequences.

Response: HUD appreciates the comments raised in response to HUD's regulatory analysis. HUD acknowledges that, without a qualified structure yet in place for the majority of FHA Title II loans as provided in this final rule, and without the CFPB's qualified mortgage regulations yet in operation, the data provided in the regulatory impact analysis are estimates to the best of HUD's ability on how the impact will play out when both sets of regulations are in effect. HUD does not believe that this final rule will have an impact on the LTV in the conventional market and the regulatory impact analysis does not analyze the effect of the CFPB's rule on the number of high loan-to-value (LTV) ratio loans made in the conventional market. The regulatory impact analysis uses a base case scenario in which the CFPB rule is in effect on January 10, 2014. In the regulatory impact analysis that accompanies this final rule, HUD strives to address some of the questions raised by the commenters, but a more accurate analysis may not be possible until the annual actuarial report for FHA prepared in the fall of each year, is prepared in the fall of 2014.

Comment: HUD's Regulatory Flexibility Act analysis failed to discuss the impact on small mortgage brokers: Two commenters stated that data from mortgage broker operations and business models indicate a significant impact on small business mortgage broker firms if the rule is finalized. The commenters stated that HUD's rule could cause a high percentage of mortgage broker firms to change business models, merge with lending operations or cease operations in order to remain in business based on HUD's qualified mortgage proposed rule.

Response: Please see HUD's Regulatory Flexibility Act analysis provided in the preamble of this final rule. HUD continues to maintain that this final rule will not have a significant economic impact on a substantial number of small entities, but HUD addresses the comments raised by the commenters.

VI. Findings and Certifications

Consultation with the Consumer Financial Protection Bureau

In accordance with section 129C(b)(3)(B)(ii) of TILA, HUD consulted with CFPB regarding this final rule.

Executive Order 12866, Regulatory Planning and Review

The Office of Management and Budget (OMB) reviewed this rule under Executive Order 12866 (entitled "Regulatory Planning and Review"). This proposed rule was determined to be a "significant regulatory action," as defined in section 3(f) of the Order (although not economically significant, as provided in section 3(f)(1) of the Order). The docket file is available for public inspection in the Regulations Division, Office of General Counsel, Department of Housing and Urban Development, 451 7th Street, SW, Room 10276, Washington, DC 20410-0500.

As already discussed in the preamble, this rule would define "qualified mortgage" for loans insured, guaranteed, or otherwise administered by HUD and, in so defining this term, replace application of CFPB's qualified mortgage regulation to these loans. Neither the economic costs nor the benefits of this proposed rule are greater than the $100 million threshold that determines economic significance under Executive Orders 12866 and 13563. The expected impact of the rule is no greater than an annual reduction of lenders' legal costs of $40.7 million on the high end to $12.2 million on the low end, and may even fall below this range.

HUD's final rule, in effect, reclassifies a sizeable group (about 19 percent) of Title II loans insured under the National Housing Act from rebuttable presumption qualified mortgages under the CFPB regulations to safe harbor qualified mortgages under HUD's regulation. A small percentage (about 1 percent) of Title II loans insured under the National Housing Act would remain rebuttable presumption qualified mortgages under HUD's rule based on HUD's APR threshold. Some HUD insured or guaranteed loans, the same number under the CFPB's definition of "qualified mortgage", would be non-qualified mortgage due to points and fees rising above the CFPB points and fees limit. Under HUD's rule, these loans would also be non-qualified mortgage. The difference is that HUD, as provided in HUD's proposed rule and retained in this final rule, will no longer insure loans with points and fees above the CFPB level for qualified mortgage. This policy provides a very strong incentive for HUD mortgagees to reduce points and fees to comply with HUD's qualified mortgage requirements. A vast majority of these loans could be expected to be made as lenders could be expected to find ways to comply with the QM requirement and still originate the loan with HUD insurance. As a result, HUD believes only a fraction of the 7 percent of non-qualified mortgage loans that HUD would have insured prior to this rulemaking (from HUD's 2012 analysis) would have to find alternatives to FHA, or not be made at all, once HUD's qualified mortgage rule is issued and effective. However, most of the 7 percent of the non-qualified loans (from HUD's 2012 analysis) are expected to comply and to continue to be insured by HUD, once the rule is in place.

In addition, HUD classifies all Title I, Title II manufactured housing and Section 184 and Section 184A insured mortgages and guaranteed loans as safe harbor qualified mortgages that would have most likely been non-qualified mortgages under the CFPB's rule. Classifying these programs as safe harbor recognizes the unique nature of these loans. For these programs, HUD believes that providing safe harbor status to these programs will not increase market share but instead maintain availability of these products to the underserved borrowers targeted. In addition, HUD considers the additional benefit of homeownership provided under these programs, which might otherwise be lost if HUD applied the points and fees and APR requirements to these programs, justifies the loss of some borrowers access to the broader ability-to-repay challenge afforded a rebuttable presumption loan. Assuming that all of these loans are re-classified from non-QMs or rebuttable presumptions QMs to safe harbor QMs, the expected reduction in costs is no greater than an annual reduction of lenders' legal costs of $2.8 million on the high end to $900 thousand on the low end, and may even fall below this range.

A difference between HUD's proposed rule and this final rule is that this final rule exempts certain institutions such as state and local housing finance agencies (HFAs) from the TILA ability-to-pay requirements, thereby aligning with CFPB's regulations in this regard. Since the loans from these institutions would be exempt under both the CFPB's regulation and HUD's regulation, it is reasonable to expect a symmetric effect in both scenarios. Typically, the loans from HFAs are made to lower income families with some form of downpayment assistance, and often with below market interest rates. By HUD's estimate, about 1.3 percent (or 0.9 percent as a share of aggregate principal balance) of its fiscal year (FY) 2012 endorsements were funded by HFAs.

Although HUD is exempting certain institutions from the TILA ability-to-repay requirements, the analysis made at the proposed rule stage and the analysis made at this final rule stage remains the same in that the majority of HUD loans insured or guaranteed prior to the implementation of this rule will qualify as safe harbor qualified mortgage under this final rule. HUD does not expect FHA's loan volume to increase nor does it expect the volume of conventional loans to be materially affected as a result of this rule, and consequently HUD's market share is not expected to increase as a result of this rule.

While HUD considered whether it should make all loans safe harbor as requested by a number of commenters, HUD believes that if the largest category of FHA loans, Title II non-manufactured housing loans, were all designated safe harbor than FHA would see an increase in market share and borrowers would be charged higher APRs than those in the conventional market. HUD does not believe that this alternative would benefit borrowers. As a result of these reclassifications, HUD continues to maintain that lenders face lower costs of compliance under HUD's regulations than under the CFPB regulations and therefore receive incentives to continue making these loans without having to pass on their increased compliance costs to borrowers.

While, under HUD's regulations, borrowers benefit from not having to pay for the higher lender costs, HUD acknowledges that they also face less opportunity to challenge the lender with regard to ability to repay. Given that litigation involves many wasteful costs, HUD expects that almost all borrowers will gain from the reduction in litigation and that the reduction of the interest rate will compensate for the loss of the option to more easily challenge a lender. As a result of the reclassification of some of HUD loans, the expected impact of the rule is an annual reduction of legal costs from \$12.2 to \$40.7 million, and may even fall below this range, as the range was derived from the CFPB's estimate of the range of legal cost differences between a qualified mortgage loan and a non-qualified mortgage loan.

Thus, the FHA qualified mortgage rule would not have an economic impact above \$100 million, and the rule is not economically significant.

HUD's full economic analysis of the costs and benefits and possible impacts of this rule is available on www.regulations.gov.

Due to security measures at the HUD Headquarters building, please schedule an appointment to review the docket file by calling the Regulations Division at 202-708-3055 (this is not a toll-free number). Individuals with speech or hearing impairments may access this number via TTY by calling the Federal Relay Service at 800-877-8339 (this is a toll-free number).

Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA) (5 U.S.C. 601 et seq.) generally requires an agency to conduct a regulatory flexibility analysis of any rule subject to notice and comment rulemaking requirements, unless the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities. For the reasons provided in the preamble to this final rule and further discussed in this section, this rule will not have a significant economic impact on a substantial number of small entities.

As provided in this final rule (and as proposed in the September 30, 2013, rule), HUD makes no change to the current requirements governing its Title I loans, its Section 184 and 184A guaranteed loans, and HECM loans. Therefore, this rule has no impact on either lenders or prospective borrowers under these programs. In addition to the exemptions provided in the proposed rule, and as discussed in the preamble to this final rule, HUD is also exempting Title I and Title II manufactured home mortgages, and certain transactions from compliance with HUD's qualified mortgage regulations. (See the second and third bulleted paragraphs in Section IV of the preamble to this final rule.) Consequently, there is also no impact on either lenders or prospective borrowers under these programs or transactions. These exemptions address several of the concerns raised by small entities in public comments submitted in response to HUD's September 30, 2013, proposed rule.

In this final rule, HUD also provides clarifications that address certain other issues raised by small entities. HUD clarifies that housing counseling fees and rehabilitation consultant fees under HUD's 203(k) program may be excluded from points and fees if made by a third-party and is not retained by the creditor, loan originator, or an affiliate of either. HUD-approved housing counseling for borrowers seeking FHA-insured mortgages, whether such counseling is voluntary or required, is not part of the points and fees calculation. HUD also clarifies that exempt from the points and fees calculation are consultant fees for ensuring program compliance and for drafting the required architectural exhibits for the 203(k) program by non-affiliated entities. HUD requires the use of a HUD consultant to ensure 203(k) program compliance and strongly encourages the use of an independent consultant to prepare the required architectural exhibits. Both consultation fees, if obtained by non-affiliated entities on the 203(k) consultant list, are not included in the points and fees calculation, and therefore adoption of the CFPB points and fees definition should not reduce access to the 203(k) program.

The primary concern, however, of commenter raising small entity concerns was the time needed to adjust systems in order to be able to comply with HUD's qualified mortgage regulation. The commenters were particularly concerned about changes that would need to be made to address the rebuttable presumption distinction for FHA loans. The commenters questioned why such a distinction was needed since, as they stated per HUD's own analysis, this category would cover only a small percentage of FHA loans. This concern was reiterated in a November 4, 2013, letter to HUD's FHA Commissioner from the Office of Advocacy of the Small Business Administration (SBA).

As stated earlier in the preamble to this final rule, HUD respects the analysis that CFPB undertook in defining "qualified mortgage" for the conventional mortgage market, and sees value in having a safe harbor qualified mortgage and a rebuttable presumption qualified mortgage as established in regulation by the CFPB. HUD's regulation differs from CFPB's regulation in distinguishing between the two types of qualified mortgages for FHA Title II mortgages based on the mortgage's APR. HUD incorporates the APR as an internal element of HUD's definition of qualified mortgages to distinguish safe harbor qualified mortgages from the rebuttable presumption qualified mortgages. The CFPB's "higher-priced covered transaction" is an external element that is applied to a single definition of "qualified mortgage."

Under this final rule, for a Title II FHA mortgage to meet the "safe harbor qualified mortgage" definition, the mortgage is required to have an APR that does not exceed the APOR for a comparable mortgage by more than the combined annual mortgage insurance premium (MIP) and 1.15 percentage points. HUD adopts a higher APR than that adopted by CFPB to remediate the fact that some FHA loans would fall under CFPB's "higher-priced covered transaction" as a result of the MIP. The MIP by itself should not be the factor that determines whether a loan is a higher-priced transaction. By reclassifying some loans that would have been rebuttable presumption loans under CFPB's "higher-priced covered transaction" definition to safe harbor qualified mortgage loans under HUD's rule, HUD thus reduces the potential cost of litigation for those loans. The reclassification will result in lenders facing lower costs under HUD's regulations than under the CFPB regulations and therefore receive incentives to continue making these loans without having to pass on their increased compliance costs to borrowers.

Because all FHA-insured mortgages include a MIP that may vary from time to time to address HUD's financial soundness responsibilities, including the MIP as an element of the threshold that distinguishes safe harbor from rebuttable presumption allows the threshold to "float" in a manner that allows HUD to fulfill its responsibilities that would not be feasible if HUD adopted a threshold based only on the amount that APR exceeds APOR. If a straight APR over APOR threshold were adopted by HUD, every time HUD would change the MIP, to ensure the financial soundness of its insurance fund and reduce risk to the fund or to reflect a more positive market, HUD would also have to consider changing the threshold APR limit.

As further stated in the preamble of this final rule HUD expects that a rebuttable presumption category could place downward pressure on the APRs of FHA mortgages. This downward pressure could have positive implications for FHA borrowers. Moreover, HUD, through having its own rebuttable presumption standard, keeps pressure on conventional lenders to keep APR within the limit for CFPB's standard for safe harbor as well. For example, a consumer who applies for a higher risk conventional loan may not meet the CFPB's QM on the basis of high points and fees, or if the points and fees are reduced to 3 percent, the APR may become too high for safe harbor under CFPB rules. However, the consumer might instead be offered a higher interest rate FHA loan in return for lower points and fees, and the lender could achieve QM with safe harbor status as an FHA loan in the absence of an FHA rebuttable presumption standard. With the FHA rebuttable presumption standard, the conventional lender would have incentive to work within the CFPB's APR-APOR spread to maintain a safe harbor status. It is for these reasons that HUD believes it is important to retain a rebuttable presumption category for Title II mortgages.

With respect to concerns about insufficient time to adjust systems to accommodate the different categories of loans, HUD has clarified that lenders can identify a safe harbor qualified mortgage for Title II loans under HUD's regulations by using the same compliance mechanisms for identifying "qualified mortgages" under the CFPB's definition. Systems that lenders have put in place to identify safe harbor qualified mortgages under the CFPB's 1.5 percent APR threshold should also identify the substantial majority of safe harbor qualified mortgages under HUD's APR threshold. A loan that meets the 1.5 percent threshold will also be in compliance with the HUD threshold. Only HUD safe harbor loans that exceed the 1.5 percent threshold and rebuttable presumption loans would not be picked up by such systems. Thus, lenders are no worse off under HUD's rule in terms of making safe harbor qualified mortgages, using systems already required to be in place, than they would be if HUD had taken no action.

HUD has heard from the industry that a change to the system would require resources but not that the specific system as proposed would be more costly than any other system. A system to identify HUD safe harbor qualified mortgage would need to pull the MIP from a specific source or be manually inputted by the individual lender to calculate an APR to APOR threshold similar to CFPB's metric. All system changes require resources and time, but, in accordance with a timetable and allocation of resources of their choosing, when lenders do implement HUD's rule it provides an immediate opportunity for lenders to increase the number of HUD-insured safe harbor qualified mortgages they make in accordance with a timetable and allocation of resources of their choosing. HUD does not consider it necessary for any lender to change systems immediately to adapt to HUD's requirements in order to make the same number of insured safe harbor qualified mortgages as a lender would otherwise make.

For the reasons provided above and in this preamble overall, the undersigned certifies that this rule would not have a significant economic impact on a substantial number of small entities.

Environmental Impact

A Finding of No Significant Impact (FONSI) with respect to the environment was made at the proposed rule stage in accordance with HUD regulations at 24 CFR part 50, which implement section 102(2)(C) of the National Environmental Policy Act of 1969 (42 U.S.C. 4332(2)(C)). That FONSI remains applicable to this final rule and is available for public inspection between 8 a.m. and 5 p.m., weekdays, in the Regulations Division, Office of General Counsel, Department of Housing and Urban Development, 451 7th Street SW, Room 10276, Washington, DC 20410–0500. Due to security measures at the HUD Headquarters building, an advance appointment to review the docket file must be scheduled by calling the Regulations Division at 202–708–3055 (this is not a toll-free number). Hearing-or speech-impaired individuals may access this number through TTY by calling the Federal Relay Service at 800–877–8339 (this is a toll-free number).

Executive Order 13132, Federalism

Executive Order 13132 (entitled "Federalism") prohibits an agency from publishing any rule that has federalism implications if the rule either (i) imposes substantial direct compliance costs on state and local governments and is not required by statute, or (ii) preempts state law, unless the agency meets the consultation and funding requirements of section 6 of the Executive Order. This rule will not have federalism implications and will not impose substantial direct compliance costs on state and local governments or preempt state law within the meaning of the Executive Order.

Unfunded Mandates Reform Act

Title II of the Unfunded Mandates Reform Act of 1995 (2 U.S.C. 1531-1538) (UMRA) establishes requirements for Federal agencies to assess the effects of their regulatory actions on state, local, and tribal governments, and on the private sector. This rule does not impose any Federal mandates on any state, local, or tribal governments, or on the private sector, within the meaning of the UMRA.

Catalog of Federal Domestic Assistance

The Catalog of Federal Domestic Assistance number for Mortgage Insurance-Homes is 14.117; for the Section 184 Loan Guarantees for Indian Housing is 14.865, and for the Section 184A Loan Guarantees is 14.874.

List of Subjects

24 CFR Part 201

Claims, Health facilities, Historic preservation, Home improvement, Loan programs--housing and community development, Manufactured homes, Mortgage insurance, Reporting and recording requirements.

24 CFR Part 203

Hawaiian Natives, Home improvement, Indians-lands, Loan programs-housing and community development, Mortgage insurance, Reporting and recordkeeping requirements, Solar energy.

24 CFR Part 1005

Indians, Loan programs—Indians, Reporting and recordkeeping requirements.

24 CFR Part 1007

Loan programs—Native Hawaiians, Native Hawaiians, Reporting and recordkeeping requirements.

Accordingly, for the reasons stated above, HUD amends 24 CFR parts 201, 203, 1005 and 1007 as follows:

PART 201--TITLE I PROPERTY IMPROVEMENT AND MANUFACTURED HOME LOANS

1. The authority citation for part 201 is revised to read as follows:

Authority: 12 U.S.C. 1703; 15 U.S.C. 1639c; 42 U.S.C. 3535(d).

2. A new § 201.7 is added to subpart A to read as follows:

§ 201.7 Qualified mortgage.

(a) Qualified mortgage. A mortgage insured under section 2 of title I of the National Housing Act (12 U.S.C. 1703), except for mortgage transactions exempted under § 203.19(c)(2), is a safe harbor qualified mortgage that meets the ability to repay requirements in 15 U.S.C. 1639c(a).

(b) Effect of indemnification on qualified mortgage status. An indemnification demand or resolution of a demand that relates to whether the loan satisfied relevant eligibility and underwriting requirements at the time of consummation may result from facts that could allow a change to qualified mortgage status, but the existence of an indemnification does not per se remove qualified mortgage status.

PART 203 – SINGLE FAMILY MORTGAGE INSURANCE

3. The authority citation for part 203 is revised to read as follows:

AUTHORITY: 12 U.S.C. 1709, 1710, 1715b, 1715z-16, 1715u, and 1717z-21; 15 U.S.C. 1639c; 42 U.S.C. 3535(d).

4. A new § 203.19 is added to read as follows:

§ 203.19 Qualified mortgage.

(a) Definitions. As used in this section:

(1) 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 mortgagors by a representative sample of mortgagees for mortgage transactions that have low-risk pricing characteristics as published by the Consumer Financial Protection Bureau (CFPB)

from time to time in accordance with the CFPB's regulations at 12 CFR 1026.35, pertaining to prohibited acts or practices in connection with higher-priced mortgage loans.

(2) Annual percentage rate is the measure of the cost of credit, expressed as a yearly rate, that relates the amount and timing of value received by the mortgagor to the amount and timing of payments made and is the rate required to be disclosed by the mortgagee under 12 CFR 1026.18, pertaining to disclosure of finance charges for mortgages.

(3) Points and fees has the meaning given to "points and fees" in 12 CFR 1026.32(b)(1) as of January 10, 2014. Any changes made by the CFPB to the points and fees definition may be adopted by HUD through publication of a notice and after providing FHA-approved mortgagees with time, as may be determined necessary, to implement.

(b) Qualified mortgage. (1) Limit. For a single family mortgage to be insured under title II of the National Housing Act (12 U.S.C. 1701 et seq.), except for mortgages for manufactured housing and mortgages under paragraph (c) of this section, the total points and fees payable in connection with a loan used to secure a dwelling shall not exceed the CFPB's limit on points and fees for qualified mortgage in its regulations at 12 CFR 1026.43(e)(3) as of January 10, 2014. Any changes made by the CFPB to the limit on points and fees may be adopted by HUD through publication of a notice and after providing FHA-approved mortgagees with time, as may be determined necessary, to implement.

(2) Rebuttable presumption qualified mortgage. (i) A single family mortgage insured under title II of the National Housing Act (12 U.S.C. 1701 et seq.), except for mortgages for manufactured housing and mortgages under paragraph (c) of this section, that has an annual percentage rate that exceeds the average prime offer rate for a comparable mortgage, as of the

date the interest rate is set, by more than the combined annual mortgage insurance premium and 1.15 percentage points for a first-lien mortgage is a rebuttable presumption qualified mortgage that is presumed to comply with the ability to repay requirements in 15 U.S.C. 1639c(a).

(ii) To rebut the presumption of compliance, it must be proven that the mortgage exceeded the points and fees limit in paragraph (b)(1) of this section or that, despite the mortgage having been endorsed for insurance under the National Housing Act, the mortgagee did not make a reasonable and good-faith determination of the mortgagor's repayment ability at the time of consummation, by failing to evaluate the mortgagor's income, credit, and assets in accordance with HUD underwriting requirements.

(3) Safe harbor qualified mortgage. (i) A mortgage for manufactured housing that is insured under Title II of the National Housing Act (12 U.S.C. 1701 et seq.) is a safe harbor qualified mortgage that meets the ability to repay requirements in 15 U.S.C. 1639c(a); and

(ii) A single family mortgage insured under title II of the National Housing Act (12 U.S.C. 1701 et seq.), except for mortgages under paragraph (c) of this section, that has an annual percentage rate that does not exceed the average prime offer rate for a comparable mortgage, as of the date the interest rate is set, by more than the combined annual mortgage insurance premium and 1.15 percentage points for a first-lien mortgage is a safe harbor qualified mortgage that meets the ability to repay requirements in 15 U.S.C. 1639c(a).

(4) Effect of indemnification on qualified mortgage status. An indemnification demand or resolution of a demand that relates to whether the loan satisfied relevant eligibility and underwriting requirements at the time of consummation may result from facts that could allow a change to qualified mortgage status, but the existence of an indemnification does not per se remove qualified mortgage status.

(c) Exempted transactions. The following transactions are exempted from the requirements in paragraph (b) of this section:

(1) Home Equity Conversion Mortgages under section 255 of the National Housing Act (12 U.S.C. 1715z–20); and

(2) Mortgage transactions exempted by the CFPB in its regulations at 12 CFR 1026.43(a)(3) as of January 10, 2014. Any changes made by CFPB to the list of exempted transactions may be adopted by HUD through publication of a notice and after providing FHA-approved mortgagees with time, as may be determined necessary, to implement.

(d) Ability to make adjustments to this section by notice. The FHA Commissioner may make adjustments to this section, including the calculations of fees or the list of transactions excluded from compliance with the requirements of this section as the Commissioner determines necessary for purposes of meeting FHA's mission, after solicitation and consideration of public comments.

PART 1005 – LOAN GUARANTEES FOR INDIAN HOUSING

5. The authority citation for part 1005 is revised to read as follows:

AUTHORITY: 12 U.S.C. 1715z-13a; 15 U.S.C. 1639c; 42 U.S.C. 3535(d).

6. A new § 1005.120 is added to read as follows:

§ 1005.120 Qualified mortgage.

A mortgage guaranteed under section 184 of the Housing and Community Development Act of 1992 (12 U.S.C. 1715z-13a), except for mortgage transactions exempted under § 203.19(c)(2), is a safe harbor qualified mortgage that meets the ability-to-repay requirements in 15 U.S.C. 1639c(a).

PART 1007 – SECTION 184A LOAN GUARANTEES FOR NATIVE HAWAIIAN HOUSING

7. The authority citation for part 1007 is revised to read as follows:

AUTHORITY: 12 U.S.C. 1715z-13b; 15 U.S.C. 1639c; 42 U.S.C. 3535(d).

8. A new § 1007.80 is added to read as follows:

§ 1007.80 Qualified mortgage.

A mortgage guaranteed under section 184A of the Housing and Community Development Act of 1992 (1715z-13b), except for mortgage transactions exempted under § 203.19(c)(2), is a safe harbor qualified mortgage that meets the ability-to-repay requirements in 15 U.S.C. 1639c(a).

Dated: December 5, 2013

Shaun Donovan, Secretary

[FR-5707-F-02]

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