

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

24 CFR Parts 201, 203, 1005, and 1007

**[Docket No. FR 5707-P-01]
RIN 2502-AJ18**

**Qualified Mortgage Definition for
HUD Insured and Guaranteed Single Family Mortgages**

AGENCY: Office of Secretary, HUD.

ACTION: Proposed rule.

SUMMARY: The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) created new section 129C in the Truth-in-Lending Act (TILA), which establishes minimum standards for consideration of 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 provides lenders more certainty about meeting the ability-to-repay requirements when lenders make "qualified mortgages," which are presumed to meet the requirements. Section 129C authorizes the agency with responsibility for compliance with TILA, which was initially the Federal Reserve Board and is now the Consumer Financial Protection Bureau (CFPB), to issue a rule implementing these requirements. 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 applicable, that are qualified mortgages. Through this proposed rule, HUD submits for public comment its definition of "qualified mortgage" for the types of loans that HUD insures, guarantees, or administers that aligns more closely with the statutory ability-to-

repay criteria of TILA and the CFPB's definition, without departing from HUD's statutory missions. In this rule, HUD proposes that any forward single family mortgage insured or guaranteed by HUD shall meet the criteria of a qualified mortgage, as defined in this rule, and HUD seeks comment on all components of its definition.

DATES: Comment Due Date: [**Insert date 30 days from the date of publication in the Federal Register**].

ADDRESSES: Interested persons are invited to submit comments regarding this rule to the Regulations Division, Office of General Counsel, Department of Housing and Urban Development, 451 7th Street, SW, Room 10276, Washington, DC 20410-0500.

Communications must refer to the above docket number and title. There are two methods for submitting public comments. All submissions must refer to the above docket number and title.

1. Submission of Comments by Mail. Comments may be submitted by mail to the Regulations Division, Office of General Counsel, Department of Housing and Urban Development, 451 7th Street, SW, Room 10276, Washington, DC 20410-0500.

2. Electronic Submission of Comments. Interested persons may submit comments electronically through the Federal eRulemaking Portal at www.regulations.gov. HUD strongly encourages commenters to submit comments electronically. Electronic submission of comments allows the commenter maximum time to prepare and submit a comment, ensures timely receipt by HUD, and enables HUD to make them immediately available to the public. Comments submitted electronically through the www.regulations.gov website can be viewed by other commenters and interested members of the public. Commenters should follow the instructions provided on that site to submit comments electronically.

Note: To receive consideration as public comments, comments must be submitted through one of the two methods specified above. Again, all submissions must refer to the docket number and title of the rule.

No Facsimile Comments. Facsimile (FAX) comments are not acceptable.

Public Inspection of Public Comments. All properly submitted comments and communications submitted to HUD will be available for public inspection and copying between 8 a.m. and 5 p.m. weekdays at the above address. Due to security measures at the HUD Headquarters building, an appointment to review the public comments must be scheduled in advance 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. Copies of all comments submitted are available for inspection and downloading at www.regulations.gov.

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 x 3094 (this is not a toll-free number). Persons with hearing or speech impairments may access this number through TTY by calling the toll-free Federal Relay Service at 800-877-8339.

SUPPLEMENTARY INFORMATION

I. Executive Summary

A. Purpose of the Regulatory Action.

This rule commences the process by which HUD will meet its 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 defined, through rulemaking, the term “qualified mortgage” for the broader single family mortgage market, HUD must define this term for use in its own 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 and provides certain protections for the lender from liability. During the years preceding the mortgage crisis, too many mortgages were made to borrowers without regard to their ability to repay the loans, and included risky features such as “no doc” loans or “interest only” loans. The result was many homeowners defaulted on these loans and faced foreclosure, causing a collapse in the housing market in 2008 and leading to the nation’s most serious financial crisis since the Great Depression.

In developing a proposed 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 are qualified mortgages; that is, they exclude risky features and are designed so that they borrower can repay the loan. However, for certain of its mortgage products, HUD proposes qualified mortgage standards similar to those established by CFPB in its definition of “qualified mortgage.”

B. Summary of the Major Provisions of the Regulatory Action.

In defining “qualified mortgage” in its rulemaking, 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 is applied to those mortgages that are not higher-priced covered transaction (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.

HUD proposes to designate Title I (home improvement loans), Section 184 (Indian housing loans), and Section 184A (Native Hawaiian housing loans) insured mortgages and guaranteed loans covered by this rule to be safe harbor qualified mortgages and HUD proposes no changes to the underwriting requirements of these mortgage and loan products. However, for its largest volume of mortgage products, those insured under Title II of the National Housing Act, HUD proposes two categories of qualified mortgages similar to the two categories of the CFPB – a safe harbor qualified mortgage and a rebuttable presumption qualified mortgage.

The rule proposes to define safe harbor qualified mortgage as a mortgage insured under Title II of the National Housing Act (with the exception of reverse mortgages insured under section 255 of this 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 less than the sum of the annual mortgage insurance premium and 1.15 percentage points. With respect to points and fees, CFPB's regulation provides total points and fees not to exceed a certain percentage of the total loan amount or not to exceed a certain dollar amount of the total loan amount, depending upon the total amount of the loan.

HUD proposes to define a rebuttable presumption qualified mortgage as a single family mortgage insured under Title II of the National Housing Act (with the exception of reverse mortgages insured under section 255 of this 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 all loans to be insured under Title II of the National Housing Act to be either a rebuttable presumption or safe harbor qualified mortgage, and meet the CFPB's points and fees limit at 12 CFR 1026.43(e)(3). The CFPB set a three percent points and fees limit for its definition of qualified mortgage, and the CFPB allowed for adjustments of this limit to facilitate the presumption of compliance for smaller loans

As more fully discussed later in this preamble, HUD's proposal to establish two categories of qualified mortgages for the majority of National Housing Act mortgages is 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. HUD specifically seeks comment on its proposed two categories.

C. Costs and Benefits

HUD's rule in effect reclassifies a sizeable group of loans (about 19 percent) of Title II loans insured under the National Housing Act from rebuttable presumption qualified mortgages under the CFPB's rule to safe harbor qualified mortgages under HUD's proposed rule. 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 proposed 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 these loans will adapt to meet the points and fees to be insured. In addition, HUD classifies all Title I, 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. Relative to the CFPB rule, HUD expects its qualified mortgage rule will not substantially decrease the potential benefits of ability-to-pay lawsuits.

If HUD had proposed a limit in excess of the CFPB standard on points and fees for receiving QM status, there would be fewer borrowers benefiting as lenders would have less incentive to reduce points and fees (in both the FHA market and in the conventional market as conventional lenders who charge points and fees above the CFPB limit but below a higher HUD limit could attain QM status by sending some of these loans to HUD). Moreover, HUD through proposing its own rebuttable presumption standard based on the spread between APOR and APR plus MIP keeps pressure on conventional lenders to keep APR within the limit for Safe Harbor as well, which will help ensure consumers are not merely charged higher interest rates in return for reduced points and fees.

As a result of the reclassification of some of HUD loans, the expected impact of the rule is no greater than an annual reduction of lenders' legal costs of \$41.0 million on the high end to \$12.3 million on the low end, and may even fall below this range.

II. Background

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 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 mortgagee 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 payment schedule that fully amortize 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.¹

New section 129C(b)(3)(B)(ii), also added by section 1412, requires that HUD, the Department of Veterans Affairs (VA), the Department of Agriculture (USDA), and the Rural Housing Service (RHS), prescribe rules in consultation with the Federal Reserve Board² to

¹ 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 may have been statutorily exempted altogether from the ability-to repay requirements. 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, CFPB 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.)

² Rulemaking authority under TILA has since been transferred to the CFPB.

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 Federal Reserve Board published a proposed rule on May 11, 2011, at 76 FR 27390, entitled, “Regulation Z; Truth in Lending,” in conformance with amendments to section 129C of TILA. On July 21, 2011, rulemaking authority under TILA transferred from the Federal Reserve Board to the CFPB. 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),” and referred to in this preamble as the Ability-to-Repay-QM final rule. This 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’s regulations at 12 CFR 1026.43(e)(2) adopt in part the statutory qualified mortgage definition, and require that a mortgage meet 6 general requirements: (i) the transaction must have regular periodic payments³; (ii) the mortgage must not exceed 30 years⁴; (iii) the points and fees paid in connection with the loan do not exceed 3 percent of the total loan amount⁵; (iv) the creditor must underwrite the loan taking into account the monthly payment for mortgage-related obligations⁶; (v) the creditor must consider and verify income and debt⁷; and (vi) the ratio of the consumer’s monthly debt to total monthly income must not exceed 43 percent⁸.

³ 129C(b)(2)(A)(i).

⁴ 129C(b)(2)(A)(viii).

⁵ 129C(b)(2)(A)(vii) (limiting total points and fees payable in connection with the loan to 3 percent of the total loan amount).

⁶ 129C(b)(2)(A)(iv)-(v).

⁷ 129C(b)(2)(A)(iii).

⁸ 129C(b)(2)(A)(vi) (directing compliance “with any guidelines or regulations established by the Board relating to ratios

The limit on points and fees is defined in 12 CFR 1026.43(e)(3) and the definition of points and fees is set out at 12 CFR 1026.32(b)(1). The total amount of points and fees for loans greater than or equal to \$100,000 (indexed for inflation) must not exceed 3 percent of the total loan amount. For a loan amount greater than or equal to \$60,000 but less than \$100,000, the points and fees must not exceed \$3,000; for a loan amount greater than or equal to \$20,000 but less than \$60,000, the points and fees must not exceed 5 percent of the total loan amount; for a loan amount greater than or equal to \$12,500 but less than \$20,000, the points and fees must not exceed \$1,000; and for a loan amount less than \$12,500, the points and fees must not exceed 8 percent of the total loan amount.

The CFPB's final rule creates both a safe harbor and a rebuttable presumption of compliance for transactions that are "qualified mortgages." Section 129C(b) of TILA provides a presumption that a qualified mortgage has met the ability-to-repay requirements. However, as the CFPB noted in its Ability-to-Repay-QM final rule, "the statute is not clear as to whether that presumption is intended to be conclusive so as to create a safe harbor that cuts off litigation or a rebuttable presumption of compliance with the ability-to-repay requirements."⁹ The CFPB's analysis of the statutory construction and policy implications demonstrates that there are sound reasons for adopting either interpretation.¹⁰ Given the statutory ambiguity, the CFPB adopted both a safe harbor and rebuttable presumption standard, exercising its authority under section 129C(b)(3)(B) of TILA to revise, add to, or subtract from the qualified mortgage criteria upon finding that the changes further the purposes of sections 129B and 129C. The CFPB's analysis

of total monthly debt to total monthly income or alternative measures . . .").

⁹ See 78 FR 6506.

¹⁰ The title of section 129C(b) refers to both a "safe harbor and rebuttable presumption," and there are references to both safe harbors and rebuttable presumptions in other provisions of the Act. The authority to revise the definition of "qualified mortgage" at 129C(b)(3)(B) is titled "revision of safe harbor criteria." See also 76 FR 27390, 27452-55 (May 11, 2011).

found that the use of a safe harbor and a rebuttable presumption standard best promoted the various policy goals of the statute.¹¹

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.” The safe harbor presumption was established to limit ability to repay challenges on mortgages that are considered to be the least risky.¹² Consumers can only challenge loans in this category by showing that the loans do not meet the definition of a “qualified mortgage.” 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 of the elements of the “qualified mortgage” definition is met. See 12 CFR 1026.43(e)(1)(ii)(B). 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.

The CFPB final rule also temporarily grants “qualified mortgage” status to loans that satisfy certain underwriting standards. See 12 CFR 1026.43(e)(4). Loans in this category must satisfy the underwriting requirements of, and are therefore eligible to be purchased, guaranteed or insured by one of the following: the government-sponsored enterprises (GSEs) (i.e., Fannie Mae and Freddie Mac) while they operate under Federal conservatorship or receivership; HUD (but only loans eligible to be insured under the National Housing Act); VA; USDA; or RHS. The temporary definition requires a qualified mortgage to satisfy only the first 3 requirements of the general definition of a qualified mortgage (must have regular periodic payments, term must

¹¹ See 78 FR 6506-6513 for the CFPB’s full analysis for adopting a safe harbor and rebuttable presumption standard.

¹² See 78 FR 6506.

not exceed 30 years, and points and fees must not exceed those specific in 1026.43(e)(3)), and excludes the underwriting, credit and income verification, and 43 percent total monthly debt-to-income ratio requirements for a “qualified mortgage.” This applicable provisions of the temporary definition phases out when: (1) each of the four Federal agencies issue their own “qualified mortgage” rule; (2) conservatorship ends for the GSEs; or (3) for all the four Federal agencies and the GSEs, no later than January 10, 2021, which is 7 years after the effective date of the CFPB’s Ability-to-Repay-QM final rule. (See 12 CFR 1026.43(e)(4) at 78 FR 6586-6588, specifically 12 CFR 1026.43(e)(4)(iii) at 78 FR 6587-6588.)

III. This Proposed Rule

As required by section 129C(b)(3)(B)(ii) of TILA, through this rule, HUD proposes to prescribe the regulations for the types of loans that HUD insures, guarantees, or administers, and which HUD has determined are qualified mortgages, under the definition proposed in this rule. Section 129C(b)(3)(B)(ii) makes clear and explicit that the four Federal agencies – HUD, VA, USDA, and RHS – are to define qualified mortgage for their respective programs. As noted earlier, section 129C(b)(3)(B)(ii) authorizes the four Federal agencies, in defining qualified mortgage for their programs, to revise, add to, or subtract from the statutory criteria used to define a qualified mortgage. HUD’s proposes to provide a definition of qualified mortgage that is aligned, to the extent feasible, with the ability-to-repay criteria set out in TILA, given the statutory mandates and missions of HUD’s mortgage insurance and loan guarantee programs.

A. Scope of coverage.

Through its Federal Housing Administration (FHA), HUD insures single family loans under the National Housing Act (12 U.S.C. 1701 et seq.). HUD guarantees 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 guarantees section 184A loans for Native Hawaiian Housing under the Housing and Community Development Act of 1992 (1715z-13b) (Section 184A guaranteed loans). Although section 129C(b)(3)(B)(ii)(I) of TILA specifically references mortgages insured by HUD under the National Housing Act, HUD submits that Section 184 guaranteed loans and Section 184A guaranteed loans were intended to be covered. While Section 184 guaranteed loans and Section 184A guaranteed loans are authorized by the Housing and Community Development Act of 1992, their authorizing sections of the 1992 law are codified in the National Housing Act. They are codified at 12 U.S.C. 1715z-13a and 1715z-13b, respectively. Additionally, the direction to all four Federal agencies in section 129C(b)(3)(B)(ii) is to prescribe regulations defining the “types” (plural) of loans they insure, guarantee, or administer, that are qualified mortgages, and this rule follows that direction. Mortgages insured under the National Housing Act are only one type of mortgage product, and therefore subclause (I) covers only a portion of the overall scope of section 129C(b)(3)(B)(ii), creating some ambiguity as to its scope. HUD reads the reference to the National Housing Act as being exemplary, and not being an exclusive, limiting provision. The more limiting reading would undercut the intent present in the broader language directing agencies to make qualified mortgage determinations for the types, without qualification, of the loans they insure, guarantee, or administer. HUD, therefore, interprets the more general language of this provision to permit HUD to define types of mortgages besides those insured under the National Housing Act as qualified mortgages.

Accordingly, this proposed rule would define “qualified mortgage” for FHA-insured single family mortgages, section 184 loan guarantees, and section 184A loan guarantees.

B. National Housing Act single family mortgage programs.

Of the insured/guaranteed loan programs covered by this rule, single family loans insured under the National Housing Act (12 U.S.C. 1701 et seq.) present the largest volume of mortgages insured by HUD, through FHA. Under the National Housing Act, FHA is not only required to meet the housing needs of borrowers (12 U.S.C. 1708(a)(7)(B)), including low and moderate income borrowers, borrowers from underserved areas, central city areas, and rural areas, and minority borrowers (12 U.S.C. 1709(w)), but to ensure the financial soundness of the Mutual Mortgage Insurance Fund, and make programmatic or premium adjustments as necessary to reduce risk to the fund. See 12 U.S.C. 1708(a)(3) and (6). Additionally, under the National Housing Act, FHA is charged with prohibiting acts or practices in connection with loans or extensions of credit for the purchase of a manufactured home that are unfair, deceptive, or otherwise not in the interests of the borrower (12 U.S.C. 1706f(d)), and to take administrative action (12 U.S.C. 1708(c)) or impose civil money penalties (12 U.S.C. 1735f-14) against participants who violate the requirements of FHA programs.

Given the broad missions to meet the housing needs of borrowers and to ensure the financial soundness of its programs, HUD is proposing to adopt a definition of qualified mortgage that adheres to the statutory criteria and the CFPB's final rule but in a manner that will appropriately fit with these missions of the National Housing Act programs. HUD is proposing to maintain its existing regulatory structure for FHA-insured single family mortgage programs for purposes of defining qualified mortgages, but augment these programs with features of the statutory criteria as revised by the CFPB that are not inconsistent with the statutory parameters of the National Housing Act single family mortgage insured programs or their mission.

In this rule, HUD proposes 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.¹³ Additionally, except for mortgages insured under its Title I Property Improvement Loan Insurance program (Title I), authorized by section 2 of the National Housing Act (12 U.S. 1703), HUD proposes to adopt the statutory points and fees structure for all of its FHA-insured single family mortgages, as this statutory feature was implemented by the CFPB in its rule. Further, similar to the CFPB's rule structure, this proposed rule would distinguish between two types of qualified mortgages – a safe harbor qualified mortgage and a rebuttable presumption qualified mortgage. For those HUD insured loans subject to the points and fees structure, HUD would 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.

All National Housing Act single family mortgages, except for HECMs, are defined as qualified mortgages by HUD. HUD is proposing to add a new § 203.19 to its regulations in 24 CFR part 203¹⁴ that would require, through the proposed definition of “qualified mortgage” for all FHA-insured single family mortgages, except for HECMs, to be “qualified mortgages.” HUD's definition would incorporate the safe harbor and rebuttable presumption standards within the definition of a “qualified mortgage” rather than create subsets based on whether a mortgage is a higher-priced covered transaction. HUD recognizes, as did the CFPB, that the Dodd-Frank Act language is ambiguous in prescribing the type of presumption provided for a qualified mortgage. The CFPB used its authority under section 129C(b)(3)(B)(i) of TILA to adopt both

¹³ Similar to action taken by the CFPB, HUD exempts HECM, HUD's reverse mortgage program, from the ability to repay requirements. As CFPB further stated in its preamble to the published January 30, 2013, final rule, making a reverse mortgage a “qualified mortgage” would be contrary to the purpose of the statute because it would allow a “qualified mortgage” to include otherwise banned prepayment penalties. (See 78 FR 6516.)

¹⁴ 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 Home Equity Conversion Mortgage (HECM) program.

standards. The CFPB found that adopting both a safe harbor and rebuttable presumption standard, based on a limit of the APR relative to the APOR, provides certainty to encourage creditors to extend credit reasonably and promotes consumers' access to credit.¹⁵ HUD also proposes to adopt both standards using its authority at section 129C(b)(3)(B)(ii) of TILA to revise, add to, or subtract from criteria used to define a qualified mortgage for purposes of section 129C(b)(2)(A).

FHA streamlined refinancing. This proposed rule requires FHA streamlined refinances to comply with HUD's qualified mortgage rule. Section 129C(a)(5) of TILA grants HUD the authority to exempt streamlined refinancing from the income verification requirements of section 129C(a)(4) as long as such refinances met certain requirements, including that the consumer is not 30 days or more past due on the prior existing residential mortgage loan, the loan does not increase the principal balance, the points and fees do not exceed 3 percent, and the new interest rate on the refinanced loan is lower than the current rate. HUD does not consider it necessary to exercise this authority under section 129C(a)(5) because HUD's qualified mortgage definition results in an exemption similar to the one contemplated under section 129C(a)(5) but consistent with HUD's mission to help existing FHA homeowners refinance. Specifically, HUD's qualified mortgage rule would require streamlined refinances to meet the points and fees requirements and the HUD requirements for FHA streamlined refinances. 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, that the loan is designed to lower the monthly principal and interest payment, and that the loan involves no cash back to the borrower except for minor adjustments.¹⁶

¹⁵ See 78 FR 6506-6513 for the CFPB's full analysis for adopting a safe harbor and rebuttable presumption standard.

¹⁶ Handbook 4155.1, Ch. 6, Sec. C (Mortgage Credit Analysis for Mortgage Insurance on One-to-Four Unit Mortgage

Requiring streamlined refinances to be “qualified mortgage” will also subject them to the APR threshold requirement for being either a rebuttable presumption or safe harbor qualified mortgage. Given the unique nature of streamlined refinances, this rule would modify the CFPB rebuttable presumption standard to clarify that a presumption is rebutted if the lender does not meet the underwriting requirements applicable to the transaction. Therefore, if a streamlined refinance was a “rebuttable presumption qualified mortgage” the presumption could only be rebutted by showing that the lender did not meet the applicable HUD requirements for originating streamlined refinances, including the points and fees limit.

Title I program. Loans insured under the Title I program would be safe harbor qualified mortgages, with no specific points and fees limits and with no APR limits. The Title I program insures loans to finance the light or moderate rehabilitation of properties, as well as the construction of nonresidential buildings on the property. This program may be used to insure such loans for up to 20 years on either single or multifamily properties. The maximum loan amount is \$25,000 for improving a single-family home. Under section 2(a) of the National Housing Act (12 U.S.C. 1703(a)), the Secretary is vested with the authority to establish the terms and conditions under which FHA will insure financial institutions that extend loan financing for manufactured homes home improvement loans. Under section 2(h) of the National Housing Act (12 U.S.C. 1703(h)), the Secretary is authorized to issue rules and regulations to carry out the provisions of Title I. HUD has determined that designating Title I loans as safe harbor qualified mortgages, as proposed in this rule furthers the purposes of Title I. HUD’s proposed approach is intended to provide the necessary flexibility to continue to meet the housing needs of underserved borrowers, recognizing the unique nature of the Title I loan program, and to make

programmatic and premium changes to maintain financial soundness. Coverage of the Title I program would be addressed by adding a definition of “qualified mortgage” to the definitions in 24 CFR 201.7.

Points and fees limitation. HUD’s proposed “qualified mortgage” definition adopts the CFPB’s points and fees limitations at 12 CFR 1026.43(e)(3). A mortgage, except a mortgage insured under Title I or a HECM that does not comply with the limit on points and fees would be ineligible for insurance under the National Housing Act.

The three percent points and fees limit is one of the statutory criteria used to define a qualified mortgage, and the CFPB has retained this criterion in its regulatory definition with adjustments to facilitate the presumption of compliance for smaller loans. Although it is also within the purview of HUD’s ability to “revise, add to, or subtract from” the definition of qualified mortgage, under section 129C(b)(3) of TILA, and amend the points and fees, HUD considers the proposed adoption of the points and fees limit as established by statute and adopted by the CFPB in its final rule to be appropriate.¹⁷ By maintaining consistency with the points and fees threshold that applies to conventional qualified mortgages under the CFPB’s rule, HUD expects to remove that requirement as a consideration in whether an insured or a conventional qualified mortgage is a more appropriate choice in a particular situation.

This approach also isolates points and fees as an independent factor and would allow HUD to focus on its existing requirements while it considers whether adjustments are necessary as HUD’s experience with the effects of qualified mortgages develops.

Specific solicitation of comment. HUD is aware of the considerable comment on the issue of the three percent points and fees limitation (which is the limitation in the statute), including specific elements of the points and fees, received in response to the proposed rule that

¹⁷ HUD’s upfront mortgage insurance premium (UFMIP) is not included in the points and fees.

preceded CFPB's final rule on qualified mortgage. With respect to FHA-insured loans, HUD has limited data on points and fees charged on past FHA-insured loans, and therefore relies, to an extent, on the analysis undertaken by CFPB, much of which was presented in CFPB's final rule responding to public comments. Essentially, the proposal that HUD presents in this rule is that CFPB's points and fees limitation for the broader mortgage market is also appropriate for FHA's segment of the market. As a result, HUD seeks comment from lenders participating in its programs on any issues specific to HUD's mortgage insurance and loan guarantee programs that HUD should take into consideration in setting its limits to points and fees consistent with the CFPB's definition, including relevant differences (if any) with the non-FHA market, and the possibility for potential adverse selection issues if FHA were not to adopt CFPB's points and fees limitation.

Two subsets of FHA-insured qualified mortgages. This rule proposes to establish two subsets of FHA-insured "qualified mortgages": a "rebuttable presumption qualified mortgage" and a "safe harbor qualified mortgage." As noted earlier in this preamble, with the exception of HECMs, the rule would require all FHA-insured single family mortgages to meet either the "rebuttable presumption qualified mortgage" or "safe harbor qualified mortgage" definition. HUD reads the "for purposes of paragraph [129(b)(2)(A) of TILA]" to include the basic purpose served by a qualified mortgage, namely, to provide mortgagees the presumption that a loan that is a qualified mortgage meets the ability to repay requirements of TILA section 129C(a). The proposed rule also states the degree to which each subset of FHA-insured qualified mortgage addresses its purpose of providing a presumption of compliance with the ability to repay requirements.

Rebuttable presumption qualified mortgage. A “rebuttable presumption qualified mortgage” would be defined as a single family mortgage that is insured under the National Housing Act, except for loans insured under Title I or a HECM, which would include the requirement that it does not exceed the CFPB’s limits on points and fees codified at 12 CFR 1026.43(e)(3), and 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. The rule provides 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). Additionally, 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, as applicable to the type of mortgage, when underwriting the mortgage in accordance with HUD requirements, or that the points and fees limit was exceeded.

Safe harbor qualified mortgage. A “safe harbor qualified mortgage” would be defined as one that is either (1) a mortgage insured under the National Housing Act, except for a mortgage insured under Title I or a HECM, and that meets the requirements of the National Housing Act, including the points and fees limit, and that has an APR for a first-lien mortgage relative to the APOR that is less than the combined annual mortgage insurance premium and 1.15 percentage points; *or* (2) a mortgage insured under Title I. A mortgagee that meets the requirements for a safe harbor qualified mortgage is deemed to meet the ability to repay requirements in 15 U.S.C. 1639c(a).

HUD's proposed categorizations of safe harbor and rebuttable presumption are similar, but not identical to those of the CFPB. The CFPB's final rule does not establish a "safe harbor qualified mortgage" or a "rebuttable presumption qualified mortgage" *per se*. Rather, the CFPB's final rule provides separate definitions of "higher-priced covered transaction" and "qualified mortgage" and then states that (1) a qualified mortgage that is not a higher-priced transaction complies with the ability-to-repay requirements; and (2) a qualified mortgage that is a higher-priced transaction is presumed to comply with the ability-to-repay requirements. Even though the CFPB's rule is structured in this way to provide only a single definition of "qualified mortgage," the preamble to the CFPB's final rule acknowledges that the result is that "the final rule distinguishes between two types of qualified mortgages based on the mortgage's APR relative to the APOR." See the CFPB's final rule at 78 FR 6505. The CFPB's final rule also acknowledges that the definition of "qualified mortgage" may be structured in different ways, and the Federal Reserve Board's proposed rule on qualified mortgage (76 FR 27390, May 11, 2011) proposed two alternative definitions of a qualified mortgage, one that would have operated as a legal safe harbor, and one that would have provided a rebuttable presumption of compliance. See 78 FR 6417, 6508.

APR (Annual Percentage Rate) relative to APOR (Average Prime Offer Rate). Similar to the CFPB's final rule, HUD's rule would distinguish between the two types of qualified mortgages based on the mortgage's APR relative to the APOR for the great majority of FHA-insured single family mortgages. Using the APR relative to APOR to distinguish between safe harbor and rebuttable presumption for most loans provides consistency with a significant feature

of the CFPB rule.¹⁸ CFPB's rule, at 12 CFR 1026.35, consistent with section 129C(b)(2)(B) of TILA, provides for CFPB to set the APOR for a comparable transaction and to publish such rate.

Title I single family mortgages are specialized products that require further study to determine additional parameters for distinguishing the rebuttable presumption and safe harbor qualified mortgages. As referenced above, HUD proposes to designate them as safe harbor qualified mortgages so as not to interfere with current lending practices until appropriate parameters to distinguish between safe harbor and rebuttable presumption mortgages under Title I can be determined.

HUD's purpose in establishing two categories of qualified mortgages for the bulk of loans it insures is 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. The difference in structure from the CFPB's rule is that HUD proposes to incorporate the APR as an internal element of HUD's definition of qualified mortgages that would distinguish the 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."

HUD's "safe harbor qualified mortgage" would provide 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 proposed rule, for a non-Title I single family mortgage to meet the "safe harbor qualified mortgage" definition, the mortgage would be 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. Because all FHA-insured mortgages include an MIP that may vary from time to time to address

¹⁸ APOR does not include private mortgage insurance (PMI).

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 ARP 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.

Specific solicitation of comment. HUD specifically seeks comment on whether lenders participating in its mortgage insurance and loan guarantee programs would lower the APR relative to the APOR such that it is always less than the combined annual mortgage insurance premium and 1.15 percentage points so that the lender is originating only safe harbor qualified mortgages. That is given the differences between a safe harbor qualified mortgage and a rebuttable presumption qualified mortgage, as proposed by HUD in this rule, would lenders in essence always opt for the safe harbor qualified mortgage and never make a rebuttable presumption qualified mortgage? If so, HUD welcomes comments on views that the effect this incentive may have on lenders, borrowers, and the broader economy.

Additionally and related to this issue, it is HUD's view that having a rebuttable presumption standard for FHA mortgages places pressure on conventional lenders to lower the APR as well. If all FHA insured mortgages were safe harbor mortgages, conventional lenders may be incentivized to send more loans with a high APR to FHA solely to gain safe harbor status. Accordingly, the two categories for FHA mortgages would benefit conventional borrowers as well. HUD welcomes commenters' views on issue – whether the lowering of the APRs by lenders to meet the definition of safe harbor, as provided in this rule, expected to result

in greater net social benefits than an alternative that would define all qualified mortgages as safe harbor.

Safe harbor versus rebuttable presumption mortgage – differences in liability protection.

FHA-approved lenders that originate a safe harbor mortgage operate with greater legal protections than those who issue rebuttable presumption mortgages, but the latter group is not without legal protections.

For an FHA-approved lender that originates a safe harbor qualified mortgage, the mortgage is conclusively presumed to comply with the ability to repay requirements. Meeting the qualified mortgage criteria and underwriting requirements and pricing of the loan at a prime rate are sufficient to ensure that the lender made a reasonable and good faith determination that the borrower will be able to repay the loan. If a borrower brings a claim that the FHA-approved lender did not make a reasonable and good faith determination of the borrower's ability-to-repay the FHA-insured mortgage, and the court finds that the originated mortgage was a safe harbor qualified mortgage, as defined by HUD, then that finding by the court conclusively establishes that lender complied with the ability to repay requirements and the consumer's claim is denied.

For an FHA-approved lender that originates a rebuttable presumption mortgage, the mortgage is presumed to comply with the ability to repay requirements. If a borrower brings a claim that the FHA-approved lender did not make a reasonable and good faith determination of the borrower's ability-to-repay the FHA-insured mortgage, and the court finds that the originated mortgage was a rebuttable presumption qualified mortgage, as defined by HUD, then the borrower may rebut the presumption. Therefore, the lender should exert greater care in underwriting the loan than would be true in the absence of any liability for extending a loan which the borrower cannot afford to repay. For the borrower to prevail on its claim against a

lender that originates a rebuttable presumption, the borrower must prove that the lender did not make a reasonable and good faith effort in evaluating the borrower's ability to repay the FHA-insured mortgage in accordance with HUD requirements.

For either type of mortgage, however, documentation of the borrower's ability to repay will be important in demonstrating compliance with the ability to repay requirements. As stated by the CFPB in the preamble to its published January 30, 2013, final rule: "As enacted by the Dodd-Frank Act, TILA section 129C(a)(1) provides that no creditor may make a residential mortgage loan unless the creditor makes a reasonable and good faith determination, based on verified and documented information, that, at the time the loan is consummated, the consumer has a reasonable ability to repay the loan according to its terms and all applicable taxes, insurance, and assessments." (See 78 FR 6460.)

C. Native American and Native Hawaiian Loan Guarantee programs.

Similar to Title I loans, HUD's Section 184 and Section 184A guaranteed loans create a very unique subset of loans for HUD and require additional study to determine the appropriate parameters for distinguishing rebuttable presumption and safe harbor qualified mortgages. HUD proposes to designate them as safe harbor qualified mortgages, with no APR limit, and with no points and fees limit, so as not to interfere with current lending practices until appropriate parameters to distinguish between safe harbor and rebuttable presumption mortgages can be determined. The pertinent regulatory provisions designating these loans safe harbor QMs are included in parts 1005 and 1007 of this title.

D. Existing HUD Requirements.

There are also provisions among HUD's requirements at 24 CFR part 203 that already apply to mortgages insured under the National Housing Act and are consistent with section

129C(b)(2)(B) of TILA and the CFPB's requirements, including that a mortgage have regular periodic payments; that the mortgage does not exceed 30 years; and that lenders apply specific underwriting requirements.¹⁹ HUD is proposing to continue to use its existing underwriting and income verification requirements. HUD is proposing to not adopt the CFPB's 43 percent total monthly debt-to-income ratio requirement to remain consistent with HUD's mission with respect to underserved borrowers. HUD does not expect its loan volume to increase as a result of its decision not to adopt the CFPB's 43 percent total monthly debt-to-income ratio requirement

E. Higher-Priced Covered Transactions.

The fact that the CFPB's final rule provides a separate definition of "higher-priced covered transaction" may potentially create issues in that some HUD safe harbor qualified mortgages would also be higher-priced covered transactions as defined by the CFPB. To the extent that there are requirements not related to qualified mortgages that apply to higher-priced covered transactions, such requirements would apply to mortgages that meet the higher-priced covered transactions definition regardless of whether they are safe harbor or rebuttable presumption. For example, the calculation of certain maximum payments with respect to loans with balloon payments under 12 CFR 1026.43(c)(5)(ii)(A) of the CFPB's regulations, is not expected to have any impact on mortgages insured under the National Housing Act. Apart from this requirement, HUD, however, is currently not aware of other possible overlaps of CFPB requirements.

F. HUD's Rule Consistent with Sections 129B and 129C of TILA.

¹⁹ See 24 CFR 203.1, 203.17(c)-(d), 203.33, 203.34; Handbook 4155.1 (Mortgage Credit Analysis for Mortgage Insurance on One-to-Four Unit Mortgage Loans) and Handbook 4155.2 (Lender's Guide to the Single Family Mortgage Insurance Process) available at http://portal.hud.gov/hudportal/HUD?src=/program_offices/administration/hudclips/handbooks/hsg; Borrowers Section 184 Loan Resources, available at http://portal.hud.gov/hudportal/HUD?src=/program_offices/public_indian_housing/ih/homeownership/184/borrowers; Section 184A Native Hawaiian Housing Loan Guarantee Program, available at http://portal.hud.gov/hudportal/documents/huddoc?id=DOC_8711.pdf.

In prescribing by rule the types of loans HUD insures that are qualified mortgages for purposes of TILA section 129C(b)(2)(A), HUD is required to consult with the CFPB and to make a finding that such rule is consistent with the purposes of sections 129B and 129C of TILA.²⁰ HUD has consulted with the CFPB in the preparation of this rule. HUD's existing regulations and guidance, promulgated under HUD's mandates to assist underserved borrowers and ensure the financial soundness of its insurance program, already require FHA lenders to carefully assess a borrower's ability to repay, prohibit the use of products with higher risk, and restrict certain fees charged to the borrower. This rule proposes to incorporate, in HUD's existing regulations, the CFPB's limit on points and fees and the APR relative to APOR calculation to establish safe harbor and rebuttable presumption qualified mortgages for the majority of FHA's portfolio and will provide further safeguards against risky lending and abusive terms. In addition, clarifying the extent of presumption of ability to repay compliance afforded a single family mortgage insured under the National Housing Act or guaranteed under section 184 or 184A of the Housing Community Development Act of 1992 provides TILA compliance assurance to lenders making loans insured and guaranteed by HUD.

HUD, therefore, finds that defining the loans it insures and guarantees as qualified mortgages in terms of its existing requirements for all lenders participating in its programs, coupled with the requirements adapted here, will provide a wide range of mortgagors access to residential mortgages on loan terms that reasonably reflect their ability to repay while protecting such mortgagors from unfair lending practices, consistent with the purpose of sections 129B and 129C of TILA, as stated in section 129B(a)(2).

²⁰ The purpose of 129B and 129C of TILA is to assure that consumers are offered and receive residential mortgages on loan terms that reasonably reflect their ability to repay the loans and that are understandable and not unfair, deceptive or abusive. 15 U.S.C.1639b(a)(2).

In defining “qualified mortgage” in this way HUD is stating that its insured single family mortgages and guaranteed residential loans meet TILA’s ability-to-repay requirements. In essence, HUD is proposing not to insure a single family mortgage or guarantee a single family residential loan that is not a qualified mortgage, as defined by HUD. When HUD’s definition is issued in final and becomes effective, following review and consideration of public comment, HUD’s definition will replace the CFPB’s qualified mortgage definition at 12 CFR 1026.43(e), and therefore preclude the applicability of the temporary definition for loans eligible to be insured by HUD under the National Housing Act, as provided in the CFPB’s final rule at 12 CFR 1026.43(e)(4)(iii).

As addressed in the following section, HUD has determined that it is important for its definition to govern its programs, consistent with statutory intent and the statutory mandate to HUD and the other three Federal agencies to issue their own definitions of qualified mortgage. The CFPB’s definition was designed for the general lending market, not specifically for HUD’s mortgage insurance and loan guarantee programs. Therefore, wholesale application of “qualified mortgage,” as defined by the CFPB, without any modifications made by HUD, does not work as well for HUD’s programs as HUD’s definition.

IV. Justification for Shortened Public Comment Period

For HUD rules issued for public comment, it is HUD’s policy to afford the public “not less than 60 days for submission of comments.” See 24 CFR 10.1. In cases in which HUD determines that a shorter public comment period may be appropriate, it is also HUD’s policy to provide an explanation of why the public comment period has been abbreviated. For the reasons provided in this section of the preamble, HUD believes that this proposed rule merits an abbreviated public comment period.

HUD's rule needs to be issued and effective by January 10, 2014, to decrease the risk of disruption to HUD's mortgage programs and avoid jeopardizing the availability of an important source of affordable home financing for first-time homebuyers, minority homebuyers, including Native Americans and Native Hawaiians. If HUD's rule is not effective by this date, these mortgages will be subject to the CFPB's definition of qualified mortgage, a definition that is not focused on, to the extent that HUD's definition is required to be, the populations that the HUD programs have a mission to serve. Specifically, CFPB's definition would result in a lower share of safe harbor qualified mortgages for FHA and would negatively affect borrowers with greater than 43 percent total monthly debt-to-income ratios. Further, the lack of a HUD rule on qualified mortgages would create uncertainty among FHA lenders. Delay in the implementation of this rule would increase the risk of disruption or delay in the availability of homeownership or home improvement financing for vulnerable groups of consumers, especially those who utilize the Title I, Section 184, and Section 184A programs

As discussed in the preamble, section 129C(b)(3)(B)(ii) of TILA charges HUD, VA, USDA, and RHS, to prescribe their own rules, in consultation with the CFPB, defining the types of loans that these agencies insure, guarantee, or administer, as applicable, that are qualified mortgages. The statutory charge to these four agencies to issue their own definitions of qualified mortgage for their financing programs reflects a statutory view that these agencies are in the best position to define "qualified mortgage" for their loan products, consistent with the purposes of sections 129B and 129C of TILA, and within the statutory parameters of the programs and the mission of each agency.

For HUD to responsibly and effectively carry out its rulemaking mandate under the Dodd-Frank Act, HUD did not issue its own qualified mortgage rule in advance of the CFPB's

Ability-to-Repay-QM final rule (nor did any of the other three federal agencies). Similar to the statutory authority provided to the four Federal agencies, the CFPB was also authorized, in prescribing its rule defining qualified mortgage, to revise, add to, or subtract from, the statutory criteria defining qualified mortgage, factoring into HUD's decision to be prudent and wait for the CFPB's final rule. HUD determined it was important to wait for the CFPB's final rule defining qualified mortgage, with HUD's objective to be as consistent as feasible with the CFPB's definition, which closely tracks the statutory definition, while remaining attentive to HUD's mission and the statutorily required features of the various types of insured mortgage products.

Although the CFPB published its Ability-to-Repay-QM final rule in the Federal Register on January 30, 2013, at 78 FR 6408 (effective as of January 10, 2014, one year from the date of the CFPB's posting of the rule on its website), the CFPB published on that same date, at 78 FR 6622, a proposed rule that submitted for public comment certain amendments to the Ability-to-Repay-QM final rule. These amendments included additional exemptions from the ability-to-repay requirements, and one such exemption was for the four Federal agencies' refinance programs. See 78 FR 6623. By final rule issued on May 29, 2013, and published on June 12, 2013, at 78 FR 35430, the CFPB determined that the federal agencies' refinance programs would not be exempt from the ability-to-repay requirements.

With CFPB having made its determinations on ability-to-pay/qualified mortgage requirements, as provided in its January 30, and June 12, 2013, final rules, it is necessary, in order to avoid disruptions in meeting the housing needs of borrowers that HUD is charged to serve, for HUD to issue for effect as quickly as possible its own rule on "qualified mortgage" so that HUD's rule is in place on or before January 10, 2014, the date the CFPB's Ability-to-Repay-QM final rule becomes effective. It was important for HUD to wait and see the scope of the

CFPB's definition of qualified mortgage, as concluded in the June 12, 2013, rule because HUD must not only take into consideration the statutory criteria and purposes for defining a qualified mortgage as set out in the Dodd-Frank Act and the regulatory criteria as promulgated in the CFPB's rules, but must take into consideration the purposes and provisions of the programs it administers. Unlike the CFPB, HUD's definition is not designed for the general lending market but the lenders who participate in HUD's mortgage insurance and guarantee programs, and the borrowers who utilize mortgages under HUD's programs, and, as previously noted, the Dodd-Frank statute is clear that HUD's definition of "qualified mortgage" is to govern HUD programs.

As discussed in this preamble, HUD maintains for its mortgage insurance and loan guarantee programs the regulatory framework now in place. HUD's proposed definition of "qualified mortgage" presents some additions to the requirements under which these programs are governed to the extent feasible to better align them with the TILA purposes and the CFPB's rule.

HUD's mortgage insurance and loan guarantee programs play a central role in the housing market and act as a stabilizing force during times of economic distress, facilitating mortgage financing during periods of severe constriction in conventional markets. Having HUD's qualified mortgage rule in place and effective by January 10, 2014, is a step that HUD must take to avoid unnecessarily disrupting the mortgage market, and seriously jeopardizing the security and certainty that HUD's mortgage insurance and loan guarantee programs provide in the housing market.

For these reasons, HUD has determined that an abbreviated comment period is appropriate for this rule. Although the comment period is an abbreviated one, HUD will consider comments that are submitted after the comment period has closed.

V. Findings and Certifications

Executive Order 12866, Regulatory Planning and Review

The Office of Management and Budget (OMB) reviewed this proposed 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 remove the application of the CFPB’s qualified mortgage rule to HUD-eligible loans and replace it with a definition of “rebuttable presumption qualified mortgage” and “safe harbor qualified mortgage” for loans insured or guaranteed by HUD. 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 \$41.0 million on the high end to \$12.3 million on the low end, and may even fall below this range.

Under HUD’s qualified mortgage rule, lenders face lower costs of compliance than under the CFPB’s rule and therefore receive incentives to continue making these loans without having to pass on their increased compliance costs to borrowers. While borrowers benefit from not having to pay for the higher lender costs, they also face less opportunity to challenge the lender with regard to ability to repay. 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. In addition, with reduced interest payments, the likelihood of a challenge and thus a challenge is reduced. Very few borrowers will lose from this rule. Generally, the reduction in legal costs represents a societal benefit. However, the rare instance a settlement in the borrower's favor is prevented that represents a transfer from the borrower to lender (to be redistributed to all other borrowers). Relative to the CFPB rule, HUD does not expect its qualified mortgage rule will substantially decrease the potential benefits of ability-to-pay lawsuits.

If HUD had proposed a limit in excess of the CFPB standard on points and fees for receiving QM status, there would be fewer borrowers benefiting as lenders would have less incentive to reduce points and fees (in both the FHA market and in the conventional market as conventional lenders who charge points and fees above the CFPB limit but below a higher HUD limit could attain QM status by sending some of these loans to HUD). Moreover, HUD through proposing its own Rebuttable Presumption standard based on the spread between APOR and APR plus MIP keeps pressure on conventional lenders to keep APR within the limit for Safe Harbor as well, which will help ensure consumers are not merely charged higher interest rates in return for reduced points and fees.

To estimate the size of the reduction in cost to FHA lenders, HUD notes that the CFPB estimated the legal costs to defend potential challenges on a non-qualified mortgage loan would add between 3 and 10 basis points to the interest rate on the loan.²¹ HUD views 10 basis points (0.10 percentage points) as an upper bound because QM loans with rebuttable presumption are expected to incur much lower legal costs to defend against challenges than non-QM loans.

²¹ Regulatory impact analysis by the CFPB of the "Ability-to-Repay and Qualified Mortgage Standards under Truth in Lending Act (Regulation Z)", page 24.

As discussed above, HUD would make all Title I, Section 184 and Section 184A insured mortgages and guaranteed loans safe harbor qualified mortgages. Under the CFPB rule, many of these loans would have upfront fees and points that exceed the cap listed and would therefore be classified as non-qualified mortgages. Estimating the FY 2013 loans for the Title I program at 5,000 with an average balance of \$47,900, the aggregate loan amount would be approximately 200 million. Estimating the FY 2013 loans for the Section 184 and Section 184A program also at 5,000 with an average balance of \$175,000 the aggregate loan amount would be approximately 900 million. Classifying this group of loans as safe harbor qualified mortgages and applying the .10 percentage points would lower lenders' legal costs to defend the loans by \$1.1M or a low estimate of \$400,000. However, because HUD does not track APR or points and fees on Title 1, 184, and 184A loans, HUD cannot estimate with certainty the percentage of loans that would be non-QM. As such, HUD believes a high share of these loans would be non-QM, and assumes 100 percent for this analysis, but it reasonable to state that this percentage may be less than 100 percent, and the resulting benefits to consumers and legal cost reductions for lenders from the proposed rule may be overstated.

Under the CFPB's rule, mortgages insured under Title II of the National Housing Act (with the exception of reverse mortgages insured under section 255 of this act) would be classified as non-qualified mortgages, while others would be qualified mortgages afforded a rebuttable presumption or a safe harbor presumption. A small number (about 7 percent) of Title II loans would not qualify as qualified mortgage based on their exceeding the points and fees limit. All other loans that FHA currently insures under Title II would meet qualified mortgage standards under the CFPB's rule, but about 20 percent only do so with rebuttable presumption of compliance with ability to repay. The remaining FHA loans under the CFPB's rule (about 74

percent) would qualify for qualified mortgage status with a safe harbor presumption of compliance with the ability to repay requirements.

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. This policy provides a very strong incentive for HUD mortgagees to comply with the qualified mortgage points and fees requirements. As a result, only a negligible fraction of these affected loans would have to find alternatives to FHA execution, or not be made at all, once the HUD qualified mortgage rule is in place. Most are expected to comply and to continue to be insured by HUD. Therefore, the costs and benefits would be similar to all other Title II loans.

The primary impact on FHA loans (excluding Title I) is the reclassification of 19 percent of FHA's non-Title I loans from rebuttable presumption to safe harbor under the proposed rule. HUD estimates the number of loans insured in FY 2013 under the Title I program to be 1,180,000 with an aggregate loan amount of \$210 billion. Only 19 percent of the portfolio would be a rebuttable presumption qualified mortgage making the adjusted aggregate loan amount \$39.9 billion. Classifying this group of loans as safe harbor qualified mortgages and applying the .10 percentage points would lower lenders' legal costs to defend the loans by \$39.9M.

Figure 1 in HUD's accompanying economic analysis illustrates the characteristics of the loan categories for FHA-insured loans under this proposed rule. A 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 202-402-3055 (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.

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.

As provided in this rule, HUD proposes no change to the current requirements governing its Title I loans, its Section 184 and 184A guaranteed loans and its FHA-insured streamlined refinance mortgages. Therefore, there is no impact on either lenders or prospective borrowers under these programs.

With respect to FHA-insured single family mortgages (except for Title I, streamlined refinance and HECMs), FHA proposes to adopt the points and fees limitation, similar to the structure provided in the CFPB's final rule. As noted earlier in this preamble, the three 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. In addition to the points and fees limitation, and similar to the CFPB's rule, HUD's rule proposes to distinguish between the two types of qualified mortgages based on the mortgage's APR relative to the APOR for the great majority of FHA-insured single family mortgages. The difference, however, in structure from the CFPB's rule is that HUD proposes to incorporate the APR as an internal element of HUD's definition of qualified mortgages that

would distinguish the safe harbor qualified mortgages from the rebuttable presumption qualified mortgages.

With these few exceptions, HUD retains its existing requirements for the majority of its FHA-insured single family mortgages, thereby creating minimal impact on its programs. As also noted earlier in this preamble, there are provisions among HUD's requirements at 24 CFR part 203 that are consistent with section 129C(b)(2)(B) of TILA and the CFPB's requirements, including that a mortgage have regular periodic payments; that the mortgage does not exceed 30 years; and that lenders apply specific underwriting requirements. See 24 CFR 203.1, 203.17(c)-(d). HUD is proposing to continue to use its existing underwriting requirements, in order to remain consistent with HUD's mission with respect to underserved borrowers, and therefore does not propose to adopt the CFPB's 43 percent total monthly debt-to-income ratio requirement. The primary change made to the status quo by Dodd-Frank and the CFPB's rule is, simply put, to extend the requirement that a lender determine that a borrower has the ability to repay most single-family loans. (See section 129C of TILA as added by title XIV, subtitle B, section 1411 of Dodd-Frank, codified at 15 U.S.C. 1639c (note).) While this may be a new requirement for private industry, HUD has long required as a matter of prudent underwriting that lenders determine that borrowers whose mortgage loans are HUD-insured have the ability to repay. For example, in HUD's single-family mortgage insurance regulations at 24 CFR 203.21 (consistent with section 203(b)(4) of the National Housing Act), the monthly payments on a mortgage must not be in excess of the borrower's reasonable ability to pay. When there is a second mortgage, the monthly payments on both mortgages must be within the borrower's reasonable ability to repay, 24 CFR 203.32(c).

Specific underwriting guidance, including factors for consideration, are found in HUD Handbook 4151.1, Mortgage Credit Analysis for Mortgage Insurance (October 18, 2010). Factors examined include factors similar to the factors stated in section 129C(a)(3) of the Dodd-Frank Act, 15 U.S.C. 1639c(a)(3). These include current income and expected income that the consumer is reasonably assured of receiving (Handbook 4155.1 chapter 4, sections D and E); debt obligations (as part of credit review in chapter 4, section C); debt-to-income ratio (chapter 4, section C); and employment (chapter 4, section D). The preamble to the CFPB's QM rule also includes alimony and child support obligations (78 FR 6408, January 30, 2013; see HUD Handbook 4155.1 at chapter 4, section C, page 18), and monthly payments on the current transaction, any mortgage-related loans, and simultaneous loans (Id.; see also chapter 5, section C, page 4 of the Handbook, stating that "The monthly payments under the insured mortgage and second lien, plus housing expense and other recurring charges, cannot exceed the borrower's ability to repay"). Thus, in large part, the requirements of Dodd-Frank and the CFPB's rule are closely aligned with HUD's existing mortgage insurance and loan guarantee programs. HUD has required verification of income on all loans and full documentation.

The one area where HUD's past practice differs from this rule is in the area of points and fees. HUD has chosen to follow the CFPB's cap of 3 percent on points and fees combined, whereas previously points and fees would be individually negotiated. As to points, generally this refers to points charged against interest, so that a higher up-front payment results in a lower interest rate, or vice-versa. Origination points and fees, although there is no firm cap for HUD-insured mortgages, fees are currently 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 (24 CFR 203.27(a)).

As the market adopts 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. 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.

As an insurer or guarantor of a loan, it is equally important to note that HUD has long had ability to repay requirements. As an insurer or guarantor of a loan, it is important for HUD to have its lenders ensure, to the best of their ability and consistent with HUD requirements, that a borrower is capable of repaying a mortgage or loan insured or guaranteed by HUD. If the borrower defaults and is unable to continue to make payments then HUD must pay the lender's claim. To this point, HUD's insurance and loan guarantee programs are statutorily exempt from the credit risk retention requirements of section 15G of the Securities and Exchange Act of 1934, as added by the Dodd-Frank Act. The statute provides that qualified residential mortgages are exempt from credit risk retention requirements and included HUD as one of the Federal agencies to define what is meant by a qualified residential mortgage. HUD's handbook 4155.1 (Mortgage Credit Analysis for Mortgage Insurance) was included by the Federal agencies charged with promulgating rules to implement the credit risk retention requirements as an appendix to the agencies' proposed rule published on April 29, 2011 (see 76 FR 24090 at 24173) for the purpose of determining and verifying, among other things, borrower funds to close, borrower's monthly household debt, total monthly debit and monthly gross, income. (See 76 FR 24119.) Given

HUD's longstanding ability to repay requirements, the transition to QM requirements is not a significant change as it is for conventional mortgages.

However, with the CFPB's QM final regulations now in place, conventional mortgages will now meet ability to repay requirements following similar underwriting guidelines long used by HUD. Since FHA-approved lenders also originate conventional mortgages, the establishment of ability to repay requirements for conventional mortgages adds more consistency in the mortgage market overall; that is, conventional mortgages will be originated based on underwriting guidelines similar to those long in use by HUD and other Federally-insured or guaranteed mortgages. Such consistency will further reduce burden on lenders, large and small.

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. Notwithstanding HUD's determination that this rule would not have a significant effect on a substantial number of small entities, HUD specifically invites comments regarding any less burdensome alternatives to this rule that will meet HUD's objectives as described in the preamble to this rule.

Environmental Impact

A Finding of No Significant Impact (FONSI) with respect to the environment has been made 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)). The FONSI 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 toll-free Federal Relay Service at 800–877–8339.

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 proposed rule would not have federalism implications and would 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 proposed rule would 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 are 14.865, and for the Section 184A Loan Guarantees are 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 proposes to amend 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 amended 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 read as follows:

§ 201.7 Qualified Mortgage.

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

PART 203 – SINGLE FAMILY MORTGAGE INSURANCE

3. The authority citation for part 203 is amended 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.

(b) Qualified Mortgage. (1) Limit. For a single-family mortgage to be insured under the National Housing Act (12 U.S.C. 1701 et seq.), except for Home Equity Conversion Mortgages under section 255 of the National Housing Act (12 U.S.C. 1715z–20) and mortgages under section 2 of Title I of the National Housing Act (12 U.S.C. 1703), 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 regulations at 12 CFR 1026.43(e)(3), or successor regulation.

(2) Rebuttable presumption qualified mortgage. (i) A single-family mortgage insured under the National Housing Act (12 U.S.C. 1701 et seq.), except for Home Equity Conversion Mortgages under section 255 of the National Housing Act (12 U.S.C. 1715z–20) and mortgages under section 2 of Title I of the National Housing Act (12 U.S.C. 1703), 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 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, mortgagor’s monthly payment on any simultaneous loans, and the mortgagor’s 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.

(3) Safe harbor qualified mortgage. (i) A mortgage that is insured under section 2, Title I of the National Housing Act (12 U.S.C. 1703) 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 the National Housing Act (12 U.S.C. 1701 et seq.), except for Home Equity Conversion Mortgages under section 255 of the National Housing Act (12 U.S.C. 1715z–20), 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).

PART 1005 – LOAN GUARANTEES FOR INDIAN HOUSING

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

AUTHORITY: 12 U.S.C. 175z-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 insured under section 184 of the Housing and Community Development Act of 1992 (12 U.S.C. 1715z-13a) 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 amended to read as follows:

AUTHORITY: 12 U.S.C. 175z-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 insured under section 184A of the Housing and Community Development Act of 1992 (1715z-13b) is a safe harbor qualified mortgage that meets the ability to repay requirements in 15 U.S.C. 1639c(a).

Dated: September 12, 2013

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Shaun Donovan, Secretary

[FR-5707-P-01]