



## CFPB Finalizes Additional Amendments to Rules Governing Ability-to Repay and Mortgage Servicing Standards

### Executive Summary

The Bureau of Consumer Financial Protection (“CFPB” or “Bureau”) released a final rule on July 10, 2013 that imposes additional amendments to its January 2013 final rule implementing the Ability-to-Repay (ATR) and Qualified Mortgage (QM) provisions (ATR/QM Rule) of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (the “Dodd-Frank Act”) as well as its January 2013 Mortgage Servicing Standards rules and its January 2013 Escrows Rules. In general, the amendments (referred to as the July Final Rules) clarify, correct or amend provisions that address:

- The determination of debt and income for purposes of originating QMs;
- The use of government-sponsored enterprise (GSE) and Federal agency purchase, guarantee or insurance eligibility for determining QM status;
- The relationship of Regulation X’s (*Real Estate Settlement Procedures Act* – RESPA) servicing provisions to State law;
- Implementation dates for adjustable-rate mortgage (ARM) disclosures;
- The small servicer exemption from certain of the new servicing rules; and
- Exclusions from the repayment ability and prepayment penalty requirements for higher-priced mortgage loans (HPMLs).

The July Final Rules become effective on January 10, 2014 except for the clarification under the Escrows Rules provisions, which become effective upon publication.

### Background

The CFPB’s ATR/QM Rule amends Regulation Z to generally prohibit a creditor from making certain residential mortgage loans unless the creditor makes a reasonable and good faith determination, based on verified and documented information, that the consumer will have a reasonable ability to repay the loan, including any mortgage-related obligations, such as property taxes. (Please refer to Regulatory Practice Letter 13-05 for additional information.) In May 2013, the CFPB amended the ATR/QM Rule to: exempt certain nonprofit creditors and certain homeownership stabilization programs from the ATR/QM Rule; add a new QM category for certain loans made and held in portfolio by small creditors; and, change the calculation of loan originator compensation that must be included in “points and fees” under the ATR/QM Rule. (Please refer to Regulatory Practice Letter 13-12 for additional information.)

The CFPB's Mortgage Servicing Standards rules amend Regulation X, which implements the *Real Estate Settlement Procedures Act* ("RESPA"), and Regulation Z, which implements the *Truth-in-Lending Act*, consistent with the Dodd-Frank Act requirements to address, among other things: handling customer accounts (such as crediting payments), correcting errors, interacting with customers, evaluating borrowers' foreclosure options, interest rate changes, force-placed insurance and avoiding foreclosure. (Please refer to Regulatory Practice Letter 13-04 for additional information.)

The CFPB's Escrow Rule amends Regulation Z to implement provisions of the Dodd-Frank Act relative to escrow accounts for closed-end mortgage loans secured by a first lien on a primary dwelling that are HPMLs, including the minimum term of a mandatory escrow account. The Escrows Rule became effective June 1, 2013. (Please refer to Regulatory Practice Letter 13-07 for additional information.) It was subsequently amended in May 2013 to clarify how to determine whether a county is considered "rural" or "underserved" for the application of the escrows requirement and to establish a temporary provision to ensure that certain protections remain in place for HPMLs between the June 1, 2013 effective date of the Escrows Rule and the January 2014 effective date of the ATR/QM Rule.

## Description

The July Final Rule provides the following revisions to clarify, correct or amend the Bureau's January 2013 final rules governing Ability-to-Repay and Qualified Mortgages and Mortgage Servicing Standards.

### Ability-to-Repay and Qualified Mortgage

Revisions to the ATR/QM rule include:

- Amendments to Appendix Q of Regulation Z related to calculation of the borrower's debt-to-income ratio, including provisions related to:
  - Stability of income and the requirement to analyze the probability of the consumer's continued employment. Creditors may now assume that employment is ongoing if the current employer does not indicate that the employment has or will terminate. Reliance on training, education, and qualifications for the job has been removed.
  - Salary, wage, and other forms of consumer income. Creditors must determine that a consumer's income level can "reasonably be expected to continue" and may consider the income will reasonably be expected to continue in the absence of an employer indication that employment has or will terminate. The three-year timeframe has been removed.
  - Analysis of overtime and bonus income. Creditors are permitted to use overtime and bonus income in the calculation if the consumer has received the income for two years and the loan documentation does not indicate the income will cease.
  - Social Security income. Creditors need only obtain a benefit verification letter from the Social Security Administration.
  - Self-employment income. Requirements to analyze sources of income, obtain business credit reports for certain corporations, and evaluate the general business outlook for similar businesses have been removed.
  - Non-employment income. The final rule amends provisions related to the analysis of trust income and notes receivable.

- Rental income. The prohibition on the acceptability of income from occupants of the consumer's primary residence has been removed. Rental income must be reflected on the consumer's tax return to be considered for loan underwriting.
- Clarifications for determining QM status for loans that are eligible for purchase, guarantee, or insurance by the GSEs or Federal agencies, including:
  - Matters wholly unrelated to ability to repay will not be relevant to determination of QM status (such as matters wholly unrelated to credit risk or underwriting of the loan).
  - Loans that meet eligibility requirements provided in a written agreement with one of the GSEs or Federal agencies will be considered to be eligible for QM status.
  - A creditor relying on approval through an automated underwriting system to establish QM status must also meet the conditions on approval that are generated by that same system.

## Mortgage Servicing Standards

Revisions to the Mortgage Servicing Standards rule include:

- Clarification that RESPA and the CFPB's regulations do not preempt servicing regulations by the States, except to the extent of any inconsistency. However, State laws or regulations that provide the consumer greater protection are not inconsistent with, and are not preempted by, RESPA or Regulation X.
- Clarification of the implementation dates for certain ARM provisions. In particular, the CFPB states that the servicers are not required to comply with the rules until the January 10, 2014 effective date, such that:
  - Notices of the first interest rate reset that are required to be provided to the consumer between 210 and 240 days in advance of the scheduled reset will not be required when such payment is due 209 or fewer days from the effective date. However, payments due 210 or more days from the effective date are subject to the rule.
  - Notices of rate changes after the first interest rate reset that are required to be provided to the consumer between 60 and 120 days in advance of the scheduled reset will not be required when such payment is due 25 to 59 days from the effective date.
- Clarification of the scope and application of the exemption for small servicers under the periodic statement rules set forth in Regulation Z.
  - A small servicer is a servicer that 1) together with affiliates services 5,000 or fewer mortgage loans, for all of which the servicer or an affiliate is the creditor or assignee, or 2) is a Housing Finance Agency as defined in the rule.
  - Three types of mortgage loans are not considered when determining small servicer status: mortgage loans voluntarily serviced for an unaffiliated entity without remuneration, reverse mortgages, and mortgage loans secured by a consumer's interest.
  - Mortgage loans are defined as closed-end consumer credit transactions secured by a dwelling – they do not have to be "Federally-related."

## Escrows Rules

The July Final Rule clarifies that construction and bridge loans and reverse mortgages are not subject to the CFPB's requirements regarding ability to repay and prepayment penalties for higher-priced mortgage loans under Regulation Z during the interim period June 1, 2013 and January 10, 2014, or thereafter.

The July Final Rule amendments generally become effective January 10, 2014 except for the clarification under the Escrows Rules provisions, which become effective upon publication.

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## Commentary

With the release of the January 2013 mortgage rules, the CFPB announced that it was committed to working with the industry to ensure compliance with the new requirements. These efforts have included amendments to clarify or correct rules (such as the amendments addressed in this Regulatory Practice Letter), as well as the publication of compliance guides, readiness guides (such as readiness questionnaires and frequently asked questions), consumer education materials and outreach campaigns, and updated supervision and examination guidance and procedures. The CFPB has created a Regulatory Implementation site dedicated to the new mortgage rules and related information.

For mortgage servicers, the new requirements will have major operational impacts on technology, staffing and training, loss mitigation, and compliance and will likely result in enforcement costs unless they are able to design and implement effective risk identification and mitigation strategies immediately. Smaller institutions, new mortgage servicers, or non-bank servicers unfamiliar with Federal supervision need to determine where to begin, what to prioritize, and how to implement the required compliance measures.

Mortgage servicers can efficiently manage the challenges of the CFPB's modifications to Regulation X and Regulation Z by gearing up efforts in three areas:

- Augmenting existing technology systems to generate the enhanced billing statements and support the organization's compliance management and monitoring processes
- Instituting better practices for managing mortgage defaults, communicating with borrowers about potential mitigation strategies and options, and providing the mandated continuity of contact
- Organizing governance and monitoring processes to verify the effectiveness of the revised or new internal procedures and controls. Servicers will need to understand that compliance with Regulations X and Z is not a one-time event, and that monitoring effectiveness will need to be integrated into their daily operations.

Mortgage originators and servicers must ensure they have a comprehensive and integrated compliance management system (CMS) that is organization-wide and communicates expectations to employees and third-party vendors. Before instituting a compliance program improvement initiative, an institution should first perform a diagnostic or risk assessment exercise to evaluate the current operating environment specific to regulatory compliance and operating controls. The assessment will help

the firm to manage and prioritize the roadmap for controls necessary for compliance monitoring and to enhance procedures for limiting risk to the firm. Trying to address each new requirement separately by adding patches to the organization's existing compliance structure can be expensive, and can create an IT infrastructure that is often needlessly complex and difficult to manage.

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