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Amendments Relating to Small Creditors and Rural or Underserved Areas Under the Truth in Lending Act (Regulation Z); Rules

BUREAU OF CONSUMER FINANCIAL PROTECTION

12 CFR Part 1026

[Docket No. CFPB–2015–0004]

RIN 3170–AA43

Amendments Relating to Small Creditors and Rural or Underserved Areas Under the Truth in Lending Act (Regulation Z)

AGENCY: Bureau of Consumer Financial Protection.

ACTION: Final rule; official interpretations.

SUMMARY: The Bureau of Consumer Financial Protection (Bureau) is amending certain mortgage rules issued by the Bureau in 2013. This final rule revises the Bureau's regulatory definitions of small creditor, and rural and underserved areas, for purposes of certain special provisions and exemptions from various requirements provided to certain small creditors under the Bureau's mortgage rules.

DATES: This final rule is effective on January 1, 2016. For additional discussion regarding the effective date of the rule see part VI of the **SUPPLEMENTARY INFORMATION** below.

FOR FURTHER INFORMATION CONTACT: Jeffrey Haywood, Paralegal Specialist; Nicholas Hluchyj, Senior Counsel, or Paul Ceja, Senior Counsel and Special Advisor, Office of Regulations, at (202) 435–7700.

SUPPLEMENTARY INFORMATION:

I. Summary of the Final Rule

In January 2013, the Bureau issued several final rules concerning mortgage markets in the United States (2013 Title XIV Final Rules), pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Public Law 111–203, 124 Stat. 1376 (2010).[1] The Bureau has clarified and revised those rules over the past two years. The purpose of those updates was to address important questions raised by industry, consumer groups, or other stakeholders. The Bureau also indicated that it would revisit the Bureau's regulatory definitions of small creditor and rural and underserved areas, promulgated in those rules and related amendments, through study and possibly through additional rulemaking.

To that end, on January 29, 2015, the Bureau proposed several amendments to its 2013 Title XIV Final Rules to revise Regulation Z provisions and official interpretations relating to escrow requirements for higher-priced mortgage loans under the Bureau's January 2013 Escrows Final Rule and ability-to-repay/qualified mortgage requirements under the Bureau's January 2013 ATR Final Rule and May 2013 ATR Final Rule. The Bureau's proposal would also affect requirements under the Bureau's 2013 HOEPA Final Rule.[2] The proposed rule was published in the **Federal Register** on February 11, 2015. *See* Amendments Relating to Small Creditors and Rural or Underserved Areas Under the Truth in Lending Act (Regulation Z), 80 FR 7769 (Feb. 11, 2015).

This final rule adopts, with some additional clarifications and technical revisions, the Bureau's proposed rule. It reflects feedback received from stakeholders through this notice and comment rulemaking regarding the Bureau's definitions of small creditor, and rural and underserved areas, as those definitions relate to special provisions and certain exemptions to requirements provided to small creditors under the Bureau's 2013 Title XIV Final Rules and updates.

Specifically, the final rule makes the following changes with regard to the definitions of small creditor and rural and underserved areas as currently provided in the Bureau's mortgage rules: [3]

- Raises the loan origination limit for determining eligibility for small-creditor status from 500 originations of covered transactions secured by a first lien, to 2,000 such originations (referred to in this rule as ''extensions of covered transactions''), and excludes originated loans held in portfolio by the creditor and its affiliates from that limit. The final rule also establishes a grace period from calendar year to calendar year to allow a creditor that exceeded the origination limit in the preceding calendar year to operate, in certain circumstances, as a small creditor with respect to transactions with applications received before April 1 of the current calendar year.
- Includes in the calculation of the $2 billion asset limit for small-creditor status the assets of the creditor's affiliates that regularly extended covered transactions. The final rule also adds a grace period to the annual asset limit, to allow a creditor that exceeded the asset limit in the preceding calendar year to operate, in certain circumstances, as a small creditor with respect to transactions with applications received before April 1 of the current calendar year.
- Adjusts the time period used in determining whether a creditor is operating predominantly in rural or underserved areas from any of the three preceding calendar years to the preceding calendar year. As with the origination and asset limits for small-creditor status, the final rule adds a grace period to allow a creditor that fails to meet this threshold in the preceding calendar year, to continue operating, in certain circumstances, as if it had met this threshold with respect to transactions with applications received before April 1 of the current calendar year.
- Amends the current exemption under § 1026.35(b)(2)(iii)(D)(*1*) provided to small creditors that operate predominantly in rural or underserved areas from the requirement for the establishment of escrow accounts for higher-priced mortgage loans. The final rule ensures that creditors who established escrow accounts solely to comply with the current rule will be eligible for the exemption if they meet the expanded definitions of small creditors operating predominantly in rural or underserved areas under the final rule.
- Expands the definition of ''rural'' by adding census blocks that are not in an urban area as defined by the U.S. Census Bureau (Census Bureau) to the current county-based definition.
- Conforms the definition of ''underserved'' to the proposals discussed above. The substance of the ''underserved'' definition is not changed.
- Adds two new safe harbor provisions related to the rural or underserved definition for creditors that rely on automated tools provided: (1) On the Bureau's Web site to allow creditors to determine whether

[1] Specifically, on January 10, 2013, the Bureau issued Escrow Requirements Under the Truth in Lending Act (Regulation Z), 78 FR 4725 (Jan. 22, 2013) (January 2013 Escrows Final Rule), High-Cost Mortgage and Homeownership Counseling Amendments to the Truth in Lending Act (Regulation Z) and Homeownership Counseling Amendments to the Real Estate Settlement Procedures Act (Regulation X), 78 FR 6855 (Jan. 31, 2013) (2013 HOEPA Final Rule), and Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act (Regulation Z), 78 FR 6407 (Jan. 30, 2013) (January 2013 ATR Final Rule). The Bureau concurrently issued a proposal to amend the January 2013 ATR Final Rule, which was finalized on May 29, 2013. *See* 78 FR 6621 (Jan. 30, 2013) (January 2013 ATR Proposal) and 78 FR 35429 (June 12, 2013) (May 2013 ATR Final Rule). On January 17, 2013, the Bureau issued the Real Estate Settlement Procedures Act (Regulation X) and Truth in Lending Act (Regulation Z) Mortgage Servicing Final Rules, 78 FR 10901 (Feb. 14, 2013) (Regulation Z) and 78 FR 10695 (Feb. 14, 2013) (Regulation X). On January 18, 2013, the Bureau issued the Disclosure and Delivery Requirements for Copies of Appraisals and Other Written Valuations Under the Equal Credit Opportunity Act (Regulation B), 78 FR 7215 (Jan. 31, 2013) and, jointly with other agencies, issued Appraisals for Higher-Priced Mortgage Loans, 78 FR 10367 (Feb. 13, 2013) (January 2013 Interagency Appraisals Final Rule). On January 20, 2013, the Bureau issued the Loan Originator Compensation Requirements under the Truth in Lending Act (Regulation Z), 78 FR 11279 (Feb. 15, 2013).

[2] The January 2013 Interagency Appraisals Final Rule provides an exemption from the requirement to obtain a second appraisal for certain higher-priced mortgage loans if the loan is secured by a property in a ''rural county.'' This final rule will not affect the scope of that exemption because it will not change the counties that are defined as ''rural'' under § 1026.35(b)(2)(iv)(A).

[3] *See* §§ 1026.35(b)(2)(iii)(A), (B), (C), and (D), and 1026.35(b)(2)(iv)(A) and (B) and commentary, cross-referenced in §§ 1026.43(e)(5) and (e)(6), 1026.43(f)(1) and (f)(2) and commentary; and § 1026.32(d)(1)(ii)(C)).

properties are located in rural or underserved areas, or (2) on the Census Bureau's Web site to assess whether a particular property is located in an urban area according to the Census Bureau's definition. The final rule maintains the current safe harbor for lists of rural and underserved counties provided by the Bureau, with technical changes. The final rule also adds commentary clarifying the circumstances under which U.S. territories will be included on the lists.

- Extends the current two-year transition period, which allows certain small creditors to make balloon-payment qualified mortgages (§ 1026.43(e)(6)) and balloon-payment high-cost mortgages (§ 1026.32(d)(1)(ii)(C)), regardless of whether they operate predominantly in rural or underserved areas. The transition period will include covered transactions for which the application was received before April 1, 2016, rather than covered transactions consummated on or before January 10, 2016.

In addition to the changes discussed above to the definitions of small creditor and rural and underserved areas, this final rule is also making a technical correction to the commentary to § 1026.36(a). This non-substantive change is discussed in the section-by-section analysis of the supplementary information section below.

II. Background

In response to an unprecedented cycle of expansion and contraction in the mortgage market that sparked the most severe U.S. recession since the Great Depression, Congress passed the Dodd-Frank Act, which was signed into law on July 21, 2010. In the Dodd-Frank Act, Congress established the Bureau and generally consolidated the rulemaking authority for Federal consumer financial laws, including the Truth in Lending Act (TILA) and the Real Estate Settlement Procedures Act, in the Bureau.[4] At the same time, Congress significantly amended the statutory requirements governing mortgage practices, with the intent to restrict the practices that contributed to and exacerbated the crisis.[5]

Under the statute, most of these new requirements would have taken effect automatically on January 21, 2013 if the Bureau had not issued implementing regulations by that date.[6] To avoid uncertainty and potential disruption in the national mortgage market at a time of economic vulnerability, the Bureau issued several final rules (the 2013 Title XIV Final Rules) in a span of less than two weeks in January 2013 to implement these new statutory provisions and provide for an orderly transition. These final rules include the January 2013 ATR Final Rule, the January 2013 Escrows Final Rule, the 2013 HOEPA Final Rule, and the January 2013 Interagency Appraisals Final Rule. Most of the mortgage rules released in January 2013 became effective on January 10, 2014.

Concurrent with the January 2013 ATR Final Rule, on January 10, 2013, the Bureau issued the January 2013 ATR Proposal, which the Bureau adopted on May 29, 2013 in the May 2013 ATR Final Rule.[7] The Bureau has issued additional corrections, revisions, and clarifications to the provisions adopted by the Bureau in the 2013 Title XIV Final Rules and the May 2013 ATR Final Rule over the past two years.[8] This final rule concerns additional revisions to the 2013 Title XIV Final Rules related to provisions regarding small creditors and rural and underserved areas.

III. Summary of the Rulemaking Process

On January 29, 2015, the Bureau issued, and on February 11, 2015, published in the **Federal Register**, its proposed rule entitled ''Amendments Relating to Small Creditors and Rural or Underserved Areas Under the Truth in Lending Act (Regulation Z).'' [9] The comment period closed on March 30, 2015. In response to the proposal, the Bureau received 90 comments from consumer groups, members of Congress, creditors, industry trade associations, and others. As discussed in more detail below, the Bureau has considered these comments in adopting this final rule.

IV. Legal Authority

The Bureau is issuing this final rule pursuant to its authority under TILA and the Dodd-Frank Act. Section 1061 of the Dodd-Frank Act transferred to the Bureau the ''consumer financial protection functions'' previously vested in certain other Federal agencies, including the Board of Governors of the Federal Reserve System (Board). The term ''consumer financial protection function'' is defined to include ''all authority to prescribe rules or issue orders or guidelines pursuant to any Federal consumer financial law, including performing appropriate functions to promulgate and review such rules, orders, and guidelines.'' [10] Title X of the Dodd-Frank Act, including section 1061 of the Dodd-Frank Act, along with TILA and certain subtitles and provisions of title XIV of the Dodd-Frank Act, are Federal consumer financial laws.[11]

A. TILA-Specific Statutory Grants of Authority

TILA as amended by the Dodd-Frank Act provides two specific statutory bases for the changes in the Bureau's final rule. TILA section 129D(c) authorizes the Bureau to exempt, by regulation, a creditor from the requirement (in section 129D(a)) that escrow accounts be established for higher-priced mortgage loans if the creditor operates predominantly in rural

[4] *See, e.g.,* sections 1011 and 1021 of the Dodd-Frank Act, 12 U.S.C. 5491 and 5511 (establishing and setting forth the purpose, objectives, and functions of the Bureau); section 1061 of the Dodd-Frank Act, 12 U.S.C. 5581 (consolidating certain rulemaking authority for Federal consumer financial laws in the Bureau); section 1100A of the Dodd-Frank Act (codified in scattered sections of 15 U.S.C.) (similarly consolidating certain rulemaking authority in the Bureau). *But see* Section 1029 of the Dodd-Frank Act, 12 U.S.C. 5519 (subject to certain exceptions, excluding from the Bureau's authority any rulemaking authority over a motor vehicle dealer that is predominantly engaged in the sale and servicing of motor vehicles, the leasing and servicing of motor vehicles, or both).

[5] *See* title XIV of the Dodd-Frank Act, Public Law 111–203, 124 Stat. 1376 (2010) (codified in scattered sections of 12 U.S.C., 15 U.S.C., and 42 U.S.C.).

[6] *See* section 1400(c) of the Dodd-Frank Act, 15 U.S.C. 1601 note.

[7] 78 FR 6621 (Jan. 30, 2013); 78 FR 35429 (June 12, 2013) (providing a two-year transition period during which small creditors that do not operate predominantly in rural or underserved areas can offer balloon-payment qualified mortgages if they hold the loans in portfolio). In May 2013, the Bureau also finalized amendments to the January 2013 Escrows Final Rule. Amendments to the 2013 Escrows Final Rule under the Truth in Lending Act (Regulation Z), 78 FR 30739 (May 23, 2013) (May 2013 Escrows Final Rule).

[8] *See, e.g.,* 78 FR 44685 (July 24, 2013) (clarifying, among other things, which mortgages to consider in determining small servicer status and the application of the small servicer exemption with regard to servicer/affiliate and master servicer/subservicer relationships); 78 FR 45842 (July 30, 2013); 78 FR 60382 (Oct. 1, 2013) (revising, among other things, two exceptions available to small creditors operating predominantly in ''rural'' or ''underserved'' areas, pending the Bureau's reexamination of the underlying definitions); 78 FR 62993 (Oct. 23, 2013) (clarifying the specific disclosures that must be provided before counseling for high cost mortgages can occur and proper compliance regarding servicing requirements when a consumer is in bankruptcy or sends a cease communication request under the Fair Debt Collection Practice Act). In the fall of 2014, the Bureau also made further amendments to the 2013 mortgage rules related to nonprofit entities and provided a cure mechanism for the points and fees limit that applies to qualified mortgages. 79 FR 65300 (Nov. 3, 2014).

[9] 80 FR 7769 (February 11, 2015).

[10] Dodd-Frank Act section 1061(a)(1)(A), 12 U.S.C. 5581(a)(1)(A).

[11] Dodd-Frank Act section 1002(14), 12 U.S.C. 5481(14) (defining ''Federal consumer financial law'' to include the ''enumerated consumer laws,'' the provisions of title X of the Dodd-Frank Act, and the laws for which authorities are transferred under title X subtitles F and H of the Dodd-Frank Act); Dodd-Frank Act section 1002(12), 12 U.S.C. 5481(12) (defining ''enumerated consumer laws'' to include TILA); Dodd-Frank section 1400(b), 12 U.S.C. 5481(12) note (defining ''enumerated consumer laws'' to include certain subtitles and provisions of Dodd-Frank Act title XIV).

or underserved areas, retains its mortgage loans in portfolio, does not exceed (together with all affiliates) a total annual mortgage loan origination limit set by the Bureau, and meets any asset size threshold, and any other criteria, the Bureau may establish. TILA section 129C(b)(2)(E) authorizes the Bureau to provide, by regulation, that certain balloon-payment mortgages originated by small creditors receive qualified mortgage status, even though qualified mortgages are otherwise prohibited from having balloon-payment features. The creditor qualifications under TILA section 129C(b)(2)(E)(iv) are essentially the same as those for the higher-priced mortgage loan escrow exemption, including operating predominantly in rural or underserved areas, together with all affiliates not exceeding a total annual mortgage loan origination limit set by the Bureau, retaining the balloon-payment loans in portfolio, and meeting any asset size threshold, and any other criteria, the Bureau may establish.

B. Other Rulemaking and Exception Authority

This final rule also relies on other rulemaking and exception authorities specifically granted to the Bureau by TILA and the Dodd-Frank Act, including the authorities discussed below.

Truth in Lending Act

As amended by the Dodd-Frank Act, section 105(a) of TILA authorizes the Bureau to prescribe regulations to carry out the purposes of TILA. 15 U.S.C. 1604(a). Under section 105(a), such regulations may contain such additional requirements, classifications, differentiations, or other provisions, and may provide for such adjustments and exceptions for all or any class of transactions, as in the judgment of the Bureau are necessary or proper to effectuate the purposes of TILA, to prevent circumvention or evasion thereof, or to facilitate compliance therewith. A purpose of TILA is ''to assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit.'' TILA section 102(a), 15 U.S.C. 1601(a). In particular, it is a purpose of TILA section 129C, as added by the Dodd-Frank Act, to assure that consumers are offered and receive residential mortgage loans on 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).

Historically, TILA section 105(a) has served as a broad source of authority for rules that promote the informed use of credit through required disclosures and substantive regulation of certain practices. Dodd-Frank Act section 1100A clarified the Bureau's section 105(a) authority by amending that section to provide express authority to prescribe regulations that contain ''additional requirements'' that the Bureau finds are necessary or proper to effectuate the purposes of TILA, to prevent circumvention or evasion thereof, or to facilitate compliance therewith. This amendment clarified the Bureau's authority under TILA section 105(a) to prescribe requirements beyond those specifically listed in the statute that meet the standards outlined in section 105(a), which include effectuating all of TILA's purposes. Therefore, the Bureau believes that its authority under TILA section 105(a) to make exceptions, adjustments, and additional provisions that the Bureau finds are necessary or proper to effectuate the purposes of TILA applies with respect to the purpose of section 129D. That purpose is to ensure that consumers understand and appreciate the full cost of homeownership. The purpose of TILA section 129D is also informed by the findings articulated in section 129B(a) that economic stabilization would be enhanced by the protection, limitation, and regulation of the terms of residential mortgage credit and the practices related to such credit, while ensuring that responsible and affordable mortgage credit remains available to consumers. *See* 15 U.S.C. 1639b(a).

TILA section 129C(b)(3)(B)(i) provides the Bureau with authority to prescribe regulations that revise, add to, or subtract from the criteria that define a qualified mortgage upon a finding that such regulations are necessary or proper to ensure that responsible, affordable mortgage credit remains available to consumers in a manner consistent with the purposes of the ability-to-repay requirements; are necessary and appropriate to effectuate the purposes of the ability-to-repay and residential mortgage loan origination requirements; prevent circumvention or evasion thereof; or facilitate compliance with TILA sections 129B and 129C. 15 U.S.C. 1639c(b)(3)(B)(i). In addition, TILA section 129C(b)(3)(A) requires the Bureau to prescribe regulations to carry out such purposes. 15 U.S.C. 1639c(b)(3)(A).

TILA section 105(a) grants the Bureau authority to make adjustments and exceptions to the requirements of TILA for all transactions subject to TILA, except with respect to the substantive provisions of TILA section 129 that apply to high-cost mortgages. With respect to the high-cost mortgage provisions of TILA section 129, TILA section 129(p), 15 U.S.C. 1639(p), as amended by the Dodd-Frank Act, grants the Bureau authority to create exemptions to the restrictions on high-cost mortgages and to expand the protections that apply to high-cost mortgages. Under TILA section 129(p)(1), the Bureau may exempt specific mortgage products or categories from any or all of the prohibitions specified in TILA section 129(c) through (i), if the Bureau finds that the exemption is in the interest of the borrowing public and will apply only to products that maintain and strengthen homeownership and equity protections. Among these referenced provisions of TILA is section 129(e), the prohibition on balloon payments for high-cost mortgages.

The Dodd-Frank Act

Section 1022(b)(1) of the Dodd-Frank Act authorizes the Bureau to prescribe rules ''as may be necessary or appropriate to enable the Bureau to administer and carry out the purposes and objectives of the Federal consumer financial laws, and to prevent evasions thereof.'' 12 U.S.C. 5512(b)(1). TILA and title X and certain enumerated subtitles and provisions of title XIV of the Dodd-Frank Act are Federal consumer financial laws. Accordingly, the Bureau is exercising its authority under Dodd-Frank Act section 1022(b) to issue rules that carry out the purposes and objectives of TILA, title X of the Dodd-Frank Act, and certain enumerated subtitles and provisions of title XIV of the Dodd-Frank Act, and to prevent evasion of those laws.

V. Section-by-Section Analysis of the Proposed Rule

Section 1026.35 Requirements for Higher-Priced Mortgage Loans

35(b) Escrow Accounts

35(b)(2) Exemptions

35(b)(2)(iii)

Section 1026.35(b)(2)(iii) currently provides that an escrow account need not be established for a higher-priced mortgage loan by small creditors who operate predominantly in rural or underserved areas if four conditions identified in § 1026.35(b)(2)(iii)(A) through (D) are satisfied at the time of consummation.[12] Section

[12] Section 1026.35(b)(2)(v) excludes from the § 1026.35(b)(2)(iii) exception any first-lien higher-

1026.35(b)(2)(iii)(A) provides a test for determining whether a creditor operates predominantly in rural or underserved areas; § 1026.35(b)(2)(iii)(B) sets an origination limit for small creditor status; § 1026.35(b)(2)(iii)(C) sets an asset limit for small creditor status; and § 1026.35(b)(2)(iii)(D) does not allow an exemption from the escrow requirement for creditors with existing escrow accounts, with certain exceptions. The Bureau proposed to make amendments to all of these conditions and, as discussed below, is adopting these amendments with some clarifications in this final rule.

Because the predominantly-rural-or-underserved test and the origination and asset limits of § 1026.35(b)(2)(iii) are cross-referenced in the Bureau's January 2013 ATR Final Rule and its 2013 HOEPA Final Rule, and amendments to those rules, they also affect eligibility for special provisions and exemptions provided in those rules, including the following:

- A qualified mortgage definition for certain loans made and held in portfolio (small creditor portfolio loans), by small creditors regardless of whether they operate predominantly in rural or underserved areas. These loans are not subject to the 43 percent debt-to-income ratio limit (or to ''appendix Q'' requirements in determining the debt and income of consumers) that applies to general qualified mortgage loans under § 1026.43(e)(2) (§ 1026.43(e)(5)). A first-lien qualified mortgage under this category also provides a safe harbor from ability-to-repay claims, if the mortgage's annual percentage rate (APR) does not exceed the applicable Average Prime Offer Rate (APOR) by 3.5 or more percentage points. In contrast, general qualified mortgage loans under § 1026.43(e)(2) provide safe harbors if their APRs do not exceed the applicable APOR by 1.5 or more percentage points.[13]
- Two qualified mortgage definitions for small creditors making certain balloon-payment loans. One is a permanent definition for small creditors operating predominantly in rural or underserved areas. The other is a temporary definition for small creditors who do not operate predominantly in such areas. These definitions provide an exception from the limitation on balloon-payment features on general qualified mortgage loans (§ 1026.43(e)(6) and (f)).[14] These two qualified mortgage definitions are also subject to a higher APR threshold for defining a higher-priced covered transaction, allowing small creditors of such qualified mortgages to receive a safe harbor under the Bureau's ability-to-repay rule.
- An exception from the prohibition on balloon-payment features for certain high-cost mortgages (§ 1026.32(d)(1)(ii)(C))—also on a permanent basis for small creditors operating predominantly in rural or underserved areas and a temporary basis for small creditors who do not operate predominantly in such areas.[15]

The Bureau adopted these special provisions and exemptions for small creditors because of the important role that small creditors play in providing mortgage credit to consumers. The Bureau believes that many small creditors use a lending model based on maintaining ongoing relationships with their customers and often limit their lending activities to a single community. They therefore may have a more comprehensive understanding of the financial circumstances of their customers and of the economic and other circumstances of that community.[16] The special provisions and exemptions facilitate the ability of small creditors that operate predominantly in rural or underserved areas, as well as small creditors that operate in areas that are neither rural nor underserved, to provide access to mortgage credit for consumers they serve.

35(b)(2)(iii)(A)

As discussed in detail below, the Bureau is adopting § 1026.35(b)(2)(iii)(A) substantially as proposed, with certain minor changes to enhance clarity. Accordingly, this final rule restores the one-year lookback period for determining whether the creditor is operating predominantly in rural or underserved areas as originally adopted by the January 2013 Escrows Final Rule. This final rule also adopts the proposed grace period that allows a creditor making a higher-priced mortgage loan based on an application received before April 1 to rely on its transactions from either the preceding calendar year or the next-to-last calendar year to meet the condition in § 1026.35(b)(2)(iii)(A).

The Bureau's Proposal

The current test under § 1026.35(b)(2)(iii)(A) for determining whether a creditor operates predominantly in rural or underserved areas is that, during any of the three preceding calendar years, the creditor extended more than 50 percent of its total first-lien covered transactions, as defined by § 1026.43(b)(1),[17] on properties that are located in counties that are either ''rural'' or ''underserved'' (the more than 50 percent test). The Bureau proposed to amend § 1026.35(b)(2)(iii)(A) and comment 35(b)(2)(iii)–1 to eliminate the three-year lookback period in § 1026.35(b)(2)(iii)(A) and to establish the preceding calendar year as the relevant time period for assessing whether the more than 50 percent test is satisfied as a general matter. The Bureau also proposed a grace period to allow otherwise eligible creditors whose first-lien covered transactions in the preceding year failed to meet the more than 50 percent test to continue to operate with the benefit of the exemption for applications received before April 1 of the current calendar year if their first-lien covered transactions during the next-to-last calendar year met the test.

The Bureau also proposed conforming and technical changes to the rule and commentary. Proposed comment 35(b)(2)(iii)–1.i was amended for consistency with the changes that the Bureau proposed to the regulation text in §§ 1026.35(b)(2)(iii)(A) and 1026.35(b)(2)(iv)(A), and to provide guidance on the one-year lookback and grace periods. The Bureau also proposed to remove from comment 35(b)(2)(iii)–1.i all discussion of the lists that the

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priced mortgage loan that, at consummation, is subject to a commitment to be acquired by a person that does not satisfy the § 1026.35(b)(2)(iii) conditions.

[13] Specifically, for purposes of determining whether a loan has a safe harbor with regard to TILA's ability-to-repay requirements (or instead is categorized as ''higher-priced'' with only a rebuttable presumption of compliance with those requirements), for first-lien covered transactions, the special qualified mortgage definitions in § 1026.43(e)(5), (e)(6) and (f) receive an APR threshold of the applicable APOR plus 3.5 percentage points, rather than plus 1.5 percentage points.

[14] Specifically these provisions allow: (1) On a permanent basis, balloon-payment qualified mortgage loans made and held in portfolio by certain small creditors operating predominantly in rural or underserved areas ((§ 1026.43(f)); and (2) for a temporary two year transition period—from January 10, 2014 to January 10, 2016—balloon-payment qualified mortgages originated by small creditors even if they do not operate predominantly in rural or underserved areas (this period is being extended under this final rule to cover transactions with applications received before April 1, 2016—*see* the section-by-section analysis below on § 1026.43(e)(6))).

[15] Specifically, this provision allows: (1) On a permanent basis, small creditors that operate predominantly in rural or underserved areas to originate high-cost loans with balloon-payment features; and (2) for loans made on or before January 10, 2016 (extended by this final rule to cover transactions with applications received before April 1, 2016), small creditors to originate high-cost mortgages with balloon-payment features even if they do not operate predominantly in rural or underserved areas, under certain conditions. *See* § 1026.32(d)(1)(ii)(C).

[16] Lending activities of many creditors that currently qualify as small are generally limited to a single community. However, creditors that will qualify as small with the adoption of the changes in this final rule generally lend and have branches (in the case of depository institutions) in several communities and counties.

[17] ''Covered transaction'' is defined in § 1026.43(b)(1) to mean a consumer credit transaction that is secured by a dwelling, as defined in § 1026.2(a)(19), including any real property attached to a dwelling, other than a transaction exempt from coverage under § 1026.43(a).

Bureau publishes of ''rural'' or ''underserved'' counties pursuant to § 1026.35(b)(2)(iv).

The Bureau invited comment on whether it should eliminate the three-year lookback period as proposed and whether it is appropriate to rely on the preceding calendar year in determining as a general matter whether the more than 50 percent test is met. The Bureau also sought feedback on whether it should provide a grace period to creditors that meet this test in one calendar year but fail to do so in the next calendar year and, if so, whether such a grace period should apply to all applications received before April 1 as proposed.

For the reasons discussed below, the Bureau is adopting § 1026.35(b)(2)(iii)(A) and the accompanying commentary as proposed, with minor technical revisions.

Comments

The Bureau received comments from national and state associations of credit unions, a national association of community banks, and state associations of banks on the proposal to use the preceding calendar year, rather than any of the three preceding calendar years, as the relevant time period for assessing whether the more than 50 percent test is satisfied and on the proposed April 1 grace period. No comments were received on the related proposed changes to the commentary.

Most of the commenters on the proposed lookback provision recommended that the Bureau maintain the three-year lookback. A national association of credit unions noted many credit unions develop their forward-looking strategies with a two- or three-year outlook and was concerned that the proposal will curtail a credit union's ability to do such planning. For the same reason, this commenter suggested extending the effective date of this rulemaking to January 1, 2017 if the three-year lookback is replaced with a one-year period. A national association and a state association of banks both noted some of their members operate close to the 50 percent threshold and that a three-year lookback would prevent these lenders from abruptly halting their loan originations should they come close to approaching the loan threshold or otherwise become concerned that they may not meet the more than 50 percent test in a given year. The state banking association recommended a six-month grace period if the Bureau adopts the one-year lookback period to allow community banks to make necessary product and system adjustments and train staff. Other commenters noted generally that the three-year lookback would provide creditors greater flexibility than a one-year period would, but provided no specific details or examples.

The majority of commenters on the proposed Apri1 1 grace period supported that provision, although a few commenters recommended extending the grace period to six months, and in one case, to one year. The commenters recommending an extension of the grace period generally cited the need for additional time to adjust systems and train staff.

Final Rule

The Bureau is finalizing § 1026.35(b)(2)(iii)(A) and its accompanying commentary generally as proposed but with minor changes to provide greater clarity.

The Bureau considered comments requesting the continuation of the three-year lookback but has not adopted this approach in the final rule. As originally adopted in the January 2013 Escrows Final Rule, § 1026.35(b)(2)(iii)(A) considered only the preceding year and established a one-year lookback period. The Bureau instituted the three-year lookback period to stabilize the escrow exemption during the period from 2013 to 2015 while the definitions were under review. 78 FR 60382, 60416 (Oct. 1, 2013). This change guaranteed eligibility for a creditor that was eligible during 2013 with respect to operating predominantly in rural or underserved areas and met the other applicable criteria through 2015. Stability in this specific period was a particular concern because during the definitional review the first year-to-year transition in the ''rural'' definition for purposes of this exemption was to coincide with the shift in the United States Department of Agriculture's Economic Research Service's (USDA–ERS) county Urban Influence Code (UIC) designations that occur once every decade.

Once the definitional review period ends, the Bureau believes that using a three-year lookback period on a permanent basis would allow creditors to maintain eligibility even if their first-lien covered transactions do not meet the more than 50 percent test in most calendar years. That result would be contrary to the goal of identifying creditors that focus their activity in rural or underserved areas.

Although the three-year lookback period provides creditors with certainty that they will be eligible for the exemption at least two years into the future, the Bureau does not believe that such extended notice will be necessary once the revisions to the definitions are effective. As explained in the section-by-section analysis of § 1026.35(b)(2)(iv)(A), below, the areas that are rural under the definition would only change once or twice a decade.[18] While the counties defined as underserved could change each year, such shifts are unlikely to affect many creditors' eligibility for the special provisions and exemptions because very few counties would be underserved but not rural under the Bureau's definitions. Furthermore, creditors can monitor the first-lien covered transactions that they originate throughout the year using the Bureau's automated tool and should generally be able to anticipate any change in their eligibility well before the end of the year. Any changes that would be made in the rural definition after each decennial census would be based on demographic shifts that have unfolded over the preceding decade and which may, in many instances, be evident to creditors serving those areas. The changes would be announced well before they become effective, allowing time for creditors to assess their status and make appropriate transitions. The Bureau therefore believes that the preceding calendar year is the appropriate time period to use as a general rule in assessing whether the more than 50 percent test is met.

The Bureau acknowledges that in some cases, a creditor could find out on or close to December 31st that it was not operating predominantly in rural or underserved areas during that calendar year. Such a creditor might have difficulty transitioning from balloon-payment loans to adjustable-rate mortgages and complying with the higher-priced mortgage loan escrow requirements by January 1 if eligibility for the special provisions and exemptions is based solely on transactions in the preceding calendar year. The Bureau therefore is adopting the proposed grace period that allows a creditor making a higher-priced mortgage loan based on an application received before April 1 to rely on its transactions from either the preceding calendar year or the next-to-last

[18] As noted in the discussion of comment 35(b)(2)(iv)–2 below, the Census Bureau released its list of urban areas based on the 2010 decennial census in 2012, and the USDA–ERS released its UIC designations based on the 2010 decennial census in 2013. If the USDA–ERS continues to incorporate decennial census results into its UIC county designations in a different year than the Census Bureau finalizes its rural-urban classification, as in 2012 and 2013, the effects of each decennial census would be incorporated into the Bureau's proposed ''rural'' definition over the course of two years, which would afford additional transition time to some of the creditors affected by the changes.

calendar year to meet the more than 50 percent test in § 1026.35(b)(2)(iii)(A).

A creditor that is otherwise eligible and that met the more than 50 percent test in calendar year one but fails to meet it in calendar year two remains eligible with respect to applications received before April 1 of calendar year three. The Bureau considered comments requesting longer grace periods of six months or one year, but the Bureau is adopting this provision as proposed. Most of the comments received favored the grace period as proposed, and the Bureau believes that a grace period of this nature facilitates the transition of creditors that no longer operate predominantly in rural or underserved areas and properly balances the importance of the substantive consumer protections provided by the higher-priced mortgage loan escrows requirement, the ability-to-repay requirement, and the high-cost mortgage requirements with concerns that have been raised regarding their potential impact on access to credit.

35(b)(2)(iii)(B)

The Bureau is adopting § 1026.35(b)(2)(iii)(B) and the accompanying commentary, substantially as proposed, with certain technical changes and commentary additions to enhance clarity, as discussed in further detail below. Accordingly, this final rule raises the origination limit for small creditor status from 500 covered transactions secured by a first-lien originated by the creditor and its affiliates, to 2,000 such loans. The final rule also excludes originated loans held in portfolio by the creditor or its affiliates from the limit. The final rule also adds a grace period to allow an otherwise eligible creditor that exceeded the origination limit in the preceding calendar year (but not in the calendar year before the preceding year) to continue to operate as a small creditor with respect to transactions with applications received before April 1 of the current calendar year.

Background—Origination Limit

As part of its rulemakings implementing title XIV of the Dodd-Frank Act, in January 2013, the Bureau adopted an annual origination limit for small creditor status of 500 first-lien covered transactions in the preceding calendar year (§ 1026.35(b)(2)(iii)(B).[19] Specifically, the origination limit in § 1026.35 (b)(2)(iii)(B) provides that, during the preceding calendar year, creditors, together with their affiliates, must have originated 500 or fewer covered transactions, as defined by § 1026.43(b)(1), secured by a first lien.

In adopting this limit the Bureau believed that an origination limit, in combination with other requirements, was the most accurate means of confining the special provisions and exemptions to the class of small creditors that focus primarily on a relationship-lending model, a business model the Bureau believed would best facilitate consumers' access to responsible, affordable credit.

However, prior to and after the effective dates of the 2013 Title XIV Final Rules, the Bureau heard repeated expressions of concern that the Bureau's definition of small creditor was under-inclusive and did not cover a significant number of institutions that met the rationale underlying the special provisions and exemptions. Accordingly, on May 6, 2014, in a Notice of Proposed Rulemaking with proposals addressing other elements of the 2013 Title XIV Final Rules, the Bureau also sought comment on the 500 total first-lien origination limit—including whether that limit is sufficient to serve the purposes of the small creditor designation.[20]

In response to the Bureau's solicitation of comments regarding the origination limit in its May 6, 2014 proposal, industry commenters, including national and state associations of banks, and national and state associations of credit unions, generally supported an increase in the 500 loan origination limit. Consumer groups generally did not support an increase, absent clear evidence that the current limit was significantly harming consumers. These consumer-group commenters asserted that evidence of consumer harm does not exist.

The Bureau's Proposal

The Bureau's proposed rule reflected stakeholder feedback on the small creditor definition received during the period since the issuance of its 2013 Title XIV Final Rules. Specifically, the Bureau proposed to raise the origination limit in § 1026.35(b)(2)(iii)(B) from 500 covered transactions secured by a first-lien originated by the creditor and its affiliates to 2,000 such loans. The Bureau also proposed to exclude loans held in portfolio by the creditor or its affiliates from the limit, so that the limit would only apply to loans that were sold, assigned, or otherwise transferred by the creditor or its affiliates to another person, or subject to a commitment to be acquired by another person. The Bureau also proposed to add a grace period from calendar year to calendar year to allow an otherwise eligible creditor that exceeded the origination limit in the preceding calendar year to continue to operate as a small creditor with respect to transactions with applications received before April 1 of the current calendar year if the creditor had not exceeded it in the calendar year before the preceding calendar year.

Proposed comment 35(b)(2)(iii)–1.ii made clear that a loan transferred by a creditor to its affiliate is a loan not retained in portfolio (it is a loan transferred to ''another person'') and therefore is counted toward the 2,000 origination limit. The proposed comment also explained and added examples on applying the grace period to the origination limit.

In issuing the proposed rule, the Bureau stated its belief that an adjustment of the current origination limit as proposed, given feedback received on the origination limit up to that point, is justified. The Bureau stated that small creditors serve a particularly critical function for consumers in rural and underserved areas, especially when these creditors make portfolio loans for which there may be no secondary market. At the same time, the Bureau recognized that an expansion of the origination limit could undermine the Bureau's title XIV regulatory protections. The Bureau stated that it wanted to ensure that the origination limit is not set at a level that will allow larger creditors to take advantage of small-creditor status to avoid important regulatory requirements that protect consumers—regulatory requirements that those larger creditors, unlike many smaller creditors, have the capacity to implement effectively.

For the reasons discussed below, the Bureau is adopting § 1026.35(b)(2)(iii)(B), and the accompanying commentary, as proposed, with several technical revisions, and commentary additions and clarifications.

Comments

Comments on the Bureau's proposal to raise the origination limit were divided between industry stakeholders and consumer groups. Industry commenters generally expressed appreciation and support for the proposed rule changes, while consumer representatives and organizations opposed or expressed concern with the proposals.

[19] For a more detailed discussion of the Board's and the Bureau's past rulemaking efforts with regard to the small creditor origination limit, see the proposed rule. 80 FR 7769, 7776–7781.

[20] Amendments to the 2013 Mortgage Rules Under the Truth in Lending Act (Regulation Z), 79 FR 25730 (May 6, 2014).

Increase limit to 2,000 loans. Industry commenters supported the proposed increase in the origination limit for small creditor status from 500 loans to 2,000 non-portfolio loans. Banks, and their national and state trade associations, were particularly supportive of the 2,000 origination limit. One national trade association stated, for example, that its internal analysis suggested that the Bureau approximated a good target through the proposed 2,000 origination limit. It stated further that from informal polling of its smaller community bank members, 1,000 loan originations per year is a common volume at banks of asset sizes below $1 billion, and that many may originate more. A state banking association agreed, stating that the Bureau's proposal better aligned the origination limit with the asset limit. This commenter stated that the current rule limiting originations to 500 covered transactions for institutions with up to $2 billion in assets does not reflect the business models of most community banks. A national association of credit unions, in expressing support for increasing the origination limit to 2,000 loans, stated that, because a large number of its members with assets under $2 billion originate more than 500 first-lien mortgages, it had long sought an increase in the origination threshold. Another state banking association stated that the increased origination limit will qualify more institutions as small creditors and promote the availability of mortgage credit for their customers.

While national and state credit union trade association commenters were supportive of the Bureau's proposal to raise the limit, a number questioned how the Bureau arrived at 2,000 loans for the limit, and suggested the Bureau analyze increasing the proposed limit. One national association of credit unions, for example, encouraged the Bureau to provide impact analyses that demonstrate how communities, consumers, and creditors would be affected if the limit were raised to 2,500, 3,000, 3,500, or 4,000, as well as the proposed threshold of 2,000, so that stakeholders and the Bureau would have more informed comments regarding what the new limit should be. Some state associations of credit unions suggested that the Bureau raise the limit to 5,000 loans, stating that a threshold at that level is more in line with the reality of credit unions that continue to maintain the virtues of a small creditor, including an elevated level of service and personal attention to borrowers.

Some state associations of credit unions suggested that the Bureau allow institutions with default rates of, for example, less than 1 percent of covered transactions in the previous calendar year to make up to 4,000 mortgage loans per year and still qualify for the small creditor exemption.

Consumer groups opposed or expressed concern regarding the proposed increase in the origination limit. Some cited a lack of an evidentiary basis to support the expansion of the origination limit, asserting that the Bureau did not provide any evidence that the current limit unreasonably constrains small creditors.

Several consumer organizations in a joint comment expressed concern about the expansion of the origination limit to 2,000 loans, with a specific focus on past practices and lack of regulatory oversight with regard to non-depository institutions. They stated that, in the past, the absence of oversight by federal financial regulators, when combined with inconsistent or weaker state oversight, created an environment where non-depository institutions, in particular, had improper incentives to push consumers into mortgage loans with problematic features. The joint commenters encouraged the Bureau to limit the increase of the origination limit to depository institutions exclusively.

Exclusion of portfolio loans from the limit. Industry commenters also supported the Bureau's proposal to exclude portfolio loans from the origination limit. A national association of banks stated that this exclusion is consistent with the rule's overall goals of ensuring safe lending while promoting credit accessibility. It stated that the success and livelihood of community banks are dependent upon repayment of their portfolio loans and that community banks carefully underwrite these loans based on knowledge of their communities and standards that meet local customer needs. It also noted the sound lending practices of "hometown banks" as demonstrated by their persistently low default and foreclosure rates, even through the recent mortgage crisis. These comments were echoed by several state banking associations.

An organization of state bank supervisors stated that the Bureau's proposal correctly acknowledges that portfolio lenders have strong incentives to consider a borrower's ability to repay a loan. It also stated that raising the small creditor origination limit from 500 to 2,000 loans, and more importantly, excluding loans originated and held in portfolio from that threshold, will provide effective and significant regulatory relief for community bank portfolio lenders.

A coalition of mid-size banks stated that this aspect of the proposal rests on the understanding that a creditor retains the risk associated with its portfolio loans and therefore has a natural incentive to underwrite such loans deliberately and under conservative standards. It stated further that this incentive is magnified for small and mid-size banks, which have substantially lower capital cushions than their larger counterparts to absorb losses in connection with default. A state association of banks stated that the Bureau is moving in the "right direction" with many of its proposals, but recommended that the Bureau exclude from the origination limit loans transferred by a creditor to a wholly-owned subsidiary.

Grace period for transactions with applications received before April 1st of current calendar year. Industry commenters supported the Bureau's proposal to allow a creditor that exceeded the origination limit in the preceding calendar year to operate, in certain circumstances, as a small creditor with respect to transactions with applications received before April 1 of the current calendar year. Some commenters, however, suggested that the grace period be extended, *e.g.,* to 6 months. These commenters expressed concern that the proposed grace period was too brief for small banks and credit unions to track their originations and to change their operations in a timely manner.

Final Rule

Increase of origination limit to 2,000 loans. As discussed above, the Bureau believes that small creditors serve a critical function for consumers in rural and underserved areas, especially when these creditors make portfolio loans for which there may be no secondary market and that larger creditors may not be willing to make. Industry comments on the current small creditor origination limit indicate that it may be restricting the ability of such creditors with relationship lending models to provide needed credit to qualified borrowers in rural and underserved areas. The intent of the small creditor test is to facilitate lending by those small creditors that provide responsible, affordable credit to consumers, and to enable consumers in rural and underserved areas to access creditors with a lending model, operations, and products that may meet their particular needs.

The Bureau has considered those industry comments that suggested raising the limit above 2,000 loans, or

raising the limit above 2,000 loans for institutions with lower default rates. The Bureau seeks to avoid setting the origination limit, however, at a level that will allow larger creditors to take advantage of small-creditor status. The Bureau's primary goal in setting the limit is to draw the appropriate line between small and large creditors, and to strike the right balance between preserving consumer access to credit and maintaining effective consumer protections. The Bureau believes that the 2,000 non-portfolio loan limit strikes that balance.

The Bureau is finalizing the origination limit as proposed, applying equally to depository institutions and non-depository institutions, as does the current rule. Excluding non-depository institutions from the changes to the origination limit, as suggested by some consumer groups, would require the Bureau to establish, and oversee, two different regulatory schemes for banks and non-banks. This introduction of complexity into the determination of small creditor status would subject similar regulated entities to different regulatory requirements, possibly creating creditor confusion regarding compliance, resulting in increased burden and compliance costs for such creditors. Moreover, the Dodd-Frank Act sets out as one of the objectives for the Bureau enforcing federal consumer financial law consistently without regard to charter type.[21]

Exclusion of portfolio loans from the limit. The Bureau's proposal to exclude loans held in portfolio by the creditor and its affiliates recognizes that the interests of small portfolio lenders are more likely to be aligned with the interests of consumers because small portfolio lenders retain the credit risk for loans held in portfolio. The Bureau has also recognized that many small creditors use a lending model based on maintaining ongoing relationships with their customers and therefore may have a more comprehensive understanding of the financial circumstances of their customers. The Bureau's exclusion of portfolio loans from the origination limit, therefore, is a recognition not only of the small creditor's community-based focus and commitment to relationship-based lending, but also of the inherent alignment of creditors' and consumers' interests associated with portfolio lending by smaller institutions. The Bureau is therefore adopting the exclusion of portfolio loans from the origination limit as proposed.

The Bureau believes the final rule provides a bright-line approach for determining what is included in the 2,000-origination limit. The Bureau also believes that the bright-line nature of this rule would be undermined by the commenter's recommendation described above that the Bureau not count toward the limit loans transferred by the creditor to its wholly-owned subsidiary. A transfer of a loan by a creditor to a subsidiary, or other affiliate, is not a loan held in the creditor's portfolio. Rather, it is a loan that is sold, assigned, or otherwise transferred by the creditor to another legal entity in this particular situation (*see* § 1026.2(a)(22), the definition of ''person'' under Regulation Z). Making distinctions between wholly-owned subsidiaries and other affiliates for purposes of the origination limit would create compliance and oversight complications for creditors, their affiliates, and regulators, for example, because whether a subsidiary is ''wholly-owned'' could be a complicated analysis in some circumstances.

Grace period for transactions with applications received before April 1st of current calendar year. The Bureau is adopting its proposed grace period to allow a creditor that exceeded the origination limit in the preceding calendar year to operate, in certain circumstances, as a small creditor with respect to transactions with applications received before April 1 of the current calendar year. The Bureau has considered commenters' suggestions for a longer grace period but believes the grace period should provide sufficient time for creditors to make any needed adjustments to come into compliance with the Bureau's regulatory requirements upon exceeding the origination limit. Further, the focus of the grace period on transactions with applications received before April 1, rather than transactions consummated before April 1, will mean that creditors will be able to consummate as small creditors not only transactions that were pending in their pipeline at the beginning of the calendar year but also transactions well into the current calendar year, as long as the application for a transaction was received before April 1 of the current calendar year. For example, if a creditor received a loan application in mid-March of the current calendar year, it could consummate that loan transaction as a small creditor 60 or 90 days later, in mid-June or July of the current calendar year.

This final rule is also making several additional technical and clarifying language changes to § 1026.35(b)(2)(iii)(B) from the proposed rule, for example, changing the phrase ''originated . . . covered transactions'' to ''extended . . . covered transactions,'' to make the language of that section consistent with the terminology generally used in Regulation Z. In addition, this final rule makes several technical and clarifying amendments to comment 35(b)(2)(iii)–1.ii, including, for example, technical changes for purposes of consistency between the regulatory text at § 1026.35(b)(2)(iii)(B) and the commentary, and additional guidance regarding the definition of ''affiliate.'' The comment states that, for purposes of § 1026.35(b)(2)(iii)(B), ''affiliate'' has the same meaning as in § 1026.32(b)(5), which defines ''affiliate'' as ''any company that controls, is controlled by or is under common control with another company, as set forth in the Bank Holding Company Act of 1956 (12 U.S.C. 1841 *et seq.*).'' The commentary also sets out the definition of ''control'' under the Bank Holding Company Act.

The Bureau believes that this final rule sets the origination limit in an effective and responsible way. As discussed, the Bureau's intent in setting the origination limit is to include small creditors that can provide responsible, affordable credit to consumers and enable consumers, particularly those in rural and underserved areas, to access creditors with a lending model, operations, and products that may meet their particular needs. As further discussed in the section 1022(b) analysis in part VII below, the Bureau estimates that expanding the origination limit to 2,000 originations, and not including portfolio loans in that originations count, will increase the number of small creditors by 700, from approximately 9,700 to approximately 10,400. The Bureau believes that this increase will include creditors with the size and responsible lending models that fit the purpose of small-creditor status that the Bureau intends.

35(b)(2)(iii)(C)

As discussed in further detail below, the Bureau is adopting § 1026.35(b)(2)(iii)(C) and the accompanying commentary, substantially as proposed, with certain technical changes and commentary additions to enhance clarity. Accordingly, this final rule includes in the calculation of the asset limit for small-creditor status the assets of the creditor's affiliates that regularly extended covered transactions secured by first liens during the applicable period. The final rule also adds a grace

[21] *See* section 1021(b)(4) of the Dodd-Frank Act, 12 U.S.C. 5511(b)(4), requiring the Bureau to ''to ensure that Federal consumer financial law is *enforced consistently, without regard to the status of a person as a depository institution, in order to promote fair competition.''* (emphasis added).

period from calendar year to calendar year to allow an otherwise eligible creditor that exceeded the asset limit in the preceding calendar year (but not in the calendar year before the preceding year) to continue to operate as a small creditor with respect to transactions with applications received before April 1 of the current calendar year.

The Bureau's Proposal

Currently, under § 1026.35(b)(2)(iii)(C), eligibility for small creditor status is limited to creditors with less than $2 billion in assets (or other current yearly adjusted limit) at the end of the preceding calendar year.

The Bureau did not propose a change to the current $2 billion asset limit in § 1026.35(b)(2)(iii)(C). The Bureau, however, did propose to amend § 1026.35(b)(2)(iii)(C) to include in the calculation of the $2 billion asset limit the assets of the creditor's affiliates that originate covered transactions secured by a first lien. Proposed comment 35(b)(2)(iii)–1.iii provided that, for purposes of § 1026.35(b)(2)(iii)(C), in addition to the creditor's assets, only the assets of a creditor's ''affiliate'' as defined in § 1026.32(b)(5) that originates covered transactions as defined by § 1026.43(b)(1) secured by a first lien would be counted toward the asset limit.

In proposing this change, the Bureau noted that counting both the creditor's assets and the assets of the creditor's affiliates that originate mortgage loans would make the tests for determining small-creditor status consistent as between the asset limit in § 1026.35(b)(2)(iii)(C) and the origination limit in § 1026.35(b)(2)(iii)(B), which currently includes the originations of the creditor's affiliates in determining whether the limit has been exceeded. The Bureau stated that this added consistency between the two tests could facilitate creditor compliance with the special provisions and exemptions for small creditors, including those that operate predominantly in rural or underserved areas.

The Bureau also stated its belief, that given the proposed change to the origination limit to exclude the creditor's and its affiliate's portfolio loans from counting toward that limit, the proposed change to the asset limit is necessary to ensure that small-creditor status does not become a means for larger creditors, through the development of affiliate relationships, to evade important consumer protections.

The Bureau stated that it was interested in receiving comments on the proposed change's potential impact on creditors and access to credit. The Bureau also sought comment on the potential for larger creditors to obtain small-creditor status without this change and the possible impact on consumers.

The Bureau also proposed to add a grace period to the $2 billion asset limit in § 1026.35(b)(2)(iii)(C), similar to the grace period proposed by the Bureau for the origination limit. This proposed grace period allowed an otherwise eligible creditor that exceeded the asset limit in the preceding calendar year to continue to operate as a small creditor with respect to transactions with applications received before April 1 of the current calendar year. This proposed grace period was available to creditors that exceeded the asset limit in the preceding calendar year but had not exceeded it in the calendar year before the preceding calendar year. The Bureau stated that it proposed the grace period to provide consistency in requirements for creditors seeking and maintaining small-creditor status.

Proposed comment 35(b)(2)(iii)–1.iii explained that creditors meet the asset limit during calendar year 2016 if the creditors' total assets (which include, in addition to the creditors' assets, the assets of the creditors' affiliates that originate mortgage loans) are under the applicable asset limit on December 31, 2015. The proposed comment explained further that creditors that did not satisfy the applicable asset limit on December 31, 2015 satisfy the asset limit during 2016 if the application for the loan was received before April 1, 2016 and the creditors had total assets under the applicable asset limit on December 31, 2014. The proposed comment also added the threshold for calendar year 2015 to the 2013 and 2014 asset limits currently listed in the comment.

For the reasons discussed below, the Bureau is adopting § 1026.35(b)(2)(iii)(C), and the accompanying commentary as proposed, with several technical revisions, and commentary additions and clarifications.

Comments

Include the assets of the creditor's mortgage affiliates in the asset limit calculation. In general, consumer groups strongly supported the Bureau's proposal to include in the calculation of the asset limit for small creditor status the assets of the creditor's affiliates that originate mortgage loans, citing it as an important ''anti-evasion'' measure. Specifically, a joint comment from three consumer organizations stated that as a result of the current rule's exclusion of affiliated assets in calculating the small creditor asset limit, very large financial institutions can create unlimited smaller affiliates and have each of them qualify as a small creditor under the rule. The comment stated further that this is a significant loophole that undermines the consumer protections created by the ability-to-repay rule and the accompanying qualified mortgage designation. Another consumer organization commenter stated that aggregating the loans for all affiliated lenders is an important anti-evasion device that preserves the ''valuable'' small creditor exemption, while preventing its abuse.

Industry commenters opposed the change. Some stated that if the Bureau adopted the proposal, it needed to increase the asset limit correspondingly. Several commenters, including a national association of banks, recommended an increase in the asset limit to $10 billion. The proposal, these commenters asserted, effectively lowers the threshold limit for financial institutions with affiliates.

Credit union commenters were concerned with the impact of the proposal on the eligibility of credit unions for small creditor status. A particular concern was regarding those credit unions with affiliated credit union service organizations (CUSOs), with some credit union commenters suggesting that the Bureau exclude CUSOs from treatment as ''affiliates'' for purposes of the asset limit. In support of different treatment for CUSOs, a credit union trade association commenter distinguished CUSOs from other affiliates, stating that they are limited in scope and purpose. This commenter alternatively requested clarification on how to calculate the asset limit in the case of a CUSO that is owned by multiple credit unions, if the Bureau adopted the proposal. Some credit unions pointed to the Bank Holding Company Act, and the reference to that Act in the Regulation Z definition of ''affiliate'' that was cited in the proposed rule, as a basis for excluding CUSOs from the asset limit calculation, stating that the Act does not apply to credit unions.

A state association of banks recommended that the Bureau exclude from counting toward the asset limit loans originated by a creditor and/or its affiliates and held in portfolio—including loans held in portfolio by a wholly-owned subsidiary of either. This commenter stated that a ''community-based institution should not lose 'small creditor' status simply because it is successful with its portfolio-based

strategy and crosses the $2 billion'' asset limit.

Add grace period for transactions with applications received before April 1st of current calendar year. Industry commenters supported the Bureau's proposal to allow a creditor that exceeded the asset limit in the preceding calendar year to operate, in certain circumstances, as a small creditor with respect to transactions with applications received before April 1 of the current calendar year. As with the grace period for the origination limit, however, some commenters suggested that the grace period be extended, *e.g.,* to 6 months.

Final Rule

Include the assets of the creditor's mortgage affiliates in the asset limit calculation. The Bureau believes this change is an important anti-evasion measure that would limit the ability of larger entities to structure arrangements such that one or more affiliates can enjoy the benefits of small creditor status. This change would also make the asset limit calculation more consistent with the origination limit calculation, which currently includes the originations of the creditor's affiliates.

Accordingly, the Bureau is finalizing § 1026.35(b)(2)(iii)(C) as proposed but with several technical revisions. The final rule changes from the proposed rule the phrase ''the creditor and its affiliates that originate covered transactions'' to ''the creditor and its affiliates that regularly extended covered transactions'' in § 1026.35(b)(2)(iii)(C) to make the language of that section more consistent with the terminology generally used in Regulation Z. This change also provides greater clarity that, as stated in the proposed rule,[22] only the assets of the creditor's affiliates that originate covered transactions, and not the assets of other affiliates of the creditor, count toward the limit. The change also indicates that there is a difference between how the covered transactions of affiliates are counted for purposes of the originations limit and how the assets of affiliates are counted for purposes of the asset limit. The originations limit requires a creditor to count each affiliate's first-lien covered transactions that were sold, assigned, or otherwise transferred to another person, or that were subject at the time of consummation to a commitment to be acquired by another person. For purposes of the asset limit, a creditor counts only the assets of those affiliates that regularly extended first-lien covered transactions and not the assets of other affiliates. This difference prevents the assets of an affiliate that does not regularly extend covered transactions from having a significant impact on the asset limit for a creditor.

To provide additional guidance, the final rule also makes several additions and clarifications to comment 35(b)(2)(iii)–1.iii. Comment 35(b)(2)(iii)–1.iii.A states that only the assets of a creditor's ''affiliate'' (as defined by § 1026.32(b)(5)) that regularly extended covered transactions (as defined by § 1026.43(b)(1)) secured by first liens, are counted toward the applicable annual asset threshold. Comment 35(b)(2)(iii)–1.iii.A also refers to comment 35(b)(2)(iii)–1.ii.C, which discusses the definition of affiliate under 1026.32(b)(5) and the definition of control under the Bank Holding Company Act referenced in that section. Comment 35(b)(2)(iii)–1.iii.B states that only the assets of creditors' affiliates that regularly extended first-lien covered transactions during the applicable period for determining whether the creditor met the asset limit are included in calculating the creditor's assets. Comment 35(b)(2)(iii)–1.iii.B then discusses the meaning of ''regularly extended,'' which is based on the number of times a person extends consumer credit for purposes of the definition of ''creditor'' in § 1026.2(a)(17), and provides examples on this point. Consistent with § 1026.2(a)(17)(v), because covered transactions are ''transactions secured by a dwelling,'' an affiliate ''regularly extended'' covered transactions if it extended more than five covered transactions in a calendar year. Also consistent with § 1026.2(a)(17)(v), because a covered transaction may be a high-cost mortgage subject to § 1026.32, an affiliate regularly extends covered transactions if, in any 12-month period, it extends more than one covered transaction that is subject to the requirements of § 1026.32 or one or more such transactions through a mortgage broker. Comment 35(b)(2)(iii)–1.iii.C states that if multiple creditors share ownership of a company that regularly extended first-lien covered transactions, the assets of the company count toward the asset limit for a co-owner creditor if the company is an ''affiliate,'' as defined in § 1026.32(b)(5), of the co-owner creditor. Comment 35(b)(2)(iii)–1.iii.C also states that if the co-owner creditor and the company are affiliates, the co-owner creditor counts all of the company's assets toward the asset limit, regardless of the co-owner creditor's ownership share. The comment also notes that because the co-owner and the company are mutual affiliates, the company also would count all of the co-owner's assets towards its own asset limit.

While credit unions in their comments expressed concern about the impact of the proposal on credit unions affiliated with CUSOs, under the proposal only the assets of affiliates that regularly extended covered transactions are counted toward the creditor's asset limit. As adopted under the Bureau's final rule, therefore, only the assets of CUSOs that meet the definition of affiliate in Regulation Z (meeting the ''control'' test under the Bank Holding Company Act) and that regularly extend covered transactions during the applicable period will be counted toward the asset limit. The Bureau is not excluding CUSOs from possible treatment as affiliates because it remains concerned that a credit union could, under the current asset limit calculation, enter into a relationship with a CUSO or CUSOs to create a large entity that would be eligible for the special provisions and exemptions accorded small creditor status. The Bureau also notes that § 1026.32(b)(5) and its definition of ''affiliate'' references the Bank Holding Company Act only for the purposes of how control is determined under that Act, which is applicable to the determination of affiliate under Regulation Z regardless of the applicability of the Act to credit unions.

As noted, the Bureau did not propose to change the current $2 billion asset limit. However, as discussed, some commenters suggested that the Bureau increase that limit to correspond with the Bureau's proposed inclusion of the assets of a creditor's affiliates in the asset limit calculation, with several commenters suggesting an increase to $10 billion. The Bureau established the current $2 billion asset limit based on its belief that an asset limit is important to preclude a very large creditor with relatively modest mortgage operations from taking advantage of provisions designed for much smaller creditors with much different characteristics and incentives and that lack the scale to make compliance less burdensome. The Bureau believes institutions that fall under the $2 billion asset limit are more likely to be engaged in relationship-based community lending than larger institutions, with such small entities having a more in-depth understanding of the economic and other circumstances of their customers and community. The Bureau believes that allowing entities of up to $10 billion in size to take advantage of the exemptions

[22] 80 FR 7769, 7781 (February 11, 2015).

and special provisions accorded to small creditors is inconsistent with the purposes of the special provisions and exemptions.

The Bureau did not propose to exclude from the asset limit loans originated by a creditor or its affiliates and held in portfolio, or loans held in portfolio by a wholly-owned subsidiary of either. Given the final rule's exclusion of portfolio loans from the origination limit, also excluding portfolio loans from the asset limit could potentially allow a large creditor with significantly more than $2 billion in assets due to the size of its loan portfolio, or the size of its affiliate's loan portfolio, to take advantage of the special provisions and exemptions designed for smaller creditors. Such a change would run counter to the Bureau's intent in establishing an asset limit and the Bureau's intent to limit the ability of creditors who become large creditors through the development of affiliate relationships to circumvent consumer protections by obtaining small creditor status.

Add grace period for transactions with applications received before April 1st of current calendar year: The Bureau is finalizing as proposed the addition of a grace period for the determination of the asset limit. It allows a creditor that exceeded the asset limit in the preceding calendar year, but that did not exceed it in the year before the preceding calendar year, to operate as a small creditor with respect to transactions with applications received before April 1 of the current calendar year. The Bureau has considered comments suggesting a longer grace period but, as with the grace period for the origination limit, believes the grace period for the asset limit as proposed should provide the time for creditors to make any needed adjustments to come into compliance with the Bureau's regulatory requirements upon exceeding the asset limit in the previous year.

35(b)(2)(iii)(D)

As discussed in detail below, the Bureau is adopting § 1026.35(b)(2)(iii)(D) substantially as proposed, with a minor change to enhance clarity. Accordingly, this final rule substitutes January 1, 2016 for January 1, 2014 where it appears in § 1026.35(b)(2)(iii)(D)(*1*) and its commentary. This change prevents creditors from losing eligibility for the escrow exemption because of escrow accounts they established pursuant to requirements in effect before the effective date of this rule.

The Bureau's Proposal

In general, § 1026.35(b)(2)(iii)(D) prohibits any creditor from availing itself of the exemption from escrow requirements in § 1026.35(b)(2)(iii) if the creditor maintains escrow accounts for any extension of consumer credit secured by real property or a dwelling that it or its affiliate currently services. However, § 1026.35(b)(2)(iii)(D) currently also provides that a creditor may qualify for the exemption if such escrow accounts were established for first-lien higher-priced mortgage loans on or after April 1, 2010, and before January 1, 2014 or were established after consummation as an accommodation for distressed consumers.[23] In light of the proposed expansion of the ''small'' and ''rural'' definitions in §§ 1026.35(b)(2)(iii)(B) and 1026.35(b)(2)(iv)(A), the Bureau proposed to substitute January 1, 2016 for January 1, 2014 where it appears in § 1026.35(b)(2)(iii)(D)(*1*) and comment 35(b)(2)(iii)(D)(*1*)–1. This change was proposed to prevent any creditors that are currently ineligible for the escrow exemption, but that would qualify if the proposed definitional changes were adopted, from losing eligibility for the escrow exemption because of escrow accounts they established for first-lien higher-priced mortgage loans pursuant to requirements in the current rule.

The Bureau solicited comment on the Bureau's proposed amendments to § 1026.35(b)(2)(iii)(D)(*1*) and comment 35(b)(2)(iii)(D)(*1*)–1, and specifically the exclusion of escrow accounts established on or after April 1, 2010 and before January 1, 2016 from the limitation in § 1026.35(b)(2)(iii)(D). In particular, the Bureau sought comment on the need for the proposed changes and the impact on consumers of extending the exemption to the escrow requirements in § 1026.35(b)(1).

The Bureau is finalizing § 1026.35(b)(2)(iii)(D)(*1*) and comment 35(b)(2)(iii)(D)(*1*)–1 generally as proposed but with a minor change to conform the regulatory and commentary language.

Comments

The commenters on this subject, including a national association of credit unions and state associations of banks and credit unions, supported the provision to disregard escrow accounts that were maintained during a period a creditor was not exempt from the escrow requirement.

Final Rule

The Bureau has considered the comments received on this provision and is finalizing § 1026.35(b)(2)(iii)(D)(*1*) and comment 35(b)(2)(iii)(D)(*1*)–1 generally as proposed but with a minor change to include in the regulation the same language currently in the comment stating that the exemption applies to loans ''for which the application was received'' on or after April 1, 2010, and before January 1, 2016.

The Bureau does not believe that creditors that maintain escrow accounts they were required to set up before the effective date of this rule should lose the exemption simply because they were required by applicable regulations to establish escrow accounts before January 1, 2016. As the Bureau discussed in the Supplementary Information to the January 2013 Escrows Final Rule and again in finalizing amendments to the January 2013 Escrows Final Rule made in the September 2013 Final Rule, the Bureau believes creditors should not be penalized for compliance with the current regulation.[24] This final rule makes creditors eligible for the exemption provided under § 1026.35(b)(2)(iii) if they otherwise meet the requirements of § 1026.35(b)(2)(iii) and they do not establish new escrow accounts for transactions for which they receive applications on or after January 1, 2016, other than those described in § 1026.35(b)(2)(iii)(D)(*2*).

A small number of commenters recommended additional exemption provisions, including exempting from the escrow requirement all loans held in portfolio if the APR does not exceed APOR by 3.5 percentage points or more. The Bureau notes, however, that the proposal did not address additional exemptions and thus such exemptions are outside the scope of this rulemaking.

35(b)(2)(iv)(A)

As discussed in detail below, the Bureau is adopting § 1026.35(b)(2)(iv)(A) substantially as proposed, amending the current definition of ''rural,'' with certain minor changes to enhance clarity. Accordingly, this final rule adds census blocks that are not in an urban area as defined by the U.S. Census Bureau to the current county-based definition in

[23] Comment 35(b)(2)(iii)(D)(*1*)–1 clarifies that the date ranges provided in § 1026.35(b)(2)(iii)(D)(*1*) apply to transactions for which creditors received applications on or after April 1, 2010, and before January 1, 2014.

[24] January 2013 Escrows Final Rule, 78 FR 4725, 4739 (Jan. 22, 2013); *see also* September 2013 Final Rule, 78 FR 60382, 60416 (Oct. 01, 2013).

§ 1026.35(b)(2)(iv)(A) and broadens the definition of rural to apply to ''an area'' rather than ''a county.''

The Bureau's Proposal

Section 1026.35(b)(2)(iv)(A) currently defines a county as ''rural'' during a calendar year if it is neither in a metropolitan statistical area (MSA) nor in a micropolitan statistical area that is adjacent to an MSA, as those terms are defined by the U.S. Office of Management and Budget and as they are applied under currently applicable UICs, established by the USDA–ERS. The current rule further provides that a creditor may rely as a safe harbor on the list of counties published by the Bureau to determine whether a county qualifies as ''rural'' for a particular calendar year. The Bureau proposed to expand the ''rural'' definition in § 1026.35(b)(2)(iv)(A) to capture additional areas classified as ''rural'' by the Census Bureau, without affecting the status of any counties that would be deemed rural under the current rule. For technical reasons, the Bureau also proposed to move the discussion of the safe harbor list of counties provided by the Bureau that is currently in § 1026.35(b)(2)(iv)(A) and comment 35(b)(2)(iv)(A)–1 to new § 1026.35(b)(2)(iv)(C) and proposed comment 35(b)(2)(iv)(A)–1.iii, which are discussed below.[25]

The proposal added to the definition of ''rural'' those census blocks that are not designated as ''urban'' by the Census Bureau in the urban-rural classification it completes after each decennial census to the county-based definition in § 1026.35(b)(2)(iv)(A). To implement this change, proposed § 1026.35(b)(2)(iv)(A) provided that an area is rural during a calendar year if it is (1) a county that meets the Bureau's current rural definition, or (2) a census block that is not in an urban area, as defined by the Census Bureau using the latest decennial census of the United States.

The Bureau also proposed revisions to comment 35(b)(2)(iv)–1 that: (1) Conform to the changes made to § 1026.35(b)(2)(iv); (2) add a cross-reference to comment 35(b)(2)(iii)–1; and (3) make technical changes for clarity. The Bureau further proposed to update the example provided in comment 35(b)(2)(iv)–2.i to reflect the Bureau's proposal to add rural census blocks to the definition of rural area. Proposed comment 35(b)(2)(iv)–2.i explains that an area is considered ''rural'' for a given calendar year based on the most recent available UIC designations by the USDA–ERS and the most recent available delineations of urban areas by the Census Bureau that are available at the beginning of the calendar year. As the proposed comment noted, these designations and delineations are updated by the USDA–ERS and the Census Bureau respectively once every ten years. The comment provides an illustrative example.

The Bureau solicited comment on whether it should add a second prong to the rural definition based on the Census Bureau's urban-rural classification and, if so, whether it should make any modifications to the Census Bureau's classification in doing so. Although the Bureau proposed to maintain the current county-based test as part of the new definition, the Bureau also solicited comment on whether the counties included in the current definition should be expanded, contracted, eliminated, or maintained as is. The Bureau also requested feedback on any alternative approaches to defining ''rural'' areas in § 1026.35(b)(2)(iv)(A) that commenters believe might be preferable to the Bureau's proposal.

For the reasons discussed below, the Bureau is adopting § 1026.35(b)(2)(iv)(A) and the accompanying commentary as proposed, with minor technical revisions.

Comments

Creditor commenters, including national and state associations of banks and credit unions and individual banks and credit unions, as well as non-creditor commenters, including national associations of home builders, realtors, and banking supervisors, generally supported the expanded definition of ''rural.'' For example, a national banking association stated that the Census Bureau's urban-rural classification appeared to be the most suitable for the purposes and objectives of the regulations, and a regional association of credit unions referred to the proposed definition as a ''common sense approach'' that it urged the Bureau to adopt. Some of the commenters supporting the proposed change also noted the need to have an effective automated tool for determining whether a covered transaction is made in an area that is rural because of the difficulties inherent in considering millions of census blocks. These concerns are addressed below in the discussion of the Bureau's automated tool.

Other commenters, generally consumer groups, noted that the current definition has not been in place long enough for the Bureau to discern its effects and questioned whether data supported the proposed changes. These commenters recommended caution before adopting any changes because consumers may be harmed by a broader definition. They also recommended narrowly tailoring any changes to the definition to prevent non-rural lenders from taking advantage of the special provisions and exemptions. These commenters and a few others also argued that high-cost mortgages should not be eligible for qualified mortgage status under any circumstances.

A few commenters also recommended alternative definitions. A state association of banks and a state association of credit unions recommended only excluding ''urbanized areas'' of 50,000 or more from the definition of rural. A national organization representing banking supervisors and one representing real estate brokers and agents both recommended the Bureau establish an application process under which a person who lives or does business in a state may apply to have an area designated as a rural area. A national nonprofit organization that supports affordable housing efforts in rural areas noted that a reliance on Census Bureau classifications for rural areas may allow rural area determinations for lending activity that is actually suburban in nature, which may have the unintended consequence of diverting credit away from truly rural communities and consumers. This commenter recommended using a sub-county designation of rural and small-town areas which incorporates measures of housing density and commuting at the Census tract level.

Final Rule

The Bureau is finalizing § 1026.35(b)(2)(iv)(A) generally as proposed with minor changes in the associated commentary to provide greater clarity and consistency with other changes made in this final rule.[26] In developing the proposal, the Bureau

[25] This proposed move was consistent with a similar move that the Bureau proposed with respect to the safe harbor discussion that currently appears with the ''underserved'' definition in § 1026.35(b)(2)(iv)(B).

[26] The addition of a census block prong in § 1026.35(b)(2)(iv)(A)'s ''rural'' definition does not affect the scope of the exemption from a requirement to obtain a second appraisal for certain higher-priced mortgage loans adopted by the January 2013 Interagency Appraisals Final Rule, as that exemption applies to credit transactions made by a creditor in a ''rural county'' as defined in § 1026.35(b)(2)(iv)(A). This definition of ''rural county'' is retained in § 1026.35(b)(2)(iv)(A) as § 1026.35(b)(2)(iv)(A)(*1*) and the reference to comment 35(b)(2)(iv)–1 in comment 35(c)(4)(vii)(H) is retained in comment 35(b)(2)(iv)–1.iii.A.

considered a variety of possible approaches that could be used to identify areas that are smaller than counties and that may be rural in nature, and the Bureau considered the alternative definitions commenters recommended. Of these, the Bureau believes that the urban-rural classification completed by the Census Bureau every ten years is the most suitable for the Bureau's current purposes. This classification is done at the level of the census block, which is the smallest geographic area for which the Census Bureau collects and tabulates decennial census data. While there are only about 3,000 counties in the United States, there are approximately 11 million census blocks.[27] The Census Bureau delineates census blocks as ''urban'' or ''rural'' based on each decennial census and most recently released its list of urban areas based on the 2010 Census in 2012. For the 2010 Census, an urban area consists of ''a densely settled core of census tracts and/or census blocks that meet minimum population density requirements, along with adjacent territory containing non-residential urban land uses as well as territory with low population density included to link outlying densely settled territory with the densely settled core.'' [28] The Census Bureau identifies two types of urban areas: ''urbanized areas'' of 50,000 or more people, and ''urban clusters'' of at least 2,500 and less than 50,000 people. Under the Census Bureau's classification, ''rural'' encompasses all population, housing, and territory not included within either type of urban area.

The definition of ''rural'' in this final rule maintains the bright-line, easy-to-apply county-based test from the current definition, while also bringing into the definition rural pockets within counties that are non-rural under the current rule.[29] Because the Census Bureau's classification is done at the census block level, it provides much more granularity than any county-based metric. To prepare the rural-urban classification, the Census Bureau uses measures based primarily on population counts and residential population density, but also considers a variety of criteria that account for nonresidential urban land uses, such as commercial, industrial, transportation, and open space that are part of the urban landscape.[30] Since the 1950 Census, the Census Bureau has reviewed and revised these criteria as necessary for each decennial census. The Census Bureau completes its rural-urban classification every ten years based on the results of the decennial census, on roughly the same schedule that the USDA–ERS uses in updating its UIC designations, which should provide a relatively stable but up-to-date measure.

The Bureau believes that use of the Census Bureau's classifications provides consistency, certainty, stability, and objectivity to the ''rural'' definition. The Census Bureau's classifications generally change only every ten years and, once established, provide a bright-line test that is not subject to discretionary judgments and manipulation, which could result under some commenters' more complex classification procedures, including those to establish an application process to have an area designated as a rural area. Used in conjunction with automated address search tools, as discussed more fully below, the Census Bureau's classifications allow the use of an easy-to-apply test, as originally provided under the county-based definition, to continue, thereby avoiding regulatory and administrative complexity.

35(b)(2)(iv)(B)

As discussed below, the Bureau is adopting § 1026.35(b)(2)(iv)(B) and (C) and comments 35(b)(2)(iv)–1, 35(b)(2)(iv)–1.iii, and 35(b)(2)(iv)–2.ii substantially as proposed, with certain minor changes to enhance clarity. Accordingly, this final rule makes minor technical and conforming changes to the definition of ''underserved'' and the regulation text and commentary discussed below.

The Bureau's Proposal

Section 1026.35(b)(2)(iv)(B) defines a county as ''underserved'' during a calendar year if, according to Home Mortgage Disclosure Act (HMDA) data for the preceding calendar year, no more than two creditors extended covered transactions, as defined in § 1026.43(b)(1), secured by a first lien, five or more times in the county. It further provides that a creditor may rely as a safe harbor on the list of rural or underserved counties published by the Bureau to determine whether a county qualifies as ''underserved'' for a particular calendar year.[31]

For technical reasons, the Bureau proposed to move the discussion of the safe harbor county lists provided by the Bureau from § 1026.35(b)(2)(iv)(B) and comment 35(b)(2)(iv)–1 to § 1026.35(b)(2)(iv)(C) and comment 35(b)(2)(iv)–1.iii.A.[32] The Bureau also proposed other technical changes to § 1026.35(b)(2)(iv)(B) and comments 35(b)(2)(iv)–1 and 35(b)(2)(iv)–2.ii and proposed to add a reference in comment 35(b)(2)(iv)–2.ii to the new grace period under § 1026.35(b)(2)(iii)(A). The Bureau did not propose a substantive change to the definition of underserved.

Comments

The Bureau did not receive comments regarding the proposed technical and conforming changes to § 1026.35(b)(2)(iv)(B), § 1026.35(b)(2)(iv)(C), comments 35(b)(2)(iv)–1, 35(b)(2)(iv)–2.ii, and 35(b)(2)(iv)–1.iii.A. Although the Bureau did not solicit comment regarding the definition of ''underserved,'' the Bureau received four comments suggesting the Bureau consider an alternative definition of ''underserved.'' These commenters suggested that the Bureau's definition of ''underserved'' is under-inclusive. These commenters recommended that the Bureau consider expanding or changing the meaning of ''underserved'' to include the consideration of socio-economic factors to determine underserved status. Specifically, they recommended that underserved areas include low- and moderate-income communities with limited credit options.

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[27] Census Bureau, *2010 Census Tallies of Census Tracts, Block Groups & Blocks, https://www.census.gov/geo/maps-data/data/tallies/tractblock.html*.

[28] Census Bureau, *2010 Census Urban and Rural Classification and Urban Area Criteria, https://www.census.gov/geo/reference/ua/urban-rural-2010.html*. To qualify as an urban area, the territory identified must encompass at least 2,500 people, of which at least 1,500 must reside outside institutional group quarters such as correctional facilities, group homes for juveniles, and mental (psychiatric) hospitals.

[29] For example, Culpeper County, Virginia is part of the Washington-Arlington-Alexandria, DC-VA-MD-WV MSA and does not currently qualify as ''rural'' under existing § 1026.35(b)(2)(iv)(A). Because the Census Bureau defined some census blocks within Culpeper County as rural in its most recent rural-urban classification, under this final rule, those portions of the county qualify as rural under § 1026.35(b)(2)(iv)(A) until the next Census Bureau rural-urban classification.

[30] *See Qualifying Urban Areas for the 2010 Census,* 77 FR 18652 (March 27, 2012); *Urban Area Criteria for the 2010 Census,* 76 FR 53030 (Aug. 24, 2011); *Proposed Urban Area Criteria for the 2010 Census,* 75 FR 52174 (Aug. 24, 2010).

[31] The rural and rural or underserved safe harbor lists are published on the Bureau's Web site on the regulatory guidance page at *http://www.consumerfinance.gov/guidance/*.

[32] This proposed move is consistent with a similar move that the Bureau proposed with respect to the safe harbor discussion that currently appears with the ''rural'' definition in § 1026.35(b)(2)(iv)(A).

Final Rule

For the reasons discussed below the Bureau is not substantively changing the definition of ''underserved'' in this final rule. The Bureau is adopting substantially as proposed the technical and conforming changes to § 1026.35(b)(2)(iv)(B) and comments 35(b)(2)(iv)–1 and 35(b)(2)(iv)–2.ii. In addition, the Bureau is adopting substantially as proposed § 1026.35(b)(2)(iv)(C) and comment 35(b)(2)(iv)–1.iii.A.

As stated in the preamble to the proposed rule the current definition of ''underserved'' appropriately identifies areas where the withdrawal of a creditor from the market could leave no meaningful competition within that market. The designation of an area as ''underserved'' under the Bureau's rules is intended to identify communities that have few creditors and, thus, may be subject to access to credit issues. The Bureau's definition focuses on whether there is access to credit by looking at the number of creditors competing for mortgage business in an area. The economic-and demographic-based definitions suggested by commenters would introduce factors unrelated to competition for consumers' mortgage business.

The changes to the ''rural'' definition discussed above expand the term ''rural or underserved'' for purposes of the exemption to the escrow requirement for higher-priced mortgage loans in § 1026.35(b)(2)(iii), the allowance for balloon-payment qualified mortgages in § 1026.43(f), and the exemption from the balloon-payment prohibition on high-cost mortgages in § 1026.32(d)(1)(ii)(C). Because these provisions reference ''underserved'' only in the alternative with ''rural'' (''rural or underserved''), the Bureau believes that the expansion of the ''rural'' definition in this final rule addresses concerns that have been raised by commenters about the overall coverage of ''rural or underserved.'' [33]

The Bureau also notes that it did not propose or seek comment on substantive revisions to the definition of ''underserved,'' and that such changes to that definition are outside the scope of this rulemaking.

The Bureau notes that comment 35(b)(2)(iv)–1.ii refers to several current HMDA provisions. The Bureau's HMDA rulemaking proposed to modify the referenced provisions.[34] The Bureau expects to issue a notice in the future making conforming changes to comment 35(b)(2)(iv)–1.ii, should such change be necessary after issuance of the HMDA final rule.

[33] As discussed in the section 1022(b) analysis in Part VII below, the Bureau estimates that the number of rural small creditors will increase from approximately 2,400 to approximately 4,100.

[34] 79 FR 51732 (Aug. 29, 2014).

35(b)(2)(iv)(C)

As discussed in detail below, the Bureau is adopting the revisions related to the safe harbors § 1026.35(b)(2)(iv)(A) and (B) and § 1026.35(b)(2)(iv)(C)(*1*), (*2*) and (*3*) and comment 35(b)(2)(iv)–1, 35(b)(2)(iv)–1.iii.A, .B, and .C substantially as proposed, with certain minor changes to enhance clarity. Accordingly, this final rule adds two new safe harbor tools and makes minor conforming changes to the regulation text and commentary discussed below.

The Bureau's Proposal

Section 1026.35(b)(2)(iv)(A) and (B) and comment 35(b)(2)(iv)–1 currently provide that a creditor may rely as a safe harbor on the list of counties published by the Bureau to determine whether a county qualifies as ''rural'' or ''underserved'' for a particular calendar year.[35] As noted above, the Bureau proposed to move the discussion of these county lists to § 1026.35(b)(2)(iv)(C)(*1*) and comment 35(b)(2)(iv)–1.iii.A. To facilitate compliance under the expanded definition of ''rural,'' the Bureau also proposed to add two additional safe harbors in proposed §§ 1026.35(b)(2)(iv)(C)(*2*) and (*3*), for an automated address search tool on the Census Bureau's Web site and an automated tool that may be provided on the Bureau's Web site.

The Bureau proposed technical changes to the safe harbor provision relating to its county lists and also proposed to publish its county lists in the **Federal Register**. Proposed comment 35(b)(2)(iv)–1.iii.A also stated that, to the extent that U.S. territories are treated by the Census Bureau as counties and are neither MSAs nor micropolitan statistical areas adjacent to MSAs, such territories will be included on these lists as rural areas in their entireties.

Because the proposed changes to § 1026.35(b)(2)(iv) created the possibility that some counties would include both rural and non-rural areas, the Bureau also adjusted the discussion of the county lists in proposed comment 35(b)(2)(iv)–1.iii.A. to § 1026.35(b)(2)(iv)(C)(*1*) to make it clear that the lists would not include counties that are partially rural and partially non-rural. The Bureau does not believe it would be practical to publish lists of the census blocks that would qualify as rural under proposed § 1026.35(b)(2)(iv)(A)(*2*) because there are approximately 11 million census blocks in the United States.

[35] A historical record of each year's lists is available at: *http://www.consumerfinance.gov/guidance/#ruralunderserved.*

To assist creditors in implementing the proposed ''rural'' definition, the Bureau proposed to develop and maintain on its Web site a tool that allows creditors to enter property addresses, both individually and in batches, to determine whether a property is located in a ''rural or underserved'' area for the relevant calendar years. The Bureau stated in the preamble to the proposed rule that it did not anticipate that the Bureau's automated tool would be available before the proposed effective date of the final rule, but it proposed that such a tool could provide a safe harbor if and when it becomes available.

Specifically, proposed § 1026.35(b)(2)(iv)(C)(*2*) provided that a property shall be deemed to be in an area that is ''rural or underserved'' in a particular calendar year if the property is designated as rural or underserved for that calendar year by any automated tool that the Bureau provides on its Web site.

In the preamble to the proposed rule, the Bureau noted that, until any automated tool that the Bureau may develop becomes available, the Bureau anticipated that creditors would use resources provided by the Census Bureau to determine whether proposed § 1026.35(b)(2)(iv)(A)(*2*), the new second prong of the proposed rural definition, is satisfied. The Bureau noted that the Census Bureau publishes maps, lists, and other reference materials on its Web site.[36] The Bureau also discussed how the Census Bureau currently provides on its Web site an automated address search tool that allows users to enter a property address to obtain census information about the property, including a designation that the property is in an urban area if that is the case.[37] The Bureau proposed that this automated tool or any similar automated address search tool provided

[36] Census Bureau, *2010 Census Urban and Rural Classification and Urban Area Criteria, available at https://www.census.gov/geo/reference/ua/urban-rural-2010.html.*

[37] *See generally* Census Bureau, *Frequently Asked Questions: How can I determine if my address is urban or rural?, available at https://ask.census.gov/faq.php?id=5000&faqId=6405* (The 2010 Urban Areas can be viewed using Reference maps and the TIGERweb interactive web mapping system; *See also* Census Bureau, American FactFinder *available at http://factfinder.census.gov/faces/nav/jsf/pages/searchresults.xhtml?ref=addr&refresh=t* (providing a link to an address search function that allows users to find Census data by entering a street address)).

by the Census Bureau could be relied on as a safe harbor. Specifically, proposed § 1026.35(b)(2)(iv)(C)(*3*) provided a safe harbor for a property not designated as located in an urban area as defined by the most recent delineation of urban areas announced by the Census Bureau through any automated address search tool that the Census Bureau provides on its public Web site for that purpose. Proposed comments 35(b)(2)(iv)–1.iii.B and .C discussed the safe harbors related to these online tools. Proposed comment 35(b)(2)(iv)–1.iii.C clarified the calendar years for which the Census Bureau's automated address search tool can be used by noting that, for any calendar year that begins after the date on which the Census Bureau announced its most recent delineation of urban areas, a property is deemed to be in a ''rural'' area if the search results provided for the property by any such tool available on the Census Bureau's public Web site do not designate the property as being in an urban area. This is consistent with proposed comment 35(b)(2)(iv)–2.i, which explains that an area is considered ''rural'' for a given calendar year based on the most recent available UIC designations by the USDA–ERS and the most recent available delineations of urban areas by the Census Bureau that are available at the beginning of the calendar year.

The Bureau solicited comment on whether Regulation Z should provide a safe harbor for automated tools of this nature. The Bureau also requested feedback relating to how it could make the automated tool it is considering developing most useful to industry and other stakeholders as they implement the rural and underserved definitions.

Comments

The Bureau did not receive comments regarding the publication of the county lists to the **Federal Register**; clarification regarding the determination of ''rural or underserved'' status of U.S. territories; or the changes to proposed comment 35(b)(2)(iv)–1.iii.A. to conform to the proposed changes to § 1026.35(b)(2)(iv). The comments received focused on the proposed safe harbor tools. Most comments were in support of the Bureau's proposed automated tool. Many commenters suggested the Bureau's proposed automated tool with a batch feature is necessary for compliance if the Bureau finalizes the definition of ''rural'' as proposed because small creditors do not have the capacity (or they need more time) to develop tools to integrate the new census block typology. One state banking association commenter suggested that the Bureau delay the effective date of the rule until the Bureau's proposed automated tool is available because identifying ''rural'' areas under the proposed definition of ''rural'' would be difficult for small institutions and presents a compliance risk that these institutions may not be willing to take. A national banking association and several state banking associations recommended an extension of the two year transition period, under § 1026.43(e)(6), allowing small creditors to issue balloon-payment qualified mortgages and high-cost mortgages regardless of whether they operate predominantly in rural or underserved areas, until banks can access the Bureau's automated tool. These commenters asserted that if the transition period is not extended until an automated tool is available, many small institutions would be incapable of ensuring compliance and may curtail or eliminate consumer mortgage financing.

The Bureau also received several comments about the current usability of the Census Bureau's automated address search tool. These commenters stated that the Census Bureau's automated address search tool is not efficient for business use. One commenter criticized the accuracy and usability of the Census Bureau's automated address search tool but did not provide examples of inaccuracies. The commenter suggested that the Bureau use housing density and commuter information on a census tract level to define rural areas because a scheme based on the census tract level is more accurate. The commenter believed the Bureau's proposed automated tool would only add to the complexity of the proposed census block scheme used to determine ''rural'' status.

The Bureau received one comment addressing the technical and conforming changes to the provisions discussing the safe harbors. The commenter was concerned about the change in language in § 1026.35(b)(2)(iv)(A) and (B) that states, ''a creditor *may* rely as a safe harbor on * * *'' to the conforming change in proposed § 1026.35(b)(2)(iv)(C) that states, ''[a] property *shall* be deemed to be in an area that is ''rural'' or ''underserved'' in a particular calendar year . . . .'' The commenter believed the Bureau's use of the word *shall* makes the use of the safe harbor tools mandatory.

Final Rule

The Bureau is adopting these provisions substantially as proposed, moving the discussion of the safe harbor lists in § 1026.35(b)(2)(iv)(A) and (B) and comment 35(b)(2)(iv)–1 to § 1026.35(b)(2)(iv)(C)(*1*) and comment 35(b)(2)(iv)–1.iii.A. The Bureau is revising § 1026.35(b)(2)(iv)(C)(*1*) and comment 35(b)(2)(iv)–1.iii.A to clarify that counties are rural or underserved under the Bureau's definitions although they may contain census blocks that are designated by the Census Bureau as urban. This revision provides greater clarity on the effect of the list of rural or underserved counties, which is that a property in a listed county is deemed to be in a rural area even if the property is located in a census block that the Census Bureau designates as urban. The Bureau is also finalizing as proposed the addition of the two new safe harbor tool provisions in § 1026.35(b)(2)(iv)(C)(*2*) and (*3*), and new comments 35(b)(2)(iv)–1.iii.B and .C, with minor changes to provide greater clarity.

The Bureau is clarifying new comment 35(b)(2)(iv)–1.iii.B and .C, to facilitate compliance. For both the Bureau's and the Census Bureau's automated tools, the comments state that a printout or electronic copy from an automated tool designating a particular property as being in a rural or underserved area may be used as ''evidence of compliance'' that a property is in a rural or underserved area for purposes of the Regulation Z record retention requirements in § 1026.25. The Bureau is also adding new comment 35(b)(2)(iv)–1.iii.D to clarify that a property is deemed to be in a rural or underserved area if that designation is provided by any one of the safe harbors, even if that designation is not provided by any of the other safe harbors, and regarding proof of compliance without the use of the enumerated safe harbor tools in § 1026.35(b)(2)(iv)(C)*(1)* through (*3*). New comment 35(b)(2)(iv)–1.iii.D states that the enumerated safe harbor tools are not the exclusive means by which a creditor can demonstrate that a property is in a ''rural or underserved'' area as defined in § 1026.35(b)(2)(iv)(A) and (B). The comment states however, that creditors are required to retain ''evidence of compliance'' in accordance with § 1026.25, including determinations of whether a property is in a rural or underserved area as defined in § 1026.35(b)(2)(iv)(A) and (B).

The Bureau considered the comment regarding the availability of the Bureau's proposed automated tool by the proposed effective date, the concern that small institutions could not benefit from the expanded definition of ''rural'' because they do not have the capacity to determine the rural status of a property under the new definition of ''rural,'' and the suggestion that small institutions would not be willing to risk

a compliance breach by trying to determine rural status without the Bureau's proposed automated tool. The Bureau also considered the comments recommending an extension of the two year transition period, under § 1026.43(e)(6), until creditors can access the Bureau's automated tool. The Bureau expects that its automated tool will be available by the effective date of this final rule, which should address the concerns of these commenters. Further, the Bureau intends to provide guidance to industry stakeholders through implementation materials on how to access and use the Bureau's automated tool. In addition, creditors may use the Census Bureau's automated tool, or other means [38] besides the designated safe harbor tools, to determine the ''rural'' status of a property as long as the creditor retains ''evidence of compliance'' in accordance with § 1026.25 of whether a property is in a rural or underserved area as defined in § 1026.35(b)(2)(iv)(A) and (B). *See* comment 35(b)(2)(iv)–1.iii.B, .C, and .D discussed above.

The Bureau also considered the commenters concerns about the Census Bureau's automated address search tool and their requests that the Bureau make available its automated tool before the effective date of this rule. As noted above, the Bureau expects its automated tool will be ready by the effective date of this rule, which should address the usability concerns about the Census Bureau's automated address search tool. Creditors are encouraged to use the Bureau's automated tool, which will have a user-friendly interface and a batch upload feature. One commenter questioned the use of the Census Bureau's automated address search tool and suggested the Bureau adopt a rural classification scheme based on the use of census tracts and factors such as housing density and commuting. The Bureau believes such a system would increase administrative burden and complexity and reduce the objectivity achieved by a definition of rural based on census blocks. Accordingly, the Bureau is not adopting such a classification scheme.

Finally, one commenter believed the use of the word ''shall'' in § 1026.35(b)(2)(iv)(C) makes the use of the safe harbor tools mandatory. Creditors are not required to use the safe harbor tools. ''Shall'' is used in § 1026.35(b)(2)(iv)(C) to convey that a creditor who uses one or both of the tools receives a conclusive presumption of compliance with the Bureau's definition of ''rural or underserved.'' Using the word *may* in this context would cause uncertainty with regard to the effect of the safe harbor tool's designation with respect to a particular property.

Section 1026.36 Prohibited Acts or Practices and Certain Requirements for Credit Secured by a Dwelling

36(a) Definitions

The commentary to § 1026.36(a) discusses the meaning of the term ''loan originator.'' The Bureau did not propose changes to this commentary. However, the Bureau discovered a technical error in comment 36(a)–1.i.A.*3*. This comment contains a reference to comment ''36(a)z4.i.'' The correct format for this reference is ''36(a)–4.i.'' Thus, the Bureau is adopting a technical amendment to comment 36(a)–1.i.A.*3* to revise the incorrect format. No substantive change is intended.

Section 1026.43 Minimum Standards for Transactions Secured by a Dwelling

43(e) Qualified Mortgages

43(e)(5) Qualified Mortgage Defined—Small Creditor Portfolio Loans

As discussed in detail below, the Bureau is adopting comments 43(e)(5)–4 and 43(e)(5)–8 substantially as proposed, with certain minor changes to enhance clarity. Accordingly, this final rule makes minor technical and conforming changes to this commentary to § 1026.43(e)(5) discussed below.

The Bureau's Proposal

Section 1026.43(e)(5) defines a category of qualified mortgages originated by certain small creditors that enjoy special treatment under the ability-to-repay rules. These mortgages must be originated by creditors that meet the origination limit and asset limit in § 1026.35(b)(2)(iii)(B) and (C), and the creditors must hold the loans in portfolio for at least three years after consummation, with certain exceptions. Such a small creditor portfolio loan can be a qualified mortgage even if the borrower's total debt-to-income ratio exceeds the 43 percent debt-to-income ratio limit that otherwise applies to general qualified mortgage loans under § 1026.43(e)(2). Qualified mortgages originated by small creditors are entitled to a safe harbor under the Bureau's ability-to-repay rule if the loan's APR does not exceed the applicable APOR by 3.5 or more percentage points—in contrast to the general qualified mortgage safe harbor which covers loans with APRs that do not exceed the applicable APOR by 1.5 or more percentage points.

The Bureau proposed several changes to the commentary to § 1026.43(e)(5) to conform to the Bureau's proposed changes to the origination limit and the asset limit in § 1026.35(b)(2)(iii)(B) and (C). Proposed comment 43(e)(5)–4 regarding creditor qualifications provides that to be eligible to make a qualified mortgage under § 1026.43(e)(5) the creditor has to satisfy the requirements of § 1026.35(b)(2)(iii)(B) and (C), including the Bureau's proposed changes to the origination limit and the asset limit, respectively, and the addition of the grace periods. The Bureau proposed to revise comment 43(e)(5)–8, regarding the transfer of a qualified mortgage to another qualifying creditor prior to three years after consummation, to conform to the proposed origination limit and asset limit in § 1026.35(b)(2)(iii)(B) and (C).

Final Rule

The Bureau did not receive comments regarding the conforming changes to comments 43(e)(5)–4 and 43(e)(5)–8. The Bureau is finalizing as proposed, with minor technical revisions to provide greater clarity, comments 43(e)(5)–4 and 43(e)(5)–8.

43(e)(6) Qualified Mortgage Defined—Temporary Balloon-Payment Qualified Mortgage Rules

43(e)(6)(ii)

As discussed in detail below, the Bureau is adopting § 1026.43(e)(6)(ii) as proposed. Accordingly, this final rule extends the temporary balloon-payment qualified mortgage provision to apply to covered transactions for which applications are received before April 1, 2016.

The Bureau's Proposal

Section 1026.43(e)(6) provides for a temporary balloon-payment qualified mortgage that requires all of the same criteria to be satisfied as the balloon-payment qualified mortgage definition in § 1026.43(f) except the requirement that the creditor extend more than 50 percent of its total first-lien covered transactions in counties that are ''rural'' or ''underserved.'' Pursuant to § 1026.43(e)(6)(ii), this temporary provision currently applies only to covered transactions consummated on or before January 10, 2016 (the sunset date). The Bureau proposed to change § 1026.43(e)(6)(ii) to provide that the temporary provision applies to covered transactions for which the application was received before April 1, 2016. The

[38] As discussed above, creditors may use Census Bureau maps, lists, and other reference materials to demonstrate compliance with § 1026.35(b)(d)(iv)(A), but alternative methods do not have the benefit of a safe harbor and a creditor must retain ''evidence of compliance'' in accordance with § 1025.25.

change was proposed to give small creditors more time to understand how any changes that the Bureau may make to the rural definition and lookback period will affect their status, if at all, and to make any required changes to their business practices.[39] This proposed change to § 1026.43(e)(6)(ii) would have also affected the HOEPA balloon-loan provisions because the Bureau had extended the exception to the general prohibition on balloon features for high-cost mortgages under § 1026.32(d)(1)(ii)(C) to allow small creditors, regardless of whether they operate predominantly in ''rural'' or ''underserved'' areas, to continue originating balloon high-cost mortgages if the loans meet the requirements for qualified mortgages under §§ 1026.43(e)(6) or 1026.43(f). The Bureau solicited comment on whether it should change the sunset date in § 1026.43(e)(6)(ii) and whether § 1026.43(e)(6)(ii) should use the date the application was received or the consummation date in applying the sunset date. For the reasons discussed below, the Bureau is adopting § 1026.43(e)(6)(ii) as proposed.

Comments

Creditors, including national and state banking associations, individual banks, and national and state associations of credit unions, generally appreciated the proposed extension to cover applications received before April 1, 2016. However, these commenters recommended that either the provision should be extended indefinitely or, if not made permanent, extended for a longer period than proposed. Suggested extensions ranged from until the Bureau's automated tool is operational to as much as two additional years.

A comment from a state association of credit unions stated this provision should be extended indefinitely until such time as the Bureau has fully studied the benefits that loans with balloon payments provide to consumers and the impact on consumers if they were unable to obtain this type of loan. A national association of banks recommended a one-year extension to allow further study of the issue, and individual banks and credit unions stated a one-year extension would help them transition from balloon loans to adjustable-rate mortgage lending programs. A national banking organization and several state banking associations urged that the sunset be delayed until banks can access an official automated tool to identify rural areas, because without such an automated tool many small institutions would be incapable of ensuring compliance with the definitions, and may curtail or eliminate consumer mortgage financing.

Final Rule

The Bureau has considered the comments submitted on this provision and is finalizing § 1026.43(e)(6)(ii) as proposed. As stated in the May 2013 ATR Final Rule, the Bureau established a temporary provision because ''the Bureau believes it is appropriate to use the two-year transition period to consider whether it can develop more accurate or precise definitions of rural and underserved. However, the Bureau believes that Congress made a deliberate policy choice in the Dodd-Frank Act not to extend qualified mortgage status to balloon-payment products outside of such [rural] areas.'' 78 FR 35429, 35490 (June 12, 2013). The rule as amended here will permit creditors to continue to make balloon-payment qualified mortgages beyond April 1, 2016 as long as the application for the transaction is received before that date, and provides additional time beyond the original and expected sunset date for creditors to make necessary adjustments. With respect to the commenters that recommended an extension until an automated tool is available, as discussed above, the Bureau expects to have such an automated tool in place and operational upon the effective date of this final rule.

43(f) Balloon-Payment Qualified Mortgages Made by Certain Creditors

As discussed below, the Bureau is adopting comments 43(f)(1)(vi)–1, 43(f)(1)(vi)–1.i.A and .B, and 43(f)(2)(ii)–1 substantially as proposed, with certain minor changes to enhance clarity. Accordingly, this final rule makes minor technical and conforming changes to the commentary discussed below.

The Bureau's Proposal

Section 1026.43(f)(1) provides an exemption to the general prohibition on qualified mortgages having balloon-payment features under § 1026.43(e)(2)(C) if the creditor satisfies the requirements stated in § 1026.35(b)(2)(iii)(A), (B), and (C) and other criteria are met. Pursuant to § 1026.43(f)(2), a qualified mortgage made under this section (a ''balloon-payment qualified mortgage'') immediately loses its qualified mortgage status upon transfer in the first three years after consummation, with certain exceptions. The Bureau proposed to revise comments 43(f)(1)(vi)–1 and 43(f)(2)(ii)–1 to reflect the proposed revisions that are described in the section-by-section analysis of § 1026.35 above, including the new grace periods and expanded tests that the Bureau proposed in § 1026.35(b)(2)(iii)(A), (B), and (C), the broader rural definition that the Bureau proposed in § 1026.35(b)(2)(iv)(A), and the safe harbor provisions that the Bureau proposed in § 1026.35(b)(2)(iv)(C). Proposed comment 43(f)(1)(vi)–1.i.A and .B also included updated examples to reflect these changes in the regulation text.

In lieu of listing out the asset limits for every year in comment 43(f)(1)(vi)–1.iii, as the asset limit is adjusted for inflation each year, the Bureau also proposed to include a cross-reference in that comment indicating that the Bureau publishes notice of the new asset limit each year by amending comment 35(b)(2)(iii)–1.iii. The Bureau also proposed technical changes to comments 43(f)(1)(vi)–1, 43(f)(2)–2, and 43(f)(2)(ii)–1.

Final Rule

The Bureau did not receive comments that addressed the proposed revisions to comments 43(f)(1)(vi)–1, 43(f)(2)(ii)–1 and proposed comment 43(f)(1)(vi)–1.i.A and .B. The Bureau is finalizing as proposed, with minor technical revisions to provide greater clarity, the aforementioned comments.

VI. Effective Date

As discussed in detail below, the Bureau is adopting the effective date for this final rule as proposed. The amendments in this final rule are effective January 1, 2016.

The Bureau's Proposal

The Bureau proposed that all of the changes in its proposed rule take effect on January 1, 2016. Specifically, the Bureau proposed that its proposed amendments to § 1026.35(b)(2)(iii)(A), (B), (C), and (D) and its commentary, to § 1026.35(b)(2)(iv)(A), (B), and (C) and its commentary, to § 1026.43(e)(6), and to the commentary to §§ 1026.43(e)(5) and 1026.43(f)(1) and (f)(2), take effect for covered transactions consummated on or after January 1, 2016. The Bureau stated that it believed that this proposed effective date provided a date that is consistent with the end of the calendar year determinations required to be made with regard to the applicability of the special provisions and exemptions that apply to small creditors under the Bureau's regulations, as amended by the Bureau's proposal, and would therefore

[39] Qualified mortgages consummated under § 1026.43(e)(6) based on applications received before April 1, 2016 would retain their qualified mortgage status after that date, as long as the other requirements of § 1026.43(e)(6) are met.

facilitate compliance by creditors. The Bureau requested comment on whether the proposed effective date is appropriate, or whether the Bureau should adopt an alternative effective date.

Comments

A community bank trade association commenter and several credit union commenters recommended that the final rule provide an earlier optional effective date—specifically, on publication of the final rule—so that banks eligible for small creditor and small creditor rural status under the expanded definitions in the rule could take earlier advantage of the special provisions and exemptions that would become available to them. One commenter suggested that, in addition to its suggestion for an optional effective date on publication, the mandatory compliance date for purposes of compliance with the final rule changes should be January 1, 2016. It stated that mandatory compliance should not be earlier for any banks that currently satisfy the requirements for small creditor status, but may not after the final rule takes effect.

One state banking association commenter suggested that the Bureau delay the effective date of the rule until the Bureau's proposed automated tool to assist creditors in determining whether a property securing a mortgage is in a rural or underserved area is available. This commenter asserted that identifying ''rural'' areas under the Bureau's proposed definition of ''rural'' is difficult for small institutions and that it presents a compliance risk that these institutions may not be willing to take.

Final Rule

After considering the comments received on the effective date, the Bureau is finalizing the rule as proposed, with the amendments in the final rule taking effect for covered transactions consummated on or after January 1, 2016. The increased origination limit and the expanded definition of rural in this final rule, for example, apply only to covered transactions consummated on or after that date. The Bureau continues to believe that a January 1, 2016 effective date is the appropriate effective date for the final rule changes as it is consistent with the end of the calendar year determinations required to be made in order to determine a creditor's eligibility for small creditor and small creditor rural or underserved (''small rural creditor'') status and for the April 1 grace period. The January 1, 2016 effective date will therefore make determinations of small creditor and small rural creditor status easier going forward for creditors. It should also facilitate supervision of regulated entities for purposes of determination of compliance with the Bureau's rules, *i.e.,* whether a creditor was in fact small or small/rural/underserved and eligible for the special provisions and exemptions available to such creditors.

An optional and mandatory effective date for the final rule changes, as suggested by some commenters, may create implementation and supervisory compliance oversight complications for the Bureau and other federal regulatory agencies—complications that may not be justified by any advantages that may be obtained by creditors seeking to operate as small or small rural creditors for the few remaining months of 2015. The Bureau believes that the January 1, 2016 effective date provides a bright line approach that will facilitate creditor compliance and avoid complexity in regulatory oversight.

The commenter seeking a delay in the effective date of the rule until the Bureau's automated tool is available may have been based on the Bureau's statement in the proposed rule that it did not expect the proposed automated tool to be available by the effective date of the final rule. The Bureau now believes however that its automated tool will be available by the effective date of the final rule, which should address the concerns of this commenter.

VII. Dodd-Frank Act Section 1022(b) Analysis

A. Overview

In developing the final rule, the Bureau has considered potential benefits, costs, and impacts.[40] The Bureau has consulted, or offered to consult with, the prudential regulators, the Federal Housing Finance Agency, the Federal Trade Commission, the U.S. Department of Agriculture, the U.S. Department of Housing and Urban Development, the U.S. Department of the Treasury, the U.S. Department of Veterans Affairs, and the U.S. Securities and Exchange Commission, including regarding consistency with any prudential, market, or systemic objectives administered by such agencies. The Bureau has also consulted with the Census Bureau on § 1026.35(b)(2)(iv)(A)(*2*) and (C)(*3*).

As discussed in greater detail elsewhere throughout this Supplementary Information, the Bureau finalizes several amendments to the Bureau's Regulation Z and official interpretations relating to escrow requirements for higher-priced mortgage loans under the Bureau's January 2013 Escrows Final Rule and ability-to-repay/qualified mortgage requirements under the Bureau's January 2013 ATR Final Rule and May 2013 ATR Final Rule. Since publication of the 2013 Title XIV Final Rules, the Bureau has received extensive feedback on the definitions of ''small creditor'' and ''rural and undeserved areas'' with many commenters criticizing the Bureau for defining ''rural'' and ''underserved'' too narrowly and urging the Bureau to consider alternative definitions. This final rule reflects feedback from stakeholders regarding the Bureau's definitions of small creditor and rural and underserved areas as those definitions relate to special provisions and certain exemptions provided to small creditors under the Bureau's aforementioned rules.

The discussion below considers the benefits, costs, and impacts of the following key provisions of the final rule (final provisions):

- Raising the loan origination limit for determining eligibility for small-creditor status;
- An expansion of the definition of ''rural area'' to include (1) a county that meets the current definition of rural county or (2) a census block that is not in an urban area as defined by the Census Bureau; and
- An extension of the temporary two-year transition period that allows certain small creditors to make balloon-payment qualified mortgages and balloon-payment high cost mortgages regardless of whether they operate predominantly in rural or underserved areas.

With respect to these provisions, the discussion considers costs and benefits to consumers and costs and benefits to covered persons. The discussion also addresses certain alternative provisions that were considered by the Bureau in the development of the proposed and of the final rule.

The Bureau has chosen to evaluate the benefits, costs, and impacts of the final rule against the current state of the world.[41] That is, the Bureau's analysis below considers the benefits, costs, and impacts of the final provisions relative to the current regulatory regime, as set forth primarily in the January 2013 ATR

[40] Specifically, section 1022(b)(2)(A) of the Dodd-Frank Act calls for the Bureau to consider the potential benefits and costs of a regulation to consumers and covered persons, including the potential reduction of access by consumers to consumer financial products or services; the impact on depository institutions and credit unions with $10 billion or less in total assets as described in section 1026 of the Dodd-Frank Act; and the impact on consumers in rural areas.

[41] In particular, the Bureau compares the impacts of the final provisions against the state of the world after January 2016 if the final provisions do not come into effect.

Final Rule, the May 2013 ATR Final Rule, and the January 2013 Escrows Final Rule.[42] The baseline considers economic attributes of the relevant market and the existing regulatory structure.

The Bureau has relied on a variety of data sources to consider the potential benefits, costs and impacts of the final provisions, including the public comment record of various Board and Bureau rules.[43] However, in some instances, the requisite data are not available or are quite limited. Data with which to quantify the benefits of the rule are particularly limited. As a result, portions of this analysis rely in part on general economic principles to provide a qualitative discussion of the benefits, costs, and impacts of the final rule.

The primary source of data used in this analysis is 2013 data collected under HMDA. The empirical analysis also uses data from the 4th quarter 2013 bank and thrift Call Reports,[44] and the 4th quarter 2013 credit union Call Reports from the NCUA, to identify financial institutions and their characteristics. Unless otherwise specified, the numbers provided include appropriate projections made to account for any missing information, for example, any institutions that do not report under HMDA. The Bureau also utilized the data from the Bureau's Consumer Credit Panel.[45]

Especially in light of some of the comments received by the Bureau that were discussed in the section-by-section analysis, it is worth emphasizing that the Bureau analyzes data from all creditors, both the ones that report under HMDA and the ones that do not, with the exception of non-depository institutions that do not report under HMDA. For HMDA reporters, the Bureau uses the data reported. For HMDA non-reporters, the Bureau uses projections based on the match of the Call Report data with HMDA.

The final provisions expand the number of institutions that are eligible to originate certain types of qualified mortgages and to take advantage of certain special provisions under the January 2013 ATR Final Rule, the May 2013 ATR Final Rule, the January 2013 Escrows Final Rule, and the 2013 HOEPA Final Rule.[46] The first set of special provisions is tailored to creditors deemed as small (small creditors) without regard to the location of their originations. Small creditors can originate qualified mortgages without regard to the bright-line debt-to-income ratio limit that is otherwise required to meet the Bureau's general qualified mortgage requirements (small creditor portfolio special provision). Qualified mortgages originated by small creditors are entitled to a safe harbor with an APR that is more than 1.5 percentage points over APOR, as long as these loans have an APR of less than 3.5 percentage points over APOR (small creditor portfolio QM special provision).

The second set of special provisions applies only to small creditors that operate predominantly in rural or underserved areas (rural small creditors). Rural small creditors can originate qualified mortgages with balloon-payment features, as long as these loans are kept in portfolio (rural qualified mortgage balloon-payment special provision) and other requirements are met.[47] These qualified mortgages with balloon-payment features are entitled to a safe harbor as long as these loans have an APR of less than 3.5 percentage points over APOR. Also, rural small creditors are generally allowed to originate higher-priced mortgage loans without setting up an escrow account for property taxes and insurance (rural higher-priced mortgage loan escrow special provision).

Among other things, the final provisions expand the number of small creditors by changing the origination limit on the number of loans that a small creditor could have originated annually together with its affiliates from no more than 500 to no more than 2,000. The final rule's origination limit also counts only loans not held in portfolio by the creditor and its affiliates that originate covered transactions secured by first liens toward that limit. Similar to the currently effective provisions, the final provisions include a requirement that creditors have less than $2 billion in total assets (adjusted annually), but under the final rule this threshold applies to the creditor's assets combined with the assets of the creditor's affiliates that originate covered transactions secured by first liens rather than just the creditor's own assets.[48]

Based on 2013 data, the Bureau estimates that the number of small creditors will increase from approximately 9,700 to approximately 10,400 (out of the 11,150 creditors in the United States that the Bureau estimates are engaged in mortgage lending). In 2013, the approximately 700 additional creditors originated about 720,000 loans (roughly 10 percent of the overall residential mortgage market), of which about 175,000 were kept in portfolio. Of these 175,000 portfolio loans, the Bureau estimates that about 15,000 were portfolio higher-priced mortgage loans and 88 percent of those had an APR between 1.5 and 3.5 percentage points over APOR.[49]

The final provisions also expand the areas deemed rural for the purposes of

[42] The Bureau has discretion in future rulemakings to choose the relevant provisions to discuss and to choose the most appropriate baseline for that particular rulemaking.

[43] The quantitative estimates in this analysis are based upon data and statistical analyses performed by the Bureau. To estimate counts and properties of mortgages for entities that do not report under HMDA, the Bureau has matched HMDA data to Call Report data and National Mortgage Licensing System data and has statistically projected estimated loan counts for those depository institutions that do not report these data either under HMDA or on the NCUA Call Report. The Bureau has projected originations of higher-priced mortgage loans in a similar fashion for depositories that do not report under HMDA. These projections use Poisson regressions that estimate loan volumes as a function of an institution's total assets, employment, mortgage holdings, and geographic presence.

[44] Every national bank, State member bank, and insured nonmember bank is required by its primary Federal regulator to file consolidated Reports of Condition and Income, also known as Call Reports, for each quarter as of the close of business on the last day of each calendar quarter (the report date). The specific reporting requirements depend upon the size of the bank and whether it has any foreign offices. For more information, see *http://www2.fdic.gov/call_tfr_rpts/*.

[45] The Consumer Credit Panel is a longitudinal, nationally representative sample of approximately 5 million deidentified credit records from one of the nationwide consumer reporting agencies. The sample provides tradeline-level information for all of the tradelines associated with each credit report record each month, including a commercially-available credit score. This information was used for the analysis of how consumers' credit scores differ depending on the size of the financial institution originating the consumers' mortgage loans.

[46] As explained in the section-by-section analysis above, the exception to the general prohibition on balloon-payment features for high-cost mortgages in the 2013 HOEPA Final Rule is also affected by the final provisions. However, the Bureau believes that the effect of the final rule on the rural balloon-payment provision in the 2013 HOEPA Final Rule is relatively small, in terms of both the consumers and covered persons affected, and thus the Bureau does not discuss this effect of the final rule in this 1022(b) analysis.

[47] As discussed in the section-by-section analysis, there is also a temporary two-year provision that allows small creditors, regardless of whether they operate predominantly in rural or underserved areas, to originate qualified mortgage balloon-payment loans and high-cost mortgages with balloon-payment features. This final rule extends the end-date for that temporary provision.

[48] All the numbers below are presented considering the affiliates' assets to the extent that the affiliates' assets are aggregated in the Call Reports, thus the number of newly exempted institutions and the number of loans that they originated could be slightly different from what the Bureau is reporting. The Bureau does not believe that aggregating assets of affiliates that originate covered transactions secured by first liens for the purposes of the $2 billion asset prong results in many, if any, creditors that are considered small under the currently effective rule, but will not be considered small under the final rule.

[49] The percentage of loans with an APR that was 1.5 to 3.5 percentage points over APOR is based exclusively on HMDA data.

the rural small creditor special provisions described above. Currently, areas deemed rural are counties that are neither in an MSA nor in a micropolitan statistical area that is adjacent to an MSA. In addition to the current definition, the final provisions also count as rural areas census blocks that are deemed rural by the Census Bureau.[50] Based on 2013 data, the Bureau estimates that the number of rural small creditors will increase from about 2,400 to about 4,100.[51] The additional 1,700 creditors originated about 220,000 loans, out of which 120,000 are estimated to be portfolio loans and about 26,000 of those are estimated to be higher-priced mortgage loans. The Bureau is not able to estimate currently what percentage of these 120,000 portfolio loans are balloon-payment loans.

B. Potential Benefits and Costs to Consumers and Covered Persons

Consumer Benefits

Consumer benefit from the final provisions is a potential expansion in access to credit. Access to credit concerns meant to be addressed by the rural small creditor provisions and the small creditor provisions are interrelated, thus the Bureau discusses them jointly in this subsection.[52]

In general, most consumer protection regulations have two effects on consumers. Regulations restrict particular practices, or require firms to provide additional services, in order to make consumers better off. However, restricting firms' practices or requiring additional services might result in firms increasing their prices or discontinuing certain product offerings, potentially resulting in reduced access to credit.

The aforementioned small and rural small creditor special provisions were included in the January 2013 ATR Final Rule and the January 2013 Escrows Final Rule (along with the May 2013 ATR Final Rule) in order to alleviate potential access to credit concerns. Note that some of these provisions were Congressionally mandated. The final provisions expand the number of financial institutions that qualify for these special provisions. Accordingly, there are two effects on consumers that originate their mortgage loans with the creditors that are exempted by the final provisions: a potential benefit from an increase in access to credit and a potential cost from reduction of certain consumer protections.

As noted above, the potential benefit of the final provisions for consumers is a potential increase in access to credit. The magnitude of this potential increase depends on whether, but for the provisions in the final rule affecting rural small creditors: (1) Financial institutions that are covered by the final provisions stop or curtail originating mortgage loans in particular market segments or increase the price of credit in those market segments in numbers sufficient to have an adverse impact on those market segments, (2) the financial institutions that remain in those market segments do not provide a sufficient quantum of mortgage loan origination at the non-increased price, and (3) there is not significant new entry into the market segments left by the departing institutions. If, but for the final rule, all three of these scenarios are realized, then the final rule increases access to credit.

Analogously, the magnitude of this potential increase in access to credit depends on whether, in the absence of the provisions in the final rule affecting small creditors and escrow accounts:[53] (1) Financial institutions that are covered by the final provisions have already stopped or curtailed originating mortgage loans in particular market segments or increased the price of credit in those market segments in numbers sufficient to have an adverse impact on those market segments, (2) the financial institutions that remained in those market segments do not provide a sufficient quantum of mortgage loan origination at the non-increased price, and (3) there has not been a significant new entry into the market segments left by the departed institutions. If, but for the final rule, all three of these scenarios are realized, then the final rule increases access to credit.

The Bureau received comments suggesting that access to credit will indeed be curtailed but for the final provisions (or is already curtailed, but could be increased after these provisions become effective). These comments are discussed in the section-by-section analysis. The evidence provided in these comments appears to be largely anecdotal. The Bureau's data do not refute the commenters' assertions; however, the Bureau does not have the direct evidence to estimate the degree to which the final provisions would increase access to credit.

In a series of analyses, the Bureau did not find specific evidence that the final provisions would increase access to credit when analyzing data on various consumers' characteristics (credit scores,[54] loan amounts relative to income,[55] availability of smaller amount loans,[56] and pricing [57]), collateral

[50] As discussed further above, census blocks deemed rural are census blocks that are not in an urban area (*i.e.,* neither in an urbanized area nor in an urban cluster) as defined by the Census Bureau.

[51] The Bureau used data from several sources to estimate whether a given creditor would be considered rural in 2013 according to both the current state of the world and if the final rule were already effective. The Bureau used HMDA data for the creditors that report to the dataset. Since creditors only have to report the census tract of the property's location, the Bureau assumed that a property in a particular census tract has the same chance of being rural as the percentage of that tract's population that lives in rural census blocks (this information is available from the Census Bureau). For the depository institutions that did not report under HMDA, the Bureau is aware of the location of the creditors' branches. The Bureau assumed that mortgage lending is spread equally across a creditor's branches. The Bureau also assumed that if a branch is in a given county, then the same proportion of loans in this branch originated to consumers living in rural or underserved areas as the percentage of population living in rural or underserved areas in that county. Note that the 4,100 includes creditors that do not qualify as small but for the final rule. However, out of the 700 creditors that do not qualify as small but for the final rule, only around 10 percent will qualify as rural even when the final provisions expanding rural areas are effective.

[52] Note that there is a difference in the current effect of the rules: currently, the creditors that are small, but not rural, enjoy the same special provisions as rural small creditors under the January 2013 ATR Final Rule and the May 2013 ATR Final Rule due to a temporary two-year provision in the May 2013 ATR Final Rule. This temporary provision is discussed in the section-by-section analysis above.

[53] Note the difference in baselines: currently, due to the temporary two-year provision discussed in the section-by-section, all the small creditors are eligible for the special provisions that apply to rural small creditors, except for the provisions in the January 2013 Escrows Final Rule.

[54] Using the Bureau's Consumer Credit Panel for 2013, the Bureau analyzed borrowers' credit score distributions at creditors with various yearly origination counts. There was no significant difference between the creditors that qualify as small due to the final rule and larger creditors, including both the median credit scores and the lower tails of the distribution (for example, the 10th percentile of FICO scores).

[55] A relationship lender might help consumers by, potentially, originating loans with a higher DTI ratio because, for example, the relationship lender is aware that the consumer is at a high DTI only temporarily. Using HMDA data, and analyzing the loan-to-income ratio as a proxy for DTI (since both variables are available in HMDA), shows that the median consumer of a small creditor has a loan-to-income ratio of 2.3. The figure is the same for larger creditors.

[56] A commenter suggested that smaller creditors might be originating more loans for smaller amounts (the commenter suggested a threshold of $40,000). According to the Bureau's analysis, while it might be true that smaller creditors make a disproportionate number of smaller amount loans, the majority of the smaller loans are made by larger creditors, and a sizable portion of smaller loans are made by creditors that already enjoy the special provisions under the currently effective rules.

[57] Instead of extending more credit, relationship lenders might be extending cheaper credit if they believe that their consumers are, effectively, less risky. In that case, given similar credit-risk profiles, the Bureau could expect that smaller creditors provide cheaper loans. However, higher-priced mortgage loans comprise on average 8.3 percent of the portfolio of creditors that are deemed small due

Continued

(census tracts with portfolio-only lending [58]), and competition (number of creditors active in a county, even assuming that all the creditors that are small,[59] or small and rural, due to the final rule would exit if the final rule did not become effective).

However, the Bureau's data are not complete and do not permit the Bureau to analyze various relevant hypotheses. For example, one possible theory that the Bureau's data do not confirm or negate is that there might be a lack of access to credit due to the particular idiosyncrasies of a property despite the fact that other properties in the same census tract are eligible for government-sponsored entity (GSE) backing. These idiosyncrasies could include, for instance, the absence of a septic tank on the property or the availability of running water only on some properties in that census tract.

Note that the presence of competition raises an important point related to some of the industry comments provided to the Bureau. While many commenters asserted access to credit issues, the implicit proof was that some smaller financial institutions could be originating fewer loans. However, even if true, that could simply mean that the same consumer would get a loan from a larger creditor instead. The Bureau's analysis of the data implies that this is at least a possibility.[60]

Similarly, many commenters raised concerns that smaller financial institutions lack the economies of scale necessary for effective compliance and implementation of, for example, adjustable-rate mortgage disclosures or escrows. While this might be true, to the extent that outsourcing and contracting have not alleviated this issue, this is only a concern to consumers to the extent that larger creditors would not originate these loans. In other words, the lack of economies of scale is a concern to consumers only to the extent that the market is less competitive than it will otherwise be when the final provisions become effective.

Consumer Costs

The potential cost to consumers of the final provisions is the reduction of certain consumer protections as compared to the baseline established by the January 2013 ATR Final Rule, the May 2013 ATR Final Rule, and the January 2013 Escrows Final Rule. These consumer protections include a consumer's private cause of action against a creditor for violating the general ability-to-repay requirements and the requirement that every higher-priced mortgage loan have an associated escrow account for the payment of property taxes and insurance for five years.

In addition, under the January 2013 ATR Final Rule, after January 10, 2016, creditors that do not meet the definition of ''small'' and ''rural or underserved'' will not be able to claim qualified mortgage status for any newly-originated balloon-payment loans. Classifying a loan as a qualified mortgage when it would not have been a qualified mortgage otherwise (based on the small creditor portfolio special provision or the rural qualified mortgage balloon-payment special provision) or making a loan a safe harbor qualified mortgage loan when it would have otherwise been a rebuttable presumption qualified mortgage (based on the small creditor portfolio QM special provision) makes it more difficult for consumers to sue their creditor successfully for failing to properly evaluate the consumers' ability to repay while originating the loans.

A creditor may have an incentive to originate loans without considering ability to repay to the full extent. As the Bureau noted in the January 2013 ATR Final Rule, there are at least three reasons why these incentives exist. First, the creditor might re-sell the loan to the secondary market or might have at least a portion of the default risk insured by a third party. In this case, the creditor does not have the privately optimal incentive to verify ability to repay. The December 2014 Credit Risk Retention Final Rule's requirement of ''skin in the game'' is designed to ameliorate this issue.[61] Second, the loan officer might not have the right incentive to verify a consumer's ability to repay due to internal organization issues: The loan officer might be benefiting from the creditor's eventual profit due to the loan only proximately and, potentially, the loan officer might have a suboptimal compensation scheme (for example, compensating simply based on the volume originated). Third, the creditor is unlikely to consider a consumer's private costs of foreclosure and the negative externality arising from the foreclosure process.[62] In particular, since the Great Depression, balloon-payment loans have been seen by economists and consumer advocates as raising particular risks of foreclosure.[63] The provision of a private cause of action solves, to an extent, this negative externality issue.

Counting only the loans that are not kept in portfolio towards the origination limit ensures that a small creditor can always originate more portfolio loans without being concerned with the possibility of crossing the origination limit. The fact that a creditor keeps the loan in portfolio gives the creditor more incentives not to originate a loan that a consumer would not be able to repay: It potentially deals with the ''skin in the game'' issue described above.

However, a creditor keeping a loan in portfolio does not fully ensure that the creditor will only originate loans that

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to the final rule and 22.2 percent of the portfolio of creditors that are deemed small and rural due to the final rule. In comparison, the figure for larger creditors is 4.0 percent.

[58] If the area nearby a property is sparsely populated, a lack of comparable properties for appraisal can be a concern. In 2013, there were about 400 tracts where the only HMDA-reported loans originated were portfolio loans (out of the roughly 73,000 tracts in HMDA). About 200 of these tracts had more than one loan originated in 2013. These 400 tracts had fewer than 1,000 loans between them; of these loans, about 400 were made by creditors that originate over 5,000 loans a year and about 300 were made by creditors that made fewer than 500 loans a year.

[59] The Bureau analyzed HMDA 2013 county-level data. For purposes of the statistics here and below, ''counties'' is used to refer to counties and county equivalents. The Bureau considered counties where there are currently at most five creditors operating, and at least one of these creditors would qualify as small only due to the final rule. The Bureau's analysis shows that there are only a few counties like this, both for the purposes of the small creditor special provisions and for the purposes of the rural small creditor special provisions.

The cutoff of five competitors is arguably enough to ensure a sufficient amount of competition for a close-to-homogenous product. However, the Bureau does not mean to imply that, for example, first-lien covered transactions in a county constitute a market in the antitrust sense.

[60] To the extent that the effect of the already effective rules might shed light on this topic, the January 2013 Escrows Final Rule has a special provision allowing rural small creditors to originate higher-priced mortgage loans without providing an escrow account. Available evidence indicates that, after the rule went into effect in June 2013, rural small creditors were just as likely to begin originating higher-priced mortgage loans as other creditors. Moreover, the counties where rural small creditors that started originating loans operate did not experience an increase in access to credit. *See* Alexei Alexandrov & Xiaoling Ang, *Identifying a Suitable Control Group Based on Microeconomic Theory: The Case of Escrows in the Subprime Market,* SSRN working paper (Dec. 30, 2014), *available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2462128.*

[61] 79 FR 77602 (Dec. 24, 2014).

[62] *See* John Y. Campbell et al., *Consumer Financial Protection,* 25(1) Journal of Economic Perspectives 91, 96 (2011). ''[A] rationale for government mortgage policy is a public interest in reducing the incidence of foreclosures, which, as we mentioned, reduce not only the value of foreclosed properties, but also the prices of neighboring properties [. . .]. The negative effect on the neighborhood is an externality that will not be taken into account by private lenders even if their foreclosure decisions are privately optimal.''

[63] *Id.* ''In the late 1920s, the dominant mortgage form was a short-term balloon loan that required frequent refinancing. Low house prices and reduced bank lending capacity in the early 1930s prevented many homeowners from refinancing, causing a wave of foreclosures that exacerbated the Depression.''

consumers are able to repay. First, as noted above, ''the negative effect on the neighborhood is an externality that will not be taken into account by private lenders even if their foreclosure decisions are privately optimal.'' [64] Second, it is important to note that a loan can be in portfolio (and thus eligible for special provisions provided by the final rule), yet fully or almost fully insured by a third party. In these cases, the creditor does not bear the risk for these loans even though the loan is in portfolio: There is no or little ''skin in the game.'' [65] Finally, the loan officer might not be compensated optimally, although advocates of relationship lending suggest that smaller creditors do not suffer from the internal organization problems described above to the same extent as larger creditors.

Escrow accounts protect consumers from a financial shock (sometimes unexpected, especially for first-time buyers) of having to pay the first lump-sum property tax bill all at once, possibly soon after spending much of the household's savings on the down payment and closing costs. Recent research argues that postponing that payment by nine months (which an escrow account approximates by spreading payments over time) decreases the probability of an early payment default by 3 to 4 percent.[66] As noted in the January 2013 Escrows Final Rule, costs to consumers of not having escrow accounts also include the inconvenience of paying several bills instead of one; the lack of a budgeting device to enable consumers not to incur a major expense later on; and the possibility of underestimating the overall cost of maintaining a residence.

The extent of the potential cost to consumers depends on whether, but for the final provisions expanding the special provisions of the January 2013 ATR Final Rule and May 2013 ATR Final Rule: (1) Creditors that qualify for special provisions solely due to the final provisions have incentives to originate loans that do not consider consumers' ability to repay despite these loans being in the creditors' portfolios; (2) consumers of these creditors who proved unable to repay are unable to secure effective loss mitigation options from the creditors that would leave consumers as well off as they would have been without getting a loan that they proved to be unable to repay; and (3) absent the final provisions, these creditors would have stronger incentives to consider consumers' ability to repay or the consumers would elect to sue their local lender, would succeed in obtaining counsel to represent them, and would prevail in such suits. The Bureau does not possess evidence to confirm or deny whether these conditions are satisfied. Anecdotal evidence suggests that smaller lenders' loans performed better than larger lenders loans through the crisis.

Similarly, the extent of the potential cost to consumers from expanding the special provisions of the January 2013 Escrows Final Rule depends on whether but for the final provisions: (1) The creditors that are exempted solely due to the final provisions would not provide escrow accounts for five years despite these loans being in the creditors' portfolios; (2) consumers of these creditors who experienced a shock due to the first-time lump-sum payment and proved to be unable to repay were unable to secure effective loss mitigation options from the creditors that would leave the consumers as well off as they otherwise would have been with an escrow account; and (3) consumers of these creditors actually experience such shocks.

As noted above, the Bureau estimates that the about 1,700 creditors that will be small and rural under the final provisions, but not under the currently effective rule, originated about 220,000 loans and 120,000 portfolio loans in 2013. Out of those 120,000 portfolio loans, 26,000 were portfolio higher-priced mortgage loans. The Bureau does not possess a good estimate of what percentage of these 120,000 portfolio loans are balloon-payment loans. Assuming HPML lending continued at the same level among these creditors, about 26,000 loans would lose the mandatory escrow protections; however, many of these creditors might extend escrow protections despite not being subject to a requirement to do so.

The Bureau believes that the approximately 700 creditors that will be small under the final provisions, but not under the currently effective rule, originated 720,000 loans, including 175,000 portfolio loans, in 2013. Out of those 175,000 portfolio loans the Bureau estimates that about 15,000 were portfolio higher-priced mortgage loans and 88 percent of those had an APR between 1.5 and 3.5 percentage points over APOR.[67] The Bureau believes that about 13,000 loans would be deemed safe harbor qualified mortgages due to the final provisions. The Bureau does not possess a good estimate of what percentage of these 175,000 portfolio loans would not have been qualified mortgages but for the small creditor special provision.

Covered Person Benefits and Costs

The creditors that will enjoy the special provisions experience benefits roughly symmetric to the protections that consumers lose. In particular, creditors that will qualify as rural small creditors will be able to originate qualified mortgage balloon-payment portfolio loans and pass the risk onto consumers, and small creditors could originate portfolio loans that would not be qualified mortgages or safe harbor qualified mortgages otherwise, resulting in a reduced probability of a successful lawsuit.[68] Additionally, rural small creditors could reduce accounting and compliance costs of providing escrow accounts. To be eligible for these benefits, the firms might need to spend a nominal amount on checking whether they qualify for the special provision.

Some of these firm benefits could be passed through to consumers in terms of lower prices or better service. Economic theory suggests that the pass-through rate should be higher the more competitive markets are, all else being equal.[69] However, a market being competitive would suggest lesser access to credit concerns. The Bureau does not possess the data required to estimate the applicable pass-through rates, and will

[64] *Id.* at 96.

[65] Note that if the third party is, for example, the FHA, then the loan would currently be a qualified mortgage regardless of this final rule.

[66] *See* Nathan B. Anderson & Jane Dokko, *Liquidity Problems and Early Payment Default Among Subprime Mortgages,* Federal Reserve's Finance and Economics Discussion Series, *available at http://www.federalreserve.gov/pubs/feds/2011/201109/201109pap.pdf.*

[67] The percentage of loans with an APR that was 1.5 to 3.5 percentage points over APOR is based exclusively on HMDA data.

[68] There are two types of risk that creditors avoid by originating, for example, a succession of five-year balloon loans as opposed to a 30-year fixed rate loan. The first type of risk is the interest rate risk: Cost of funds may increase and the fixed rate will be too cheap, in a sense, for current market conditions. This type of risk is almost fully hedged by choosing an appropriate index for a 5/5 adjustable-rate mortgage. The second type of risk is the risk of the deterioration of the consumer's idiosyncratic conditions. For example, if the consumer's credit profile deteriorates or the consumer loses their job, their fixed rate will be too cheap for that consumer's current conditions. Arguably, creditors can project this risk better than individual consumers and are the lowest cost-avoiders, especially if one assumes that moral hazard is not a major concern in this situation (that consumers are not more likely to lose a job simply because they know that their mortgage is a 30-year loan as opposed to a 5-year balloon loan).

[69] *See* Alexei Alexandrov & Sergei Koulayev, *Using the Economics of the Pass Through in Proving Antitrust Injury in Robinson-Patman Cases,* SSRN working paper (Jan. 26, 2015), *available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2555952.*

therefore not discuss the pass-through possibilities further.

The benefit of originating balloon-payment loans to the firms is cheaper risk management. Consumers might not realize the riskiness involved in balloon-payment loans, encouraging the creditor to pass on the risk to consumers. The Bureau does not possess a good estimate of what percentage of these creditors' portfolio loans are balloon-payment loans.

The Bureau believes that an additional 1,700 creditors will qualify as small and rural due to the final provisions. These creditors will not have to provide consumers with escrow accounts when originating higher-priced mortgage loans; however, the Bureau believes that about 1,300 of the 1,700 creditors already originate higher-priced mortgage loans, thus these savings might be small (or none) for these firms since these firms currently have to provide escrow accounts. Note, that the marginal costs of providing an escrow account are small, if not negative: For various reasons, a creditor that has an escrow system established generally prefers consumers to establish an escrow account even if one is not required by government regulations.

Approximately 700 creditors will be deemed as small due to the final provisions. These creditors originated approximately 175,000 portfolio loans in 2013, out of which about 13,000 loans would be deemed safe harbor qualified mortgages due to the final provisions. The Bureau does not possess sufficient data to estimate what percentage of these loans would be qualified mortgages solely due to the final provisions. Loans being deemed qualified mortgages or safe harbor qualified mortgages imply a reduced risk of losing consumer-initiated ability-to-repay litigation. The Bureau previously estimated that this risk accounts for, at most, 0.1 percent of the loan amount.

Note that all 700 creditors are currently not eligible for the small creditor special provision, and thus any sunk costs necessary to transition to originating non-qualified mortgage loans have already been incurred, except for those creditors that have decided not to originate any non-qualified mortgage loans.

To be eligible for these benefits, the creditors might need to spend a nominal amount on checking whether they qualify for the special provisions. Since the final provisions are expanding special provisions and extending qualified mortgage status, covered persons will not experience any costs other than, potentially, a nominal amount to check whether they qualify for the exemptions or extensions of qualified mortgage status.

Temporary Balloon-Payment Qualified Mortgage Period—Benefits and Costs to Consumers and Covered Persons

The Bureau is providing an extension of the two-year temporary special provision that effectively deemed all small creditors rural for the purposes of the rural qualified mortgage balloon-payment special provision. This temporary special provision, allowing these creditors to make qualified mortgage balloon-payment loans, is applicable (for transactions with mortgage applications received in the first three months of 2016) to any creditor that is currently small even if they do not operate predominantly in rural or underserved areas. The Bureau estimates that there are about 5,700 such creditors, and that they originated about 430,000 loans, out of which about 220,000 were portfolio loans in 2013. Note, that only the transactions with applications received in the first quarter of 2016 are eligible for this special provision. The Bureau does not possess a good estimate of what percentage of these portfolio loans are balloon-payment loans.

The benefits and costs to consumers and to covered persons are identical to the ones discussed above during the discussion of the rural balloon-payment qualified mortgage special provision. Note that various property idiosyncrasies that might make access to credit an issue in rural areas are less likely for the consumers of these 5,700 creditors since they do not operate predominantly in rural areas, even as defined by the final rule.

The Bureau is also finalizing an annual grace period for creditors that stop qualifying as either small creditors or small and rural creditors.[70] Given the finalized origination limit, the Bureau believes that the number of these transitions is likely to be low from year-to-year: The number of the creditors that are close to the threshold of small is minimal in comparison to the total number qualified (approximately 10,400 small creditors and approximately 4,100 rural small creditors) and rural areas change only after each decennial Census. Thus the Bureau does not estimate the effect of this provision in this 1022(b)(2) analysis.

[70] Currently, creditors qualify as operating predominantly in rural or underserved areas based on a three-year lookback period: A creditor is considered as operating predominantly in rural or underserved areas as long as the creditor operated predominantly in rural or underserved areas in any of the three preceding years. Thus, this final provision could potentially deem a creditor that would be rural in January 2016 not rural. However, the Bureau believes that this possibility will not actually occur or, in other words, any small creditor that was operating in predominantly rural or underserved areas in any of the preceding three years according to the current definition qualifies as rural small under the final rule.

C. Impact on Covered Persons With No More Than $10 Billion in Assets

The only covered persons affected by the final provisions are those with no more than $10 billion in assets. The effect on these covered persons is described above.

D. Impact on Access to Credit

The Bureau does not believe that there will be an adverse impact on access to credit resulting from the final provisions. Moreover, as described above, the Bureau received comments strongly suggesting that there will be an expansion of access to credit.

E. Impact on Rural Areas

The rural small creditor final provisions affect only creditors operating predominantly in rural or underserved areas, as defined according to the definition that the Bureau is proposing. These creditors predominantly originate loans to consumers that live in rural areas, thus the vast majority of the up to 120,000 consumers that will be affected by these provisions live in rural areas. The effect of these final provisions is described above.

The creditors that will qualify as small due to the final provisions are about as well represented in rural as in non-rural areas, thus there will be no disproportionate effect on rural areas.[71]

F. Discussion of Significant Alternatives

Instead of proposing (and finalizing) that a property is in a rural area if the property is either in one of the counties currently designated as rural by the Bureau or if the property is not in an urban area as designated by the Census Bureau, the Bureau considered proposing that a property is in a rural area only if the property is not in an urban area as designated by the Census Bureau. The effective difference between the two definitions is that under the finalized definition areas designated as urban areas by the Census Bureau that are located in counties currently designated as rural by the Bureau would be classified as rural, but these urban areas would not be classified as rural under the alternative.

For example, Wise County in Virginia (population of about 40,000, density of

[71] If anything, these creditors are overrepresented in non-rural counties.

about 100 people per square mile) is currently designated as a rural area by the Bureau. Under the proposed (and finalized) definition the whole county remains rural. However, under the alternative definition, some census blocks in that county, including most of the census blocks that comprise the town of Wise, Virginia (population of about 3,000, density of about 1,000 people per square mile) would stop being classified as rural areas. A similar example is Gillespie County in Texas (population of about 25,000, density of about 25 people per square mile), which is rural under the current definition and under the proposed (and finalized) definition. Most of the city of Fredericksburg (population of about 11,000, density of about 1,500 people per square mile) in Gillespie County would not be considered rural under the alternative. Overall, about 22 percent of the U.S. population lives in areas that are deemed as rural under the final provisions. About 19 percent of the U.S. population lives in census blocks that are not in an urban area according to the Census Bureau.

In comparison to this alternative, the final provisions allow several hundred small creditors to continue to enjoy the special provisions for creditors operating predominantly in rural or underserved areas. Under the alternative, these creditors would have to incur the cost of adapting to originating mortgages without enjoying the provisions that they currently enjoy. Moreover, under the alternative, compliance might become more burdensome for the remaining creditors that would have qualified as rural small creditors even if the final rule were not to become effective: They would not be able to simply check a list of rural counties (as they do now), since parts of these counties would cease to be rural. These costs, both the cost of adaptation for some creditors and the cost of more complicated compliance for others, are likely fixed, and economic theory suggests that these creditors would not pass these costs on to consumers.

Other consumer benefits and costs and covered persons benefits and costs of these several hundred small creditors ceasing to qualify as rural are similar to the ones described above for the final provisions in general.

VIII. Regulatory Flexibility Act Analysis

The Regulatory Flexibility Act (RFA), as amended by the Small Business Regulatory Enforcement Fairness Act of 1996, requires each agency to consider the potential impact of its regulations on small entities, including small businesses, small governmental units, and small nonprofit organizations. The RFA defines a ''small business'' as a business that meets the size standard developed by the Small Business Administration pursuant to the Small Business Act.

The RFA generally requires an agency to conduct an initial regulatory flexibility analysis (IRFA) and a final 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.[72] The Bureau also is subject to certain additional procedures under the RFA involving the convening of a panel to consult with small business representatives before proposing a rule for which an IRFA is required.[73]

In the Proposed Rule, the Bureau concluded that the proposal, if adopted, would not have a significant economic impact on a substantial number of small entities and that an initial regulatory flexibility analysis was therefore not required. This final rule adopts the Proposed Rule substantially as proposed. Therefore, a final regulatory flexibility analysis is not required.

The final rule does not have a significant economic impact on any small entities.[74] As noted in the Section 1022(b)(2) Analysis, above, the Bureau does not expect that the final rule will impose costs on covered persons, including small entities. All methods of compliance under current law remain available to small entities when these provisions become effective. Thus, a small entity that is in compliance with current law will not need to take any additional action under the final rule.

Certification

Accordingly, the undersigned certifies that this final rule will not have a significant economic impact on a substantial number of small entities.

IX. Paperwork Reduction Act

Under the Paperwork Reduction Act of 1995 (PRA) (44 U.S.C. 3501 *et seq.*), Federal agencies are generally required to seek the Office of Management and Budget (OMB) approval for information collection requirements before implementation. The collections of information related to Regulation Z have been previously reviewed and approved by OMB in accordance with the PRA and assigned OMB Control Number 3170–0015 (Regulation Z). Under the PRA, the Bureau may not conduct or sponsor, and, notwithstanding any other provision of law, a person is not required to respond to an information collection unless the information collection displays a valid control number assigned by OMB.

The Bureau has determined that this final rule does not impose any new or revised information collection requirements (recordkeeping, reporting, or disclosure requirements) on covered entities or members of the public that would constitute collections of information requiring OMB approval under the PRA.

[72] 5 U.S.C. 601 *et seq.*

[73] 5 U.S.C. 609.

[74] It is theoretically possible that a creditor qualifies as small under the current definition, but fails to qualify as small due to the final rule provision including in the calculation of the asset limit for small-creditor status the assets of the creditor's affiliates that originate mortgage loans. The Bureau is unaware of any such creditors.

List of Subjects in 12 CFR Part 1026

Advertising, Consumer protection, Credit, Credit unions, Mortgages, National banks, Savings associations, Recordkeeping requirements, Reporting, Truth in lending.

Authority and Issuance

For the reasons set forth in the preamble, the Bureau amends Regulation Z, 12 CFR part 1026, as set forth below:

PART 1026—TRUTH IN LENDING (REGULATION Z)

■ 1. The authority citation for part 1026 continues to read as follows:

Authority: 12 U.S.C. 2601, 2603–2605, 2607, 2609, 2617, 3353, 5511, 5512, 5532, 5581; 15 U.S.C. 1601 *et seq.*

Subpart E—Special Rules for Certain Home Mortgage Transactions

■ 2. Section 1026.35 is amended by revising paragraphs (b)(2)(iii)(A) through (D)(*1*) and (b)(2)(iv)(A) and (B) and adding paragraph (b)(2)(iv)(C) to read as follows:

§ 1026.35 Requirements for higher-priced mortgage loans.

* * * * *

(b) * * *

(2) * * *

(iii) * * *

(A) During the preceding calendar year, or, if the application for the transaction was received before April 1 of the current calendar year, during either of the two preceding calendar years, the creditor extended more than 50 percent of its total covered transactions, as defined by § 1026.43(b)(1), secured by first liens on properties that are located in areas that are either ''rural'' or ''underserved,'' as

set forth in paragraph (b)(2)(iv) of this section;

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

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

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

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

* * * * *

(iv) * * *

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

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

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

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

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

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

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

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

* * * * *

■ 3. Section 1026.43 is amended by revising paragraph (e)(6) to read as follows:

§ 1026.43 Minimum standards for transactions secured by a dwelling.

* * * * *

(e) * * *

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

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

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

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

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

■ 4. In Supplement I to Part 1026—Official Interpretations:

■ A. Under *Section 1026.35—Requirements for Higher-Priced Mortgage Loans:*

■ i. Under *Paragraph 35(b)(2)(iii),* paragraphs 1 introductory text and 1.i through iii are revised.

■ ii. Under *Paragraph 35(b)(2)(iii)(D)(1),* paragraph 1 is revised.

■ iii. Under *Paragraph 35(b)(2)(iv),* paragraphs 1 and 2 are revised.

■ B. *Under Section 1026.36—Prohibited Acts or Practices and Certain Requirements for Credit Secured by a Dwelling,* subheading *36(a) Definitions,* paragraph 1.i.A.*3* is revised.

■ C. Under *Section 1026.43—Minimum Standards for Transactions Secured by a Dwelling:*

■ i. Under *Paragraph 43(e)(5),* paragraphs 4 and 8 are revised.

■ ii. Under *Paragraph 43(f)(1)(vi),* paragraph 1 is revised.

■ iii. Under *Paragraph 43(f)(2),* paragraph 2 is revised.

■ iv. Under *Paragraph 43(f)(2)(ii),* paragraph 1 is revised.

The revisions read as follows:

Supplement I to Part 1026—Official Interpretations

Subpart E—Special Rules for Certain Home Mortgage Transactions

* * * * *

Section 1026.35—Requirements for Higher-Priced Mortgage Loans

* * * * *

35(b) Escrow accounts.

* * * * *

35(b)(2) Exemptions.

* * * * *

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

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

i. During the preceding calendar year, or during either of the two preceding calendar years if the application for the loan was received before April 1 of the current calendar year, more than 50 percent of the creditor's total first-lien covered transactions, as defined in § 1026.43(b)(1), are secured by properties located in areas that are either ''rural'' or ''underserved,'' as set forth in § 1026.35(b)(2)(iv).

A. In general, whether this condition (the more than 50 percent test) is satisfied depends on the creditor's activity during the preceding calendar year. However, if the application for the loan in question was received before April 1 of the current calendar year, the creditor may instead meet the more than 50 percent test based on its activity during the next-to-last calendar year. This provides creditors with a grace

period if their activity meets the more than 50 percent test (in § 1026.35(b)(2)(iii)(A)) in one calendar year but fails to meet it in the next calendar year.

B. A creditor meets the more than 50 percent test for any higher-priced mortgage loan consummated during a calendar year if a majority of its first-lien covered transactions in the preceding calendar year are secured by properties located in rural or underserved areas. If the creditor's transactions in the preceding calendar year do not meet the more than 50 percent test, the creditor meets this condition for a higher-priced mortgage loan consummated during the current calendar year only if the application for the loan was received before April 1 of the current calendar year and a majority of the creditor's first-lien covered transactions during the next-to-last calendar year are secured by properties located in rural or underserved areas. The following examples are illustrative:

1. Assume that a creditor extended 180 first-lien covered transactions during 2016 and that 91 of these are secured by properties located in rural or underserved areas. Because a majority of the creditor's first-lien covered transactions during 2016 are secured by properties located in rural or underserved areas, the creditor can meet this condition for exemption for any higher-priced mortgage loan consummated during 2017.

2. Assume that a creditor extended 180 first-lien covered transactions during 2016, including 90 transactions secured by properties that are located in rural or underserved areas. Assume further that the same creditor extended 200 first-lien covered transactions during 2015, including 101 transactions secured by properties that are located in rural or underserved areas. Assume further that the creditor consummates a higher-priced mortgage loan in 2017 for which the application was received in November 2017. Because the majority of the creditor's first-lien covered transactions during 2016 are not secured by properties that are located in rural or underserved areas, and the application was received on or after April 1, 2017, the creditor does not meet this condition for exemption. However, assume instead that the creditor consummates a higher-priced mortgage loan in 2017 based on an application received in February 2017. The creditor meets this condition for exemption for this loan because the application was received before April 1, 2017, and the majority of the creditor's first-lien covered transactions in 2015 are secured by properties that are located in areas that were rural or underserved.

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

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

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

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

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

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

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

affiliate. If the creditor, together with its affiliates that regularly extended first-lien covered transactions, exceeded the asset limit in the preceding calendar year—to be eligible to operate as a small creditor for transactions with applications received before April 1 of the current calendar year—the assets of the creditor's affiliates that regularly extended covered transactions in the year before the preceding calendar year are included in calculating the creditor's assets.

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

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

E. Under § 1026.35(b)(2)(iii)(C), the $2,000,000,000 asset threshold adjusts automatically each year based on the year-to-year change in the average of the Consumer Price Index for Urban Wage Earners and Clerical Workers, not seasonally adjusted, for each 12-month period ending in November, with rounding to the nearest million dollars. The Bureau will publish notice of the asset threshold each year by amending this comment. For historical purposes:

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

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

3. For calendar year 2015, the asset threshold was $2,060,000,000. Creditors that had total assets of less than $2,060,000,000 on December 31, 2014, satisfied this criterion for purposes of any loan consummated in 2015 and, if the creditor's assets together with the assets of its affiliates that regularly extended first-lien covered transactions during calendar year 2014 were less than that amount, for purposes of any loan consummated in 2016 for which the application was received before April 1, 2016.

* * * * *

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

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

* * * * *

Paragraph 35(b)(2)(iv)

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

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

ii. Under § 1026.35(b)(2)(iv)(B), an area is underserved during a calendar year if, according to Home Mortgage Disclosure Act (HMDA) data for the preceding calendar year, it is a county in which no more than two creditors extended covered transactions, as defined in § 1026.43(b)(1), secured by first liens, five or more times on properties in the county. Specifically, a

county is an ''underserved'' area if, in the applicable calendar year's public HMDA aggregate dataset, no more than two creditors have reported five or more first-lien covered transactions, with HMDA geocoding that places the properties in that county. For purposes of this determination, because only covered transactions are counted, all first-lien originations (and only first-lien originations) reported in the HMDA data are counted except those for which the owner-occupancy status is reported as ''Not owner-occupied'' (HMDA code 2), the property type is reported as ''Multifamily'' (HMDA code 3), the applicant's or co-applicant's race is reported as ''Not applicable'' (HMDA code 7), or the applicant's or co-applicant's sex is reported as ''Not applicable'' (HMDA code 4). The most recent HMDA data are available at *http://www.ffiec.gov/hmda.*

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

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

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

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

2. *Examples.* i. An area is considered ''rural'' for a given calendar year based on the most recent available UIC designations by the USDA–ERS and the most recent available delineations of urban areas by the U.S. Census Bureau that are available at the beginning of the calendar year. These designations and delineations are updated by the USDA–ERS and the U.S. Census Bureau respectively once every ten years. As an example, assume a creditor makes first-lien covered transactions in Census Block X that is located in County Y during calendar year 2017. As of January 1, 2017, the most recent UIC designations were published in the second quarter of 2013, and the most recent delineation of urban areas was announced in the **Federal Register** in 2012, *see* U.S. Census Bureau, *Qualifying Urban Areas for the 2010 Census,* 77 FR 18652 (Mar. 27, 2012). To determine whether County Y is rural under the Bureau's definition during calendar year 2017, the creditor can use USDA–ERS's 2013 UIC designations. If County Y is not rural, the creditor can use the U.S. Census Bureau's 2012 delineation of urban areas to determine whether Census Block X is rural and is therefore a ''rural'' area for purposes of § 1026.35(b)(2)(iv)(A).

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

* * * * *

Section 1026.36—Prohibited Acts or Practices and Certain Requirements for Credit Secured by a Dwelling

36(a) Definitions.

1. * * *

i. * * *

A. * * *

3. Assisting a consumer in obtaining or applying for consumer credit by advising on particular credit terms that are or may be available to that consumer based on the consumer's financial characteristics, filling out an application form, preparing application packages (such as a credit application or pre-approval application or supporting documentation), or collecting application and supporting information on behalf of the consumer to submit to a loan originator or creditor. A person who, acting on behalf of a loan originator or creditor, collects information or verifies information provided by the consumer, such as by asking the consumer for documentation to support the information the consumer provided or for the consumer's authorization to obtain supporting documents from third parties, is not collecting information on behalf of the consumer. See also comment 36(a)–4.i through .iv with respect to application-related administrative and clerical tasks and comment 36(a)–1.v with respect to third-party advisors.

* * * * *

Section 1026.43—Minimum Standards for Transactions Secured by a Dwelling

* * * * *

Paragraph 43(e)(5).

* * * * *

4. *Creditor qualifications.* To be eligible to make qualified mortgages under § 1026.43(e)(5), a creditor must satisfy the requirements stated in § 1026.35(b)(2)(iii)(B) and (C). Section 1026.35(b)(2)(iii)(B) requires that, during the preceding calendar year, or, if the application for the transaction was received before April 1 of the current calendar year, during either of the two preceding calendar years, the creditor and its affiliates together extended no more than 2,000 covered transactions, as defined by § 1026.43(b)(1), secured by first liens, that were sold, assigned, or otherwise transferred to another person, or that were subject at the time of consummation to a commitment to be acquired by another person. Section 1026.35(b)(2)(iii)(C) requires that, as of the preceding December 31st, or, if the application for the transaction was received before April 1 of the current calendar year, as of either of the two preceding December 31sts, the creditor and its affiliates that regularly extended, during the applicable period, covered transactions, as defined by § 1026.43(b)(1), secured by first liens, together, had total assets of less than $2 billion, adjusted annually by the Bureau for inflation.

* * * * *

8. *Transfer to another qualifying creditor.* Under § 1026.43(e)(5)(ii)(B), a qualified mortgage under § 1026.43(e)(5) may be sold, assigned, or otherwise transferred at any time to another creditor that meets the requirements of § 1026.43(e)(5)(i)(D). That section requires that a creditor together with all its affiliates, extended no more than 2,000 first-lien covered transactions that were sold, assigned, or otherwise transferred by the creditor or its affiliates to another person, or that were subject at the time of consummation to a commitment to be acquired by another person; and have, together with its affiliates that regularly extended covered transactions secured by first liens, total assets less than $2 billion (as adjusted for inflation). These tests are assessed based on transactions and assets from the calendar year preceding the current calendar year or from either of the two calendar years preceding the current calendar year if the application for the transaction was received before April 1 of the current calendar year. A qualified mortgage under § 1026.43(e)(5) transferred to a creditor that meets these criteria would retain its qualified mortgage status even if it is transferred less than three years after consummation.

* * * * *

43(f) Balloon-payment qualified mortgages made by certain creditors.

43(f)(1) Exemption.

* * * * *

Paragraph 43(f)(1)(vi).

1. *Creditor qualifications.* Under § 1026.43(f)(1)(vi), to make a qualified mortgage that provides for a balloon payment, the creditor must satisfy three criteria that are also required under § 1026.35(b)(2)(iii)(A), (B) and (C), which require:

i. During the preceding calendar year or during either of the two preceding calendar years if the application for the transaction was received before April 1 of the current calendar year, the creditor extended over 50 percent of its total first-lien covered transactions, as defined in § 1026.43(b)(1), on properties that are located in areas that are designated either ''rural'' or ''underserved,'' as defined in § 1026.35(b)(2)(iv), to satisfy the requirement of § 1026.35(b)(2)(iii)(A). Pursuant to § 1026.35(b)(2)(iv), an area is considered to be rural if it is: A county that is neither in a metropolitan statistical area, nor a micropolitan statistical area adjacent to a metropolitan statistical area, as those terms are defined by the U.S. Office of Management and Budget; or a census block that is not in an urban area, as defined by the U.S. Census Bureau using the latest decennial census of the United States. An area is considered to be underserved during a calendar year if, according to HMDA data for the preceding calendar year, it is a county in which no more than two creditors extended covered transactions secured by first liens on properties in the county five or more times.

A. The Bureau determines annually which counties in the United States are rural or underserved as defined by § 1026.35(b)(2)(iv)(A)(*1*) or § 1026.35(b)(2)(iv)(B) and publishes on its public Web site lists of those counties to assist creditors in determining whether they meet the criterion at § 1026.35(b)(2)(iii)(A). Creditors may also use an automated tool provided on the Bureau's public Web site to determine whether specific properties are located in areas that qualify as ''rural'' or ''underserved'' according to the definitions in § 1026.35(b)(2)(iv) for a particular calendar year. In addition, the U.S. Census Bureau may also provide on its public Web site an automated address search tool that specifically indicates if a property address is located in an urban area for purposes of the Census Bureau's most recent delineation of urban areas. For any calendar year that begins after the date on which the Census Bureau announced its most recent delineation of urban areas, a property is located in an area that qualifies as ''rural'' according to the definitions in § 1026.35(b)(2)(iv) if the search results provided for the property by any such automated address search tool available on the Census Bureau's public Web site do not identify the property as being in an urban area.

B. For example, if a creditor extended 100 first-lien covered transactions during 2016 and 90 first-lien covered transactions during 2017, the creditor meets this element of the exception for any transaction consummated during 2018 if at least 46 of its 2017 first-lien covered transactions are secured by properties that are located in one or more counties on the Bureau's lists for 2017 or are located in one or more census blocks that are not in an urban area, as defined by the Census Bureau.

C. Alternatively, if the creditor's 2017 transactions do not meet the over 50 percent test (*see* comment 43(f)(1)(vi)–1.i), the creditor satisfies this criterion for any transaction consummated during 2018 for which it received the

application before April 1, 2018, if at least 51 of its 2016 first-lien covered transactions are secured by properties that are located in one or more counties on the Bureau's lists for 2016 or are located in one or more census blocks that are not in an urban area.

ii. During the preceding calendar year, or, if the application for the transaction was received before April 1 of the current calendar year, during either of the two preceding calendar years, the creditor together with its affiliates extended no more than 2,000 covered transactions, as defined by § 1026.43(b)(1), secured by first liens, that were sold, assigned, or otherwise transferred to another person, or that were subject at the time of consummation to a commitment to be acquired by another person, to satisfy the requirement of § 1026.35(b)(2)(iii)(B).

iii. As of the preceding December 31st, or, if the application for the transaction was received before April 1 of the current calendar year, as of either of the two preceding December 31sts, the creditor and its affiliates that regularly extended covered transactions secured by first liens, together, had total assets that do not exceed the applicable asset threshold established by the Bureau, to satisfy the requirement of § 1026.35(b)(2)(iii)(C). The Bureau publishes notice of the asset threshold each year by amending comment 35(b)(2)(iii)–1.iii.

43(f)(2) Post-consummation transfer of balloon-payment qualified mortgage.

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2. *Application to subsequent transferees.* The exceptions contained in § 1026.43(f)(2) apply not only to an initial sale, assignment, or other transfer by the originating creditor but to subsequent sales, assignments, and other transfers as well. For example, assume Creditor A originates a qualified mortgage under § 1026.43(f)(1). Six months after consummation, Creditor A sells the qualified mortgage to Creditor B pursuant to § 1026.43(f)(2)(ii) and the loan retains its qualified mortgage status because Creditor B complies with the conditions relating to operating in rural or underserved areas, asset size, and number of transactions. If Creditor B sells the qualified mortgage, it will lose its qualified mortgage status under § 1026.43(f)(1) unless the sale qualifies for one of the § 1026.43(f)(2) exceptions for sales three or more years after consummation, to another qualifying institution, as required by supervisory action, or pursuant to a merger or acquisition.

* * * * *

Paragraph 43(f)(2)(ii).

1. *Transfer to another qualifying creditor.* Under § 1026.43(f)(2)(ii), a balloon-payment qualified mortgage under § 1026.43(f)(1) may be sold, assigned, or otherwise transferred at any time to another creditor that meets the requirements of § 1026.43(f)(1)(vi). That section requires that a creditor: (1) Extended over 50 percent of its total first-lien covered transactions, as defined in § 1026.43(b)(1), on properties located in rural or underserved areas; (2) together with all affiliates, extended no more than 2,000 first-lien covered transactions that were sold, assigned, or otherwise transferred by the creditor or its affiliates to another person, or that were subject at the time of consummation to a commitment to be acquired by another person; and (3) have, together with its affiliates that regularly extended covered transactions secured by first liens, total assets less than $2 billion (as adjusted for inflation). These tests are assessed based on transactions and assets from the calendar year preceding the current calendar year or from either of the two calendar years preceding the current calendar year if the application for the transaction was received before April 1 of the current calendar year. A balloon-payment qualified mortgage under § 1026.43(f)(1) transferred to a creditor that meets these criteria would retain its qualified mortgage status even if it is transferred less than three years after consummation.

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Richard Cordray,

Director, Bureau of Consumer Financial Protection.

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