

~~higher-priced mortgage loans. Section 226.35(b)(1) contains the ability to repay requirement for higher-priced mortgage loans. Section 226.35(b)(2) sets forth restrictions on prepayment penalties for higher-priced mortgage loans. Section 226.35(b)(3) contains escrow rules for higher-priced mortgage loans. Section 226.35(b)(4) prohibits evasion of the higher-priced mortgage loan protections by structuring a transaction as open-end credit.~~

~~The proposed changes to Regulation Z in the 2011 Escrow Proposal and this proposal would render all of current § 226.35 unnecessary. The 2011 Escrow Proposal would adopt in proposed § 226.45(a) the coverage test for higher-priced mortgage loans in 226.35(a); would revise and adopt in § 226.45(b) the escrow requirements in § 226.35(b)(3); and would adopt in proposed § 226.45(d) the prohibition of evasion of the higher-priced mortgage loan protections by structuring a transaction as open-end credit, now in § 226.35(b)(4). This proposal, as discussed below, would supersede in § 226.43(a) (f) the ability to repay requirement in § 226.35(b)(1), and would supersede in § 226.43(g) the prepayment penalty rules in § 226.34(b)(2). Accordingly, the Board proposes to remove and reserve § 226.35 and its accompanying commentary. For ease of reading, the Board is not reprinting § 226.35 and its accompanying commentary in this proposed rule.~~

### *Section 226.43 Minimum Standards for Transactions Secured by a Dwelling*

TILA Sections 129C(a), (b), and (c) establish, for residential mortgage loans: (1) A requirement to consider a consumer's repayment ability; (2) alternative requirements for "qualified mortgages"; and (3) limits on prepayment penalties, respectively. The Board proposes to implement TILA Section 129C(a) through (c) in new § 226.43, as discussed in detail below.

#### 43(a) Scope

##### Background

Section 1411 of the Dodd-Frank Act adds a new TILA Section 129C that requires creditors to determine a consumer's ability to repay a "residential mortgage loan." Section 1401 of the Act adds a new TILA Section 103(cc) that defines "residential mortgage loan" to mean, with some exceptions, any consumer credit transaction secured by a mortgage, deed of trust, or other equivalent consensual security interest on "a dwelling or on residential real property that includes a

dwelling." TILA Section 103(v) defines "dwelling" to mean a residential structure or mobile home which contains one- to four-family housing units, or individual units of condominiums or cooperatives. Thus, a "residential mortgage loan" is a dwelling-secured consumer credit transaction, which can include: (1) A home purchase, refinancing, or home equity loan; (2) a loan secured by a first lien or a subordinate lien on a dwelling; (3) a loan secured by a dwelling that is a principal residence, second home, or vacation home (other than a timeshare residence); or (4) a loan secured by a one-to-four unit residence, condominium, cooperative, mobile home, or manufactured home.

However, the term "residential mortgage loan" does not include an open-end credit plan or an extension of credit relating to a timeshare plan, for purposes of the Act's repayment ability and prepayment penalty provisions under TILA Section 129C, among other provisions. See TILA Section 103(cc)(5); see also TILA Section 129C(i) (providing that timeshare transactions are not subject to TILA Section 129C). Further, the repayment ability provisions of TILA Section 129C(a) do not apply to reverse mortgages or temporary or "bridge" loans with a loan term of 12 months or less, including a loan to purchase a new dwelling where the consumer plans to sell another dwelling within 12 months. See TILA Section 129C(a)(8). The repayment ability provisions of TILA Section 129C(a) also do not apply to consumer credit transactions secured by vacant land and not by a dwelling.

~~The scope of the 2008 HOEPA Final Rule differs from the scope of TILA Section 129C in three respects. First, as discussed above, the 2008 HOEPA Final Rule applies only to loans designated "higher-priced mortgage loans" or "high-cost mortgages" based on their APR or points and fees. Section 226.34(a)(4), 226.35(b)(1). By contrast, TILA Sections 129C(a) through (c) apply regardless of the residential mortgage loan's cost. Second, the 2008 HOEPA Final Rule is limited to loans secured by the consumer's principal dwelling. Section 226.32(a)(1), 226.35(a)(1). Finally, the 2008 HOEPA Final Rule does not exempt transactions secured by a consumer's interest in a timeshare plan.~~

##### The Board's Proposal

Proposed § 226.43(a) describes the scope of the requirement to determine a consumer's ability to repay a residential mortgage loan. Proposed § 226.43(a)(1) and (2) provide that the repayment ability provisions under proposed

§ 226.43 apply to consumer credit transactions secured by a dwelling, as defined in § 226.2(a)(19), except for (1) a home equity line of credit (HELOC) subject to § 226.5b, and (2) a mortgage transaction secured by a consumer's interest in a timeshare plan, as defined in 11 U.S.C. 101(53(D)). The exemptions under proposed § 226.43(a)(1) and (2) implement the exclusions from the definition of "residential mortgage loan" under TILA Section 103(cc)(5). Proposed § 226.43(a)(3) provides that the following transactions are exempt from coverage by proposed § 226.43(e) through (f): (1) A reverse mortgage subject to § 226.33; and (2) a temporary or "bridge loan" with a term of 12 months or less, such as a loan to finance the purchase of a new dwelling where the consumer plans to sell a current dwelling within 12 months or a loan to finance the initial construction of a dwelling.

As discussed in detail below, proposed § 226.43(e) and (d) implement repayment ability provisions and special rules for refinancings of "non-standard" mortgages into "standard" mortgages under TILA Section 129C(a). TILA Section 129C(a)(8) specifically provides that reverse mortgages and temporary or "bridge" loans with a term of 12 months or less are not subject to TILA Section 129C(a). The Board also proposes to apply this exception for purposes of alternative requirements for "qualified mortgages" and balloon-payment qualified mortgages pursuant to TILA Section 129C(b). Although TILA Section 129C(b) does not specifically exempt reverse mortgages or temporary or "bridge" loans with a term of 12 months or less from coverage by the alternative requirements for qualified mortgages, the Board believes the alternative requirements for qualified mortgages are relevant only if a transaction is subject to the repayment ability requirements. Accordingly, proposed § 226.43(a)(3) provides that reverse mortgages and temporary or "bridge" loans with a term of 12 months or less are not subject to the alternative requirements for qualified mortgages and balloon-payment qualified mortgages, under proposed § 226.43(e) or (f). Such transactions nevertheless are subject to the prepayment penalty restrictions under proposed § 226.43(g), discussed in detail below.

"Residential mortgage loan." Proposed § 226.43(a) clarifies that requirements under proposed § 226.43 apply to any consumer credit transaction secured by a dwelling, as defined in § 226.2(a)(19), with certain exceptions discussed above. Proposed § 226.43(a) does not use the term "residential mortgage loan,"

for two reasons. First, the usefulness of the defined term “residential mortgage loan” is limited, because the coverage of provisions applicable to “residential mortgage loans” varies under different TILA provisions. For example, TILA Section 103(cc) excludes transactions secured by a consumer’s interest in a timeshare transaction from the definition of “residential mortgage loan” for purposes of some, but not all, TILA provisions, and the Dodd-Frank Act provides or authorizes other specific exemptions from coverage by requirements for “residential mortgage loans.”<sup>22</sup> Specifying which transactions are subject to and exempt from coverage by proposed § 226.43 in a scope provision thus would facilitate compliance better than using the defined term “residential mortgage loan.”

Second, the term “residential mortgage loan” could be confused with the similar term “residential mortgage transaction,” which means a transaction in which a mortgage or equivalent consensual security interest is created or retained against the consumer’s dwelling to finance the acquisition or initial construction of the dwelling. See 15 U.S.C. 1602(w). The term “residential mortgage transaction,” used in connection with rescission provisions under § 226.15 and 226.23, does not encompass such transactions as refinance transactions and home equity loans. Using the similar term “residential mortgage loan,” which encompasses refinance transactions and home equity loans, could confuse creditors subject to proposed § 226.43.

~~Owner occupancy; consumer credit transaction. If a transaction is a dwelling secured extension of consumer credit, proposed § 226.43 applies regardless of whether or not the consumer occupies the dwelling (unless an exception from coverage applies under proposed § 226.43(a)(1)-(3)). However, TILA and Regulation Z do not apply to credit extensions that are primarily for business purposes. 15 U.S.C. 1603(l); § 226.3(a)(1). Current guidance in comment 3(a)-2 clarifies the factors to be considered to determine whether a credit extension is business or consumer credit. Further, comment 3(a)-3 states that credit extended to acquire, improve, or maintain rental~~

~~property that is not owner-occupied (that is, in which the owner does not expect to live for more than fourteen days during the coming year) is deemed to be for business purposes. Proposed comment 43(a)-1 clarifies that § 226.43 does not apply to an extension of credit primarily for a business, commercial, or agricultural purpose and cross-references the existing guidance on determining the primary purpose of an extension of credit in commentary on § 226.3.~~

~~Dwelling. TILA Section 129(cc) defines “residential mortgage loan” to mean a consumer credit transaction secured by a mortgage or equivalent consensual security interest “on a dwelling or on residential real property that includes a dwelling.” Under TILA and Regulation Z, the term “dwelling” means a residential structure with one to four units, whether or not the structure is attached to real property, and includes a condominium or cooperative unit, mobile home, and trailer, if used as a residence. See 15 U.S.C. 1602(v); § 226.2(a)(19). To facilitate compliance by using consistent terminology throughout Regulation Z, the proposal uses the term “dwelling,” as defined in § 226.2(a)(19), and not the phrase “residential real property that includes a dwelling.” Proposed comment 43(a)-2 clarifies that, for purposes of § 226.43, the term “dwelling” includes any real property to which the residential structure is attached that also secures the covered transaction.~~

~~Renewable temporary or “bridge” loan. As discussed above, proposed § 226.43(a)(3)(ii) provides that a temporary or “bridge” loan with a term of 12 months or less, such as a loan to finance the purchase of a new dwelling where the consumer plans to sell a current dwelling within 12 months and a loan to finance the initial construction of a dwelling, is excluded from coverage by § 226.43(c) through (f). Proposed comment 43(a)-3 clarifies that, where a temporary or “bridge” loan is renewable, the loan term does not include any additional period of time that could result from a renewal provision. Proposed comment 43(a)-3 also provides an example where a construction loan has an initial loan term of 12 months but is renewable for another 12-month loan term. In that example, the loan is excluded from coverage by § 226.43(c) through (f), because the initial loan term is 12 months.~~

~~The Board recognizes the risk that determining coverage by ability to repay requirements for a renewable temporary or “bridge” loan with an initial loan term of 12 months or less based only on the~~

~~initial loan term may allow circumvention of those requirements. The Board solicits comment on whether or not renewal loan terms should be considered under proposed § 226.43(a)(3)(ii). In particular, the Board requests comment on whether the proposed exclusion should be limited to certain types of temporary or “bridge” loans, such as loans to finance the initial construction of a dwelling, or should not apply for certain types of temporary or “bridge” loans, such as balloon payment loans.~~

~~Interaction with RESPA. TILA Section 129C applies to dwelling secured consumer credit transactions (other than those specifically excluded from coverage), even if they are not “federally related mortgage loans” subject to the Real Estate Settlement Procedures Act (RESPA). See 12 U.S.C. 2602(1); 24 CFR 3500.2(b), 3500.5. Consistent with TILA Section 129C, proposed § 226.43(a) applies broadly to consumer credit transactions secured by a dwelling (other than transactions excepted from coverage under § 226.43(a)(1)-(3)).~~

#### 43(b) Definitions

~~Section § 226.43(b) provides several definitions for purposes of implementing the ability to repay, qualified mortgage, and prepayment penalty provisions under § 226.43(b) through (g), which implement TILA Sections 129C(a) through (c), as added by Sections 1411, 1412 and 1414 of the Dodd-Frank Act. These proposed defined terms are discussed in detail below.~~

#### 43(b)(1) Covered Transaction

~~As discussed above in the section-by-section analysis of the scope provisions under proposed § 226.43(a), the Board proposes to apply § 226.43 to consumer credit transactions secured by a dwelling, other than (1) a HELOC; (2) a mortgage transaction secured by a consumer’s interest in a timeshare plan; and (3) except for purposes of prepayment penalty requirements under proposed § 226.43(g), a reverse mortgage or a temporary or “bridge” loan with a loan term of 12 months or less. Accordingly, proposed § 226.43(b)(1) defines “covered transaction” to mean a consumer credit transaction that is secured by a dwelling, other than a transaction exempt from coverage under proposed § 226.43(a), for purposes of proposed § 226.43.~~

#### 43(b)(2) Fully Amortizing Payment

~~TILA Section 129C(a)(3) requires, in part, that the creditor determine the consumer’s ability to repay a loan “using a payment schedule that fully amortizes~~

<sup>22</sup> See, e.g., TILA Section 129C(a)(8) (providing an exemption from repayment ability requirements for reverse mortgages and temporary or “bridge” loans with a term of 12 months or less); TILA Section 129D(d), (e) (authorizing an exemption from escrow requirements for certain creditors operating predominantly in rural or underserved areas and providing an exemption from escrow requirements for transactions secured by shares in a cooperative).