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CFPB Proposal to Ease Restrictions on Smaller Banks*

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The Consumer Financial Protection Bureau recently issued a notice of proposed rulemaking to ease some of the restrictions on smaller banks and smaller banks that operate primarily in rural and underserved areas. If adopted, the new rules will make it easier for these banks to qualify for some exemptions applicable to first mortgage lending. The comment period on this proposal ends on March 30, 2016. The proposed rulemaking would primarily affect escrow accounts for higher priced mortgages, balloon mortgages, the 43 percent debt-to-income test for qualified mortgages, and the types of loans that qualify for the QM safe harbor.

I. Current Benefits for Smaller Lenders

Under current rules, exceptions from certain prohibitions and requirements are made for smaller lenders or in some cases, for smaller institutions that principally operate in rural or underserved areas ("covered institutions"). The exceptions permit covered institutions:

- to make "qualified mortgages" that have balloon payments;
- to make qualified mortgages that exceed the 43 percent debt-to-income limit;
- to enjoy an irrefutable presumption of compliance with the ability-to-repay standard for higher cost loans, i.e., first mortgages with an APR that is up to 3.5 percent higher than the average prime rate offer;
- to make "high cost" mortgages with balloon payments; and
- to make "higher cost" mortgages without requiring an escrow account.

*The information contained in this newsletter does not constitute legal advice. This newsletter is intended for educational and informational purposes only.

II. Proposed Changes

The notice of proposed rulemaking would make several changes to broaden the number of banks that would meet the eligibility requirements for these exceptions. However, the proposal would also make two changes that would tighten the standards, which may offset somewhat the impact of the liberalizing amendments.

A. Definition of Smaller Creditor

The current definition of a smaller creditor has two prongs: (i) a limit on the number of first mortgages originated in a calendar year; and (ii) an asset size cap. The proposal would make liberalizing changes to both prongs.

With respect to the limitation on the number of first mortgages made by the creditor, the proposal would increase the limit from 500 loans to 2,000 loans. First mortgage loans made by the creditor or an affiliated company would count toward the limit. However, loans held in portfolio would not count. In other words, the numerical limit would only apply to loans that were sold or otherwise transferred, and not to mortgages held by the lender or an affiliated company. A three month grace period (until April 1 of the following year) would be given to lenders that exceed the loan origination limit as of yearend.

With respect to asset size, current regulations limit the asset size of a smaller creditor to $2 billion, calculated at the end of the year. The proposal would amend the calculation of the $2 billion by including the assets of affiliated companies that originate first mortgage loans. The CFPB explained that it wants to prevent a large bank to create small affiliated companies that could originate an unlimited number of loans to be held in portfolio, and thereby take advantage of the special rules for smaller lenders. The proposal would have a three month grace period for lenders that fall out of compliance as of yearend.

B. Three Year Look Back

Under the current regulation, a lender meets the requirement to "principally serve rural or underserved areas" if it originated at least 50 percent of its first mortgages in designated counties in any one of the prior three calendar years. The NPR would eliminate the three year look back, and require a lender to meet the 50 percent test in the prior calendar year. The proposal would also provide a three month grace period, so that if a lender fails to meet the 50 percent test in the prior year, it would not have to change its lending practices until April 1 of the current year.

C. Definition of Rural

The current rule defines the term "rural county" to mean a county that is not in a metropolitan statistical area (MSA) or in an adjacent micropolitan statistical area. The current regulation defines a county as "underserved" if, according to HMDA data, no more than two lenders originated mortgages five or more times in the county. The proposal would expand the definition of rural to include any census block designated as "rural" by the Census Bureau. Thus, a loan made in a rural pocket within a larger non-rural county would count toward the 50 percent test of "operating principally in a rural or underserved area." The term "rural" would continue to include entire rural counties, even if a particular census block within that county is not designated as rural. The NPR notes that the CFPB is considering developing an automated tool that allows lenders to enter property addresses on the Bureau's public Web site to determine whether the properties are located in a rural or underserved area for the relevant calendar years.

The chart below summarizes the proposed changes:

Principally Serve Rural or Underserved Areas	Satisfied if the test is met in any single year within a three year "look back."	Test must be met in the prior year.
First Loan Origination Limit	Lender and affiliates cannot originate more than 500 loans.	Lender and affiliates cannot originate more than 2,000 loans. Excludes loans held in portfolio.
Asset Size Cap	Lender's assets cannot exceed $2 billion.	Lender and affiliates' assets cannot exceed $2 billion. Affiliates that do not originate first mortgages are not included.
Definition of "Rural"	Counties designated as "rural" by Census Bureau.	Counties and census blocks designed as rural.

III. Conclusion

The regulatory proposal contains provisions that would both broaden and constrict the number of smaller lenders that would qualify for one or more exceptions from current regulatory constraints. The impact of the proposal, should it be adopted, will depend on the asset size, organizational structure, and operational profile of any particular lending institution.

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