

## Changes Relating to Small Creditors and Rural or Underserved Areas under the Truth in Lending Act

If your credit union originates or services consumer mortgages, changes to the Truth in Lending Act (TILA) and regulatory amendments made by the Consumer Financial Protection Bureau (CFPB) may give you more flexibility in complying with applicable standards. Most of the changes make it more likely that your credit union can be considered to be a small creditor or to be operating in a rural or underserved area. However, a change requiring you to count assets of your mortgage-originating affiliates towards the asset threshold for small creditor status may mean your credit union will not be considered a small creditor.<sup>1</sup>

### I. Overview

On October 2, 2015, CFPB published a final rule amending the standards used for determining whether your credit union is a “small creditor” or operates in a “rural” or “underserved” area under Regulation Z (October 2015 Small Creditor Final Rule).<sup>2</sup> The amendments to Regulation Z, which implements TILA, took effect January 1, 2016.

On December 4, 2015, President Obama signed the HELP Rural Communities Act of 2015 (HELP Act).<sup>3</sup> The HELP Act required CFPB to establish a temporary process to apply to CFPB for rural designation of a specified area. On March 3, 2016, CFPB published a final rule describing the detailed process (March 2016 Application Process Final Rule).<sup>4</sup> CFPB began accepting applications on March 31, 2016. The Act terminates the application process on December 4, 2017.

The HELP Act also makes it easier to qualify for small creditor status for some Regulation Z provisions by eliminating the requirement that a small creditor operate “predominantly” in a rural area. CFPB published a final rule (March 2016 Operations Final Rule) on March 25, 2016, effective March 31, 2016.<sup>5</sup>

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<sup>1</sup> This document is intended to provide general information about the final rules discussed, but only the final rules and their official interpretations can provide comprehensive and definitive information regarding their requirements.

<sup>2</sup> See 80 FR 59943 (Oct. 2, 2015).

<sup>3</sup> The HELP Act is Title LXXXIX of the Fixing America’s Surface Transportation Act (FAST Act), Public Law 114-94 (Dec. 4, 2015).

<sup>4</sup> See 81 FR 11099 (Mar. 3, 2016).

<sup>5</sup> See 81 FR 16074 (Mar. 25, 2016).

## II. Background

In January 2013 and May 2013, CFPB issued several final rules governing mortgage originations<sup>6</sup> and servicing, most of which took effect in January 2014.<sup>7</sup> Among these rules, the Ability to Repay (ATR) provisions require that creditors make reasonable and good-faith determinations that prospective borrowers have the ability to repay their loans. A loan meeting certain standards is a “Qualified Mortgage” (QM), and a creditor making it is presumed to have satisfied ATR requirements. For a loan to be a QM, it cannot have certain features.

Special provisions in the 2013 final rules gave additional flexibility to credit unions that meet the standards for “small creditor” status or that originate mortgages in “rural” or “underserved” areas:

- Loans a small creditor holds in portfolio can be QMs, even if the borrower’s debt-to-income ratio is higher than the general 43 percent limit for QMs.
- Small creditors operating predominantly in rural or underserved areas may originate loans with balloon payments that meet QM requirements, even though balloon payments are otherwise not allowed under QM requirements.
- Small creditors can originate high-cost mortgages<sup>8</sup> (as determined under the Home Ownership and Equity Protection Act (HOEPA)) with balloon payments.
- Under CFPB’s escrow requirements, eligible small creditors operating predominantly in rural or underserved areas need not establish escrow accounts for higher-priced mortgage loans (HPMLs).

For additional information, see **What Special Regulation Z Provisions and Exemptions Do the Changes Affect?** later in this document.

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<sup>6</sup> NCUA issued five Regulatory Alerts on rules that provide relief for small creditors. They are: New Escrow Requirements Under the Truth in Lending Act, available [here](#); Ability-to-Repay and Qualified Mortgage Requirements from the Consumer Financial Protection Bureau (CFPB), available [here](#); Mortgage Servicing Requirements from the Consumer Financial Protection Bureau (CFPB) under the Truth in Lending Act (TILA), available [here](#); Mortgage Servicing Requirements from the Consumer Financial Protection Bureau under the Real Estate Settlement Procedures Act (RESPA), available [here](#); and Updated Ability-to-Repay and Qualified Mortgage Requirements from the Consumer Financial Protection Bureau (CFPB), available [here](#).

<sup>7</sup> CFPB made limited changes to the Final Rule in 2014 unrelated to credit union small creditor status. See 79 FR 65299 (Nov. 3, 2014).

<sup>8</sup> See 12 CFR § 1026.32.

### **III. How Do the October 2015 Small Creditor and March 2016 Operations Final Rules Affect Small Creditor Status?**

Taken together, the October 2015 Small Creditor Final Rule and March 2016 Operations Final Rule—

- **Raise the loan origination limit for determining eligibility for small creditor status.** The October 2015 Small Creditor Final Rule increases the annual loan origination limit for first-lien covered transactions from 500 to 2,000.<sup>9</sup> Also, loans *held in portfolio* by a credit union and its affiliates *no longer count* towards the first-lien covered transaction limit.
  - *Originations by affiliates.* As under the final rules issued in 2013 and 2014, under the October 2015 Small Creditor Final Rule you count covered loans you issue *and* covered loans your mortgage-lending affiliates issue. “Affiliate” means “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.*).” Even though the Bank Holding Company Act does not apply to credit unions, its definition of “affiliate” applies under the October 2015 Small Creditor Final Rule and Regulation Z in general.<sup>10</sup> A credit union service organization (CUSO) that meets the standards in the definition can be an affiliate.
  - *Grace period.* Ordinarily, the period for determining eligibility for small creditor status is the preceding calendar year. Under the October 2015 Small Creditor Final Rule, your credit union satisfies the origination standard for a small creditor with respect to transactions where an application was received before April 1 of the current calendar year, if, during either of the two preceding calendar years, your credit union and its affiliates together extended *no more* than 2,000 covered transactions secured by first liens that were—
    - Sold, assigned, or otherwise transferred to another person, or
    - Subject at the time of consummation to a commitment to be acquired by another person.

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<sup>9</sup> As under the existing provisions of the ATR/QM rules of Regulation Z, certain dwelling-secured transactions are not covered by ATR requirements and do not count toward the origination limit, including: open-end home equity lines of credit; timeshare mortgage transactions; reverse mortgages; certain temporary or bridge loans; and construction phase of 12 months or less of construction-to-permanent loans. *See* 12 CFR § 1026.43(a).

<sup>10</sup> *See* 80 FR 59953 (Oct. 2, 2015) (“The Bureau also notes that § 1026.32(b)(5) and its definition of “affiliate” references [sic] 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.”)

- **Provide for assets of mortgage affiliates to count towards the asset limit for small-creditor status.** The October 2015 Small Creditor Final Rule retains the current asset limit for small-creditor status of total assets less than \$2 billion, adjusted annually for inflation. However, the October 2015 Small Creditor Final Rule includes the assets of any affiliate that regularly extended first-lien covered transactions in the preceding calendar year. As stated previously, a CUSO can be an affiliate.<sup>11</sup>
- *Grace period.* As under the previous rule, asset size is ordinarily determined as of December 31 of the preceding calendar year. Under the October 2015 Small Creditor Final Rule, your credit union satisfies the asset threshold for a small creditor with respect to transactions where an application was received before April 1 of the current calendar year, if the assets of your credit union and its affiliates that regularly extended covered loans either—
    - Did not exceed the asset limit in the preceding calendar year; or
    - Did not exceed the asset limit in the year *before* the preceding calendar year.
- **Eliminate the requirement of originating more than 50 percent of mortgage loans in rural or underserved areas.** Under the March 2016 Operations Final Rule, your credit union satisfies the requirement for operating in a rural or underserved area if during the *preceding calendar year* it extended at least one first-lien covered mortgage loan transaction in a “rural” or “underserved” area.<sup>12</sup>

  - *Grace period.* Under the October 2015 Small Creditor and March 2016 Operations Final Rules, your credit union satisfies the standards for originating loans in “rural” or “underserved” areas with respect to transactions where an application was received before April 1 of the current calendar year if, during either of the two preceding calendar years, you extended at least one first-lien covered transaction on a property located in a “rural” or “underserved” area.

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<sup>11</sup> See 80 FR at 59953 (“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.”)

<sup>12</sup> The October 2015 Small Creditor and March 2016 Operations Final Rules restore the one-year lookback period in the original rule issued in January 2013. The one-year lookback period was temporarily changed to a three-year lookback period, for stability during a period of changes in county Urban Influence Code (UIC) designations. The October 2015 Small Creditor and March 2016 Operations Final Rules restore the one-year lookback period when UIC designation changes end.

#### IV. How Do the Changes Affect Whether Property Used as Collateral is in a Rural or Underserved Area?

The changes—

- **Expand the definition of “rural.”** Under the October 2015 Small Creditor Final Rule, the term “rural” now includes *census blocks* that are not in an urban area as defined by the U.S. Census Bureau. Under the final rules issued in 2013 and 2014, “rural” status was determined only at the *county* level.
  - *New safe harbors.* The October 2015 Small Creditor Final Rule adds two new safe harbors for determining whether a property location meets the definition of rural. Your credit union will be able to rely on an automated address look-up tool available on the U.S. Census Bureau’s website (available [here](#)) or on a new CFPB automated tool (available [here](#)).
  - *Continuing safe harbor.* The October 2015 Small Creditor Final Rule retains the current safe harbor for creditors who choose to rely on the county lists, which are available on CFPB’s website (available [here](#)).
- **Establish a process to seek “rural” designation for an area not considered so by CFPB.** Under the March 2016 Application Process Final Rule, available [here](#), your credit union may apply to CFPB for designation of an “area” as rural. The March 2016 Application Process Final Rule contains detailed instructions for submitting an application, the standards CFPB uses to make its determination and the process for considering applications. It contemplates April 8, 2017, as the last date to submit an application so CFPB can make its determination before December 4, 2017, the sunset date for the process.
  - *Rural designation application process.* Your credit union may submit its application to CFPB by regular mail, e-mail or hand-delivery. Although CFPB does not provide an application form, the Application Process Final Rule describes in detail the required content, which includes a section for justifying the requested rural designation. It requires including documents providing the necessary information. If the application is complete and complies with other requirements, CFPB will, within 60 days of receipt, publish the application in the *Federal Register* for a 90-day public comment period. CFPB will issue its decision within 90 days from the end of the comment period. A party may resubmit a request after 90 days from a denial.

V. **What Special Regulation Z Provisions and Exemptions Do the Changes Affect?**

The changes affect—

- **The provision exempting small creditor portfolio loans meeting QM requirements from the 43 percent debt-to-income ratio limit and the underwriting requirements for QM status in Appendix Q.** The provision applies to covered loans by small creditors kept in portfolio for at least three years, or assigned or transferred to other small creditors or to creditors under specified federal programs.<sup>13</sup> These small creditors may make covered loans that exceed the average prime offer rate by up to 3.5 percentage points for purposes of the QM safe harbor.
- **The exception permitting small creditors to make mortgage loans meeting QM requirements with balloon-payment features.**<sup>14</sup> Existing rules permit balloon-payment features for certain loans small creditors hold in portfolio, even though ordinarily balloon-payment loans cannot be QMs. They also allow a higher annual percentage rate threshold for the safe harbor from claims related to ATR than generally allowed. Credit unions that now meet the amended small creditor qualifications may use this provision.
- **The exception permitting small creditors to make high-cost mortgage loans meeting QM requirements with balloon-payment features.**<sup>15</sup> Small creditors operating in a rural or underserved area as determined under the October 2015 Small Creditor and March 2016 Operations Final Rules may make such loans.
- **The small creditor exception from the requirement to establish escrow accounts for certain higher-priced mortgage loans.** Generally, a small creditor operating in rural or underserved areas need not establish escrow accounts, unless it maintains an escrow account for real estate- or dwelling-secured consumer credit transactions it or an affiliate services. The previous exception applied to first-lien

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<sup>13</sup> These include transfers: by or under instructions of a bankruptcy trustee; related to capital restoration plans under the Federal Deposit Insurance Act; and pursuant to orders of State or Federal agencies. *See* 12 CFR § 1026.43(e)(5)(ii)(C).

<sup>14</sup> Before April 1, 2016, small creditors (as defined at the applicable time) that did not operate in a rural or underserved area could originate loans with balloon payments meeting QM requirements, through an exception available to small creditors. That exception applied to loans for which the small creditor received applications before April 1, 2016.

<sup>15</sup> Before April 1, 2016, small creditors that did not operate in a rural or underserved area could originate high-cost mortgage loans with balloon payments as QM loans, through an exception available to small creditors. That exception applied to loans for which the small creditor received applications before April 1, 2016.



higher-priced mortgage loans for which a creditor received applications between April 1, 2010 and January 1, 2016. The March 2016 Operations Final Rule extends the period for exception to May 1, 2016, and retains in the exception escrow accounts established as an accommodation to a distressed consumer and those established during the exception period solely to comply with the higher-priced mortgage loan requirement.

## **VI. What Should You Do Next?**

If your credit union offers or services first-lien mortgage loans covered by the final rules and relies on provisions applicable to small creditors or creditors operating in rural or underserved areas:

- Become familiar with the provisions of the final rules;
- Determine the business, process and system changes in connection with the final rules;
- Develop a plan to implement the new requirements by the compliance dates, including by developing a schedule and a budget;
- Review the plan with executive management;
- Identify third-party relationships impacted by the final rules, including relationships with affiliates and vendors, and discuss adjusting relevant processes;
- Develop and provide training for staff and management; and
- Test and implement technology changes.

## **VII. What Other Resources Are Available?**

The full text of the October 2015 Small Creditor Final Rule is available [here](#). The full text of the March 2016 Operations Final Rule is available [here](#). The full text of the March 2016 Application Process Final Rule is available [here](#).

CFPB's Title XIV Rule Implementation page, which provides resources about the final rules and related mortgage rules, is available [here](#). The resources provide information based on the rules in place as of April 1, 2016.

If you have questions, contact NCUA's Office of Consumer Protection at (703) 518-1140 or [ComplianceMail@ncua.gov](mailto:ComplianceMail@ncua.gov), your regional office, or state supervisory authority.