BILLING CODE: 4810-AM-P

BUREAU OF CONSUMER FINANCIAL PROTECTION

12 CFR Part 1026

[Docket No. CFPB-2014-0016]

RIN 3170-ZA00

Application of Regulation Z's Ability-to-Repay Rule to Certain Situations Involving Successors-in-Interest

AGENCY: Bureau of Consumer Financial Protection.

ACTION: Final rule.

SUMMARY: The Bureau of Consumer Financial Protection (Bureau) is issuing this interpretive rule to clarify that the Bureau's Ability-to-Repay Rule incorporates the existing definition of "assumption" under Regulation Z.

DATES: July 11, 2014

FOR FURTHER INFORMATION CONTACT: William R. Corbett, Senior Counsel, Office of Regulations, Consumer Financial Protection Bureau, 1700 G Street, N.W., at (202) 435-7700.

SUPPLEMENTARY INFORMATION:

I. Background

The Bureau is issuing this interpretive rule to clarify that where a successor-in-interest (successor) who has previously acquired title to a dwelling agrees to be added as obligor or substituted for the existing obligor on a consumer credit transaction secured by that dwelling, the creditor's written acknowledgement of the successor as obligor is not subject to the Bureau's

Ability-to-Repay Rule (ATR Rule), § 1026.43, because such a transaction does not constitute an assumption as defined by Regulation Z § 1026.20(b).[1]

In the Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203, 124 Stat. 1376 (2010), (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, effective July 21, 2011.[2] Historically, Regulation Z, which was issued by the Board of Governors of the Federal Reserve System (Board), 12 CFR part 226, had implemented TILA. On December 22, 2011, pursuant to the Dodd-Frank Act and TILA, as amended by the Dodd-Frank Act, the Bureau published an interim final rule establishing a new Regulation Z (Truth in Lending), 12 CFR part 1026, implementing TILA (except with respect to persons excluded from the Bureau's rulemaking authority by section 1029 of the Dodd-Frank Act). The interim final rule substantially duplicated the Board's Regulation Z, as it existed at that time, making only non-substantive, technical, formatting, and stylistic changes.

Beginning January 10, 2013, the Bureau issued several final rules implementing amendments to TILA under the Dodd-Frank Act (the Title XIV Final Rules), including the ATR

[1] This interpretive rule refers generally to "creditors." Under Regulation Z the term "creditor" generally means the one to whom the obligation is initially payable. *See* § 1026.2(a)17. Where a mortgage has been sold after consummation, the original "creditor" may no longer be in position to agree to add an obligor. When evaluating whether acknowledging a new obligor triggers the requirements of § 1026.20(b) or § 1026. 43, servicers and assignees of the original obligation may rely on this interpretive rule.

[2] *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).

Rule.[3] On February 13, 2013, the Bureau announced an initiative to support implementation of its new mortgage rules,[4] under which the Bureau would work with the mortgage industry and other stakeholders to ensure that the new rules could be implemented accurately and expeditiously.

Since the issuance of the Title XIV Final Rules, industry and consumer advocates have expressed uncertainty about the application of the ATR Rule in situations where a successor seeks to be added as an obligor or substituted for the current obligor on an existing mortgage. The Bureau has been asked whether the creditor is obligated under the ATR Rule to determine the successor's ability to repay the mortgage before formally adding the successor as an obligor. Often, this issue arises upon the death of the obligor, with the surviving spouse or children asserting rights under the mortgage, but it may also present itself in other settings, such as in separation or divorce, after a transfer from living parents to children, or a transfer to an inter vivos trust of which the consumer is the beneficiary. If the ATR Rule applies when a creditor adds a successor as an obligor, such transactions may be less likely to occur. There can be significant consequences for a successor that is not able to become an obligor on a mortgage. For instance, if the successor seeks a modification of the existing transaction as part of trying to retain the home, the creditor may refuse to modify the terms of the debt on the grounds that the

[3] On January 10, 2013, the Bureau issued the January 2013 ATR Final Rule. 78 FR 6407 (Jan. 30, 2013). That same day the Bureau issued the 2013 Escrows Final Rule, and the 2013 HOEPA Final Rule. 78 FR 4725 (Jan. 22, 2013); 78 FR 6855 (Jan. 31, 2013). On January 17, 2013, the Bureau issued the 2013 Mortgage Servicing Final Rules. 78 FR 10695 (Feb. 14, 2013); 78 FR 10901 (Feb. 14, 2013). On January 18, 2013, the Bureau issued the 2013 ECOA Valuations Final Rule and, jointly with other agencies, the 2013 Interagency Appraisals Final Rule. 78 FR 7215 (Jan. 31, 2013); 78 FR 10367 (Feb. 13, 2013). On January 20, 2013, the Bureau issued the 2013 Loan Originator Final Rule. 78 FR 11279 (Feb. 15, 2013). Pursuant to the Dodd-Frank Act, which permitted a maximum of one year for implementation, most of these rules became effective on January 10, 2014.

[4] Press Release, Consumer Financial Protection Bureau, *CFPB Lays Out Implementation Plan for New Mortgage Rules* (Feb. 13, 2013), *available at* http://www.consumerfinance.gov/newsroom/consumer-financial-protection-bureau-lays-out-implementation-plan-for-new-mortgage-rules/.

successor is not a party to the existing obligation and therefore cannot enter into a modification agreement.[5]

In general, as discussed in part II below, in these situations, where the addition or substitution of the successor as the obligor is not an "assumption" under § 1026.20(b), such addition or substitution is not subject to the ATR Rule's requirements. A creditor may rely on this interpretation as a safe harbor under section 130(f) of TILA. The Bureau plans to incorporate this interpretation into Regulation Z's Official Interpretations at a later date.

The Bureau is aware of other questions related to a servicer's obligations under the 2013 Mortgage Servicing Final Rules with respect to successors. Under Regulation X § 1024.38(b)(1)(vi), servicers are required to maintain policies and procedures reasonably designed to ensure the servicer can promptly identify and facilitate communication with the successor-in-interest of a deceased borrower upon notification of the death of the borrower. On October 15, 2013, the Bureau issued a guidance bulletin providing examples of servicer practices the Bureau would consider to be components of the policies and procedures mortgage servicers must have in place to comply with these requirements regarding successors-in-interest.[6] The Bureau is monitoring these issues to determine whether they require further guidance or rulemaking.

II. Application of ATR to certain situations involving Successors-in-Interest

The Bureau has received many questions regarding the applicability of the ATR Rule where a successor acquires a home that is the collateral for an existing consumer credit

[5] As discussed in part II below, most workout agreements are not "refinancings" subject to the ATR Rule. However, creditors generally require a successor to enter into an assumption agreement prior to or simultaneous with the execution of the modification agreement in part because creditors are concerned about their ability to enforce the terms of the modified debt absent a written agreement, executed by an obligor with authority.

[6] CFPB Bulletin, 2013-12 (Oct. 15, 2013), http://files.consumerfinance.gov/f/201310_cfpb_mortgage-servicing_bulletin.pdf.

transaction and seeks to become an obligor on that transaction. A successor is a person who receives legal interest in a property, typically by a transfer from a family member, by operation of law upon another's death, or under a divorce decree or separation agreement.[7] In all of these situations, where the successor acquires property that is subject to a mortgage, the successor is not personally liable for the associated debt, but may choose to assume the debt. The Garn-St Germain Depository Institutions Act of 1982 prohibits the creditor from exercising a due-on-sale clause based upon certain types of transfers, including the common situation of transfer upon death of a relative.[8] Even where a due-on-sale clause may be exercised, however, creditors may agree to add the successor as a named obligor under the loan contract.

A. Application of the ATR Rule to a change in obligors.

Under Regulation Z § 1026.43, the ATR Rule applies to any "covered transaction" defined, with certain enumerated exceptions, as "any consumer credit transaction that is secured by a dwelling … including any real property attached to a dwelling." Under § 1026.43(c), a creditor must make a reasonable and good faith determination that the consumer has the ability to repay at or before consummation of the covered transaction. Similarly, Regulation Z generally requires creditors to provide disclosures required under § 1026.18 or § 1026.19 to consumers before consummation of certain closed-end loans. In certain circumstances, however, creditors and consumers agree, *after* consummation, to changes to an existing transaction that are treated as a "new transaction" under Regulation Z, requiring new disclosures.

Section 1026.20(a) and (b) provide that if a creditor and consumer engage in activity that constitutes a "refinancing" or an "assumption," the creditor must make new disclosures.

[7] The term successor also may include an inter vivos trust, created by a borrower who transfers his or her property into the trust in which the obligor is or remains a beneficiary.

[8] *See* 12 U.S.C.1701j-3(d).

Comment 43(a)-1 is consistent with this approach in excluding from the scope of § 1026.43 changes to the loan that are not a refinancing under § 1026.20(a).

The terms "refinancing" and "assumption" are each assigned a specific meaning in § 1026.20(a) and (b). These terms generally define when a change in a closed-end loan's terms or obligors constitutes a new transaction under Regulation Z. For example, under § 1026.20(a), a refinancing occurs when an existing obligation is "satisfied and replaced by a new obligation undertaken by the same consumer." Certain changes to the loan's terms, including, generally, workout agreements for delinquent borrowers, do *not* meet the definition of a "refinancing," under § 1026.20(a). *See* § 1026.20(a)(4); comment 20(a)(4)-1. As comment 43(a)-1 makes explicit, such agreements are therefore not covered transactions and are not subject to § 1026.43.

Section 1026.20(a) and (b) address different types of events. Section 1026.20(a) addresses changes to a loan's terms—such as an increase in the interest rate in a transaction initially disclosed as a fixed-rate transaction. In contrast, § 1026.20(b) applies to changes in the loan's obligors. Under § 1026.20(b) an assumption occurs when—and only when—the creditor "expressly agrees in writing with a subsequent consumer to accept that consumer as a primary obligor on an existing residential mortgage transaction."

The Bureau believes that just as comment 43(a)-1 explicitly incorporates the definition of "refinancing" in § 1026.20(a)—and the limitations on that definition—into the scope of § 1026.43, so, too, the ATR requirement in § 1026.43 should be interpreted to incorporate the existing Regulation Z standard for transactions involving a change of obligors set forth in § 1026.20(b). Unless the change satisfies the definition of an "assumption" under § 1026.20(b), a change of obligors does not trigger the ATR requirements under § 1026.43.

The Bureau's interpretation is consistent with comment 43(a)-1 and consistent with the Bureau's purposes in issuing the Ability-to-Repay Rule. This interpretation applies a standard to transactions that involve new obligors that is consistent with the standard that exists in Regulation Z generally. The Bureau believes it would be potentially incongruous to interpret § 1026.43 as *never* applying to transactions involving a new obligor, which by definition are excluded from being refinancings under § 1026.20(a). The Bureau also believes that interpreting § 1026.43 as either never applying to transactions with new obligors or as applying to some transactions with new obligors based on a standard other than the familiar rule set forth in § 1026.20(b) would not be consistent with the policies underlying the ATR Rule, the Bureau's intent in promulgating the rule, or the public's understanding of Regulation Z.

B. The addition of a successor as named obligor generally does not constitute an "assumption."

As noted above, § 1026.43 should be interpreted to incorporate the existing standards under § 1026.20(b) for determining whether a transaction is an "assumption." An assumption under § 1026.20(b) occurs when the creditor agrees in writing to accept a subsequent consumer as a primary obligor on an existing "residential mortgage transaction." A "residential mortgage transaction" is a transaction in which a consumer finances the acquisition or initial construction of the consumer's principal dwelling. *See* § 1026.2(a)(24). For purposes of determining whether the transaction is an "assumption," the creditor must look to whether the new obligor is seeking to finance the acquisition of that subsequent consumer's principal dwelling.[9] Whether the existing extension of consumer credit was a residential mortgage transaction as to the existing primary obligor is immaterial.

[9] Comment 20(b)-2 states that creditors "must look to the *assuming consumer* in determining whether a residential mortgage transaction exists." (emphasis added.)

A residential mortgage transaction does not arise where a successor takes on the debt obligation that is secured by property the successor previously acquired.[10] In these situations, § 1026.20(b) does not apply when the successor agrees to be added as an obligor on an existing mortgage loan. Although these transactions are commonly referred to as assumptions, they are not assumptions under § 1026.20(b) because the transaction is not a residential mortgage transaction as to the successor. Accordingly, the ATR Rule in § 1026.43 does not apply to a transaction in which a successor seeks to take on the debt secured by property that the successor previously acquired.

In contrast to the successor situation described above, if a consumer without an existing interest takes on the obligation of the existing borrower in order to finance the acquisition of the consumer's principal dwelling, the transaction is a residential mortgage transaction. In such a case, where the creditor expressly agrees in writing to the new primary obligor, an assumption has occurred under § 1026.20(b), and it is subject to the ability-to-repay requirements in § 1026.43, in addition to other requirements of Regulation Z. Moreover, where a creditor adds a successor as the obligor, whether that event is subject to § 1026.43 or not, the extension of credit remains a consumer credit transaction under Regulation Z. The creditor, assignee, or servicer must comply with any ongoing obligations pertaining to the extension of consumer credit, such as the requirement to provide monthly statements in § 1026.41 and the requirement to notify the obligors of adjustments to the loan's interest rate in § 1026.20(c) and (d).

[10] As comment 2(a)(24)-5 states, the term residential mortgage transaction "does not include a transaction involving a consumer's principal dwelling if the consumer had previously purchased and acquired some interest to the dwelling even through the consumer had not acquired full legal title."

III. Regulatory Requirements

This rule articulates the Bureau's interpretation of Regulation Z, and the Truth-in-Lending Act. It is therefore exempt from the APA's notice and comment rulemaking requirements pursuant to 5 U.S.C. 553(b).

Because no notice of proposed rulemaking is required, the Regulatory Flexibility Act does not require an initial or final regulatory flexibility analysis. 5 U.S.C. 603(a), 604(a).

The Bureau has determined that this rule does not impose any new or revise any existing recordkeeping, reporting, or disclosure requirements on covered entities or members of the public that would be collections of information requiring OMB approval under the Paperwork Reduction Act, 44 U.S.C. 3501, *et seq.*

* * * * *

[THIS SIGNATURE PAGE PERTAINS TO THE FINAL RULE TITLED "APPLICATION OF REGULATION Z's ABILITY-TO-REPAY RULE TO CERTAIN SITUATIONS INVOLVING SUCCESSORS-IN-INTEREST"]

Dated: July 1, 2014.

Richard Cordray

Richard Cordray,

Director, Bureau of Consumer Financial Protection.