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**October 2015**

**CFPB EXPANDS SMALL CREDITOR RULE**

Many of Scheer Law Group's (SLG's) smaller clients, who did not initially meet the threshold definition allowing them to make loans at the Small Creditor Qualified Mortgage (QM) rate, will be deemed small creditors under the new final rule announced September 21, 2015, which goes into effect January 1, 2016. The CFPB expects that over 7,000 more lenders will qualify to make small creditor loans under the new rule.

● What changed in the final rule:

Under the new rule, the number of first position closed end covered transactions a small creditor, including its affiliates, is allowed to make per year has been increased to 2,000. Also, loans that are retained in portfolio, (not sold or transferred, including to affiliates) are not counted toward the 2,000 covered transaction limit. The prior limit was 500, and loans held in portfolio were counted toward the 500 covered transaction limit. Since many small creditors do not sell their loans, there would be no limit on the number of covered transactions that the small creditor could originate, since loans held by the lender are not counted toward the 2,000 loan limit. The final rule defined more clearly which entities would be deemed "affiliates," made changes to the "rural area" rule and implemented a "grace period" available under certain circumstances. These changes will be discussed below.

● What didn't change in the final rule:

The \$2 billion dollar total assets limit, that the lender (including the assets of each affiliate) must not reach or exceed in order to qualify as a small creditor, did not change, except that the cost of living escalation provision brought the 2015 asset limit to "less than \$2,060,000,000."

● What is the benefit of qualifying as a small creditor:

A small creditor may charge a sum less than 3.5% over APOR for a loan, and if the loan otherwise is a Qualified Mortgage (QM), the rate will not deprive the lender of QM status. Lenders who are not small creditors, with a few exceptions, can only charge a sum less than 1.5% above APOR for a first position covered transaction, if they do not want their loans to be deemed Higher Priced Covered Transactions (HPCTs). An HPCT may still qualify for a presumption that the borrower had the Ability To Repay (ATR), but the presumption of ATR is rebuttable.<sup>1</sup> Many lenders are unwilling to make loans that are not subject to the conclusive presumption that the borrower has the Ability to Repay. Small creditors also have other advantages, not available to larger lenders, when making QM loans. These advantages include the ability to make certain balloon payment loans that would not otherwise be QMs, and exemption from: 1) the strict 43% debt to income ratio; 2) the need to underwrite the loan using Appendix Q; and 3) the need under certain circumstances to impose an escrow account. (Call SLG for more information on advantages of qualifying as a small creditor).

- "Affiliates" as defined under the new final rule.

The new rule clarifies the definition of an affiliate for the determination of qualification as a small creditor as follows: "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." (Call SLG for more information on what types of lender relationships will be deemed to be "affiliates").

- Changes to the rules regarding rural areas.

Small lenders who can show that they, along with their affiliates, extended more than 50 percent of their total first-lien covered transactions on properties located in rural or underserved areas in calendar year 2015, are eligible to extend certain kinds of QM loans not allowed to other lenders. The final rule expands the

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<sup>1</sup>As a practical matter where ATR is conclusively presumed, the lender can defeat the borrower's claim for violation of the ATR rule by a motion, as a matter of law. If the presumption is only rebuttable, then the borrower may be entitled for a jury determination of whether the borrower has rebutted the presumption. The defense costs and risk to the lender are much greater where ATR is not conclusively presumed.

definition of rural or underserved areas and provides a safe harbor for lenders seeking to qualify. Note that these rural area rules are not applicable to the definition of rural counties with regard to the need to get a second appraisal for Higher Priced Mortgage Loans. (Call SLG for more information on whether you can qualify under the revised rural area rules.)

- April 1 grace period for certain small creditor or rural area loans.

The final rule provides a grace period to a creditor that does not meet one or more of the requirements to be a small creditor, or a creditor that operates predominantly in rural or underserved areas, in the preceding calendar year, but did qualify in the second preceding year. Such a lender is permitted to extend loans under the applicable exemption for loan applications received before April 1 of the current year. Under these circumstances, loans made pursuant to applications received by the lender before April 1 of the current year will still qualify for the respective exemption, if the lender qualified during second preceding year. Applications received on or April 1 of the current year will not be eligible for the exemption.

- Rationale for the small creditor and rural exemptions.

The CFPB final rule announcement, which occupies 114 pages, states that the liberalized lending rules for small creditors are justified because unlike lenders who originate loans and sell them in the secondary market, the small creditor who keeps the loan in its portfolio has a greater motivation to underwrite loans making sure the borrowers have the ability to repay. With regard to the rural exemption, the CFPB expresses concerns that borrowers in such areas may not have access to credit that is more available in urban areas.

- Conclusion

The Dodd Frank Act is complex and difficult to follow. Most sections refer to numerous other sections of the Act, and of other federal statutes and regulations. To avoid the risks of being sued by defaulting borrowers, for failure to properly assess ATR, lenders must accept low APR rates for a QM mortgage where ATR is conclusively presumed. Lenders who can qualify as small creditors, or creditors predominately making loans in rural or underserved areas, can make loans where ATR is conclusively presumed at two percent higher APR's than competing larger lenders. If you can qualify, it is well worth your time to take advantage of the small creditor and rural lender exemptions. SLG has spent countless hours going over these regulations to help our clients that can qualify take advantage of these exemptions. Call us at (415) 491-8900, extension \_\_\_\_.

