

**DEPARTMENT OF THE TREASURY**

**Internal Revenue Service**

**26 CFR Part 1**

[TD 9664]

RIN 1545–BF80

**Section 67 Limitations on Estates or Trusts**

**AGENCY:** Internal Revenue Service (IRS), Treasury.

**ACTION:** Final regulations and removal of temporary regulations.

**SUMMARY:** This document contains final regulations that provide guidance on which costs incurred by estates or trusts other than grantor trusts (non-grantor trusts) are subject to the 2-percent floor for miscellaneous itemized deductions under section 67(a) of the Internal Revenue Code. These regulations affect estates and non-grantor trusts.

**DATES:** *Effective Date:* These regulations are effective on May 9, 2014.

*Applicability Date:* For date of applicability, see § 1.67–4(d).

**FOR FURTHER INFORMATION CONTACT:** Jennifer N. Keeney, (202) 317–6852 (not a toll-free number).

**SUPPLEMENTARY INFORMATION:**

**Background**

This document amends the Income Tax Regulations (26 CFR Part 1) under section 67 of the Internal Revenue Code (Code) by adding § 1.67–4 regarding which costs incurred by an estate or a non-grantor trust are subject to the 2-percent floor for miscellaneous itemized deductions under section 67(a).

Section 67(a) of the Code provides that, for an individual taxpayer, miscellaneous itemized deductions are allowed only to the extent that the aggregate of those deductions exceeds 2 percent of adjusted gross income. Section 67(b) excludes certain itemized deductions from the definition of “miscellaneous itemized deductions.” Section 67(e) provides that, for purposes of section 67, the adjusted gross income of an estate or trust shall be computed in the same manner as in the case of an individual. However, section 67(e)(1) provides that the deductions for costs paid or incurred in connection with the administration of the estate or trust that would not have been incurred if the property were not held in such estate or trust shall be treated as allowable in arriving at adjusted gross income. Therefore, deductions described in section 67(e)(1) are not subject to the 2-percent floor for miscellaneous itemized deductions under section 67(a).

A notice of proposed rulemaking (REG–128224–06) was published in the *Federal Register* (72 FR 41243) on July 27, 2007 (the 2007 proposed regulations). The 2007 proposed regulations provided that a cost is fully deductible to the extent that the cost is unique to an estate or trust. If a cost is not unique to an estate or trust, such that an individual could have incurred the expense, then that cost was subject to the 2-percent floor. The 2007 proposed regulations also addressed costs subject to the 2-percent floor that are included as part of a comprehensive fee paid to the trustee or executor (bundled fees). Written comments were received in response to the notice of proposed rulemaking. A public hearing was held on November 14, 2007, at which several commentators offered comments on the notice of proposed rulemaking.

On January 16, 2008, the Supreme Court of the United States issued its decision in *Michael J. Knight, Trustee of the William L. Rudkin Testamentary Trust v. Commissioner*, 552 U.S. 181, 128 S. Ct. 782 (2008), holding that fees paid to an investment advisor by an estate or non-grantor trust generally are subject to the 2-percent floor for miscellaneous itemized deductions under section 67(a). The Court reached this decision based upon an interpretation of section 67(e) that differed from the 2007 proposed regulations. The Court held that the proper reading of the language in section 67(e), which asks whether the expense “would not have been incurred if the property were not held in such trust or estate,” requires an inquiry into whether a hypothetical individual who held the same property outside of a trust “customarily” or “commonly” would incur such expenses. Expenses that are “customarily” or “commonly” incurred by individuals are subject to the 2-percent floor.

After consideration of the Court’s holding in *Knight*, the Treasury Department and the IRS issued Notice 2008–32 (2008–11 IRB 593) (March 17, 2008) to provide interim guidance on the treatment of bundled fees. Subsequent notices extended the interim guidance. (Notice 2008–116 (2008–52 IRB 1372) (December 29, 2008); Notice 2010–32 (2010–16 IRB 594) (April 19, 2010); Notice 2011–37 (2011–20 IRB 785) (May 16, 2011)). On September 7, 2011, a notice of proposed rulemaking and a notice of public hearing (REG–128224–06) were published in the *Federal Register* (76 FR 55322) (the 2011 proposed regulations) and the 2007 proposed regulations were withdrawn.

A public hearing on the 2011 proposed regulations was scheduled for December 19, 2011, but later was cancelled because no one requested to speak. However, comments responding to the 2011 proposed regulations were received. After consideration of these comments, the 2011 proposed regulations are adopted as revised by this Treasury decision. These final regulations generally retain the provisions of the 2011 proposed regulations with minor modifications.

**Summary of Comments and Explanation of Revisions**

*A. Commonly or Customarily Incurred—In General*

The proposed regulations provide that a cost is subject to the 2-percent floor to the extent that it is included in the definition of miscellaneous itemized deductions under section 67(b), is incurred by an estate or non-grantor trust, and commonly or customarily would be incurred by a hypothetical individual holding the same property. To determine whether the cost commonly or customarily would be incurred by a hypothetical individual owning the same property, it is the type of product or service rendered to the estate or non-grantor trust that is determinative. The proposed regulations also provide that costs that do not depend on the identity of the payor (in particular, whether the payor is an individual or, instead, is an estate or trust) are costs that are incurred commonly or customarily by individuals.

One commentator stated that treating costs that do not depend on the identity of the payor as costs that are commonly or customarily incurred in all cases is overly broad, and that such treatment effectively represents a disguised reassertion of the standard rejected by *Knight* of making the 2-percent floor applicable to any expense that could be incurred by an individual. In response to this comment, the final regulations remove the reference to costs that do not depend on the identity of the payor.

*B. Ownership Costs*

The proposed regulations provide that, for purposes of section 67(e), ownership costs are costs that are commonly or customarily incurred by a hypothetical individual owner of such property. Therefore, ownership costs are subject to the 2-percent floor. The proposed regulations define ownership costs as costs that are chargeable to or incurred by an owner of property simply by reason of being the owner of the property, such as condominium

fees, real estate taxes, insurance premiums, maintenance and lawn services, automobile registration and insurance costs, and partnership costs deemed to be passed through to and reportable by a partner. One commentator suggested that the final regulations adopt a rebuttable presumption that ownership costs are not subject to the 2-percent floor. The final regulations do not adopt this comment because the Treasury Department and the IRS believe that ownership costs are costs that commonly or customarily would be incurred by a hypothetical individual holding the same property, and accordingly, should be subject to the 2-percent floor.

Several commentators stated that the examples used to illustrate ownership costs in the proposed regulations are problematic. First, commentators correctly pointed out that real estate taxes are not a miscellaneous itemized deduction because they are fully deductible under section 62(a)(4) or section 164(a). Second, commentators suggested that the final regulations clarify that costs incurred in connection with a trade or business or for the production of rents or royalties are fully deductible under section 162 or section 62(a)(4) and thus are not miscellaneous deductions. Third, a commentator requested that the final regulations clarify that the partnership costs reportable by a partner are subject to the 2-percent floor only if those costs are miscellaneous itemized deductions under section 67(b). Thus, for example, a partnership cost that is fully deductible is not subject to the 2-percent floor. The final regulations adopt these clarifications.

#### C. Tax Return Preparation Costs

The proposed regulations provide that the application of the 2-percent floor to the cost of preparing tax returns on behalf of the estate, decedent, or non-grantor trust will depend upon the particular tax return. The proposed regulations provide that all costs of preparing estate and generation-skipping transfer tax returns, fiduciary income tax returns, and the decedent's final individual income tax returns are not subject to the 2-percent floor. However, the proposed regulations also provide that costs of preparing other individual income tax returns, gift tax returns, and tax returns for a sole proprietorship or a retirement plan, for example, are costs commonly and customarily incurred by individuals and thus are subject to the 2-percent floor.

Several commentators pointed out that it would be very rare for a trust to

pay for the preparation of the tax return of an individual other than the decedent. In the unlikely event that it did, such a cost would either be a deemed beneficiary distribution or would represent a breach of fiduciary duty. Furthermore, tax preparation fees for sole proprietorships and retirement plans would be fully deductible as business expenses under section 162.

To resolve these ambiguities in the proposed regulations, the final regulations provide an exclusive list of tax return preparation costs that are not subject to the 2-percent floor. Any other tax return preparation cost that is included in the definition of miscellaneous itemized deduction under section 67(b) is subject to the 2-percent floor.

A few commentators suggested that the final regulations should expressly provide that the cost of preparing all gift tax returns should be exempt from the application of the 2-percent floor. However, gifts are made by individuals, and the gift tax returns required to report those gifts are commonly and customarily required to be prepared and filed by or on behalf of individuals. Therefore, the final regulations do not adopt the recommendation to include gift tax returns within the category of returns whose preparation costs are exempt from the 2-percent floor.

#### D. Investment Advisory Fees

The proposed regulations provide that fees for investment advice (including any related services that would be provided to any individual investor as part of an investment advisory fee) are incurred commonly or customarily by a hypothetical individual investor and, therefore, are subject to the 2-percent floor. The proposed regulations also provide guidance regarding a special type of investment advice discussed by the Supreme Court in *Knight*. The Court noted that it is conceivable "that a trust may have an unusual investment objective, or may require a specialized balancing of the interests of various parties, such that a reasonable comparison with individual investors would be improper." The Court further stated that, "in such a case, the incremental cost of expert advice beyond what would normally be required for the ordinary taxpayer would not be subject to the 2-percent floor."

The proposed regulations provide that, to the extent that a portion (if any) of an investment advisory fee exceeds the fee generally charged to an individual investor, and that excess is attributable to an unusual investment objective of the trust or estate or to a

specialized balancing of the interests of various parties such that a reasonable comparison with individual investors would be improper, that excess is not subject to the 2-percent floor. The preamble to the proposed regulations explained that individual investors commonly have investment objectives that may require a balancing between investing for income and investing for growth and/or a specialized approach for particular assets. The preamble requested comments on the types of incremental charges, as described in this paragraph, that may be incurred by trusts or estates, as well as a specific description and rationale for any such charges. No response to this request was received, and the final regulations retain this provision as proposed.

#### E. Appraisal Fees and Certain Other Fiduciary Expenses

One commentator suggested that the final regulations include appraisal fees incurred by an estate or trust as a category of expense that is not subject to the 2-percent floor. Although individuals commonly or customarily would have assets appraised, estates and non-grantor trusts are required to undertake valuations for the maintenance and administration of these entities that an individual would not undertake. For example, Form 5227, "Split-Interest Trust Information Return", requires taxpayers to determine the fair market value of the trust's assets for each taxable year.

Accordingly, in response to these comments, the final regulations expressly provide that certain appraisal fees incurred by an estate or non-grantor trust are not subject to the 2-percent floor. Those appraisal fees are for appraisals needed to determine value as of the decedent's date of death (or the alternate valuation date), to determine value for purposes of making distributions, or as otherwise required to properly prepare the estate's or trust's tax returns. Appraisals for these purposes are not customarily obtained by individuals (unlike, for example, appraisals to determine the proper amount of insurance needed on certain property) and thus meet the requirements for exemption from the 2-percent floor under section 67(e).

One commentator requested confirmation of the inapplicability of the 2-percent floor to certain other fiduciary expenses. The final regulations contain such a statement with regard to some examples of fiduciary expenses that are not commonly or customarily incurred by individuals.

#### F. Bundled Fees

The proposed regulations provide that a bundled fee (generally, a fee for both costs that are subject to the 2-percent floor and costs that are not) must be allocated between those two categories of costs. However, the proposed regulations provide an exception to this allocation requirement for a bundled fee that is not computed on an hourly basis. Specifically, for such a fee, only the portion attributable to investment advice (including any related services that would be provided to any individual investor as part of the investment advisory fee) will be subject to the 2-percent floor. Notwithstanding this exception, payments made to third parties out of the bundled fee that would have been subject to the 2-percent floor if they had been paid directly by the estate or non-grantor trust, and any payments for expenses separately assessed by the fiduciary or other service provider that are commonly or customarily incurred by an individual owner of such property will be subject to the 2-percent floor.

The proposed regulations contain an example to illustrate a type of expense that is separately assessed: an additional fee charged by the fiduciary for managing rental real estate owned by the estate or non-grantor trust. Several commentators correctly noted that the expense in this example is not a miscellaneous itemized deduction, but is instead fully deductible. See sections 62(a)(4), 212, and 611. Therefore, the final regulations delete this example.

Most commentators objected to the requirement that a fiduciary commission be unbundled. They recommended that a single fiduciary commission that is not computed on an hourly basis, or otherwise separately stated, be entirely exempt from the 2-percent floor. The primary reason that commentators gave for this recommendation is the administrative difficulty and burden of the required calculations and recordkeeping. At least one commentator, however, acknowledged that unbundling a fiduciary commission is appropriate to provide the same tax treatment to the same expenses, regardless of how those expenses are billed.

Commentators also challenged the regulatory authority to require this unbundling, arguing that there is no statutory ambiguity with regard to a fiduciary commission and thus no authority to apply the 2-percent floor to any portion of that commission.

The Treasury Department and IRS believe the authority to unbundle rests with the authority to define expenses

that “would not have been incurred if the property were not held in such trust or estate.” Consistent with the *Knight* decision, these final regulations interpret this statutory exception to the 2-percent floor to capture those expenses that would not commonly or customarily be incurred by an individual. In identifying these expenses, the *Knight* Court specifically recognized that unbundling may be required in the case of investment advisory fees, the costs of which exceed the costs charged to an individual investor and which are incurred either because the investment advice is being rendered to a fiduciary or because of an unusual investment objective or the need for a specialized balancing of interests of various parties. The final regulations adopt this reasoning and, consistent with the *Knight* decision, provide that the portion of such a fee in excess of what would have been charged to an individual investor may be exempt from the 2-percent floor. Based upon the *Knight* decision and the authority to promulgate interpretative regulations, the Treasury Department and IRS believe that the final regulations are within the scope of regulatory authority.

The Treasury Department and IRS also believe that retaining the unbundling requirement in the final regulations is appropriate because it provides equitable tax treatment to similarly situated taxpayers. Taxpayers that pay investment fees to a third-party investment advisor and those that pay investment fees as part of a bundled fee should receive similar tax treatment.

The Treasury Department and IRS also believe that the limitations to the unbundling requirement reduce administrative burdens. For example, a fiduciary fee, an attorney’s fee, or an accountant’s fee that is not computed on an hourly basis is fully deductible except for (i) amounts allocable to investment advice; (ii) amounts paid out of the bundled fee by the fiduciary to third parties if those amounts would have been subject to the 2-percent floor if they had been paid directly by the non-grantor estate or trust; and (iii) amounts that are separately assessed (in addition to the usual or basic fiduciary fee or commission) by the fiduciary or other service provider that are commonly or customarily incurred by an individual owner of such property. Because the latter two categories relate to amounts that are traceable to separate payments, the Treasury Department and IRS believe that the administrative burden associated with subjecting these amounts to the 2-percent floor is insubstantial.

Furthermore, where amounts are allocable to investment advice but are not traceable to separate payments, the final regulations retain the flexibility of allowing the use of any reasonable method to make the allocation to investment advice. The Treasury Department and the IRS believe that the availability of any reasonable method mitigates administrative burden. However, to provide additional guidance, these final regulations provide non-exclusive factors to further reduce administrative burden for both taxpayers and the IRS.

In the preamble to the proposed regulations, the Treasury Department and the IRS requested comments on the types of methods for making a reasonable allocation to investment advice, including possible factors on which a reasonable allocation is most likely to be based, and on the related substantiation needed to satisfy the reasonable method standard. The Treasury Department and the IRS received only one comment in response to this request, which explained that there is no single standard that could be applied to multiple trusts or even to the same trust in different years.

In finalizing these regulations, the Treasury Department and the IRS reconsidered comments received in response to Notice 2008–32. Although some comments supported a percentage safe harbor, the percentages suggested assumed that all fees that are customarily incurred by individuals (and not just investment advisory fees) would be required to be unbundled. For this reason, the percentages that were suggested are not readily applied to the framework of the final regulations. The final regulations, however, permit the Treasury Department and the IRS to provide safe harbors in future published guidance.

#### Effective/Applicability Date

The final regulations apply to taxable years beginning on or after May 9, 2014.

#### Availability of IRS Documents

The IRS notices cited in this preamble are available at [www.irs.gov](http://www.irs.gov).

#### Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive Order 13563. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these



regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking that preceded these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business, and no comments were received.

#### Drafting Information

The principal author of these regulations is Jennifer N. Keeney, Office of the Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the Treasury Department and the IRS participated in their development.

#### List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

#### Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

#### PART 1—INCOME TAXES

■ **Paragraph 1.** The authority citation for part 1 continues to read in part as follows:

**Authority:** 26 U.S.C. 7805 \* \* \*

■ **Par. 2.** Section 1.67–4 is added to read as follows:

#### § 1.67–4 Costs paid or incurred by estates or non-grantor trusts.

(a) *In general.* Section 67(e) provides an exception to the 2-percent floor on miscellaneous itemized deductions for costs that are paid or incurred in connection with the administration of an estate or a trust not described in § 1.67–2T(g)(1)(i) (a non-grantor trust) and that would not have been incurred if the property were not held in such estate or trust. A cost is subject to the 2-percent floor to the extent that it is included in the definition of miscellaneous itemized deductions under section 67(b), is incurred by an estate or non-grantor trust, and commonly or customarily would be incurred by a hypothetical individual holding the same property.

(b) *“Commonly” or “Customarily” Incurred—(1) In general.* In analyzing a cost to determine whether it commonly or customarily would be incurred by a hypothetical individual owning the same property, it is the type of product or service rendered to the estate or non-grantor trust in exchange for the cost, rather than the description of the cost of that product or service, that is

determinative. In addition to the types of costs described as commonly or customarily incurred by individuals in paragraphs (b)(2), (3), (4), and (5) of this section, costs that are incurred commonly or customarily by individuals also include, for example, costs incurred in defense of a claim against the estate, the decedent, or the non-grantor trust that are unrelated to the existence, validity, or administration of the estate or trust.

(2) *Ownership costs.* Ownership costs are costs that are chargeable to or incurred by an owner of property simply by reason of being the owner of the property. Thus, for purposes of section 67(e), ownership costs are commonly or customarily incurred by a hypothetical individual owner of such property. Such ownership costs include, but are not limited to, partnership costs deemed to be passed through to and reportable by a partner if these costs are defined as miscellaneous itemized deductions pursuant to section 67(b), condominium fees, insurance premiums, maintenance and lawn services, and automobile registration and insurance costs. Other expenses incurred merely by reason of the ownership of property may be fully deductible under other provisions of the Code, such as sections 62(a)(4), 162, or 164(a), which would not be miscellaneous itemized deductions subject to section 67(e).

(3) *Tax preparation fees.* Costs relating to all estate and generation-skipping transfer tax returns, fiduciary income tax returns, and the decedent's final individual income tax returns are not subject to the 2-percent floor. The costs of preparing all other tax returns (for example, gift tax returns) are costs commonly and customarily incurred by individuals and thus are subject to the 2-percent floor.

(4) *Investment advisory fees.* Fees for investment advice (including any related services that would be provided to any individual investor as part of an investment advisory fee) are incurred commonly or customarily by a hypothetical individual investor and therefore are subject to the 2-percent floor. However, certain incremental costs of investment advice beyond the amount that normally would be charged to an individual investor are not subject to the 2-percent floor. For this purpose, such an incremental cost is a special, additional charge that is added solely because the investment advice is rendered to a trust or estate rather than to an individual or attributable to an unusual investment objective or the need for a specialized balancing of the interests of various parties (beyond the

usual balancing of the varying interests of current beneficiaries and remaindermen) such that a reasonable comparison with individual investors would be improper. The portion of the investment advisory fees not subject to the 2-percent floor by reason of the preceding sentence is limited to the amount of those fees, if any, that exceeds the fees normally charged to an individual investor.

(5) *Appraisal fees.* Appraisal fees incurred by an estate or a non-grantor trust to determine the fair market value of assets as of the decedent's date of death (or the alternate valuation date), to determine value for purposes of making distributions, or as otherwise required to properly prepare the estate's or trust's tax returns, or a generation-skipping transfer tax return, are not incurred commonly or customarily by an individual and thus are not subject to the 2-percent floor. The cost of appraisals for other purposes (for example, insurance) is commonly or customarily incurred by individuals and is subject to the 2-percent floor.

(6) *Certain Fiduciary Expenses.* Certain other fiduciary expenses are not commonly or customarily incurred by individuals, and thus are not subject to the 2-percent floor. Such expenses include without limitation the following: Probate court fees and costs; fiduciary bond premiums; legal publication costs of notices to creditors or heirs; the cost of certified copies of the decedent's death certificate; and costs related to fiduciary accounts.

(c) *Bundled fees—(1) In general.* If an estate or a non-grantor trust pays a single fee, commission, or other expense (such as a fiduciary's commission, attorney's fee, or accountant's fee) for both costs that are subject to the 2-percent floor and costs (in more than a de minimis amount) that are not, then, except to the extent provided otherwise by guidance published in the Internal Revenue Bulletin, the single fee, commission, or other expense (bundled fee) must be allocated, for purposes of computing the adjusted gross income of the estate or non-grantor trust in compliance with section 67(e), between the costs that are subject to the 2-percent floor and those that are not.

(2) *Exception.* If a bundled fee is not computed on an hourly basis, only the portion of that fee that is attributable to investment advice is subject to the 2-percent floor; the remaining portion is not subject to that floor.

(3) *Expenses Not Subject to Allocation.* Out-of-pocket expenses billed to the estate or non-grantor trust are treated as separate from the bundled fee. In addition, payments made from

the bundled fee to third parties that would have been subject to the 2-percent floor if they had been paid directly by the estate or non-grantor trust are subject to the 2-percent floor, as are any fees or expenses separately assessed by the fiduciary or other payee of the bundled fee (in addition to the usual or basic bundled fee) for services rendered to the estate or non-grantor trust that are commonly or customarily incurred by an individual.

(4) *Reasonable Method.* Any reasonable method may be used to allocate a bundled fee between those costs that are subject to the 2-percent floor and those costs that are not, including without limitation the allocation of a portion of a fiduciary commission that is a bundled fee to investment advice. Facts that may be considered in determining whether an allocation is reasonable include, but are not limited to, the percentage of the value of the corpus subject to investment advice, whether a third party advisor would have charged a comparable fee for similar advisory services, and the amount of the fiduciary's attention to the trust or estate that is devoted to investment advice as compared to dealings with beneficiaries and distribution decisions and other fiduciary functions. The reasonable method standard does not apply to determine the portion of the bundled fee attributable to payments made to third parties for expenses subject to the 2-percent floor or to any other separately assessed expense commonly or customarily incurred by an individual, because those payments and expenses are readily identifiable without any discretion on the part of the fiduciary or return preparer.

(d) *Effective/applicability date.* This section applies to taxable years beginning on or after May 9, 2014.

**§ 1.67–4T [Removed]**

■ **Par. 3.** Section 1.67–4T is removed.

**John Dalrymple,**

*Deputy Commissioner for Services and Enforcement.*

Approved: April 1, 2014.

**Mark J. Mazur,**

*Assistant Secretary of the Treasury (Tax Policy).*

[FR Doc. 2014–10661 Filed 5–8–14; 8:45 am]

**BILLING CODE 4830–01–P**

**DEPARTMENT OF VETERANS AFFAIRS**

**38 CFR Part 36**

**RIN 2900–AO65**

**Loan Guaranty: Ability-To-Repay Standards and Qualified Mortgage Definition Under the Truth in Lending Act**

**AGENCY:** Department of Veterans Affairs.

**ACTION:** Interim final rule.

**SUMMARY:** This document amends the Department of Veterans Affairs (VA) Loan Guaranty regulations to implement provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, requiring that VA define the types of VA loans that are “qualified mortgages” for the purposes of the new Ability to Repay provisions of the Truth in Lending Act. This rule establishes which VA-guaranteed loans are to be considered “qualified mortgages” and have either safe harbor protection or the presumption that the borrower is able to repay a loan, in accordance with the new Ability to Repay provisions. The rule does not change VA’s regulations or policies with respect to how lenders are to originate mortgages, except to the extent lenders want to make qualified mortgages.

**DATES:** *Effective Date:* This interim final rule is effective May 9, 2014.

*Comment Date:* Comments must be received on or before June 9, 2014. While the standard comment period is 60 days, in order for VA to provide thorough responses to all comments and publish the final regulation as soon as possible with a target date of within 90 days of the publication of this interim final rule, we are limiting the period for comments to 30 days. VA believes it is important to publish the final rule soon because of the certainty the final rule will provide veterans and lenders. See below for further explanation.

**ADDRESSES:** Written comments may be submitted through [www.Regulations.gov](http://www.Regulations.gov); by mail or hand-delivery to Director, Regulation Policy and Management (02REG), Department of Veterans Affairs, 810 Vermont Ave. NW., Room 1068, Washington, DC 20420; or by fax to (202) 273–9026. Comments should indicate that they are submitted in response to “RIN 2900–AO65—Loan Guaranty: Ability-to-Repay Standards and Qualified Mortgage Definition under the Truth in Lending Act.” Copies of comments received will be available for public inspection in the Office of Regulation Policy and Management, Room 1068, between the

hours of 8:00 a.m. and 4:30 p.m., Monday through Friday (except holidays). Please call (202) 461–4902 (this is not a toll-free number) for an appointment. In addition, during the comment period, comments may be viewed online through the Federal Docket Management System (FDMS) at [www.Regulations.gov](http://www.Regulations.gov).

**FOR FURTHER INFORMATION CONTACT:** John Bell III, Assistant Director for Loan Policy and Valuation (262), Veterans Benefits Administration, Department of Veterans Affairs, 810 Vermont Avenue NW., Washington, DC 20420, (202) 632–8786. (This is not a toll-free number.)

**SUPPLEMENTARY INFORMATION:** The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Public Law 111–203, 124 Stat. 1376 (2010), became law on July 21, 2010. The Dodd-Frank Act established as an independent agency the Consumer Financial Protection Bureau (CFPB) and charged it with implementing many reforms to Federal oversight of residential mortgage lending, including a requirement that lenders be able to demonstrate that borrowers are reasonably able to repay their mortgage loans at the time the loans are made. Public Law 111–203, Sec. 1411. As directed by the Dodd-Frank Act, the CFPB has issued rules regarding implementation of the Truth in Lending Act (TILA), 15 U.S.C. 1601, et seq. The CFPB rules became effective January 10, 2014. The CFPB has amended the rules, as explained below, several times since initial publication.

The Dodd-Frank Act also requires various Federal agencies to define which of their loans are qualified mortgages for the purposes of sections 129B and 129C of TILA and authorizes such agencies to exempt streamlined refinances from certain income verification requirements. Public Law 111–203, Secs. 1411 and 1412. In compliance with sections 1411 and 1412 of the Dodd-Frank Act, VA is in this rulemaking defining qualified mortgage to mean any loan guaranteed, insured, or made by VA, with certain limitations on streamlined refinances, also known as Interest Rate Reduction Refinance Loans (IRRRLs). The terms “streamlined refinance” and “IRRRL” are used interchangeably in this rule. VA is also specifying income verification requirements for IRRRLs.

**Note on Comments and Publication of Final Rule**

VA believes it is important to publish a final rule promptly after the publication of this interim final rule. Veterans want full assurance that the

the bundled fee to third parties that would have been subject to the 2-percent floor if they had been paid directly by the estate or non-grantor trust are subject to the 2-percent floor, as are any fees or expenses separately assessed by the fiduciary or other payee of the bundled fee (in addition to the usual or basic bundled fee) for services rendered to the estate or non-grantor trust that are commonly or customarily incurred by an individual.

(4) *Reasonable Method.* Any reasonable method may be used to allocate a bundled fee between those costs that are subject to the 2-percent floor and those costs that are not, including without limitation the allocation of a portion of a fiduciary commission that is a bundled fee to investment advice. Facts that may be considered in determining whether an allocation is reasonable include, but are not limited to, the percentage of the value of the corpus subject to investment advice, whether a third party advisor would have charged a comparable fee for similar advisory services, and the amount of the fiduciary's attention to the trust or estate that is devoted to investment advice as compared to dealings with beneficiaries and distribution decisions and other fiduciary functions. The reasonable method standard does not apply to determine the portion of the bundled fee attributable to payments made to third parties for expenses subject to the 2-percent floor or to any other separately assessed expense commonly or customarily incurred by an individual, because those payments and expenses are readily identifiable without any discretion on the part of the fiduciary or return preparer.

(d) *Effective/applicability date.* This section applies to taxable years beginning on or after May 9, 2014.

**§ 1.67–4T [Removed]**

■ **Par. 3.** Section 1.67–4T is removed.

**John Dalrymple,**

*Deputy Commissioner for Services and Enforcement.*

Approved: April 1, 2014.

**Mark J. Mazur,**

*Assistant Secretary of the Treasury (Tax Policy).*

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**DEPARTMENT OF VETERANS AFFAIRS**

**38 CFR Part 36**

**RIN 2900–AO65**

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**SUMMARY:** This document amends the Department of Veterans Affairs (VA) Loan Guaranty regulations to implement provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, requiring that VA define the types of VA loans that are “qualified mortgages” for the purposes of the new Ability to Repay provisions of the Truth in Lending Act. This rule establishes which VA-guaranteed loans are to be considered “qualified mortgages” and have either safe harbor protection or the presumption that the borrower is able to repay a loan, in accordance with the new Ability to Repay provisions. The rule does not change VA’s regulations or policies with respect to how lenders are to originate mortgages, except to the extent lenders want to make qualified mortgages.

**DATES:** *Effective Date:* This interim final rule is effective May 9, 2014.

*Comment Date:* Comments must be received on or before June 9, 2014. While the standard comment period is 60 days, in order for VA to provide thorough responses to all comments and publish the final regulation as soon as possible with a target date of within 90 days of the publication of this interim final rule, we are limiting the period for comments to 30 days. VA believes it is important to publish the final rule soon because of the certainty the final rule will provide veterans and lenders. See below for further explanation.

**ADDRESSES:** Written comments may be submitted through [www.Regulations.gov](http://www.Regulations.gov); by mail or hand-delivery to Director, Regulation Policy and Management (02REG), Department of Veterans Affairs, 810 Vermont Ave. NW., Room 1068, Washington, DC 20420; or by fax to (202) 273–9026. Comments should indicate that they are submitted in response to “RIN 2900–AO65—Loan Guaranty: Ability-to-Repay Standards and Qualified Mortgage Definition under the Truth in Lending Act.” Copies of comments received will be available for public inspection in the Office of Regulation Policy and Management, Room 1068, between the

hours of 8:00 a.m. and 4:30 p.m., Monday through Friday (except holidays). Please call (202) 461–4902 (this is not a toll-free number) for an appointment. In addition, during the comment period, comments may be viewed online through the Federal Docket Management System (FDMS) at [www.Regulations.gov](http://www.Regulations.gov).

**FOR FURTHER INFORMATION CONTACT:** John Bell III, Assistant Director for Loan Policy and Valuation (262), Veterans Benefits Administration, Department of Veterans Affairs, 810 Vermont Avenue NW., Washington, DC 20420, (202) 632–8786. (This is not a toll-free number.)

**SUPPLEMENTARY INFORMATION:** The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Public Law 111–203, 124 Stat. 1376 (2010), became law on July 21, 2010. The Dodd-Frank Act established as an independent agency the Consumer Financial Protection Bureau (CFPB) and charged it with implementing many reforms to Federal oversight of residential mortgage lending, including a requirement that lenders be able to demonstrate that borrowers are reasonably able to repay their mortgage loans at the time the loans are made. Public Law 111–203, Sec. 1411. As directed by the Dodd-Frank Act, the CFPB has issued rules regarding implementation of the Truth in Lending Act (TILA), 15 U.S.C. 1601, et seq. The CFPB rules became effective January 10, 2014. The CFPB has amended the rules, as explained below, several times since initial publication.

The Dodd-Frank Act also requires various Federal agencies to define which of their loans are qualified mortgages for the purposes of sections 129B and 129C of TILA and authorizes such agencies to exempt streamlined refinances from certain income verification requirements. Public Law 111–203, Secs. 1411 and 1412. In compliance with sections 1411 and 1412 of the Dodd-Frank Act, VA is in this rulemaking defining qualified mortgage to mean any loan guaranteed, insured, or made by VA, with certain limitations on streamlined refinances, also known as Interest Rate Reduction Refinance Loans (IRRRLs). The terms “streamlined refinance” and “IRRRL” are used interchangeably in this rule. VA is also specifying income verification requirements for IRRRLs.

**Note on Comments and Publication of Final Rule**

VA believes it is important to publish a final rule promptly after the publication of this interim final rule. Veterans want full assurance that the



home loan benefit will remain easy to utilize, and lenders want the certainty that comes with a final rule. As such, VA will review comments as they are received. Once the comment period closes, VA will exercise all reasonable efforts to publish the final rule as quickly as possible, with a goal of closing out the full rulemaking process within 90 days of publication of this interim final rule.

### General Definitions of Qualified Mortgage

Section 1412 of the Dodd-Frank Act amended section 129C of TILA, 15 U.S.C. 1601, et seq., to include a definition of a “qualified mortgage.” Public Law 111–203, Sec. 1412. Although the qualified mortgage definition applies generally to loans subject to TILA, a number of Federal agencies, including VA, are required to prescribe rules defining the types of loans they insure, guarantee, or administer, as the case may be, that are qualified mortgages. Id. Such rules may revise, add to, or subtract from the criteria used to define a qualified mortgage under section 129C of TILA, upon a finding that they are consistent with the purposes of TILA’s provisions respecting the borrower’s ability to repay in sections 129B and 129C. Id.

On January 30, 2013, the CFPB published its revision of Regulation Z, in which, among other things, it established a definition of “Qualified Mortgage.” 78 FR 6407. That CFPB final rulemaking also generally prohibits a creditor from making a mortgage loan unless the creditor determines that the consumer will have the ability to repay the loan. Id. at 6415.

The rule further identified two types of qualified mortgages. Id. at 6408. One type enjoys a rebuttable presumption that the creditor making the loan satisfied the borrower’s ability-to-repay requirements. Id. With these types of loans, the presumption favors the assertion that the creditor complied with the ability-to-repay requirements unless the borrower proves—based on information that the creditor was aware of at the time the loan was made—that the consumer would be left with insufficient residual income or assets to meet living expenses after paying the mortgage and other debts. Id. The other type, safe harbor qualified mortgages, are those that are considered to have conclusively met all requirements of a qualified mortgage and a borrower’s ability to repay a loan. Id.

### Subsequent Regulatory Changes to Qualified Mortgage Definition

The issues CFPB must regulate are some of the most complex problems faced in the lending industry today. VA recognizes that CFPB must act nimbly to address myriad issues affecting many facets of the housing finance industry and that, while VA is an important part of the industry, VA’s market share is relatively small.

CFPB rules published on January 30, 2013, created a temporary qualified mortgage applicable to VA-guaranteed loans, among other agency guaranteed loans. Under these rules, VA-guaranteed loans could be qualified mortgages even if they did not meet the 43 percent debt-to-income ratio applicable to many other types of qualified mortgages. 78 FR 6617.

CFPB has issued multiple rulemaking documents related to its original final rule, including (1) a concurrent proposal, published on January 30, 2013 (78 FR 6621); (2) a proposed revision to the final rule, published on April 18, 2013 (78 FR 23171); (3) a final rule official interpretation, published on June 12, 2013 (78 FR 35430); (4) a final rule official interpretation, published on July 24, 2013 (FR 78 FR 44686); (5) a final rule amendment, published October 1, 2013 (78 FR 60442); and (6) an interim final rule, published on October 23, 2013 (78 FR 62993).

Some VA stakeholders have expressed uncertainty regarding the impact of these amendments on the requirements for VA-guaranteed loans to be qualified mortgages under CFPB’s regulations. For instance, the concurrent proposal published on January 30, 2013, stated that CFPB was proposing to exempt from the ability to repay requirements streamlined refinances made pursuant to a program administered by VA and other Federal agencies. See 78 FR 6623. However, the CFPB did not adopt this exemption in its final rule published on June 12, 2013, stating that the exemption from the ability to repay requirements for streamlined refinances was unnecessary in light of the temporary qualified mortgage provisions. See 78 FR 35471–3. CFPB explained in the preamble to its rule that while it did not believe that an exemption for streamlined refinances was appropriate: “[Under] the temporary qualified mortgage provisions in § 1026.43(e)(4), for instance, creditors need only comply with the documentation and underwriting requirements established by the respective Federal agencies, and need not apply the 43 percent debt-to-income ratio or follow the documentation and

underwriting procedures applicable to the general category of qualified mortgages under § 1026.43(e)(3) and appendix Q.” 78 FR 35473. The Bureau noted, however, that under § 1026.43(e)(4), a loan that is eligible to be purchased, guaranteed, or insured by one of the Federal agencies (including VA), would still need to meet certain minimum requirements imposed by the Dodd-Frank Act, including the prohibitions on certain “higher-risk loan terms,” loan terms exceeding 30 years, or excessive points and fees. Id.

The CFPB published a further amendment on July 24, 2013, revising the temporary qualified mortgage provision applicable to loans eligible for government-sponsored enterprise (GSE) and federal agency purchase, insurance, or guaranty, including VA guaranty. Where the original provision, published on January 30, 2013, required that such a loan be “eligible to be guaranteed by the U.S. Department of Veterans Affairs,” 78 FR 6587, the revised provision required that the loan be “eligible to be guaranteed, *except with regard to matters wholly unrelated to ability to repay*, by the U.S. Department of Veterans Affairs,” 78 FR 44718 (emphasis added). The amendment also revised the CFPB’s official commentary to this provision. As revised, comment 43(e)(4)–4 states that the provision “requires only that the creditor determine that the loan is eligible (i.e., meets the criteria) for [VA] . . . guarantee . . . at consummation.” 78 FR 44727. The comment further identifies methods for determining eligibility: “A valid underwriting recommendation by [an automated underwriting system] that relies on an Agency underwriting tool,” “compliance with the standards in the . . . Agency written guide in effect at the time,” “a written agreement between the creditor . . . and a[n] . . . Agency” permitting variations, and “an individual loan waiver granted by the . . . Agency to the creditor.” Id. However, “[i]n using any of the[se] methods . . . , the creditor need not satisfy standards that are wholly unrelated to assessing a consumer’s ability to repay that the creditor is required to perform.” Id. For ease of reading, VA will refer to this change as the “July Revision.”

In the same rule, CFPB revised Appendix Q. Appendix Q provides the standards by which a creditor must assess a borrower’s debts and income to determine whether the borrower’s debt-to-income exceeds 43 percent for purposes of the CFPB’s general qualified mortgage provision. See 78 FR 6589; 78 FR 44718; see also 12 CFR 1026.43(e)(2)(vi). As revised in the July

amendment, Appendix Q states that “a creditor may not rely on Agency or GSE guidance to reach a resolution contrary to that provided by the following standards, even if such Agency or GSE guidance specifically addresses the particular type of debt or income . . .” *Id.*

#### Questions About the July Revision, Appendix Q, and Debt-to-Income Ratios

After the publication of the amendments in June and July 2013, some VA stakeholders raised questions about what requirements might apply to VA. These stakeholders had originally believed CFPB’s rule would not substantially affect VA’s program requirements, but raised concerns to VA regarding the effect of the June and July 2013 publications. Two important areas of concern were income verification requirements for IRRRLs and debt-to-income calculations for originations and refinances other than IRRRLs.

VA has fielded numerous questions related to the July Revision and whether it means all IRRRLs will be subject to income verification requirements. As noted above, the preamble to the CFPB’s rule published in June stated that “[u]nder the temporary qualified mortgage provisions in § 1026.43(e)(4), for instance, creditors need only comply with the documentation and underwriting requirements established by the respective Federal agencies, and need not apply the 43 percent debt-to-income ratio or follow the documentation and underwriting procedures applicable to the general category of qualified mortgages under § 1026.43(e)(3) and appendix Q.” 78 FR 35473. Also in the preamble to the July rule, CFPB stated that the July Revision was intended “to make clear that matters wholly unrelated to ability to repay will not be relevant to determination of [qualified mortgage] status.” 78 FR 44686, July 24, 2013. Lenders have nonetheless informed VA that as long as they have any doubts, they will proceed as if the income verification requirements apply to IRRRLs, even though the Dodd-Frank Act provides for a specific exemption, as do VA regulations. See Public Law 111–203, Sec. 1411; 38 CFR 36.4307. VA guaranteed over 300,000 IRRRLs in fiscal year (FY) 2013. VA estimates that, had lenders been required to verify income for IRRRLs in the same manner that they verify income for purchase-money guaranteed loans, the average closing time for an IRRRL would have taken two to four weeks longer.

In addition, many VA stakeholders have raised concerns about the debt-to-income ratio. According to these

stakeholders, one interpretation of the CFPB rule seems to exempt VA loans from the CFPB debt-to-income requirements of 12 CFR 1026.43(e)(2)(vi). Under 12 CFR 1026.43(e)(4), VA guaranteed loans are qualified mortgages with safe harbor protections if they also (i) provide for regular periodic payments, (ii) do not exceed a term of 30 years, and (iii) include points and fees that do not exceed specified amounts. Note: The three requirements summarized here are more fully described at 12 CFR 1026.43(e)(2)(i)–(iii). As debt-to-income ratio requirement is not one of those, the argument is that it does not apply to VA-guaranteed loans. The preamble and official commentary discussed above support this position. Also supporting this position is the small entity compliance guide published by the CFPB. The guide states: “To meet the Temporary QM definition, loans must be underwritten using the required guidelines of the [GSE/Agency] entities above, including any relevant DTI guidelines. They do *not* have to meet the 43 percent debt-to-income ratio threshold that applies to General QM loans. The creditor does not have to satisfy GSE or agency standards which are wholly unrelated to the credit risk or underwriting of the loan or any standards which apply after the consummation of the loan.” Ability-to-Repay and Qualified Mortgage Rule Small Entity Compliance Guide at 33, [http://files.consumerfinance.gov/f/201401\\_cfpb\\_atr-qm\\_small-entity-compliance-guide.pdf](http://files.consumerfinance.gov/f/201401_cfpb_atr-qm_small-entity-compliance-guide.pdf) (emphasis in original).

Some VA stakeholders have suggested that there might be another interpretation of the CFPB’s rules. Since Appendix Q states that a creditor may not rely on Agency guidance to reach a resolution of the appropriate treatment of a specific kind of debt or income contrary to the resolution provided by Appendix Q, some stakeholders have suggested to VA that the 43 percent debt-to-income ratio will apply after all. In FY 2013, there were 95,198 VA-guaranteed loans that exceeded the 43 percent debt-to-income ratio. VA understands that lenders may not make similar loans going forward if the loans are not qualified mortgages with safe harbor protections. Alternatively, the perceived risk of non-qualified mortgage loans may cause investors in the marketplace to artificially deflate the prices they would pay for VA loans, which would lead to lenders increasing their loan prices to veterans to meet that shortfall. This is due in part to VA’s maximum 25 percent guaranty, as

opposed to the 100 percent guaranty provided by other Federal agencies.

CFPB published another amendment in October 2013. See 78 FR 60382, Oct. 1, 2013. This time the rule removed the July Revision, at least with regard to VA. 78 FR 60442, Oct. 1, 2013. Another amendment was published three weeks later reinstating the July Revision. See 78 FR 62993, Oct. 23, 2013. The amendment explained that the omission of the July Revision was inadvertent and no substantive change was intended. 78 FR 63002, Oct. 23, 2013.

VA has attempted to eliminate the uncertainty by explaining to stakeholders that, in VA’s view, neither the July Revision nor Appendix Q changes the way debt-to-income ratio affects the underwriting of VA-guaranteed loans. Some stakeholders continue to advise, however, that the issue goes beyond education or training. They seek legal certainty, and advise that in the absence of the legal certainty they seek, they are concerned whether investors will continue to view VA-guaranteed loans as high-quality investments that warrant premium pricing.

VA does not have authority to state with legal effect the proper interpretation of CFPB’s rules. CFPB has the authority to interpret, enforce, and amend the rules CFPB promulgates. Courts and Congress could also have a role in resolving any issues surrounding the merits of the legal interpretations explained above.

As a result, VA’s approach in this rule is to define which VA loans satisfy the qualified mortgage requirements, notwithstanding other limitations. In other words, VA may not be able to provide a definitive interpretation of CFPB’s rule, but VA can make sure that VA’s rule removes stakeholder uncertainties concerning VA loans. Since VA’s goal is to ensure that veterans’ benefits are delivered without interruption, additional burden, or cost to veterans, VA intends through this interim final rule to quell such concerns by specifying exactly what is required for a VA loan to be considered a qualified mortgage with safe harbor protections.

#### VA’s Interim Final Rule

In this interim final rule, VA is amending 38 CFR 36.4300(b) to establish that almost all VA loans that meet current VA underwriting standards will be safe harbor qualified mortgages with regard to the revised TILA Ability to Repay provisions. In paragraph (b)(1), VA defines safe harbor qualified mortgage as one that meets the Ability-to-Repay requirements of sections 129B



and 129C of TILA regardless of whether the loan might be considered a high cost mortgage transaction as defined by section 103bb of TILA (15 U.S.C. 1602bb). Paragraph (b)(2) states that subject to certain exceptions pertaining to IRRRLs, any guaranteed or insured loan made in compliance with this subpart is a safe harbor qualified mortgage. There are some VA IRRRLs which will be considered rebuttable presumption qualified mortgages instead. Those are described later in this preamble.

Paragraph (b)(3) incorporates without change CFPB's category of exempted transactions, except that VA is omitting reverse mortgages because they are not mortgages that VA guarantees, insures, or makes. Under CFPB's rule, 12 CFR 1026.43(a), exempted transactions are not subject to challenge under the ability-to-pay requirements of TILA (15 U.S.C. 1639C).

With regard to the loans that are subject to the ability-to-repay provisions (i.e., loans other than the type described in § 36.4300(b)(3)), VA and CFPB's definitions of qualified mortgage may differ. To the extent there are differences between CFPB's definition and VA's, VA intends for its definition of qualified mortgage to loans guaranteed, insured, or made by VA to preempt rules that may seem contrary to VA's. This would include those loans which would fit under VA's definition, but not necessarily under the CFPB definition (i.e., negative amortization, documentation requirements for IRRRLs, minimum FICO score documentation, and in one possible legal interpretation, debt-to-income ratios). Congress has authorized VA to deliver veterans' benefits in a way that helps as many veterans as possible. In so doing, VA's statutory framework expressly includes authority for negative amortizing loans under certain circumstances, streamlined refinances that are simply improving a borrower's ability to repay a loan that the Secretary has already guaranteed under more stringent underwriting guidelines, and Secretarial discretion to guarantee loans after taking into consideration the unique circumstances that affect veterans.

Despite some of the differences between VA's definition and CFPB's, VA has made a finding that, for the following reasons, VA's definition is consistent with TILA. Pursuant to 38 U.S.C. 3710, VA already has in place an extensive regulatory framework for determining whether a borrower is a satisfactory credit risk to obtain a loan guaranteed or insured by VA. Specifically, the regulations found at 38

CFR 36.4340 and 36.4313 include credit underwriting standards such as debt-to-income ratios, criteria for evaluating the reliability and stability of the income of a veteran, procedures for ascertaining and verifying the monthly income required by the veteran to meet the anticipated loan payment terms, residual income standards, allowable fees and charges to be paid at closing, and document retention requirements for lenders.

#### **VA's Underwriting Standards for Qualified Mortgages**

VA's current underwriting standards for guaranteed loans are consistent with, if not prototypical for, the generally applicable definition of qualified mortgage in TILA. VA's rules already require full underwriting of all origination loans such as purchase money loans and refinances other than IRRRLs. By statute, the maturity of a VA-guaranteed loan at the time of origination shall not be more than thirty years and thirty-two days. See 38 U.S.C. 3703(d)(1). VA requires that loans generally be amortized in equal periodic payments that are substantially equal. See 38 CFR 36.4310. VA requires that discount points be reasonable as determined by the Secretary of Veterans Affairs. See 38 CFR 36.4313(d)(7)(ii)(C). These requirements would seem to correspond to those in CFPB's rule at 12 CFR 1026.43(e)(2)(i)-(iii).

Also, as with CFPB's rule, VA's rule already requires lenders to verify assets, employment, credit reports, and the accuracy of all other information provided in support of a purchase money origination loan or a refinance that is not an IRRRL. See 38 CFR 36.4340(j). VA regulates allowable fees and charges that may be charged to or paid by a veteran borrower. See 38 CFR 36.4313. VA has a structure in place for determining acceptable debt-to-income ratio. See 38 CFR 36.4340(c). It should be noted, too, that in addition to all of these requirements, VA has had a longstanding requirement for residual income to ensure that the borrower has sufficient income to cover family living expenses after meeting monthly mortgage and debt obligations. See 38 CFR 36.4340(e).

Where VA's rule differs somewhat from CFPB's is that VA must also balance credit underwriting with its mission of serving veterans. For instance, VA makes room for limited underwriting exceptions when a debt-to-income ratio might not provide a complete picture of a borrower's ability to repay a loan. See 38 CFR 36.4340(c). VA also permits underwriters to make judgment calls based on a veteran's

unique circumstances, such as when recently discharged veterans have a limited credit history. See 38 CFR 36.4340(g). A key tenet of the VA Home Loan program is the allowance it provides to underwriters to review a veteran's entire loan profile and consider all compensating factors in order to determine the credit worthiness of the veteran. It is not one characteristic alone that reveals whether a veteran maintains the ability to repay a loan, but the culmination of all characteristics in a veteran's profile. Veterans show a high degree of borrowing responsibility as a population, which is borne out by the fact that VA's loans performed better than even conventional loans during the peak of the financial crisis. According to the Mortgage Bankers Association National Delinquency Survey, as of the second quarter 2013 VA has held the lowest foreclosure rate for the past 22 quarters and the lowest seriously delinquent rate for 15 of the past 18 quarters when compared to prime, subprime, and Federal Housing Administration (FHA) loans.

Accordingly, this rule amends 38 CFR 36.4300 by designating as safe harbor qualified mortgages all purchase money origination loans and refinances other than certain IRRRLs guaranteed or insured by VA. Such a designation helps to assure veterans that they can continue using their benefits to obtain loans on favorable terms, while also easing any liability concerns expressed by lenders making VA-guaranteed loans and any marketplace concerns about the stability of investing in VA-guaranteed loans.

#### **Qualified Mortgage Status for VA Direct Loans**

In addition to designating qualified mortgage status for VA-guaranteed and VA-insured loans, this rulemaking is designating as a qualified mortgage any loan that VA makes directly to a borrower. One such type of loan, authorized in 38 U.S.C. 3711, is typically made to recipients of a Specially Adapted Housing grant. Another type, authorized in 38 U.S.C. 3761, is made to Native American veterans who live on trust lands. A third, which VA calls a vendee loan, is authorized in 38 U.S.C. 3720 and 3733, and is made to purchasers of properties VA acquires as a result of foreclosures in the guaranteed loan program. Given that each of these types of loans is required to meet either the same or substantially similar standards as those prescribed for the guaranteed program, there is no reason to categorize them

differently for the purposes of a borrower's ability to repay them.

Accordingly, VA is amending 38 CFR 36.4500 by stating that all VA direct loans, Native American direct loans, and vendee loans are safe harbor qualified mortgages for the purposes of sections 129B and 129C of TILA. VA is using the same definition of safe harbor qualified mortgage as in § 36.4300(b)(1). We also amend the section heading and include the authority citation to 15 U.S.C. 1639C(b)(3)(B)(ii) and 38 U.S.C. 3710 for new § 36.4500(c). As a conforming amendment, VA is revising § 36.4501 to define "Vendee loan" as a loan made by the Secretary for the purpose of financing the purchase of a property acquired pursuant to chapter 37 of title 38, United States Code. We also include the authority citation to 38 U.S.C. 3720 and 3733.

We are redesignating current paragraph (c) of § 36.4500 as paragraph (d) and also make a few conforming changes to include headings for 38 CFR 36.4500(a), (b), and newly redesignated paragraph (d) so that they are consistent with the format of newly added paragraph (c). Each paragraph will now have its own heading as follows: "Applicability to direct loans" for paragraph (a); "Applicability to direct loans to Native Americans" for paragraph (b); "Safe harbor qualified mortgage" for paragraph (c); and "Restatement" for paragraph (d).

#### **Safe Harbor Versus Rebuttable Presumption Qualified Mortgages—IRRRLs**

While all VA IRRRLs will be considered qualified mortgages, not all will be safe harbor qualified mortgages. The ones that are not safe harbor qualified mortgages, meaning that they cannot conclusively meet the Ability-to-Repay requirements, are qualified mortgages entitled to a presumption that they meet the Ability-to-Repay requirements of the Dodd-Frank Act. Unlike a safe harbor qualified mortgage, a rebuttable presumption qualified mortgage provides the borrower with the opportunity to argue that the lender did not make a good faith determination that the borrower would have a reasonable ability to repay the loan. (Provided a loan meets VA underwriting standards and complies with the requirements of 38 CFR 36.4300–36.4393, inclusive, it will be a VA guaranteed loan regardless of whether it is considered a safe harbor qualified mortgage or a rebuttable presumption qualified mortgage or neither under TILA.)

In order for an IRRRL to be considered a safe harbor qualified mortgage, the

loan must meet all of the requirements of 36.4300(c)(1): (i) The loan being refinanced was originated at least 6 months before the new loan's closing date, and the veteran has not been more than 30 days past due during the 6 months preceding the new loan's closing date; (ii) the recoupment period for all allowable fees and charges (see 38 CFR 36.4313) financed as part of the loan or paid at closing does not exceed thirty-six (36) months; and (iv) all other VA requirements for guaranteeing an IRRRL are met.

The purpose of an IRRRL is to place veterans into a better financial position by (i) reducing their interest rate in effect lowering their payment, (ii) reducing the term of the loan which would reduce the total of payments on the loan, or (iii) reducing their concern for market fluctuations by converting a loan from an ARM to a fixed rate. In establishing a "cooling off" period and recoupment requirement, VA intends to keep the tenets of the IRRRL program strong by ensuring that veterans who obtain an IRRRL are placed in a better financial position. VA believes that a veteran who has recently undergone the rigorous underwriting process associated with loan origination, and who is still within six months of obtaining the loan, should give him or herself time to understand the benefits of the original loan. If a veteran is experiencing financial hardships or other concerns during the first six months of the loan, VA has alternative means to help the veteran navigate through those issues outside of an IRRRL. The recoupment period helps disclose to the veteran the true costs associated with refinancing a loan. In FY 2013, 308,332 IRRRLs were originated and 12,900 (4%) loans would have failed to meet the seasoning requirement in this rule. Currently, data is not available to address the number of files in FY 2013 that would be affected by the 36 month recoupment requirement.

A proposed IRRRL that does not meet the seasoning and recoupment requirements of section 36.4300(c)(1) is still considered a qualified mortgage, but it will not have the safe harbor protection. Instead, it will only be considered a qualified mortgage with the presumption that a borrower has the ability to repay the loan. VA believes that a veteran should be able to take advantage of any opportunity that puts the veteran in a better financial situation. To make it effectively impossible for a veteran to refinance a loan solely because a veteran has not been in the home for the prescribed period or because the recoupment might

fall just short of the requirement seems overly restrictive. At the same time, VA believes that lenders and borrowers should proceed with caution in such circumstances and understand that there is some risk associated with these sorts of loans. As such, VA has determined that the various interests are best balanced by designating such loans as qualified mortgages, but only to the extent that they provide a presumption of the borrower's ability to repay.

A proposed IRRRL that does not meet the requirements for exemption of income verification, as explained below, must receive prior approval from VA to be guaranteed. If VA grants approval, the IRRRL will satisfy the requirements of a qualified mortgage with the presumption that the borrower is able to repay the loan. Safe harbor protections will only apply to such an IRRRL if it also meets the seasoning and recoupment requirements.

In the rule text we also include the authority citation to 15 U.S.C. 1639C(b)(3)(B)(ii) and 38 U.S.C. 3710 for new § 36.4300(c)(1) and make a few conforming changes. The conforming changes redesignate current paragraph (b) of 38 CFR 36.4300 as paragraph (e), and add headings for 38 CFR 36.4300(a) and newly redesignated paragraph (e) so that they are consistent with the format of newly added paragraphs (b) thru (d). Each paragraph will now have its own heading as follows: "Applicability to guaranteed loans" for paragraph (a); "Safe harbor qualified mortgage" for paragraph (b); "Interest rate reduction refinancing loans (IRRRLs)" for paragraph (c); "Effect of indemnification on qualified mortgage status" for paragraph (d); and "Restatement" for paragraph (e).

#### **IRRRL Income Verification Requirements**

VA is exercising its authority under section 1411 of the Dodd-Frank Act to exempt IRRRLs from many of the income verification requirements of TILA. In 2009, when Congress began deliberating the requirements associated with income verification, the bills introduced to address the issues did not include an exemption for VA IRRRLs. See H.R. 1728 EH, 111th Congress (2009–2010); H.R. 4173 RFS, 111th Congress (2009–2010). By 2010 when the Dodd-Frank Act was passed, the law expressly allowed VA to exclude its IRRRLs from income verification requirements. Congress worked closely with VA in drafting the final section 1411 to ensure that the majority of veterans who wanted to take advantage of the IRRRL program would be able to continue to do so.

An IRRRL can only be made if it is to refinance a loan that VA has already guaranteed. 38 U.S.C. 3710(a)(8). As explained above, all VA-guaranteed loans must meet VA's strict underwriting standards at origination. Loan proceeds from an IRRRL can only be used to pay off the original principal balance and to finance closing costs; the veteran cannot receive cash back. See 38 U.S.C. 3710(e)(1)(C).

Pursuant to 38 U.S.C. 3710(e)(2), an IRRRL is guaranteed without regard to the amount of outstanding entitlement available for use by the veteran, and the amount of such entitlement is not charged as a result of a guaranty provided for an IRRRL. The IRRRL is deemed to have been obtained with the guaranty entitlement used to obtain the loan being refinanced. In other words, for the purposes of the benefit, the IRRRL is essentially the same loan as the original, the key difference being that the veteran should be in a better financial position than before. The veteran is either paying a lower interest rate, meaning a reduced monthly payment, or the veteran is in a fixed-rate loan and no longer subject to market fluctuations associated with adjustable rate mortgages. If the veteran could afford the original loan, then the idea is that the IRRRL should be even more affordable.

As explained above, CFPB originally proposed that VA streamlined refinancing would be exempt from CFPB's income verification requirements. In response to the rule, most commenters supported the proposed exemption. 78 FR 35472. One consumer advocate group feared, however, that the exemption would lead to serial refinancing and equity-stripping, usually affecting those consumers who are the most vulnerable. *Id.*

The consumer advocate's comment highlighted a possible vulnerability in the IRRRL program. Some borrowers are easily enticed into refinancing their loans simply by understanding that the refinance can lead to two months without making a mortgage payment; the current month of the refinance and a second month due to the interest financed into the new loan. Other borrowers become fixated on a lower interest rate provided by an IRRRL without understanding that they might not ever recoup their investment of closing costs. That is why VA has defined safe harbor qualified mortgage to exclude IRRRLs that put a veteran at risk of equity-stripping. By classifying such an IRRRL as a rebuttable presumption qualified mortgage rather than a safe harbor qualified mortgage,

VA is providing a disincentive for lenders to make these sorts of loans. Nevertheless, as shown above, VA estimates that only four percent of its IRRRLs guaranteed in FY 2013 would have failed to meet the proposed seasoning requirement.

VA believes it is unfair to negate the income verification exemption when it seems only to help the overwhelming majority of veterans who obtain an IRRRL. VA estimates that if the exemption were not protected, the closing time for an IRRRL would be delayed on average for two to four weeks. Lenders have expressed concern that time and costs associated with internal income verification procedures (e.g., hiring processors and underwriters to request the verification and review its contents) would affect the borrower negatively in price and closing time delays. VA does not have the means to track the exact costs or delays, but lenders have indicated those additional timeframes and enhanced process procedures if income verification was required.

Accordingly, in new § 36.4340(b)(2), VA is exempting streamlined refinances from income verification requirements as long as the following Dodd-Frank Act conditions are met:

(i) The veteran is not 30 days or more past due on the loan being refinanced;

(ii) The proposed streamlined refinance does not increase the principal balance outstanding on the prior existing residential mortgage loan, except to the extent of fees and charges allowed by VA;

(iii) Total points and fees payable in connection with the proposed streamlined refinance loan are in accordance with 12 CFR 1026.32, will not exceed 3 percent of the total new loan amount, and are in compliance with VA's allowable fees and charges found at 38 CFR 36.4313;

(iv) The interest rate on the proposed streamlined refinance is lower than the interest rate on the loan being refinanced, unless the borrower is refinancing from an adjustable rate to a fixed-rate loan, under guidelines that VA has established;

(v) The proposed streamlined refinance is subject to a payment schedule that will fully amortize the IRRRL in accordance with VA regulations;

(vi) The terms of the proposed streamlined refinance do not result in a balloon payment, as defined in TILA; and

(vii) Both the residential mortgage loan being refinanced and the proposed streamlined refinance satisfy all other VA requirements.

If a streamlined refinancing does not satisfy all seven of the criteria, above, the lender must verify the income in accordance with standards set forth in VA's regulation at 38 CFR 36.4340 and with those that are generally applicable under CFPB's regulations on TILA.

VA's goal through this rulemaking is to protect the integrity of the Home Loan program and provide veterans an assurance that they are truly improving their financial position when proceeding with an IRRRL. The seasoning and recoupment requirements discussed above, as well as the income verification exemption provided when certain criteria are met, all serve to further this goal.

In addition, VA is redesignating current paragraph (b) of § 36.4340 as paragraph (b)(1) and adding a new paragraph (b)(2). We are also including an authority citation to 15 U.S.C. 1639C(a)(5) and 38 U.S.C. 3710 for new § 36.4340(b)(2). In current § 36.4340(a), the reference to § 36.4807 is revised to refer to § 36.4307. The reference to § 36.4807 was a typographical error.

#### **Indemnification Agreements and Qualified Mortgage Status**

Pursuant to 38 U.S.C. 3710(g)(4), VA is authorized to seek civil penalties if VA determines a lender has knowingly and willfully made a false certification with regard to compliance with VA's credit information and loan processing standards. It is important to note that this sort of violation does not necessarily mean fraud. If criminal fraud is suspected, VA will notify the Office of Inspector General. 38 CFR 1.201. Sometimes during an audit of a lender VA does not find fraud but does find a loan that was so egregiously underwritten that VA believes the penalties might be applicable. As an alternative to the penalties, VA may agree, pursuant to 38 U.S.C. 3720, to a compromise and accept the lender's indemnification agreement.

With this rule, VA is adopting a standard similar to the Department of Housing and Urban Development (HUD) with regard to indemnification agreements. HUD, in its final rule published December 11, 2013, clarified that "an indemnification demand or resolution of a demand that relates to whether the loan satisfied relevant eligibility and underwriting requirements at time of consummation may result from facts that could allow a change in qualified mortgage status, but the existence of an indemnification does not per se remove qualified mortgage status." 78 FR 75220-75221, Dec. 11, 2013. VA is adopting, § 36.4300(d), the same language as HUD



for VA-guaranteed loans that are subject to indemnification agreements.

### Consultation With CFPB

Section 1412 of the Dodd-Frank Act directs VA to consult with CFPB regarding this rulemaking. Accordingly, on May 6, 2013, VA submitted a draft of this interim final rulemaking to the CFPB Office of Regulation. CFPB attorneys raised a number of suggestions for revising the preamble language to this document, but indicated that they did not object to the content or intent of this interim final rule. CFPB's suggestions have been incorporated into the text of the preamble. In January of 2014, CFPB reviewed the rule and made additional suggestions. We have incorporated those suggestions into this interim final rule, and rely on this consultation as a further finding that this rule is consistent with the requirements of the Dodd-Frank Wall Street Reform and Consumer Financial Protection Act.

### Administrative Procedure Act

In accordance with 5 U.S.C. 553(b)(B) and (d)(3), the Secretary of Veterans Affairs finds that there is good cause to dispense with the opportunity for advance notice and opportunity for public comment and good cause to publish this rule with an immediate effective date. VA is issuing this rulemaking as an interim final rule. VA sees an urgent need to clarify for veterans, lenders, and investors the applicability and potential effect of the qualified mortgage requirements on VA's programs. VA understands that while our interpretation is such that under CFPB's Temporary Qualified Mortgage (TQM) rules, VA would have been exempt from the debt-to-income ratio rule and the points and fees rule, some lenders have expressed a different interpretation of this rule. VA has been advised by the industry that many lenders may not make loans that are not considered "qualified mortgages." Additionally, stakeholders have voiced concerns that the uncertainty surrounding the applicability of TQM for VA loans could cause upheaval in the delivery of benefits to veterans. This type of uncertainty may lead investors to decrease the prices they will pay, causing lenders to increase the prices they charge veterans and affecting a veteran's ability to obtain mortgages.

VA has identified 95,198 of its purchase and cash-out refinance loans guaranteed in FY 2013 that would have exceeded the debt-to-income ratio of 43 percent under CFPB's rule. Though VA cannot predict how many loans would not have been made had CFPB's rule

been in place and lenders not interpreted TQM to exclude VA from the debt-to-income ratio rule, up to 95,198 veterans would not have been able to obtain a VA home loan or would have been subject to higher costs. VA has examined its FY 2013 loan data and identified 4,734 loans whose interest rates exceeded the national Average Prime Offer Rate (APOR) by the CFPB standard of 150 basis points. Applying CFPB's high-interest rate loan provisions to VA, without VA's rule in place, 4,734 veterans may not have been able to obtain a VA home loan or would have been subject to higher loan costs. Consequently, VA believes an interim final rule is necessary to re-stabilize the market for VA loans and to assure program participants, especially those who are veterans, that VA's programs are not undergoing large-scale changes.

VA has also been advised that, without the explicit statements issued under this rule, veterans could see the costs of VA loans increase, particularly with regard to IRRRLs, as much out of uncertainty as any concrete requirement imposed by TILA rules. VA has identified a total of 308,332 IRRRLs guaranteed in FY 2013 that would not have met CFPB's income verification requirements. Assuming that some of these loans would not have been made had CFPB's verification requirements been applicable, up to 308,332 veterans would not have been able to refinance their home loan or would have been subject to higher loan costs.

VA also is concerned that investors will demur from purchasing mortgage backed securities of VA-guaranteed loans due to perceived issues regarding what constitutes "safe harbor" without issuance of formal guidance on the qualified mortgage rules from VA. Issuing this rule will help to remove these perceptions and allow veterans to continue to utilize the benefit they have earned without bearing the brunt of increased pricing and limited availability of the VA product. Veterans, lenders, and investors have expressed concern over the applicability and potential effect of CFPB's qualified mortgage definition on the VA Home Loan program. VA has engaged in an extensive drafting process to assure that this rulemaking comprehensively addresses and eases the concerns expressed by these stakeholders.

### Executive Orders 12866 and 13563

Executive Orders 12866 and 13563 direct agencies to assess the costs and benefits of available regulatory alternatives and, when regulation is necessary, to select regulatory approaches that maximize net benefits

(including potential economic, environmental, public health and safety effects, and other advantages; distributive impacts; and equity). Executive Order 13563 (Improving Regulation and Regulatory Review) emphasizes the importance of quantifying both costs and benefits, reducing costs, harmonizing rules, and promoting flexibility. Executive Order 12866 (Regulatory Planning and Review) defines a "significant regulatory action," which requires review by OMB, as "any regulatory action that is likely to result in a rule that may: (1) Have an annual effect on the economy of \$100 million or more or adversely affect in a material way the economy, a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or State, local, or tribal governments or communities; (2) Create a serious inconsistency or otherwise interfere with an action taken or planned by another agency; (3) Materially alter the budgetary impact of entitlements, grants, user fees, or loan programs or the rights and obligations of recipients thereof; or (4) Raise novel legal or policy issues arising out of legal mandates, the President's priorities, or the principles set forth in this Executive Order."

The economic, interagency, budgetary, legal, and policy implications of this regulatory action have been examined, and the rule may be an economically significant regulatory action under Executive Order 12866. VA's impact analysis can be found as a supporting document at <http://www.regulations.gov>, usually within 48 hours after the rulemaking document is published. Additionally, a copy of the rulemaking and its impact analysis are available on VA's Web site at <http://www1.va.gov/orpm/>, by following the link for "VA Regulations Published."

### Unfunded Mandates

The Unfunded Mandates Reform Act of 1995 requires, at 2 U.S.C. 1532, that agencies prepare an assessment of anticipated costs and benefits before issuing any rule that may result in expenditure by State, local, and tribal governments, in the aggregate, or by the private sector, of \$100 million or more (adjusted annually for inflation) in any one year. This interim final rule will have no such effect on State, local, and tribal governments, or on the private sector.

### Paperwork Reduction Act

This interim final rule contains no provisions constituting a collection of information under the Paperwork

Reduction Act of 1995 (44 U.S.C. 3501–3521).

### Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA), 5 U.S.C. 601–612, applies only to rules for which an agency is required to publish a notice of proposed rulemaking pursuant to 5 U.S.C. 553(b) or any other law. 5 U.S.C. 603(a). The RFA does not apply to this rulemaking because VA has found good cause to publish this rule without notice and comment pursuant to 5 U.S.C. 553(b).

### Catalog of Federal Domestic Assistance

The Catalog of Federal Domestic Assistance number and title for the program affected by this document is 64.114, Veterans Housing—Guaranteed and Insured Loans.

### Signing Authority

The Secretary of Veterans Affairs, or designee, approved this document and authorized the undersigned to sign and submit the document to the Office of the Federal Register for publication electronically as an official document of the Department of Veterans Affairs. Jose D. Riojas, Chief of Staff, Department of Veterans Affairs, approved this document on October 28, 2013, for publication.

### List of Subjects in 38 CFR Part 36

Condominiums, Housing, Individuals with disabilities, Loan programs—housing and community development, Loan programs—veterans, Manufactured homes, Mortgage insurance, Reporting and recordkeeping requirements, Veterans.

Dated: May 5, 2014.

### Robert C. McFetridge,

Director, Regulation Policy and Management, Office of the General Counsel, Department of Veterans Affairs.

For the reasons set forth in the preamble, VA is amending 38 CFR part 36 as follows:

## PART 36—LOAN GUARANTY

■ 1. The authority citation for part 36 continues to read as follows:

**Authority:** 38 U.S.C. 501 and as otherwise noted.

■ 2. Amend § 36.4300 by:

- a. Revising the section heading.
- b. Adding a heading to paragraph (a).
- c. Redesignating paragraph (b) as paragraph (e).
- d. Adding new paragraphs (b) through (d).
- e. Adding a heading to newly redesignated paragraph (e).

The revision and additions read as follows:

### § 36.4300 Applicability and qualified mortgage status.

(a) *Applicability to guaranteed loans.*  
\* \* \*

(b) *Safe harbor qualified mortgage.* (1) *Defined.* A safe harbor qualified mortgage meets the Ability-to-Repay requirements of sections 129B and 129C of the Truth-in-Lending Act (TILA) regardless of whether the loan might be considered a high cost mortgage transaction as defined by section 103bb of TILA (15 U.S.C. 1602bb).

(2) *General.* Subject to paragraphs (c) and (d) of this section, any guaranteed or insured loan made in compliance with this subpart is a safe harbor qualified mortgage.

(3) *Exempted transactions.* The following loans are not subject to challenge under the ability-to-repay requirements of the Truth-in-Lending Act (15 U.S.C. 1639C).

(i) 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;

(ii) A construction phase of 12 months or less of a construction-to-permanent loan;

(iii) An extension of credit made pursuant to a program administered by a Housing Finance Agency, as defined under 24 CFR 266.5;

(iv) An extension of credit made by:

(A) A creditor designated as a Community Development Financial Institution, as defined under 12 CFR 1805.104(h);

(B) A creditor designated as a Downpayment Assistance through Secondary Financing Provider, pursuant to 24 CFR 200.194(a), operating in accordance with regulations prescribed by the U.S. Department of Housing and Urban Development applicable to such persons;

(C) A creditor designated as a Community Housing Development Organization provided that the creditor has entered into a commitment with a participating jurisdiction and is undertaking a project under the HOME program, pursuant to the provisions of 24 CFR 92.300(a), and as the terms community housing development organization, commitment, participating jurisdiction, and project are defined under 24 CFR 92.2; or

(D) A creditor with a tax exemption ruling or determination letter from the Internal Revenue Service under section 501(c)(3) of the Internal Revenue Code of 1986 (26 U.S.C. 501(c)(3)); 26 CFR 1.501(c)(3)–(1), provided that:

(1) During the calendar year preceding receipt of the consumer’s application,

the creditor extended credit secured by a dwelling no more than 200 times;

(2) During the calendar year preceding receipt of the consumer’s application, the creditor extended credit secured by a dwelling only to consumers with income that did not exceed the low- and moderate-income household limit as established pursuant to section 102 of the Housing and Community Development Act of 1974 (42 U.S.C. 5302(a)(20)) and amended from time to time by the U.S. Department of Housing and Urban Development, pursuant to 24 CFR 570.3;

(3) The extension of credit is to a consumer with income that does not exceed the household limit specified in 12 CFR 1026.43(a)(3); and

(4) The creditor determines, in accordance with written procedures, that the consumer has a reasonable ability to repay the extension of credit.

(v) An extension of credit made pursuant to a program authorized by sections 101 and 109 of the Emergency Economic Stabilization Act of 2008 (12 U.S.C. 5211; 5219);

(c) *Interest rate reduction refinancing loans (IRRRLs).* (1) *Safe harbor.* A streamlined refinance loan made pursuant to 38 U.S.C. 3710(a)(8) and (e) is a safe harbor qualified mortgage, as defined in paragraph (b) of this section, if all of the following conditions are met:

(i) The loan being refinanced was originated at least 6 months before the date of the new loan’s closing date, and the veteran has not been more than 30 days past due during such 6-month period;

(ii) The recoupment period for all fees and charges financed as part of the loan or paid at closing does not exceed thirty-six (36) months;

(iii) The streamlined refinance loan is either exempt from income verification requirements pursuant to 38 CFR 36.4307 or the refinance loan complies with other income verification requirements pursuant to 38 CFR 36.4340, as well as the Truth-in-Lending Act (15 U.S.C. 1639C) and its implementing regulations; and

(iv) All other applicable requirements of this subpart are met.

(Authority: 15 U.S.C. 1639C(b)(3)(B)(ii), 38 U.S.C. 3710)

(2) *Rebuttable presumption.* A streamlined refinance that does not meet all of the requirements of safe harbor in paragraph (c)(1), is a qualified mortgage for which there is a presumption that the borrower had the ability to repay the loan at the time of consummation, if such streamlined refinance, at the time of consummation,

satisfies the requirements of (c)(1)(iii) and (iv) of this section.

(d) *Effect of indemnification on qualified mortgage status.* An indemnification demand or resolution of a demand that relates to whether the loan satisfied relevant eligibility and underwriting requirements at the time of consummation may result from facts that could allow a change to qualified mortgage status, but the existence of an indemnification does not per se remove qualified mortgage status.

(Authority: 15 U.S.C. 1639C(b)(3)(B)(ii), 38 U.S.C. 3710, 3720)

(e) *Restatement.* \* \* \*

\* \* \* \* \*

- 3. Amend § 36.4340 by:
- a. Revising paragraph (a).
- b. Redesignating paragraph (b) as paragraph (b)(1).
- c. Adding a new paragraph (b)(2).

The revision and addition read as follows:

**§ 36.4340 Underwriting standards, processing procedures, lender responsibility, and lender certification.**

(a) *Use of standards.* The standards contained in paragraphs (c) through (j) of this section will be used to determine whether the veteran’s present and anticipated income and expenses, and credit history, are satisfactory. These standards do not apply to loans guaranteed pursuant to 38 U.S.C. 3710(a)(8) except for cases where the Secretary is required to approve the loan in advance under § 36.4307.

(b)(1) \* \* \*

(2) *Exemption from income verification for certain refinance loans.* Notwithstanding paragraphs (a) and (b)(1) of this section, a streamlined refinance loan to be guaranteed pursuant to 38 U.S.C. 3710(a)(8) and (e) is exempt from income verification requirements of the Truth-in-Lending Act (15 U.S.C. 1639C) and its implementing regulations only if all of the following conditions are met:

- (i) The veteran is not 30 days or more past due on the prior existing residential mortgage loan;
- (ii) The proposed streamlined refinance loan would not increase the principal balance outstanding on the prior existing residential mortgage loan, except to the extent of fees and charges allowed by VA;
- (iii) Total points and fees payable in connection with the proposed streamlined refinance loan are in accordance with 12 CFR 1026.32, will not exceed 3 percent of the total new loan amount, and are in compliance with VA’s allowable fees and charges found at 38 CFR 36.4313;

(iv) The interest rate on the proposed streamlined refinance loan will be lower than the interest rate on the original loan, unless the borrower is refinancing from an adjustable rate to a fixed-rate loan, under guidelines that VA has established;

(v) The proposed streamlined refinance loan will be subject to a payment schedule that will fully amortize the IRRRL in accordance with VA regulations;

(vi) The terms of the proposed streamlined refinance loan will not result in a balloon payment, as defined in TILA; and

(vii) Both the residential mortgage loan being refinanced and the proposed streamlined refinance loan satisfy all other VA requirements.

(Authority: 15 U.S.C. 1639C(a)(5), 38 U.S.C. 3710)

\* \* \* \* \*

- 4. Amend § 36.4500 by:
- a. Revising the section heading.
- b. Adding a heading to paragraph (a).
- c. Adding a heading to paragraph (b).
- d. Redesignating paragraph (c) as paragraph (d).
- e. Adding a new paragraph (c).
- f. Adding a heading to newly redesignated paragraph (d).

The revision and additions read as follows:

**§ 36.4500 Applicability and qualified mortgage status.**

(a) *Applicability to direct loans.* \* \* \*

(b) *Applicability to direct loans to Native Americans.* \* \* \*

(c) *Safe harbor qualified mortgage.* (1) *Defined.* A safe harbor qualified mortgage meets the Ability-to-Repay requirements of sections 129B and 129C of the Truth-in-Lending Act (TILA) regardless of whether the loan might be considered a high cost mortgage transaction as defined by section 103bb of TILA (15 U.S.C. 1602bb).

(2) *Applicability of safe harbor qualified mortgage.* All VA direct loans made pursuant to 38 U.S.C. 3711, Native American Direct Loans made pursuant to 38 U.S.C. 3761, et seq., and vendee loans made pursuant to 38 U.S.C. 3720 and 3733 are safe harbor qualified mortgages.

(Authority: 15 U.S.C. 1639C(b)(3)(B)(ii), 38 U.S.C. 3710)

(d) *Restatement.* \* \* \*

\* \* \* \* \*

- 5. In § 36.4501, add the term “Vendee loan” immediately after the definition of “Trust land” to read as follows:

**§ 36.4501 Definitions.**

\* \* \* \* \*

*Vendee loan* means a loan made by the Secretary for the purpose of

financing the purchase of a property acquired pursuant to chapter 37 of title 38, United States Code.

(Authority: 38 U.S.C. 3720, 3733)

\* \* \* \* \*

[FR Doc. 2014–10600 Filed 5–8–14; 8:45 am]

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**ENVIRONMENTAL PROTECTION AGENCY**

**40 CFR Part 52**

[EPA–R10–OAR–2013–0707; FRL–9910–54–Region 10]

**Revision to the Washington State Implementation Plan; Update to the Solid Fuel Burning Devices Regulations**

**AGENCY:** Environmental Protection Agency (EPA).

**ACTION:** Final rule.

**SUMMARY:** The EPA is approving a State Implementation Plan (SIP) revision submitted by the Washington State Department of Ecology (Ecology) on January 30, 2014. The SIP submission contains revisions to Washington’s solid fuel burning device rules to control fine particulate matter (PM<sub>2.5</sub>) from residential wood combustion. The updated regulations reflect Washington State statutory changes made in 2012, setting revised PM<sub>2.5</sub> trigger levels for impaired air quality burn bans and setting criteria for prohibiting solid fuel burning devices that are not certified. The submission also contains updates to the regulations to improve the clarity of the language.

**DATES:** *Effective Date:* This final rule is effective June 9, 2014.

**ADDRESSES:** The EPA has established a docket for this action under Docket ID No. EPA–R10–OAR–2013–0707. All documents in the docket are listed on the [www.regulations.gov](http://www.regulations.gov) Web site. Although listed in the index, some information is not publicly available, e.g., Confidential Business Information (CBI) or other information the disclosure of which is restricted by statute. Certain other material, such as copyrighted material, is not placed on the Internet and will be publicly available only in hard copy form. Publicly available docket materials are available either electronically through [www.regulations.gov](http://www.regulations.gov) or in hard copy at the Air Programs Unit, Office of Air Waste and Toxics, EPA Region 10, 1200 Sixth Avenue, Seattle, WA, 98101. The EPA requests that if at all possible, you contact the individual listed in the **FOR FURTHER INFORMATION CONTACT** section to