Guidance from CFPB on Appropriate Interest Rate for Excluding Discount Points under Final ATR Rule

September 4, 2013

This document contains questions posed by the MBA and a summary of oral responses to these questions from Consumer Financial Protection Bureau (CFPB) staff. Please be advised that the CFPB advises that only rules and written commentary from the CFPB are authoritative.

Background: On August 3, 2013, MBA requested guidance concerning how to determine the appropriate interest rate for excluding bona fide discount points for purposes of the QM points and fees calculation. Specifically, MBA asked: (1) if the interest rate to be used is the rate unique to each consumer or is simply a rate from a standard rate sheet and (2) what the appropriate rate to use is if the lender does not offer a rate with zero points. The email requesting guidance attached examples of various rate point scenarios to illustrate this concern.

- Section 1026.32(b)(1)(i)(E) of the "points and fees" definition provides that, for purposes of calculating the points and fees for a loan, up to two bona fide discount points paid by the consumer in connection with the transaction may be excluded *if the interest rate without any discount* does not exceed the average prime offer rate by more than one percentage point.

- Section 1026.32(b)(1)(i)(F) of the "points and fees" definition provides if no discount points have been excluded under Section 1026.32(b)(1)(i)(E), then up to one bona fide discount point paid by the consumer in connection with the transaction may be excluded *if the interest rate without any discount* does not exceed the average prime offer rate by more than two percentage points.

- Section 1026.32(b)(3) defines a "bona fide discount point" and provides that the discount points paid by the consumer must reduce the interest rate based on a calculation that is consistent with established industry practices for determining the amount of reduction in the interest rate appropriate for the amount of discount points paid.

- Issue 1: The regulation and commentary do not explicitly provide guidance on whether "interest rate without any discount" includes – or excludes – loan level risk adjusters and/or other pricing risk adjusters that must be applied to a particular consumer's loan before it is presented to the consumer. Accordingly, the first question is whether the rate intended is the rate unique to the consumer's loan as a result of any number of credit factors or simply the rate on a rate sheet that does not include discount points?

- Issue 2: If there is no exact "zero point" rate (a rate without discount or premium), the submission asked whether the creditor could have the option of choosing to use:

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1) The rate with the closest discount to zero
2) The rate with the closest premium to zero;
3) The rate closest to zero points (regardless of premium or discount); or
4) The rate determined by applying a linear interpolation calculation.

CFPB Guidance - At a meeting at the CFPB on Tuesday, August 20, 2013, Paul Mondor, Managing Counsel, stated that questions on this issue had been raised by a number of stakeholders, including the Mortgage Bankers Association ("MBA").

- He said CFPB interprets the statute to require a discount point to be the amount *but for the payment of which* the consumer would have paid the starting adjusted rate. He indicated that the CFPB had developed the following principles for determining the starting rate that is referred to here as the "starting adjusted rate."

- **Principle #1: CFPB defines the base rate as the starting rate to be adjusted for the particular consumer before discount points are applied -** The starting adjusted rate should be the rate available to the consumer based on the particular consumer's profile and loan characteristics. It must include the LLPAs and other specific adjustments applicable to that consumer.

- **Principle #2: Discount points excluded from points and fees may not exceed the discount points actually paid by the consumer -** The discount points that are excluded from points and fees may not exceed the actual discount point amount paid by the consumer. So, if the starting adjusted rate offers a rebate and the consumer chooses to pay discount points, the amount of the points actually paid are the maximum that can be excluded up to the two points allowed in the rule.

  The following example was provided in the meeting: Starting adjusted rate of 4.250% with a 0.375 point rebate. Consumer agrees to pay an additional 1.50 discount points to lower the rate to 3.750%. The maximum discount points that could be eligible for exclusion from points and fees is 1.50 points

- **Principle #3(a): No requirement for zero point loan to be available -** The starting adjusted rate does not have to be a rate with zero points. Mr. Mondor noted the language in the regulation ("the interest rate without any discount") is an inexact translation of the statutory language in section 1412 of the Dodd-Frank Act ("the interest rate from which the mortgage's interest rate will be discounted").

- **Principle #3(b): Starting adjusted rate actually must be available -**The starting adjusted rate used must actually be available to the consumer. This eliminates linear interpolation as an acceptable means of determining the starting adjusted rate as well as using a hypothetical rate as a starting adjusted rate. Neither are rates available to the consumer.

- **Principle #4: Discount Points that may be excluded from points and fees are those applied to the starting adjusted rate for the consumer to reduce the interest rate** - If the starting adjusted rate for the consumer includes a required point or portion thereof, when calculating the discount points to be excluded, such required points are included in the QM's points and fees.

The following example was provided in the meeting: Starting adjusted rate of 4.125% with 0.125 discount points. The consumer agrees to pay 1.625 in discount points to lower the rate to 3.750%. Only 1.50 additional discount points paid by the consumer to lower the rate is eligible for exclusion from points and fees since the .125 points paid are required to get the starting adjusted rate.

- **Additionally the methodology of reaching starting rate can vary for different loans:** In following the above principles to determine the appropriate interest rate, CFPB indicated a consistent methodology to determine the interest rate without a discount is not required. The CFPB indicated that retention of rate sheets would help prove compliance if challenged.

- **All Requirements to Exclude Discount Points Still Apply:** The Principles do not set forth all the requirements to exclude discount points from points and fees. The requirements in Sections 1026.32(b)(1)(i)(E), 1026.32(b)(1)(i)(F) and 1026.32(b)(3) that are set forth above still apply.

  Additional Note on Written Guidance: MBA requested that the CFPB issue the guidance in writing so that industry and examiners would have a consistent standard to follow. Mr. Mondor stated that the CFPB was considering other methods of providing this guidance. He specifically mentioned that the CFPB may conduct webinars to address outstanding issues regarding the CFPB's rules and that this guidance could be included. He also mentioned the possibility of a bulletin or additional proposed amendments to the Official Interpretations, but cited resource and time constraints. He dismissed suggestions that the guidance be included in the small entity compliance guide or the final rule adopting the amendments to the mortgage rules proposed by the CFPB in June.