

**COMMENTS  
to the  
Consumer Financial Protection Bureau**

**regarding**

**12 CFR Part 1026  
[Docket No. CFPB-2014-0009]  
RIN 3170-AA43  
79 Fed. Reg. 25,730 (May 5, 2014)**

**Truth in Lending Act – Regulation Z  
Qualified Mortgage Rule**

**by the  
National Consumer Law Center  
on behalf of its low income clients**

**and the**

**National Association of Consumer Advocates**

**July 7, 2014**

## Table of Contents

I.	Introduction.....	2
II.	Allowing a DTI Cure or Correction Would Do More Harm Than Good.....	3
A.	Overview .....	3
B.	Strong Consumer Protections Do Not Restrict Access to Credit.....	4
C.	The Existing Qualified Mortgage Rule—Without a Right to Cure— is Compatible with Access to Credit .....	5
D.	The Proposed Rule May Weaken Market Discipline When It Is Needed Most. ....	7
E.	Curing a DTI overage is impossible as a practical matter. ....	8
F.	Allowing documentation corrections would promote sloppy underwriting.....	8
III.	The small-creditor definition should be limited to small creditors. Leave the 500-loan cap in place. ....	9

The National Consumer Law Center ("NCLC")<sup>1</sup> submits the following comments, on behalf of its low-income clients, with the National Association of Consumer Advocates.<sup>2</sup>

## I. Introduction

In addition to the proposal the CFPB makes in 79 Fed. Reg. 25,730 (May 6, 2014), the Bureau has also requested comment on two other issues regarding the Qualified Mortgage Rule (QM Rule): whether to allow creditors to cure or correct overages in the 43 percent debt-to-income ratio requirement;<sup>3</sup> and whether it is appropriate to limit the rule's small-creditor definition to creditors making no more than 500 first mortgages.<sup>4</sup> In response to the Bureau's request, we recommend leaving both aspects of the rule unchanged. These comments, while similar to our previously filed comments (regarding the points-and-fees-cure) have been updated and tailored to this proposal.

As the Bureau correctly notes, there are many problems with allowing a creditor to either cure or correct a purported qualified mortgage that exceeds the debt-to-income ratio limit (the DTI cap). These problems include the inherent difficulty of reducing a borrower's DTI and the moral hazard of giving creditors what could be perceived as a green light for sloppy underwriting. In addition, as we explained on our earlier comments<sup>5</sup> and below, there is no merit to the argument that the QM Rule will lead to an underwriting "buffer,"<sup>6</sup> or will otherwise reduce access to credit. Instead, it appears that market forces are leading creditors to **increase** access to credit. The DTI cap is at the heart of the ability-to-repay rule. Anything that weakens it should be resisted. For all of these reasons, as detailed below, the Bureau should not allow creditors to correct or cure DTI cap overages.

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<sup>1</sup> The **National Consumer Law Center**® (NCLC®) is a non-profit Massachusetts corporation specializing in low-income consumer issues, with an emphasis on consumer credit. Since 1969, NCLC has used its expertise in consumer law and energy policy to work for consumer justice and economic security for low-income and other disadvantaged people, including older adults, in the United States. NCLC's expertise includes policy analysis and advocacy; consumer law and energy publications; litigation; expert witness services, and training and advice for advocates. NCLC works with nonprofit and legal services organizations, private attorneys, policymakers, and federal and state government and courts across the nation to stop exploitive practices, help financially stressed families build and retain wealth, and advance economic fairness. NCLC publishes a series of consumer law treatises including Mortgage Lending, Truth in Lending and Foreclosures. These comments are written by NCLC attorneys Alys Cohen and Andrew Pizor.

<sup>2</sup> The **National Association of Consumer Advocates** (NACA) is a non-profit corporation whose members are private and public sector attorneys, legal services attorneys, law professors, and law students, whose primary focus involves the protection and representation of consumers. NACA's mission is to promote justice for all consumers.

<sup>3</sup> 79 Fed. Reg. 25730, 25743 (May 6, 2014).

<sup>4</sup> *Id.* at 25745

<sup>5</sup> [www.nclc.org/images/pdf/foreclosure\\_mortgage/predatory\\_mortgage\\_lending/comments-regZ-79\\_FR\\_25730-june2014.pdf](http://www.nclc.org/images/pdf/foreclosure_mortgage/predatory_mortgage_lending/comments-regZ-79_FR_25730-june2014.pdf).

<sup>6</sup> *See* 79 Fed. Reg. at 25743 (describing "buffer" theory).

We also recommend leaving the 500-loan limit unchanged in the small-creditor definition. There is no basis for increasing this limit. Doing so would expose thousands of consumers to the same risks that the QM rule was designed to eliminate. The QM rule has not even been in place for a year and the mortgage markets have not yet fully recovered from the recent crisis. It is too soon to blame any limits on access to credit on the QM rule. The Bureau should not consider expanding the small-creditor definition or otherwise weakening the QM rule further without clear, unambiguous evidence that the rule is causing a problem and that the proposed fix is appropriate.

## **II. Allowing a DTI Cure or Correction Would Do More Harm Than Good.**

### **A. Overview**

The Bureau seeks comment on whether it should allow a creditor to maintain the qualified-mortgage status of a loan despite exceeding the DTI cap. To do so, the creditor would be required to correct or cure the overage in a manner analogous to the proposed points-and-fee cure.<sup>7</sup> The Bureau appears reluctant to propose such a rule. And we strongly urge the Bureau to abandon it entirely. Such a cure rule would do more harm to consumers than the harm it is proposed to remedy. It is also unnecessary and contrary to Congressional intent.

The primary reason for this proposal, as explained in the Bureau's Federal Register notice, is concern that the failure to allow a post-consummation cure might lead some lenders and secondary market participants to establish a "buffer threshold" near the DTI cap to avoid the risk of unintentionally making a non-QM loan. The possibility that lenders might impose such buffers, in turn, created concern at the Bureau that consumers near the margins of the DTI cap might have reduced access to QM credit or might be faced with more expensive credit.<sup>8</sup>

The likely benefit to creditors from this proposal are clear: it would reduce pre-closing compliance costs, because creditors could fix mistakes later;<sup>9</sup> and more loans would qualify for the QM safe harbor or rebuttable presumption, providing full insulation from liability for prime loans and substantial protection for other loans.

The Bureau admits that the chief benefit to consumers—the potential of slightly expanded access to credit—is speculative. In fact, not only is it unsupported by any evidence, but the fear of reduced access to credit is contrary to substantial evidence. Historically, claims that regulation would undermine access to credit have been unfounded. While the credit box is restricted now, that is the industry's response to the financial crisis—

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<sup>7</sup> In these comments, unless otherwise noted, any reference to the right to cure includes the right to correct an error even though the Bureau differentiates between the two.

<sup>8</sup> 79 Fed. Reg. at 25741, 25743.

<sup>9</sup> As explained below, creditors and secondary market participants will already be performing post-consummation reviews so this rule does not create any incentive to add a new review process.

it was not caused by regulation. Below we further refute the theory that regulations limit access to credit.

The harm to consumers from this proposal is clear. The existence of a right to cure weakens creditors' incentive to be diligent before closing. Why make an extra effort to catch errors before the closing when any overage that slips through can be cured later? For prime loans in particular, when creditors or assignees discover an overage and cure it (providing QM status), the borrower will be deprived of the right to use the creditor's shoddy underwriting practices as a defense to foreclosure—even though the overage is evidence that the creditor failed to process the loan correctly and that the borrower may be unable to repay. For subprime loans, the right to cure will give the creditor or assignee an unjustified presumption of compliance despite evidence to the contrary.

## **B. Strong Consumer Protections Do Not Restrict Access to Credit**

The chief premise underlying the perceived need for a right to cure is erroneous. The QM rule will not reduce access to credit (or increase the cost of credit), even if the “buffer” assertion proves true. The lending industry has repeatedly argued that strong consumer protections hurt access to credit. Long experience and history tell us that these “Chicken Little” warnings from the industry are the key talking point for each and every consumer protection reform. Yet that argument has just as often been proven wrong.

Researchers have examined the impact of the FTC's Anti-Holder Rule,<sup>10</sup> the Credit Card Accountability Responsibility and Disclosure (CARD) Act,<sup>11</sup> state small-dollar-loan usury caps,<sup>12</sup> and state anti-predatory mortgage lending laws<sup>13</sup> and have found that these laws

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<sup>10</sup> See 40 Fed. Reg. 53506, 53517-518 (Nov. 18, 1975) (describing industry warnings about impact of FTC Anti-Holder Rule). See also Federal Reserve Statistical Release G.19 (In 1970 total non-revolving credit in the U.S. was approximately \$124 billion; growth continued steadily through the 1970s – with not even a blip in 1975 and 1976 when the FTC rule was announced. By December 1980, total non-revolving credit in the United States was approximately \$297 billion.)

<sup>11</sup> Agarwal, Sumit and Chomsisengphet, Souphala and Mahoney, Neale and Stroebel, Johannes, Regulating Consumer Financial Products: Evidence from Credit Cards (April 2014), available at <http://ssrn.com/abstract=2330942> (abstract stating “we find that regulatory limits on credit card fees reduced overall borrowing costs to consumers by an annualized 2.8% of average daily balances, with a decline of more than 10% for consumers with the lowest FICO scores”); Consumer Financial Protection Bureau, Card Act Report 60-61 (Oct. 1, 2013), available at [http://files.consumerfinance.gov/f/201309\\_cfpb\\_card-act-report.pdf](http://files.consumerfinance.gov/f/201309_cfpb_card-act-report.pdf) (finding that the tightening of credit supply in the credit card market was attributable to market cycles, not Credit CARD Act regulations); Frank, Joshua M., Credit Card Clarity: CARD Act Reform Works (February 16, 2011), available at: <http://ssrn.com/abstract=2000416> (finding “the CARD Act has not caused prices to rise or credit to constrict.”).

<sup>12</sup> Robert Mayer, Loan Sharks, Interest-Rate Caps, and Deregulation, 69 Wash. & Lee L. Rev. 807, 824-825 (2012) (arguing that regulation of small loans by imposing usury caps that were moderately higher than existing usury caps but well below market rates for salary loans did not lead to a restriction of the credit market and the rise of black market loan sharking as predicted by opponents of regulation); George J. Benston, An Analysis of Maine's 36-Month Limitation on Finance

neither restricted access to credit nor significantly increased the cost of credit. Additionally, extensive experience in the field after HOEPA was passed reveals that creditors did not generally impose much of a buffer. Instead, lenders often skated right along the 8% points-and-fees cap, charging 7.99%.

While today's credit box is tight, that problem predates Dodd-Frank's protections. The CFPB is a data-driven institution. And there is a strong history of data showing that consumer protection rules do not restrict access to credit. There is no data showing that requiring creditors to comply with the QM rule as written will restrict access to credit. Moreover, the Bureau has had a number of years to examine the market and determine whether the QM standards themselves should be adjusted. Clear guidelines are the best remedy for skittish creditors who have tightened credit. Authorizing a cure for errors caused by poor judgment will only promote abusive credit and greater non-compliance. For these reasons, the CFPB should not adopt the proposed right to cure.

### **C. The Existing Qualified Mortgage Rule—Without a Right to Cure—is Compatible with Access to Credit**

The single biggest driver of credit practices in the mortgage lending industry is the bottom line. The lending industry changes practices and products as it deems necessary to maximize profits and minimize expenses.<sup>14</sup> While regulations play some role in this, that role ultimately is far smaller than other factors.

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Company Small Loans, 33–41 (Dec. 1972), reprinted in the Nat'l Comm'n on Consumer Finance, Technical Studies, vol. II (Maine rate cap on refinanced loans resulted in many high-rate borrowers finding alternative and often lower-rate alternatives and others viewed themselves as better off not having high rate credit); R. Peterson & G. Falls, Credit Research Center, Purdue Univ., Impact of a Ten Percent Usury Ceiling: Empirical Evidence (1981) (credit more available in Arkansas with 10% usury limit than in other states).

<sup>13</sup> Raphael W. Bostic et al., State and Local Anti-Predatory Lending Laws: The Effect of Legal Enforcement Mechanisms, 60 J. Econ. & Bus. 47 (2008); Giang Ho and Anthony Pennington-Cross, Predatory Lending Laws and the Cost of Credit, Fed. Res. Bank of St. Louis, Working Paper 2006-022A, available at <http://research.stlouisfed.org/wp/2006/2006-022.pdf> (finding state anti-predatory lending laws associated with “at most a modest increase in cost.”); Wei Li and Keith Ernst, The Best Value in the Subprime Market: State Predatory Lending Reform (Feb. 23, 2006), available at [www.responsiblelending.org/mortgage-lending/research-analysis/StateEffectsToolkit.pdf](http://www.responsiblelending.org/mortgage-lending/research-analysis/StateEffectsToolkit.pdf).

<sup>14</sup> See OCC, Semiannual Risk Perspective at 29-30 (Spring 2014) (noting regulatory concerns regarding looser underwriting standards and observing “underwriting standards are easing in both commercial and retail products, as banks adapt to changing economic conditions and competition.”); AnnaMaria Andriotis and Robin Sidel, Credit Cards for Riskiest Customers Roar Back, Wall St. J., A1 (June 27, 2014) (“Lenders...have really saturated the higher-credit-quality market, so it is only natural that as they look for growth opportunities, they expand downward,” said Randy Hopper, vice president of consumer lending at Navy Federal Credit Union....”); Nick Timiraos and AnnaMaria Andriotis, Mortgage Lenders Ease Rules for Home Buyers in Hunt for Business, Wall St. J. (April 18, 2014) available at

In the years leading up to the foreclosure crisis, lenders thought it was profitable to be liberal with credit. As a result, their underwriting standards relaxed and there was little effort to maintain quality assurance. After the crisis, underwriting standards and quality assurance efforts were reversed. The industry decided that the best way to stem losses and preserve assets was to adopt much stricter underwriting guidelines and rigorous quality assurance efforts. But during those time periods—both before and after the crisis—the relevant body of law governing the mortgage lending industry remained unchanged, until the effective dates for the Dodd-Frank Act and implementation of CFPB’s new regulations.<sup>15</sup> Now, even though the QM rule has taken effect without a right to cure, mortgage lenders are easing credit standards in the quest to get more business.<sup>16</sup>

For the CFPB, one of the most important lessons the aftermath of the foreclosure crisis yields is this: lenders’ business decisions regarding the size of the credit box have a far greater impact on access to credit than do the Bureau’s regulations.<sup>17</sup> The QM rule has been

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<http://online.wsj.com/article/SB10001424052702304626304579509463522046346.html>; (“With volume dropping as much as it has, many lenders are looking to expand their credit box,” said Michael Fratantoni, the MBA’s chief economist.”); Nick Timiraos, Wells Fargo to Ease Mortgage Standards Slightly, Wall St. J. (Feb. 14, 2014), available at <http://online.wsj.com/article/SB10001424052702303704304579383180007672774.html> (“Industry analysts have said that lenders are likely to slowly ease credit standards this year because home prices have stabilized and refinancing volumes have dropped, leaving banks on the prowl for new business. ‘With volume going down, everyone is looking to tweak, if not loosen, the underwriting in certain areas,’ said Guy Cecala, publisher of Inside Mortgage Finance.”).

<sup>15</sup> While the Federal Reserve and other agencies began to scrutinize the mortgage industry more closely before the Dodd-Frank Act, the initial government response to the financial crisis was to attempt to stabilize the industry. Efforts to design regulations came later.

<sup>16</sup> See Nick Timiraos and AnnaMaria Andriotis, Mortgage Lenders Ease Rules for Home Buyers in Hunt for Business, Wall St. J. (April 18, 2014) available at <http://online.wsj.com/article/SB10001424052702304626304579509463522046346.html>; (“With volume dropping as much as it has, many lenders are looking to expand their credit box,” said Michael Fratantoni, the MBA’s chief economist.”); Nick Timiraos, Wells Fargo to Ease Mortgage Standards Slightly, Wall St. J. (Feb. 14, 2014), available at <http://online.wsj.com/article/SB10001424052702303704304579383180007672774.html> (“Industry analysts have said that lenders are likely to slowly ease credit standards this year because home prices have stabilized and refinancing volumes have dropped, leaving banks on the prowl for new business. ‘With volume going down, everyone is looking to tweak, if not loosen, the underwriting in certain areas,’ said Guy Cecala, publisher of Inside Mortgage Finance.”).

<sup>17</sup> See Kate Berry, Six Months Later, Does the QM Rule Still Matter?, Am. Bankr. (June 18, 2014), available at [www.americanbanker.com/issues/179\\_116/six-months-later-does-the-qm-rule-still-matter-1068143-1.html](http://www.americanbanker.com/issues/179_116/six-months-later-does-the-qm-rule-still-matter-1068143-1.html) (quoting CoreLogic Chief Economist Mark Fleming as saying “it would be hard to argue that the QM rule stifled credit.”); Jim Parrott and Mark Zandi, Moody’s Analytics and the Urban Institute, Opening the Credit Box (Sept. 30, 2013), available at <http://www.urban.org/UploadedPDF/412910-Opening-the-Credit-Box.pdf> (describing causes of tight mortgage credit in 2013). See also Nick Timiraos and AnnaMaria Andriotis, Mortgage Lenders Ease Rules for Home Buyers in Hunt for Business, Wall St. J. (April 18, 2014) available at <http://online.wsj.com/article/SB10001424052702304626304579509463522046346.html> (“With

in effect since January 2014 and access to credit (as measured by the size of the credit box) is already expanding as the industry sees the need to attract more customers.<sup>18</sup> Importantly, bank regulators have noted that lenders are easing underwriting standards for commercial and retail loan products.<sup>19</sup> These trends strongly suggest that mortgage credit will become easier to obtain as the economy improves and that the Bureau does not need to adopt any cure rule (either for points and fees or DTI) to protect access to credit.

To the extent that credit is tight due to the risk of repurchase demands from the secondary market, the industry has already taken steps to allay that concern. Fannie Mae and Freddie Mac recently announced a set of revised quality review policies and a right to fix documentation problems that will reduce lenders' exposure to repurchase demands.<sup>20</sup> These and other changes announced by FHFA director Mel Watt are said to "remove one of the largest overhangs holding back a housing recovery."<sup>21</sup> The FHA has also announced changes calculated to increase access to credit.<sup>22</sup> These, like those announced by FHFA, will reduce creditors' need to impose credit overlays—and the buffer that the CFPB has been concerned about.

For all of these reasons, the CFPB's proposed right to cure is not needed.

#### **D. The Proposed Rule May Weaken Market Discipline When It Is Needed Most.**

Today, concerns are about access to credit. But, as the real estate market heats up, creditors will loosen their standards in order to increase their market share—just as they did

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volume dropping as much as it has, many lenders are looking to expand their credit box,' said Michael Fratantoni, the MBA's chief economist.").

<sup>18</sup> See Kate Berry, Six Months Later, Does the QM Rule Still Matter?, Am. Bankr. (June 18, 2014), available at [www.americanbanker.com/issues/179\\_116/six-months-later-does-the-qm-rule-still-matter-1068143-1.html](http://www.americanbanker.com/issues/179_116/six-months-later-does-the-qm-rule-still-matter-1068143-1.html) (describing CoreLogic Chief Economist Mark Fleming as saying the 43% DTI ratio is "pretty loose" by most traditional standards, "so it would be hard to argue that the QM rule stifled credit."). See also note 14 (indicating that lenders are relaxing credit standards to attract business).

<sup>19</sup> OCC, Semiannual Risk Perspective at 29-30 (Spring 2014) (noting regulatory concerns regarding looser underwriting standards and observing "underwriting standards are easing in both commercial and retail products, as banks adapt to changing economic conditions and competition."); FRB, Senior Loan Officer Opinion Survey on Bank Lending Practices (May 5, 2014) ("April survey results generally indicated that, on balance, banks eased their lending policies for commercial and industrial (C&I) and commercial real estate (CRE) loans").

<sup>20</sup> Kate Berry, GSEs Offer 'Get Out of Putbacks Free' Card, Am. Bankr. at 2 (May 15, 2014) ("By easing up on mortgage buyback requests, [the GSEs] just went a long way toward encouraging lenders to make more loans to borrowers with lower credit scores.").

<sup>21</sup> Kate Berry, GSEs Offer 'Get Out of Putbacks Free' Card, Am. Bankr. at 2 (May 15, 2014).

<sup>22</sup> Press Release, Fed. Hous. Admin., FHA Takes Additional Steps To Provide Access To Credit for Underserved Borrowers (May 13, 2014), available at [https://portal.hud.gov/hudportal/HUD?src=/press/press\\_releases\\_media\\_advisories/2014/HUD\\_No\\_14-048](https://portal.hud.gov/hudportal/HUD?src=/press/press_releases_media_advisories/2014/HUD_No_14-048).

before the foreclosure crisis. The Dodd-Frank Act was adopted to prevent the market from flying out of control again. Each exception or loophole the Bureau adds to the QM rule weakens the restraints the Dodd-Frank Act imposed.

If the Bureau allows creditors to cure DTI errors, there will be a significant risk in the future that creditors will switch to an “originate first, fix later” model. Loan originators and processors will face pressure to close loans. Lender personnel may be pressured to overlook problems before closing in the belief that they can be cured or corrected later, after closing. Plus, the same pre-closing, quality assurance procedures that would reveal excess points and fees or a DTI error would also reveal other problems. If the Bureau reduces the incentive to discover some problems before closing, other problems will remain concealed. As we have already seen, when the market heats up and profits are at stake, quality assurance will be less valued. The Bureau should not adopt rules that weaken incentives to be careful before closing, when it matters most to the borrower.

For the same reasons, the Bureau should avoid measures that weaken the fundamental principle that TILA requires strict compliance. As one judge explained, requiring strict compliance “has largely been responsible for the TILA’s success in achieving widespread compliance with its requirements.”<sup>23</sup> Adopting a right to cure could be misperceived as contrary to the argument that Regulation Z must be strictly followed.

**E. Curing a DTI overage is impossible as a practical matter.**

As the Bureau correctly notes, one of the problems with allowing creditors to cure DTI overages is the difficulty in fashioning a cure. The only options are to increase the borrower’s income or decrease their debt. The difficulty with increasing a borrower’s income needs no elaboration. While decreasing a borrower’s debt is technically easier, it would pose many practical barriers. Modifying the mortgage could trigger repurchase demands from the secondary market. Asking the consumer to refund part of the loan amount would be disastrous. Giving a credit toward the principal balance or paying down other debts would have income-tax consequences for the borrower. These problems show that creditors cannot cure a DTI overage. As a result, creating the option to do so would be futile and would invite creditors to get into trouble while trying.

**F. Allowing documentation corrections would promote sloppy underwriting.**

The Bureau has also suggested allowing creditors to correct DTI overages that result solely from documentation errors. But this too would be problematic. The ability to fix paperwork errors when problems are discovered (even if limited to a brief post-consummation window), would reduce the incentive to document a borrower’s debts and income correctly the first time. It would also facilitate fraud. Loan originators who have trouble selling non-QM loans after consummation, or who face other negative business

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<sup>23</sup> *In re Brown*, 106 B.R. 852, 857 (Bankr. E.D. Pa. 1989). *See also* *Balderas v. Countrywide Bank*, 664 F.3d 787, 791 (9<sup>th</sup> Cir. 2011); *Marr v. Bank of Am.*, 662 F.3d 963, 968 (7<sup>th</sup> Cir. 2011).

consequences from making a non-QM loan, would have an easy solution: “correct” the paperwork by manufacturing new income or reducing the borrower’s debts. While allowing creditors to fix paperwork errors sounds innocuous, it is likely to create significant problems.

### **III. The small-creditor definition should be limited to small creditors. Leave the 500-loan cap in place.**

Under the current rule, small creditors, i.e. those making up to 500 first mortgage loans (and meeting other requirements), are eligible for generous exceptions to the QM rule. These include an exception from the DTI cap, a higher APR cap for the safe harbor under the ability-to-repay rule, an exception from the escrow requirement for higher-priced mortgage loans, and an exception from the ban on balloon payments for certain mortgages.<sup>24</sup> The Bureau asks for comment on whether this exception should be extended to creditors making more than 500 originations.<sup>25</sup>

Because these exceptions apply to some of the most important provisions of the QM rule, the CFPB should not extend them to other creditors (by raising the 500-loan cap) absent **clear, unambiguous** evidence that the cap is causing significant harm to a large number of consumers. Creditors making 500 or more loans (and likely even fewer) should be able to comply with the requirements of the QM rule. Five hundred loans likely involve millions of dollars and this exception will already affect thousands of borrowers. Expanding this exception any further will substantially weaken the QM rule and should not be done without an overwhelmingly clear and urgent justification. Such a justification does not currently exist. For that reason, the Bureau should leave the rule unchanged.

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<sup>24</sup> See 79 Fed. Reg. at 25745 (summarizing).

<sup>25</sup> 79 Fed. Reg. at 25745.