



Updated April 19, 2011

Fed Proposes Dodd-Frank Mortgage Escrow Account Rules

Executive Summary

- The Federal Reserve Board (Fed) has issued a proposed rule on residential mortgage escrow accounts under the Dodd-Frank Act that would amend Regulation Z to expand the minimum period for mandatory escrow accounts and implement new disclosure requirements, if finalized. The Dodd-Frank Act added a new section 129D to the Truth in Lending Act (TILA) that requires the establishment of escrow accounts for many closed-end first and second mortgage loans. It is anticipated that the Consumer Financial Protection Bureau—which is scheduled to assume jurisdiction for the Truth in Lending Act on July 21, 2011—will issue the final version of this proposed regulation.
- Comments are due to the Fed by May 2, 2011; **please submit comments to CUNA by April 27, 2011.** Please feel free to e-mail your responses to SVP and Deputy General Counsel Mary Dunn (mdunn@cuna.coop) or Senior Assistant General Counsel Michael Edwards (medwards@cuna.coop). You can also mail them to CUNA's Regulatory Advocacy Department, 601 Pennsylvania Avenue, NW, South Building, 6th Floor, Washington, DC 20004. Comments can be submitted to the Fed at regs.comments@federalreserve.gov; if commenting directly to the Fed please reference Docket No. R-1406 in the subject line of the email. You may access a copy of the Fed's proposal [here](#).
- Under the proposal, credit unions would generally be required to establish an escrow account for the payment of taxes and hazard insurance, etc., for mortgages secured by a first lien on the principal dwelling of the consumer—other than a consumer credit transaction under an open end credit plan or a reverse mortgage—as well as for certain closed-end second lien mortgages, if:
 - The escrow account is required by Federal or State law;
 - The mortgage is made, guaranteed, or insured by State or Federal governmental lending or insurance agency (e.g., FHA, VA); or

- The mortgage is a closed-end “higher cost” mortgage that does not fall within an exemption (such as the proposed exemption for mortgages made by a lender predominately operating in a rural or underserved area that retains its mortgages in portfolio and has made no more than 100 exempt mortgages total over a two-year look-back period), generally meaning:
 - The loan is a first mortgage that is below the GSE conforming loan limit (generally \$417,000 but higher in “high cost” areas) and which has an annual percentage rate (APR) that will exceed the average prime offered rate (APOR) by more than 1.5 percentage points;
 - The loan is a “jumbo” first mortgage that exceeds the GSE conforming loan limit and which has an APR that will exceed the APOR by more than 2.5 percentage points (the Fed recently released a final rule on mandatory jumbo mortgage escrow account; CUNA’s final rule analysis for that rulemaking is available [here](#)); or
 - The loan is a second mortgage product that exceeds the APOR by more than 3.5 percentage points.
- The proposal also includes extensive disclosure requirements as well as model forms, as detailed below.
- Average Prime Offer Rate (APOR) Definition. The APOR will be determined by the CFPB based on the average of similar mortgage transactions from a “representative sample” of mortgage lenders—including average APR, points, and other pricing terms—with “low-risk pricing” that are offered to consumers. CFPB will publish the APOR at least weekly. The CFPB’s APOR is not the same as the “prime rate” published in the *Wall Street Journal*; rather CFPB’s APOR is likely to be similar to the *Wall Street Journal*’s published average rates on various mortgage products.

DESCRIPTION OF THE PROPOSED RULE

Section-by-Section Analysis

- **Proposed 12 C.F.R. § 226.2—Definitions and rules of construction:** TILA section 129D requires creditors to disclose information about mandatory mortgage escrow accounts at least three business days before closing of the mortgage loan.
 - Business day. The Fed proposes defining the term “business day” for purposes of section 226.19(f) and 226.20(d) (further described below) to mean all calendar days except Sundays, and legal public holidays such as New Year’s Day, Martin Luther King’s Birthday, Washington’s Birthday, Memorial Day, Independence Day, Labor Day, Columbus Day, Veterans

Day, Thanksgiving, and Christmas Day. If one of these holidays falls on a weekend, the staff commentary proposes that any “observed holiday” by the federal government count as a “business day.” This “business day” definition already applies to existing requirements under 12 C.F.R. § 226.19(a).

- **Proposed 12 C.F.R. § 226.19—Certain transactions secured by real property or a dwelling:** Proposed section 226.19(f) would set forth new escrow disclosure requirements for closed-end transactions secured by a lien on real property or a dwelling (including, as proposed in the staff commentary, mobile homes, boats, and so forth that are used as a principal dwelling). The staff commentary proposes to define “real property” to include vacant and unimproved land.
 - Disclosures for escrow accounts. The definition of “escrow account” would be the same as under Regulation X (24 C.F.R. § 3500.17(b))¹ which implements the Real Estate Settlement Procedures Act (RESPA).
 - Format requirements. The disclosures must generally similar to proposed Model Form H-24 (if an escrow account is established) or Model Form H-25 (if an escrow account is not established) which would part of 12 C.F.R. Part 226 Appendix H. These proposed model forms are included on the 26th and 27th pages of the Fed’s Notice of Proposed Rulemaking in PDF format available [here](#).
 - Generally, the text of the forms are in a tabular, question and answer format, must be presented in at least 10 point type, and must have a heading that is more conspicuous than and must precede other disclosures required under section 226.19(f).
 - Certain requirements must be highlighted, including the dollar amount for estimated total home-related costs for the first year of the mortgage, the dollar amount that the consumer will be required to deposit at closing to initially fund the escrow account, the dollar amount that the mortgage payments will include for deposit into the escrow account, the dollar amount of any fee charged for not having an escrow account (if the consumer has chosen not to have

¹ Under Regulation X: “Escrow account means any account that a servicer establishes or controls on behalf of a borrower to pay taxes, insurance premiums (including flood insurance), or other charges with respect to a federally related mortgage loan, including charges that the borrower and servicer have voluntarily agreed that the servicer should collect and pay. The definition encompasses any account established for this purpose, including a “trust account”, “reserve account”, “impound account”, or other term in different localities. An “escrow account” includes any arrangement where the servicer adds a portion of the borrower’s payments to principal and subsequently deducts from principal the disbursements for escrow account items. For purposes of this section, the term “escrow account” excludes any account that is under the borrower’s total control.” 24 C.F.R. § 3500.17.

an escrow account), and a statement regarding the “risk of not having an escrow account.”

- The staff commentary proposes to require the summarized mandatory and optional content (see below) to be grouped together on the front side of a “separate document with no other material” for both the disclosure for “establishment of escrow account” under 12 C.F.R. § 226.19(f)(2)(i) and the disclosure for “non-establishment of escrow account” under 12 C.F.R. § 226.19(f)(2)(ii), both of which are summarized below under “Content requirements for establishment of an escrow account” and “Content requirements for non-establishment of an escrow account,” respectively. The proposed staff commentary would also require the “content requirements for establishment of an escrow account” disclosure (summarized immediately below) to be a separate document from the escrow disclosures required under 12 C.F.R. § 226.18 (requiring TILA disclosures for closed-end credit) and RESPA.
 - The staff commentary proposes that the disclosure must be in a form that “the consumer may keep,” and proposes to further define “clear and conspicuous” to mean “in a reasonably understandable form and readily noticeable to consumers.”
- Content requirements for establishment of an escrow account. If an escrow account will be established within 45 days of closing, the proposal would require the following information to be clearly and conspicuously disclosed under the heading “Information About Your Mortgage Escrow Account:”
- Purpose of notice. A statement that the notice is intended to inform consumers.
 - Explanation of escrow account. An explanation that an “escrow account” is used to pay home-related costs like taxes and insurance. It must also include a highlighted dollar estimate of the amount to be paid into escrow in the first year. The staff commentary proposes that it acceptable to rely on the Regulation X/RESPA escrow account analysis for these figures.
 - Risk of not having an escrow account. A statement that, without an escrow account, the consumer would be responsible for paying the taxes, insurance, etc., on his or her own.

- Funding of escrow account. This must include a highlighted dollar amount for the amount that the consumer will be required to deposit in escrow at closing, as well as a highlighted dollar amount of the regular mortgage payment's escrow amount. In addition, this must say that the escrow dollar amount may change in the future.
- The staff commentary proposes that this disclosure does not need to be provided when an escrow account is established solely because a consumer is delinquent or in default on the underlying mortgage.
- Content requirements for non-establishment of an escrow account. If an escrow account will not be established within 45 days of closing, the notice must state that the mortgage lender will not be establishing an escrow account and include the following information:
 - Purpose of notice. A statement that the notice is to inform consumers about not having an escrow account and the risks of not having one.
 - Explanation of escrow account. An explanation that an "escrow account" is used to pay home-related costs like taxes and insurance and that the creditor uses the escrow money to pay these costs.
 - Reason why mortgage will not have an escrow account. A statement either that the creditor does not offer escrow accounts or that the consumer was offered one and turned it down.
 - Fee for choosing not to have an escrow account. Either a statement that no fee for not having an escrow will be charged, or, if a fee for not having an escrow account will be charged, the highlighted dollar amount of the fee. If the creditor is not establishing an escrow account because it doesn't offer them, the creditor should omit this disclosure from the table.
 - Risk of not having an escrow account. In bold face font, a statement that the homeowner will be responsible for paying the home-related costs in potentially large annual or semi-annual amounts.
 - Consequences of failure to pay home-related costs. A statement that if the homeowner does not pay the home-

related costs, the creditor may establish such an account, or add the costs to the loan balance, and a statement that the creditor may also charge the consumer for force-placed insurance that it may buy to protect its collateral. Followed by a statement that this insurance would likely be more expensive and provide fewer benefits than traditional homeowner's insurance.

- Option to establish escrow account. Unless the creditor does not offer an option to establish an escrow account, the phone number that the consumer can call to establish an escrow account.
- Optional information. A creditor has the option to include on the disclosure the creditor's name or logo, the consumer's name, property address, and/or the loan number. The staff commentary proposes that this optional information must be outside the table on the form.
- Waiting period for disclosures. The disclosure must be provided to the consumer at least three business days before closing.
- Timing of receipt. If the disclosure is not provided in person (such as if it is mailed) the consumer will not be considered to have received the disclosure until three business days after it is "mailed or delivered." The staff commentary proposes to use this approach when a creditor uses email or a courier to send the disclosure.
- Consumer's waiver of waiting period before consummation. If each primarily-liable consumer provides a written, signed, dated statement describing a "bona fide personal financial emergency" that also specifically waives or modifies the waiting period, the waiting period may be waived. Pre-printed forms would not be permitted for the emergency waiver statement.
 - The staff commentary proposes to clarify that a consumer must have received this disclosure before he or she can waive the waiting period, and also proposes that, when multiple consumers are primarily liable on the mortgage, that the consumers may sign the same document or different documents. In addition, the staff commentary proposes that a bona fide emergency depends on the individual facts of the situation but generally includes the imminent loss of or harm to a dwelling or harm to the health or safety of a natural person, and that creditor must not be aware of facts that would indicate that an emergency does not exist.

- **Proposed 12 C.F.R. § 226.20—Subsequent disclosure requirements:** The Fed is proposing to add a new subsection (d) to 12 C.F.R. § 226.20 to regulate cancellations of mortgage escrow accounts for mortgages on real property or a dwelling. The staff commentary proposes to define “real property” to include vacant or unimproved land, and “dwelling” to include mobile homes, boats, and trailers used as residences.
 - Cancellation of escrow account. The following disclosure is proposed to be required if a consumer decides to cancel the escrow account for a closed-end first mortgage that has an existing escrow account. “Escrow account” and “servicer” have the same meanings as under Regulation X/RESPA.² The staff commentary proposes that this disclosure requirement not apply when a mortgage is terminated, including termination by repayment, refinancing, rescission, or foreclosure.
 - Format requirements. As proposed, the disclosure would have the following contents and formatting requirements:
 - In general. Must be formatted similarly to Model Form H-26, in 10-point type on the front side of one piece of paper, separate from all other material. Proposed Model Form H-26 is included on the 28th page of the Fed’s Notice of Proposed Rulemaking in PDF format available [here](#).
 - Disclosure of heading. The heading must be conspicuous and apart from the rest of the form’s information, outside the below-referenced table.
 - Form of disclosure; tabular format. The rest of the disclosure’s contents outlined below must be in tabular format, and may only include the information specifically required by this section.
 - Question and answer format. The content’s must be presented in a question and answer format in the below order.
 - Highlighting. The fee for closing the account would be highlighted in bold, as would the statement described below regarding the risks of not having an escrow.

² See footnote 1 on page 3, above, for the Regulation X definition of “escrow account.” Under Regulation X: “Servicer means the person responsible for the servicing of a mortgage loan (including the person who makes or holds a mortgage loan if such person also services the mortgage loan).” The term does not include Fannie Mae, Freddie Mac, Ginnie Mae, NCUA, FDIC, FHA, the Department of Veterans Affairs, HUD, and certain agricultural finance agencies.

- The staff commentary proposes that the below content requirements and optional information must be grouped together on the front side of a separate document that has no other information, and that the disclosure must be in a form that the consumer can keep.
- Content requirements. As proposed, the disclosure would have to clearly and conspicuously disclose the following contents:
 - Heading. Must bear the heading “Required Direct Payment of Property Taxes and Insurance.”
 - Purpose of notice. A statement that the purpose of the disclosure is to inform the consumer regarding closing an escrow account and the attendant risks of not having one. The disclosure must also identify the creditor by name.
 - Explanation of escrow account. An explanation that an “escrow account” is used to pay home-related costs like taxes and insurance and that the creditor uses the escrow money to pay these costs.
 - Reason why mortgage will not have an escrow account. A statement that the consumer had an escrow account but asked the creditor or servicer to close it or the creditor or servicer independently decided to cancel it.
 - Fee for closing an escrow account. If the consumer has asked to close the escrow account, the highlighted dollar amount of the fee to close the account, if any. If the creditor decides to close the account independently and does not charge a fee, this part of the disclosure may be omitted.
 - Risk of not having an escrow account. In bold face font, a statement that the homeowner will be responsible for paying the home-related costs in potentially large annual or semi-annual amounts.
 - Consequences of failure to pay home-related costs. A statement that if the homeowner does not pay the home-related costs, the creditor may establish such an account, or add the costs to the loan balance. In addition, it must include a statement that the creditor may also charge the consumer for force-placed insurance that it may buy to protect its collateral and a statement that this insurance would likely be more expensive and provide fewer benefits than traditional homeowner’s insurance.

“principal dwelling” include personal property that people live in primarily, such as mobile homes, boats, and trailers. The definition of closed-end “higher-priced mortgage loan” under existing section 226.35 (which the Fed is not proposing to change) is:

- The loan is a first mortgage that is below the GSE conforming loan limit (generally \$417,000 but higher in “high cost” areas) and which has an APR that will exceed the average APOR by more than 1.5 percentage points;
 - The loan is a “jumbo” first mortgage that exceeds the GSE conforming loan limit and which has an APR that will exceed the APOR by more than 2.5 percentage points (the Fed recently released a final rule on mandatory jumbo mortgage escrow account; CUNA’s final rule analysis for that rulemaking is available [here](#)); or
 - The loan is a subordinate-lien mortgage product that exceeds the APOR by more than 3.5 percentage points.
- The APOR will be determined by the CFPB based on the average of similar mortgage transactions from a “representative sample” of mortgage lenders—including average APR, points, and other pricing terms—with “low-risk pricing” that are offered to consumers. CFPB will publish the APOR at least weekly. The CFPB’s APOR is not the same as the “prime rate” published in the *Wall Street Journal*; rather CFPB’s APOR is likely to be similar to the *Wall Street Journal*’s published average rates on various mortgage products.
 - The staff commentary proposes that acceptable escrow account administration follow the rules of Regulation X/RESPA,³ and also proposes that an escrow account does not need to be established with respect to insurance premiums for types of insurance, such as earthquake insurance or debt-protection insurance, that are not required by the creditor.
 - Exemptions for loans secured by shares in a cooperative and for certain condominium units. Higher-priced mortgage loans secured by shares in a cooperative housing organization are exempted from the escrow requirement. In addition, mortgages on condos are exempt from the mortgage insurance escrow requirements if the condo association has an obligation to its condo owners to maintain a master insurance policy for the building.

³ Regulation X’s escrow account servicing standards are codified at 24 C.F.R. § 3500.17 and are too long to be reprinted here. For more information about Regulation X’s escrow account requirements please access the CUNA e-Guide’s RESPA/Regulation X [resources](#).

- Exemptions:
 - Mortgages secured by shares in a cooperative housing organization are exempt from these requirements.
 - Mortgages on condos, planned unit developments, or similar arrangements involving a governing association are exempt from the mortgage insurance escrow requirements if the association has an obligation to maintain a master insurance policy. The staff commentary proposes that escrow accounts for condo mortgages for payment of property taxes would be required in all cases.
 - In addition, mortgages are exempt if:
 - The creditor made at least 50% of its mortgages in a “rural” or “underserved” area, as defined below, during the prior calendar year, so long as the loan is not subject to being acquired by an entity that does not meet this exemption (e.g., Fannie Mae, Freddie Mac, Ginnie Mae, Goldman Sachs, etc.);
 - During either of the prior two calendar years, the creditor originated and retained in portfolio 100 or fewer first mortgages on a dwelling (the proposed staff commentary uses the phrase “extended and services” 100 or fewer first mortgages, and notes that a creditor would generally need to exceed the 100 mortgage threshold for two consecutive years to become ineligible for this exemption); and
 - Neither the creditor nor the creditor’s affiliates maintain escrow accounts on any of their mortgage loans.
 - Definitions of “rural” and “underserved.” The proposed staff commentary notes that the Fed annually determines which counties are “rural” or “underserved” for purposes of this section.
 - “Rural:” Rural, as proposed, is defined as a county that is not part of an Office of Management and Budget Metropolitan Statistical Area or Micropolitan Statistical Area, and is either: (a) not adjacent to either type of Area, or (b) it is adjacent to a Metropolitan Statistical Area that has fewer than 1

million residents and the county has no town with more than 2,500 residents.

- “Underserved.” A county is proposed to be “underserved” if, during the prior calendar year, no more than two creditors made five or more first mortgages in the county.
- Cancellation. Escrow accounts under this authority may only be canceled if:
 - The mortgage is paid off;
 - At least five years have passed since closing and the consumer makes a request to cancel the account, but only if:
 - The mortgage has at least 20% equity (the staff commentary proposes to clarify that the 20% equity must be 20% relative to the value of the property at the time the loan was made, and that in making the equity calculation, the creditor must include in the amount of encumbered value any second mortgage that the creditor is aware of as well as the value of the first mortgage); and
 - The consumer is not delinquent.
- Evasion; open-end credit. A creditor may not style a closed-end mortgage product as an open-end product or take other steps in order to evade this section.
- **Model Forms:** The model forms are included on pages 26-28 of the PDF version of the Fed’s proposed rule, available [here](#). The proposed staff commentary includes a number of additional details about permissible changes to the forms; these details are included at the end of the PDF copy of the proposal. In general, the proposed generally acceptable changes to the model forms would include:
 - Referring to the borrower in the first person instead of the second person;
 - Using “borrower” and “creditor” instead of pronouns;
 - Rearranging the sequence of the disclosures;
 - Not using bold type for headings;
 - Deleting, whiting out, crossing out, etc., inapplicable parts of forms; and

- Using a vertical instead of a horizontal format for the disclosures.

Questions to Consider Regarding the Proposed Rule

1. What do you think of the proposed contents and format of the disclosures summarized above in terms of credit union operations? How would you improve the model disclosures and other disclosure requirements to be less burdensome on your credit union? Do you foresee any unintended consequences?

2. What changes could be made to the model disclosures and other requirements to make the disclosures more meaningful to consumers? Do you foresee your members being confused by any of the proposed disclosure requirements?

3. The proposed rule contains an exemption from insurance escrow requirements for mortgages secured by shares in a housing cooperative or a condominium where an association holds a master insurance policy for the building. The proposed staff commentary, however, states that this section applies to “higher-priced mortgage loans secured by a first lien on a condominium or cooperative unit if it is in fact used as a principal residence.” (See page 11, above.) How should the rule and/or staff commentary be clarified regarding the proposed rule’s “exemption” for coops and condos and the proposed staff commentary?

4. "Evasion:" Proposed 12 C.F.R. § 226.45 contains a prohibition on "evasion" such as using an open-end mortgage instead of a closed-end mortgage in order to "evade" the closed-end escrow disclosure. In addition, the proposed rule's preamble states that several other aspects of the proposal are intended to limit "circumvention or evasion" of these escrow rules (for example, the proposed requirement that escrow disclosures be required even for voluntary escrow accounts, as well as for when an escrow account is mandatory, is premised in part on a "circumvention and evasion" legal theory). Do you have concerns that examiners or other parties may read the "evasion" prohibition to mean that a credit union could not offer an open-end product (such as a HELOC) to a member instead of a closed-end product (such as a closed-end home equity loan)? Do you have other concerns about application of these types of "evasion" clauses to credit union operations?

5. Do you recommend any changes to the proposed regulation that are not addressed by the above questions? Do you have any other comments?
