BUREAU OF CONSUMER FINANCIAL PROTECTION

12 CFR Part 1026

[Docket No. CFPB–2013–0001]

RIN 3170–AA16

Escrow Requirements Under the Truth in Lending Act (Regulation Z)

AGENCY: Bureau of Consumer Financial Protection.

ACTION: Final rule; official interpretations.

SUMMARY: The Bureau of Consumer Financial Protection (Bureau) is publishing a final rule that amends Regulation Z (Truth in Lending) to implement certain amendments to the Truth in Lending Act made by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). Regulation Z currently requires creditors to establish escrow accounts for higher-priced mortgage loans secured by a first lien on a principal dwelling. The rule implements statutory changes made by the Dodd-Frank Act that lengthen the time for which a mandatory escrow account established for a higher-priced mortgage loan must be maintained. The rule also exempts certain transactions from the statute's escrow requirement. The primary exemption applies to mortgage transactions extended by creditors that operate predominantly in rural or underserved areas, originate a limited number of first-lien covered transactions, have assets below a certain threshold, and do not maintain escrow accounts on mortgage obligations they currently service.

DATES: *Effective date:* The rule is effective June 1, 2013.

Applicability date: Its requirements apply to transactions for which creditors receive applications on or after that date.

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SUPPLEMENTARY INFORMATION:

I. Summary of the Final Rule

In response to the recent mortgage crisis, Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) to strengthen certain consumer protections under existing law. The Bureau of Consumer Financial Protection (Bureau) is issuing this final rule to implement provisions of the Dodd-Frank Act requiring creditors to establish escrow accounts for certain mortgage transactions to help ensure that consumers set aside funds to pay property taxes, and premiums for homeowners insurance, and other mortgage-related insurance required by the creditor. The final rule takes effect on June 1, 2013.

The final rule has three main elements:

- As directed by the Dodd-Frank Act, the rule amends existing regulations that require creditors to establish and maintain escrow accounts for at least one year after originating a ''higher-priced mortgage loan'' to require generally that the accounts be maintained for at least five years.
- The rule creates an exemption from the escrow requirement for small creditors that operate predominately in rural or underserved areas. Specifically, to be eligible for the exemption, a creditor must: (1) Make more than half of its first-lien mortgages in rural or underserved areas; (2) have an asset size less than $2 billion; (3) together with its affiliates, have originated 500 or fewer first-lien mortgages during the preceding calendar year; and (4) together with its affiliates, not escrow for any mortgage it or its affiliates currently services, except in limited instances. Under the rule, eligible creditors need not establish escrow accounts for mortgages intended at consummation to be held in portfolio, but must establish accounts at consummation for mortgages that are subject to a forward commitment to be purchased by an investor that does not itself qualify for the exemption.
- Finally, the rule expands upon an existing exemption from escrowing for insurance premiums (though not for property taxes) for condominium units to extend the partial exemption to other situations in which an individual consumer's property is covered by a master insurance policy.

II. Background

A. TILA and Regulation Z

Congress enacted the Truth in Lending Act (TILA), 15 U.S.C. 1601 *et seq.,* based on findings that economic stability would be enhanced and competition among consumer credit providers would be strengthened by the informed use of credit resulting from consumers' awareness of the cost of credit. One of the purposes of TILA is to provide meaningful disclosure of credit terms to enable consumers to compare credit terms available in the marketplace more readily and avoid the uninformed use of credit. TILA's disclosures differ depending on whether credit is an open-end (revolving) plan or a closed-end (installment) transaction. TILA also contains certain procedural and substantive protections for consumers.

With the enactment of the Dodd-Frank Act, general rulemaking authority under TILA transferred from the Board of Governors of the Federal Reserve System (Board) to the Bureau on July 21, 2011. Pursuant to the Dodd-Frank Act and TILA, as amended, the Bureau published for public comment an interim final rule establishing a new Regulation Z, 12 CFR part 1026, implementing TILA (except with respect to persons excluded from coverage by section 1029 of the Dodd-Frank Act). *See* 76 FR 79768 (Dec. 22, 2011). This rule did not impose any new substantive obligations but did make technical and conforming changes to reflect the transfer of authority and certain other changes made by the Dodd-Frank Act. The Bureau's Regulation Z took effect on December 30, 2011. An official commentary interprets the requirements of Regulation Z. By statute, creditors that follow in good faith official interpretations contained in the commentary are insulated from civil liability, criminal penalties, and administrative sanction.

On July 30, 2008, the Board published a final rule amending Regulation Z to establish new regulatory protections for consumers in the residential mortgage market pursuant to authority originally granted to the Board by the Home Ownership and Equity Protection Act of 1994 (HOEPA). *See* 73 FR 44522 (July 30, 2008) (2008 HOEPA Final Rule). Among other things, the 2008 HOEPA Final Rule defined a class of higher-priced mortgage loans that are subject to certain protections. A higher-priced mortgage loan was established by the 2008 HOEPA Final Rule as a closed-end transaction secured by a consumer's principal dwelling with an annual percentage rate that exceeds an ''average prime offer rate'' for a comparable transaction by 1.5 or more percentage points for transactions secured by a first lien, or by 3.5 or more percentage points for transactions secured by a subordinate lien.[1] Under the 2008 HOEPA Final Rule, such transactions are subject to a number of special requirements, including that creditors

[1] The ''average prime offer rate'' is derived from average interest rates, points, and other loan pricing terms currently offered to consumers by a representative sample of creditors for mortgage transactions that have low-risk pricing characteristics. The Bureau publishes average prime offer rates for a broad range of types of transactions in a table updated at least weekly, as well as the methodology the Bureau uses to derive these rates.

assess consumers' ability to repay such transactions before extending credit, that creditors establish escrow accounts for higher-priced mortgage loans secured by a first lien on a principal dwelling (with some exceptions), and imposes significant restrictions on the use of prepayment penalties. Specifically with regard to escrows, the rule required that creditors establish and maintain escrow accounts for property taxes and premiums for mortgage-related insurance required by the creditor for a minimum of one year after originating a higher-priced mortgage loan secured by a first lien on a principal dwelling. The escrow requirement was effective on April 1, 2010, for transactions secured by site-built homes, and on October 1, 2010, for transactions secured by manufactured housing.

B. The Dodd-Frank Act

On July 21, 2010, Congress enacted the Dodd-Frank Act after a cycle of unprecedented expansion and contraction in the mortgage market sparked the most severe U.S. recession since the Great Depression.[2] The Dodd-Frank Act created the Bureau and consolidated various rulemaking and supervisory authorities in the new agency, including the authority to implement HOEPA and TILA.[3] At the same time, Congress significantly amended the statutory requirements governing mortgage practices with the intent to restrict the practices that contributed to the crisis.

As part of these changes, the Dodd-Frank Act enacted several substantive requirements designed to address questionable practices in the mortgage market. Several of these provisions expanded upon elements of the 2008 HOEPA Final Rule. For instance, among other provisions, title XIV of the Dodd-Frank Act amends TILA to establish certain requirements for escrow accounts for consumer credit transactions secured by a first lien on a consumer's principal dwelling. Sections 1461 and 1462 of the Dodd-Frank Act create new TILA section 129D, 15 U.S.C. 1639d, which substantially codifies Regulation Z's escrow requirement for higher-priced mortgage loans but lengthens the period for which escrow accounts are required, adjusts the rate threshold for determining whether escrow accounts are required for ''jumbo loans,'' whose principal amounts exceed the maximum eligible for purchase by the Federal Home Loan Mortgage Corporation (Freddie Mac), and adds two disclosure requirements. The new section also authorizes the Bureau to create an exemption from the escrow requirement for transactions originated and held in portfolio by creditors that operate predominantly in ''rural or underserved'' areas and meet certain other prescribed criteria.

The Dodd-Frank Act also expanded upon the 2008 HOEPA Final Rule to require that creditors assess all consumers' ability to repay mortgage transactions, even if they are not higher-priced mortgage loans. Sections 1411 and 1412 set forth these ability-to-repay requirements and provide a presumption of compliance for certain ''qualified mortgages,'' including certain balloon-payment mortgages originated and held in portfolio by creditors that operate predominantly in ''rural or underserved'' areas and meet certain other prescribed criteria. The provisions for balloon-payment qualified mortgages and for the potential escrow exemption are similar but not identical under the statute.

In the spring of 2011, the Board issued two proposals to implement the escrow and ability-to-repay/qualified mortgage provisions. Specifically, on March 2, 2011, the Board published a proposed rule to implement the requirements of sections 1461 and 1462 of the Dodd-Frank Act. 76 FR 11598 (Mar. 2, 2011) (the Board's 2011 Escrows Proposal). The Board's 2011 Escrows Proposal would have amended the escrow requirement of Regulation Z, by creating an exemption for transactions by certain creditors operating in rural or underserved areas, and by establishing two new disclosure requirements relating to escrow accounts. The proposal also would have adjusted the threshold for ''higher-priced mortgage loans'' based on a loan's ''transaction coverage rate,'' rather than its annual percentage rate (APR). This element of the proposal grew out of a separate initiative by the Board in which it had proposed to expand the definition of finance charge to include more fees and charges, and thus also generally to increase APRs, under Regulation Z to make disclosures more useful to consumers. Because those changes would have caused more transactions to exceed the thresholds for higher-priced mortgage loans, the Board proposed using a ''transaction coverage rate'' metric to keep coverage levels relatively constant. *See* 74 FR 43232 (Aug. 26, 2009); 75 FR 58539, 58660–61 (Sept. 24, 2010).

On May 11, 2011, the Board published a proposal 2011 ATR Proposal to implement the ability-to-repay/qualified mortgage provisions added to TILA by the Dodd Frank Act, as discussed above. *See* 76 FR 27390 (May 11, 2011) (the Board's 2011 ATR Proposal). The Board's 2011 Escrows and 2011 ATR Proposals used similar definitions of ''rural'' and ''underserved'' but varied with regard to certain other proposed provisions for the balloon-payment qualified mortgage and escrow exemptions.

On July 21, 2011, section 1061 of the Dodd-Frank Act transferred to the Bureau the ''consumer financial protection functions'' previously vested in certain other Federal agencies, including the Board. On November 23, 2012, the Bureau published a final rule that delays the implementation of certain disclosure requirements contained in title XIV of the Dodd-Frank Act, including those contained in TILA section 129D, as added by Dodd-Frank Act sections 1461 and 1462. *See* 77 FR 70105 (Nov. 23, 2012). Consequently, the disclosure portions of the Board's 2011 Escrows Proposal will be the subject of future rulemaking by the Bureau and are not finalized in this rule.

C. Size and Volume of the Current Mortgage Origination Market

Even with the economic downturn and tightening of credit standards, approximately $1.28 trillion in mortgage loans were originated in 2011.[4] In exchange for an extension of mortgage credit, consumers promise to make regular mortgage payments and provide their home or real property as collateral. The overwhelming majority of homebuyers continue to use mortgages to finance at least some of the purchase price of their property. In 2011, 93 percent of all home purchases were financed with a mortgage credit transaction.[5]

Consumers may obtain mortgage credit to purchase a home, to refinance an existing mortgage, to access home equity, or to finance home improvement. Purchase transactions and refinancings together produced 6.3 million new first-lien mortgage originations in 2011.[6] The proportion of

[2] For a more in-depth discussion of the mortgage market, the financial crisis, and mortgage origination generally, see the Bureau's 2013 ATR Final Rule, discussed below in part III.C.

[3] Sections 1011, 1021, and 1061 of title X of the Dodd-Frank Act, the ''Consumer Financial Protection Act,'' Public Law 111–203, sections 1001–1100H, codified at 12 U.S.C. 5491, 5511, 5581. The Consumer Financial Protection Act is substantially codified at 12 U.S.C. 5481–5603.

[4] *Credit Forecast 2012,* Moody's Analytics (2012), available at: http://www.economy.com/default.asp (reflects first-lien mortgage loans) (data service accessibly only through paid subscription).

[5] 1 Inside Mortg. Fin., The 2012 Mortgage Market Statistical Annual 12 (2012).

[6] Credit Forecast 2012; 1 Inside Mortg. Fin., The 2012 Mortgage Market Statistical Annual 17 (2012).

transactions that are for purchases as opposed to refinancings varies with the interest rate environment and other market factors. In 2011, 65 percent of the market was refinance transactions and 35 percent was purchase transactions, by volume.[7] Historically the distribution has been more even. In 2000, refinancings accounted for 44 percent of the market while purchase transactions comprised 56 percent; in 2005, the two products were split evenly.[8]

With a home equity transaction, a homeowner uses his or her equity as collateral to secure consumer credit. The credit proceeds can be used, for example, to pay for home improvements. Home equity credit transactions and home equity lines of credit resulted in an additional 1.3 million mortgage originations in 2011.[9]

The market for higher-priced mortgage loans remains significant. Data reported under the Home Mortgage Disclosure Act (HMDA) show that in 2011 approximately 332,000 transactions, including subordinate liens, were reportable as higher-priced mortgage loans. Of these transactions, refinancings accounted for approximately 44 percent of the higher-priced mortgage loan market, and 90 percent of the overall higher-priced mortgage loan market involved first-lien transactions. The median first-lien higher-priced mortgage loan was for $81,000, while the interquartile range (where one quarter of the transactions are below, and one quarter of the transactions are above) was $47,000 to $142,000.

III. Summary of the Rulemaking Process

A. The Board's 2011 Escrows Proposal

The Board's 2011 Escrows Proposal would have made certain amendments to Regulation Z's escrow requirement, in accordance with the Dodd-Frank Act. First, the Board's 2011 Escrows Proposal would have expanded the minimum period for mandatory escrow accounts from one to five years, and under certain circumstances longer. Second, the Board's 2011 Escrows Proposal would have extended the partial exemption for certain transactions secured by a condominium unit to planned unit developments and other, similar property types that have governing associations that maintain a master insurance policy. Third, the Board's 2011 Escrows Proposal would have created an exemption from the escrow requirement for any transaction extended by a creditor that makes most of its first-lien higher-priced mortgage loans in counties designated by the Board as ''rural'' or ''underserved,'' has annual originations (together with affiliates) of 100 or fewer first-lien mortgage transactions originated and retained servicing rights in either the current or prior year, and does not escrow for any mortgage obligation it services. The Board's 2011 Escrows Proposal would have limited the definition of ''rural'' areas to those based on the ''urban influence codes'' numbered 7, 10, 11, and 12, maintained by the Economic Research Service (ERS) of the United States Department of Agriculture. Additionally, the Board's 2011 Escrows Proposal would also have designated a county as ''underserved'' where no more than two creditors extend consumer credit secured by a first lien on real property or a dwelling five or more times in that county during either of the two previous calendar years.

The Board's 2011 Escrows Proposal also would have established two new disclosure requirements relating to escrow accounts. One disclosure would have been required to be given three business days before consummation of a mortgage transaction for which an escrow account would have been established, explaining what an escrow account is, how it works, and the risks of not having an escrow account. The disclosure would also have contained the estimated amount of the first year's disbursements, the amount to be paid at consummation to fund the escrow account initially, the amount of the consumer's regular mortgage payments to be paid into the escrow account, as well as a statement that the amount of the regular escrow payment could change in the future.

In addition, the Board's 2011 Escrows Proposal would have created a second disclosure to be given for mortgage transactions where an escrow account would not be established or when an escrow account on an existing mortgage obligation was to be cancelled. This disclosure would have explained what an escrow account is, how it works, the risk of not having an escrow account, as well as the potential consequences of failing to pay home-related costs such as taxes and insurance in the absence of an escrow account. Further, it would have stated why there would be no escrow account or why it was being cancelled, as applicable, the amount of any fee imposed for not having an escrow account, and how the consumer could request that an escrow account be established or left in place, along with any deadline for such requests. The Board's 2011 Escrows Proposal would have required that this disclosure be delivered at least three business days before consummation or cancellation of the existing escrow account, as applicable.

B. Overview of Comments Received

The Bureau reviewed the approximately 70 comment letters submitted to the Board and in one case directly to the Bureau concerning the Board's 2011 Escrows Proposal. These comments came from mortgage creditors, banks, savings associations, credit unions, industry trade groups, Federal agencies and officials, individual consumers, and consumer advocates. In addition to this overview, comments received are discussed in more detail, where applicable, in part V below.

Commenters generally supported the Board's effort to implement the new Dodd-Frank Act escrow requirements. However, industry commenters expressed concerns about the costs of implementation, particularly with respect to the proposed disclosure requirements. In addition, several industry commenters recommended that the proposed exemptions from the escrow requirement for higher-priced mortgage loans be broadened to include: (1) Transactions a creditor holds in portfolio; (2) transactions made by community banks and local credit unions; (3) transactions made in broader areas than the Board's proposed definitions of ''rural'' and ''underserved''; and (4) transactions for certain chattel dwellings, including manufactured homes, trailers, and house boats.

In contrast, consumer advocates were concerned that certain provisions could allow creditors to skirt the proposed rule. Consumer advocates suggested a narrower exemption than the one proposed by the Board to ensure that higher-priced mortgage loans made in well-served rural areas would be subject to the escrow requirement.

C. Other Rulemakings

In addition to this final rule, the Bureau is adopting several other final rules and issuing one proposal, all relating to mortgage credit to implement requirements of title XIV of the Dodd-Frank Act. The Bureau is also issuing a final rule jointly with other Federal agencies to implement requirements for mortgage appraisals in title XIV. Each of the final rules follows a proposal issued in 2011 by the Board or in 2012 by the

[7] Inside Mortg. Fin., Mortgage Originations by Product, Mortgage Market Statistical Annual (2012).

[8] *Id.* These percentages are based on the dollar amounts of the transactions.

[9] *Credit Forecast 2012.*

Bureau alone or jointly with other Federal agencies. Collectively, these proposed and final rules are referred to as the Title XIV Rulemakings.

• *Ability to Repay:* The Bureau is finalizing a rule, following a May 2011 proposal issued by the Board (the Board's 2011 ATR Proposal),[10] to implement provisions of the Dodd-Frank Act (1) requiring creditors to determine that a consumer has a reasonable ability to repay covered transactions and establishing standards for compliance, such as by making a ''qualified mortgage,'' and (2) establishing certain limitations on prepayment penalties, pursuant to TILA section 129C as established by Dodd-Frank Act sections 1411, 1412, and 1414. 15 U.S.C. 1639c. The Bureau's final rule is referred to as the 2013 ATR Final Rule. Simultaneously with the 2013 ATR Final Rule, the Bureau is issuing a proposal to amend the final rule implementing the ability-to-repay requirements, including by the addition of exemptions for certain nonprofit creditors and certain homeownership stabilization programs and a definition of a ''qualified mortgage'' for certain mortgages made and held in portfolio by small creditors (the 2013 ATR Concurrent Proposal). The Bureau expects to act on the 2013 ATR Concurrent Proposal on an expedited basis, so that any exceptions or adjustments to the 2013 ATR Final Rule can take effect simultaneously with that rule.

• *HOEPA:* Following its July 2012 proposal (the 2012 HOEPA Proposal),[11] the Bureau is issuing a final rule to implement Dodd-Frank Act requirements expanding protections for ''high-cost mortgages'' under the Homeownership and Equity Protection Act (HOEPA), pursuant to TILA sections 103(bb) and 129, as amended by Dodd-Frank Act sections 1431 through 1433. 15 U.S.C. 1602(bb) and 1639. The Bureau also is finalizing rules to implement certain title XIV requirements concerning homeownership counseling, including a requirement that lenders provide lists of homeownership counselors to applicants for federally related mortgage loans, pursuant to RESPA section 5(c), as amended by Dodd-Frank Act section 1450. 12 U.S.C. 2604(c). The Bureau's final rule is referred to as the 2013 HOEPA Final Rule.

• *Servicing:* Following its August 2012 proposals (the 2012 RESPA Servicing Proposal and 2012 TILA Servicing Proposal),[12] the Bureau is adopting final rules to implement Dodd-Frank Act requirements regarding force-placed insurance, error resolution, information requests, and payment crediting, as well as requirements for mortgage loan periodic statements and adjustable-rate mortgage reset disclosures, pursuant to section 6 of RESPA and sections 128, 128A, 129F, and 129G of TILA, as amended or established by Dodd-Frank Act sections 1418, 1420, 1463, and 1464. 12 U.S.C. 2605; 15 U.S.C. 1638, 1638a, 1639f, and 1639g. The Bureau also is finalizing rules on early intervention for troubled and delinquent borrowers, and loss mitigation procedures, pursuant to the Bureau's authority under section 6 of RESPA, as amended by Dodd-Frank Act section 1463, to establish obligations for mortgage servicers that it finds to be appropriate to carry out the consumer protection purposes of RESPA, and its authority under section 19(a) of RESPA to prescribe rules necessary to achieve the purposes of RESPA. The Bureau's final rule under RESPA with respect to mortgage servicing also establishes requirements for general servicing standards policies and procedures and continuity of contact pursuant to its authority under section 19(a) of RESPA. The Bureau's final rules are referred to as the 2013 RESPA Servicing Final Rule and the 2013 TILA Servicing Final Rule, respectively.

• *Loan Originator Compensation:* Following its August 2012 proposal (the 2012 Loan Originator Proposal),[13] the Bureau is issuing a final rule to implement provisions of the Dodd-Frank Act requiring certain creditors and loan originators to meet certain duties of care, including qualification requirements; requiring the establishment of certain compliance procedures by depository institutions; prohibiting loan originators, creditors, and the affiliates of both from receiving compensation in various forms (including based on the terms of the transaction) and from sources other than the consumer, with specified exceptions; and establishing restrictions on mandatory arbitration and financing of single premium credit insurance, pursuant to TILA sections 129B and 129C as established by Dodd-Frank Act sections 1402, 1403, and 1414(a). 15 U.S.C. 1639b, 1639c. The Bureau's final rule is referred to as the 2013 Loan Originator Final Rule.

• *Appraisals:* The Bureau, jointly with other Federal agencies,[14] is issuing a final rule implementing Dodd-Frank Act requirements concerning appraisals for higher-risk mortgages, pursuant to TILA section 129H as established by Dodd-Frank Act section 1471. 15 U.S.C. 1639h. This rule follows the agencies' August 2012 joint proposal (the 2012 Interagency Appraisals Proposal).[15] The agencies' joint final rule is referred to as the 2013 Interagency Appraisals Final Rule. In addition, following its August 2012 proposal (the 2012 ECOA Appraisals Proposal),[16] the Bureau is issuing a final rule to implement provisions of the Dodd-Frank Act requiring that creditors provide applicants with a free copy of written appraisals and valuations developed in connection with applications for transactions secured by a first lien on a dwelling, pursuant to section 701(e) of the Equal Credit Opportunity Act (ECOA) as amended by Dodd-Frank Act section 1474. 15 U.S.C. 1691(e). The Bureau's final rule is referred to as the 2013 ECOA Appraisals Final Rule.

The Bureau is not at this time finalizing proposals concerning various disclosure requirements that were added by title XIV of the Dodd-Frank Act, integration of mortgage disclosures under TILA and RESPA, or a simpler, more inclusive definition of the finance charge for purposes of disclosures for closed-end mortgage transactions under Regulation Z. The Bureau expects to finalize these proposals and to consider whether to adjust regulatory thresholds under the Title XIV Rulemakings in connection with any change in the calculation of the finance charge later in 2013, after it has completed quantitative testing, and any additional qualitative testing deemed appropriate, of the forms that it proposed in July 2012 to combine TILA mortgage disclosures with the good faith estimate (RESPA GFE) and settlement statement (RESPA settlement statement) required under the Real Estate Settlement Procedures Act (RESPA), pursuant to Dodd-Frank Act section 1032(f) and sections 4(a) of RESPA and 105(b) of TILA, as amended by Dodd-Frank Act sections 1098 and 1100A, respectively (the 2012 TILA–RESPA Proposal).[17] Accordingly, the Bureau already has issued a final rule delaying implementation of various

[10] 76 FR 27390 (May 11, 2011).

[11] 77 FR 49090 (Aug. 15,2012).

[12] 77 FR 57200 (Sept. 17, 2012) (RESPA); 77 FR 57318 (Sept. 17, 2012) (TILA).

[13] 77 FR 55272 (Sept. 7, 2012).

[14] Specifically, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the National Credit Union Administration, and the Federal Housing Finance Agency.

[15] 77 FR 54722 (Sept. 5, 2012).

[16] 77 FR 50390 (Aug. 21, 2012).

[17] 77 FR 51116 (Aug. 23, 2012).

affected title XIV disclosure provisions.[18] The Bureau's approaches to coordinating the implementation of the Title XIV Rulemakings and to the finance charge proposal are discussed in turn below.

Coordinated Implementation of Title XIV Rulemakings

As noted in all of its foregoing proposals, the Bureau regards each of the Title XIV Rulemakings as components of a single, comprehensive undertaking; each of them affecting aspects of the mortgage industry and its regulation. Many of these rules intersect with one or more of the others. Accordingly, as noted in its proposals, the Bureau is coordinating carefully the Title XIV Rulemakings, both in terms of their interrelated substantive provisions and, in recognition thereof, particularly with respect to their effective dates. The Dodd-Frank Act requirements to be implemented by the Title XIV Rulemakings generally will take effect on January 21, 2013, unless final rules implementing those requirements are issued on or before that date and provide for a different effective date. *See* Dodd-Frank Act section 1400(c), 15 U.S.C. 1601 note. In addition, some of the Title XIV Rulemakings are to take effect no later than one year after they are issued. *Id.*

The comments on the appropriate implementation date for this final rule are discussed in detail below in part VI of this notice. In general, however, consumer advocates requested that the Bureau put the protections in the Title XIV Rulemakings into effect as soon as practicable. In contrast, the Bureau received some industry comments indicating that implementing so many new requirements at the same time would create a significant cumulative burden for creditors. In addition, many commenters also acknowledged the advantages of implementing multiple revisions to the regulations in a coordinated fashion.[19] Thus, a tension exists between coordinating the adoption of the Title XIV Rulemakings and facilitating industry's implementation of such a large set of new requirements. Some have suggested that the Bureau resolve this tension by adopting a sequenced implementation, while others have requested that the Bureau simply provide a longer implementation period for all of the final rules.

The Bureau recognizes that many of the new provisions will require creditors to make changes to automated systems and, further, that most administrators of large systems are reluctant to make too many changes to their systems at once. At the same time, however, the Bureau notes that the Dodd-Frank Act established virtually all of these changes to institutions' compliance responsibilities, and contemplated that they be implemented in a relatively short period of time. And, as already noted, the extent of interaction among many of the Title XIV Rulemakings necessitates that many of their provisions take effect together. Finally, notwithstanding commenters' expressed concerns for cumulative burden, the Bureau expects that creditors actually may realize some efficiencies from adapting their systems for compliance with multiple new, closely related requirements at once, especially if given sufficient overall time to do so.

Accordingly, the Bureau is requiring that, as a general matter, creditors and other affected persons begin complying with the final rules on January 10, 2014. As noted above, section 1400(c) of the Dodd-Frank Act requires that some provisions of the Title XIV Rulemakings take effect no later than one year after the Bureau issues them. Accordingly, the Bureau is establishing January 10, 2014, one year after issuance of the Bureau's 2013 ATR, Escrows, and HOEPA Final Rules (*i.e.,* the earliest of the title XIV final rules), as the baseline effective date for most of the Title XIV Rulemakings. The Bureau believes that, on balance, this approach will facilitate the implementation of the rules' provisions, while also affording creditors sufficient time to implement the more complex or resource-intensive new requirements.

The Bureau has identified certain rulemakings or selected aspects thereof, however, that do not present significant implementation burdens for industry. Accordingly, the Bureau is setting earlier effective dates for those final rules or certain aspects thereof, as applicable. Those effective dates are set forth and explained in the **Federal Register** notices for those final rules.

More Inclusive Finance Charge Proposal

As noted above, the Bureau proposed in the 2012 TILA–RESPA Proposal to make the definition of finance charge more inclusive, thus rendering the finance charge and annual percentage rate a more useful tool for consumers to compare the cost of credit across different alternatives. 77 FR 51116, 51143 (Aug. 23, 2012). Because the new definition would include additional costs that are not currently counted, it would cause the finance charges and APRs on many affected transactions to increase. This in turn could cause more such transactions to become subject to various compliance regimes under Regulation Z. Specifically, the finance charge is central to the calculation of a transaction's ''points and fees,'' which in turn has been (and remains) a coverage threshold for the special protections afforded ''high-cost mortgages'' under HOEPA. Points and fees also will be subject to a 3-percent limit for purposes of determining whether a transaction is a ''qualified mortgage'' under the 2013 ATR Final Rule. Meanwhile, the APR serves as a coverage threshold for HOEPA protections as well as for certain protections afforded ''higher-priced mortgage loans'' under § 1026.35, including the mandatory escrow account requirements being amended by this final rule. Finally, because the 2013 Interagency Appraisals Final Rule uses the same APR-based coverage test as is used for identifying higher-priced mortgage loans, the APR affects that rulemaking as well. Thus, the proposed more inclusive finance charge would have had the indirect effect of increasing coverage under HOEPA and the escrow and appraisal requirements for higher-priced mortgage loans, as well as decreasing the number of transactions that may be qualified mortgages—even holding actual loan terms constant—simply because of the increase in calculated finance charges, and consequently APRs, for closed-end mortgage transactions generally.

As noted above, these expanded coverage consequences were not the intent of the more inclusive finance charge proposal. Accordingly, as discussed more extensively in the Escrows Proposal, the HOEPA Proposal, the ATR Proposal, and the Interagency Appraisals Proposal, the Board and subsequently the Bureau (and other agencies) sought comment on certain adjustments to the affected regulatory thresholds to counteract this

[18] 77 FR 70105 (Nov. 23, 2012).

[19] Of the several final rules being adopted under the Title XIV Rulemakings, six entail amendments to Regulation Z, with the only exceptions being the 2013 RESPA Servicing Final Rule (Regulation X) and the 2013 ECOA Appraisals Final Rule (Regulation B); the 2013 HOEPA Final Rule also amends Regulation X, in addition to Regulation Z. The six Regulation Z final rules involve numerous instances of intersecting provisions, either by cross-references to each other's provisions or by adopting parallel provisions. Thus, adopting some of those amendments without also adopting certain other, closely related provisions would create significant technical issues, *e.g.,* new provisions containing cross-references to other provisions that do not yet exist, which could undermine the ability of creditors and other parties subject to the rules to understand their obligations and implement appropriate systems changes in an integrated and efficient manner.

unintended effect. First, the Board and then the Bureau proposed to adopt a ''transaction coverage rate'' for use as the metric to determine coverage of these regimes in place of the APR. The transaction coverage rate would have been calculated solely for coverage determination purposes and would not have been disclosed to consumers, who still would have received only a disclosure of the expanded APR. The transaction coverage rate calculation would exclude from the prepaid finance charge all costs otherwise included for purposes of the APR calculation except charges retained by the creditor, any mortgage broker, or any affiliate of either. Similarly, the Board and Bureau proposed to reverse the effects of the more inclusive finance charge on the calculation of points and fees; the points and fees figure is calculated only as a HOEPA and qualified mortgage coverage metric and is not disclosed to consumers. The Bureau also sought comment on other potential mitigation measures, such as adjusting the numeric thresholds for particular compliance regimes to account for the general shift in affected transactions' APRs.

The Bureau's 2012 TILA–RESPA Proposal sought comment on whether to finalize the more inclusive finance charge proposal in conjunction with the Title XIV Rulemakings or with the rest of the TILA–RESPA Proposal concerning the integration of mortgage disclosure forms. *See* 77 FR 51116, 51125 (Aug. 23, 2012). Upon additional consideration and review of comments received, the Bureau decided to defer a decision whether to adopt the more inclusive finance charge proposal and any related adjustments to regulatory thresholds until it later finalizes the TILA–RESPA Proposal. *See* 77 FR 54843 (Sept. 6, 2012); 77 FR 54844 (Sept. 6, 2012).[20] Accordingly, this final rule as well as the 2013 HOEPA, ATR, and Interagency Appraisals Final Rules all are deferring any action on their respective proposed adjustments to regulatory thresholds.

IV. Legal Authority

The Bureau is issuing this final rule on January 10, 2013, in accordance with 12 CFR 1074.1, pursuant to its authority under TILA and the Dodd-Frank Act. *See* TILA section 105(a), 15 U.S.C. 1604(a). On July 21, 2011, section 1061 of the Dodd-Frank Act transferred to the Bureau the ''consumer financial protection functions'' previously vested in certain other Federal agencies, including the Board. The term ''consumer financial protection function'' is defined to include ''all authority to prescribe rules or issue orders or guidelines pursuant to any Federal consumer financial law, including performing appropriate functions to promulgate and review such rules, orders, and guidelines.''[21] TILA is defined as a Federal consumer financial law.[22] Accordingly, the Bureau has general authority to issue regulations pursuant to TILA.

A. Escrow Provisions Under the Dodd-Frank Act

As discussed above, the Dodd-Frank Act amended TILA to mandate escrow accounts for certain consumer credit transactions secured by a first lien on a consumer's principal dwelling. Sections 1461 and 1462 of the Dodd-Frank Act create new TILA section 129D, which establishes a minimum period for which escrows must be held for higher-priced mortgage loans, creates a rate threshold for determining whether escrow accounts are required for ''jumbo loans,'' whose principal amounts exceed the maximum eligible for purchase by Freddie Mac, and adds two disclosure requirements concerning escrow accounts. The Dodd-Frank Act further provides that the Bureau may exempt certain creditors from the escrow requirement by regulation. *See* TILA section 129D(c), 15 U.S.C. 1639(c). In addition, the Dodd-Frank Act provides the Bureau with authority to prescribe regulations that revise, add to, or subtract from the criteria that describe when an escrow account is required upon a finding that such regulations are in the interest of the consumers and in the public interest. *See* 15 U.S.C. 1639d note.

B. Other Rulemaking and Exception Authorities

This final rule also relies on other rulemaking and exception authorities specifically granted to the Bureau by TILA and the Dodd-Frank Act, including the authorities discussed below.

TILA Section 105(a)

As amended by the Dodd-Frank Act, TILA section 105(a), 15 U.S.C. 1604(a), directs the Bureau to prescribe regulations to carry out the purposes of TILA, and provides that such regulations may contain additional requirements, classifications, differentiations, or other provisions and may provide for such adjustments and exceptions for all or any class of transactions that the Bureau judges are necessary or proper to effectuate the purposes of TILA, to prevent circumvention or evasion thereof, or to facilitate compliance therewith. A purpose of TILA is '' * * * to assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit* * * .'' TILA section 102(a), 15 U.S.C. 1601(a). This stated purpose is informed by Congress's finding that ''* * * economic stabilization would be enhanced and the competition among the various financial institutions and other firms engaged in the extension of consumer credit would be strengthened by the informed use of credit.'' *Id.* Thus, strengthened competition among financial institutions is a goal of TILA, achieved through the effectuation of TILA's purposes.

Historically, TILA section 105(a) has served as a broad source of authority for rules that promote the informed use of credit through required disclosures and substantive regulation of certain practices. However, Dodd-Frank Act section 1100A clarified the Bureau's section 105(a) authority by amending that section to provide express authority to prescribe regulations that contain ''additional requirements'' that the Bureau finds are necessary or proper to effectuate the purposes of TILA, to prevent circumvention or evasion thereof, or to facilitate compliance therewith. This amendment clarified the Bureau's authority under TILA section 105(a) to prescribe requirements beyond those specifically listed in the statute that meet the standards outlined in section 105(a), which include effectuating all of TILA's purposes. Therefore, the Bureau believes that its authority under TILA section 105(a) to make exceptions, adjustments, and additional provisions that the Bureau finds are necessary or proper to effectuate the purposes of TILA applies with respect to the purpose of section 129D. That purpose is to ensure that consumers understand and appreciate the full cost of home ownership. The purpose of TILA section 129D is also informed by the findings articulated in section 129B(a) that economic stabilization would be enhanced by the

[20] These notices extended the comment period on the more inclusive finance charge and corresponding regulatory threshold adjustments under the 2012 TILA–RESPA and HOEPA Proposals. It did not change any other aspect of either proposal.

[21] 12 U.S.C. 5581(a)(1).

[22] *See* Dodd-Frank Act section 1002(14), 12 U.S.C. 5481(14) (defining ''Federal consumer financial law'' to include the ''enumerated consumer laws'' and the provisions of title X of the Dodd-Frank Act); Dodd-Frank Act section 1002(12), 12 U.S.C. 5481(12) (defining ''enumerated consumer laws'' to include TILA).

protection, limitation, and regulation of the terms of residential mortgage credit and the practices related to such credit, while ensuring that responsible and affordable mortgage credit remains available to consumers. *See* 15 U.S.C. 1639b(a).

As discussed in the section-by-section analysis below, the Bureau is issuing regulations to carry out TILA's purposes, including such additional requirements, adjustments, and exceptions as, in the Bureau's judgment, are necessary and proper to carry out the purposes of TILA, prevent circumvention or evasion thereof, or to facilitate compliance therewith. In developing these aspects of the final rule pursuant to its authority under TILA section 105(a), the Bureau has considered the purposes of TILA, including the purposes of TILA section 129D, and the findings of TILA, including strengthening competition among financial institutions and promoting economic stabilization, and the findings of TILA section 129B(a)(1) that economic stabilization would be enhanced by the protection, limitation, and regulation of the terms of residential mortgage credit and the practices related to such credit, while ensuring that responsible, affordable mortgage credit remains available to consumers.

Dodd-Frank Act Section 1022(b)

Section 1022(b)(1) of the Dodd-Frank Act authorizes the Bureau to prescribe rules "as may be necessary or appropriate to enable the Bureau to administer and carry out the purposes and objectives of the Federal consumer financial laws, and to prevent evasions thereof[.]" 12 U.S.C. 5512(b)(1). TILA and title X of the Dodd-Frank Act are Federal consumer financial laws.[23] Accordingly, in adopting this final rule, the Bureau is exercising its authority under Dodd-Frank Act section 1022(b) to prescribe rules that carry out the purposes and objectives of TILA and title X of the Dodd-Frank Act and prevent evasion of those laws.

V. Section-by-Section Analysis

Section 1026.19 Certain Mortgage and Variable-Rate Transactions

In the 2011 Escrows Proposal, the Board proposed a new § 226.19(f) to implement the account disclosure requirements of TILA section 129D, as enacted by Sections 1461 and 1462 of the Dodd- Frank Act. Proposed § 226.19(f) [24] would have required disclosures for the establishment or non-establishment of an escrow account in connection with consummation of a transaction secured by a first lien, but not a subordinate lien. As discussed above, on November 23, 2012, the Bureau published in the **Federal Register** a rule that delays the implementation of certain disclosure requirements contained in title XIV of the Dodd-Frank Act, including those contained in sections 1461 and 1462. *See* 77 FR 70105 (Nov. 23, 2012). Consequently, the Bureau will not be adopting a new § 1026.19(f) in this rule.

Section 1026.20 Subsequent Disclosure Requirements

In the 2011 Escrows Proposal, the Board proposed a new § 226.20(d) to implement the disclosure requirements of TILA sections 129D(j)(1)(B) and 129D(j)(2), as enacted by section 1462 of the Dodd-Frank Act. TILA section 129D(j)(1)(B) requires a creditor or servicer to provide the disclosures set forth in TILA section 129D(j)(2) when a consumer requests closure of an escrow account that was established in connection with a transaction secured by real property. Proposed § 226.20(d) would have directed the creditor or servicer to disclose the information about escrow accounts in accordance with certain format and timing requirements. As previously noted, the Bureau has delayed the implementation of certain disclosure requirements contained in title XIV of the Dodd-Frank Act, including those contained in sections 1461 and 1462. *See* 77 FR 70105 (Nov. 23, 2012). Consequently, the Bureau will not be adopting a new § 1026.20(d) in this rule.

Section 1026.34 Prohibited Acts or Practices in Connection With High-Cost Mortgages

34(a) Prohibited Acts or Practices for High-Cost Mortgages 34(a)(4)(i) Mortgage-Related Obligations

In the 2011 Escrows Proposal, the Board proposed amendments to the definition of mortgage-related obligations in § 226.34(a)(4)(i) and comment 34(a)(4)(i)–1, which contained cross-references to the definition of mortgage-related insurance in § 226.35(b)(3)(i). Because the Board proposed removing and reserving § 226.35(b)(3)(i) and preserving the substance of that provision in the proposed new § 226.45(b)(1), the Board made conforming amendments to § 226.34(a)(4)(i) and staff comment 34(a)(4)(i))–1 to reflect the new cross-reference. Section 1026.34(a)(4)(i) and staff comment 34(a)(4)(i)–1 are being amended under the 2013 HOEPA Final Rule to remove the cross-reference to § 1026.35(b)(3)(i). Consequently, the Bureau will not be adopting conforming amendments in this rule.

Section 1026.35 Requirements for Higher-Priced Mortgage Loans

35(a) Definitions

35(a)(1)

As noted above, the Dodd-Frank Act substantially codified the Board's escrow requirement for higher-priced mortgage loans, but with certain differences. One of those differences is the higher threshold above the average prime offer rate established by the Dodd-Frank Act for determining when escrow accounts are required for transactions that exceed the maximum principal balance eligible for sale to Freddie Mac ("jumbo" transactions). In general, the coverage thresholds are 1.5 percentage points above the average prime offer rate for first-lien transactions and 3.5 percentage points above the average prime offer rate for subordinate-lien transactions. Under section 1461 of the Dodd-Frank Act, however, Congress established a new threshold of 2.5 percentage points above the average prime offer rate for "jumbo" transactions. Under an interim final rule published concurrently with the Board's 2011 Escrows Proposal, the Board implemented this special coverage test for "jumbo" transactions by amending its existing escrow requirement for higher-priced mortgage loans in § 226.35(b)(3). *See* 76 FR 11319 (Mar. 2, 2011) (the Board's 2011 "Jumbo" Final Rule).

Under the Board's 2011 Escrows Proposal, proposed § 226.45(a)(1) would have provided that a higher-priced mortgage loan is a consumer credit transaction secured by the consumer's principal dwelling that exceeds the applicable pricing threshold as of the date the transaction's rate is set. The Board's proposed § 226.45(a)(1) incorporated the special, separate coverage threshold for "jumbo" transactions, as provided by the Dodd-Frank Act. In addition, as discussed above, the Board's proposed § 226.45(a)(1) would have based "higher-priced mortgage loan" status on a comparison of the transaction's

[23] *See* Dodd-Frank Act section 1002(14), 12 U.S.C. 5481(14) (defining "Federal consumer financial law" to include the "enumerated consumer laws" and the provisions of title X of the Dodd-Frank Act); Dodd-Frank Act section 1002(12), 12 U.S.C. 5481(12) (defining "enumerated consumer laws" to include TILA).

[24] This section-by-section analysis discusses the Board's 2011 Escrows Proposal by reference to the Board's Regulation Z, 12 CFR part 226, which the Board proposed to amend, and discusses this final rule by reference to the Bureau's Regulation Z, 12 CFR part 1026, which this final rule amends.

''transaction coverage rate,'' rather than its APR, to the average prime offer rate.

A few commenters suggested that the proposed thresholds should be reconsidered. However, the Bureau believes the current thresholds capture the expansion intended by Congress and is therefore generally adopting proposed § 226.45(a)(1) as § 1026.35(a)(1). As discussed above, however, the Bureau is suspending consideration of the transaction coverage rate until it considers the proposed expansion of the definition of finance charge in connection with the TILA–RESPA Final Rule. Accordingly, the final rule continues to base the definition of higher-priced mortgage loans on a comparison of the transaction's APR to the average prime offer rate. The Bureau will consider comments received concerning the transaction coverage rate proposal in connection with the TILA–RESPA Final Rule. Comment 35(a)(1)–1 clarifies how to determine if a transaction is a higher-priced mortgage loan by comparing the annual percentage rate to the average prime offer rate. Comment 35(a)(1)–2 clarifies when the comparison between the annual percentage rate and the average prime offer rate should occur. Comment 35(a)(1)–3 clarifies how to determine whether a transaction is a higher-priced mortgage loan when the principal balance exceeds the limit in effect as of the date the transaction's rate is set for the maximum principal obligation eligible for purchase by Freddie Mac.

35(a)(2)

The Bureau is not altering current § 1026.35(a)(2), which defines the ''average prime offer rate'' as the annual percentage rate derived from average interest rates, points, and other transaction pricing terms currently offered to consumers by a representative sample of creditors for mortgage transactions that have low-risk pricing characteristics. The Bureau is, however, adding comment 35(a)(2)–3 to clarify that the average prime offer rate in § 1026.35 has the same meaning as in Regulation C, 12 CFR part 1003. *See* 12 CFR 1003.4(a)(12)(ii).

35(b) Escrow Accounts

35(b)(1)

As amended by the Dodd-Frank Act, TILA section 129D(a) contains the general requirement that an escrow account be established for any consumer credit transaction secured by a first lien on a consumer's principal dwelling. TILA section 129D(b), however, restricts that general requirement to four specified circumstances: (1) Where an escrow account is required by Federal or State law; (2) where the transaction is made, guaranteed, or insured by a State or Federal agency; (3) where the transaction's annual percentage rate exceeds the average prime offer rate by prescribed amounts; and (4) where an escrow account is ''required pursuant to regulation.''

The Board's proposed § 226.45(b)(1) implemented only the third of the four circumstances, pursuant to TILA section 129D(b)(3), because the other three either are self-effectuating or are effectuated by other agencies' regulations. Nonetheless, the Bureau recognizes that those other three provisions may have implications for existing State and Federal credit programs, under which the applicable agencies may need to revise their own underlying guidelines to accommodate or otherwise reflect the statutory changes. Moreover, the Board's proposed § 226.45(b)(1) would have stated that, for purposes of § 226.45(b), ''escrow account'' has the same meaning as under Regulation X. This proposed provision paralleled existing § 226.35(b)(3)(iv).

No comments were received on the scope and structure of § 226.45(b)(1). The Bureau is adopting the proposed language with certain technical changes as § 1026.35(b)(1).

35(b)(2) Exemptions

Under existing regulations, certain categories of transactions are exempt from the escrow requirement. The Board proposed § 226.45(a)(3) and (b)(2)(i) and (ii) to reflect these provisions. The Board's proposed § 226.45(a)(3) would have provided that a ''higher-priced mortgage loan'' does not include a transaction to finance the initial construction of a dwelling, a temporary or ''bridge'' transaction with a term of twelve months or less, a reverse mortgage transaction, or a home equity line of credit. This provision is identical to existing § 1026.35(a)(3) (adopted as § 226.35(a)(3) in the 2008 HOEPA Final Rule), which provides that the term ''higher-priced mortgage loan'' does not include a transaction to finance the initial construction of a dwelling, a temporary or ''bridge'' transaction with a term of twelve months or less, a reverse mortgage transaction, or a home equity line of credit. The Board's proposed § 226.45(b)(2)(i) would have provided that escrow accounts need not be established for transactions secured by shares in a cooperative. This provision would track existing § 1026.35(b)(3)(ii)(A). It also is consistent with new TILA section 129D(e), as added by section 1461 of the Dodd-Frank Act.

In light of the way in which the Dodd-Frank Act has expanded on various elements of the 2008 HOEPA Final Rule, the Bureau believes that a more tailored approach is appropriate to specify what types of transactions are exempt from specific substantive requirements in Regulation Z. Accordingly, with the exception of home equity lines of credit (HELOCs), the Bureau is using its exemption authority under TILA section 129D [25] to recodify the exemptions that were formerly located in § 1026.35(a)(3) and § 1026.35(b)(3)(ii)(A) in the exemptions from coverage of the escrow requirement under new § 1026.35(b)(2). The separate exemption for HELOCs is no longer necessary because § 1026.35(a)(1) has been modified to apply only to closed-end consumer credit transactions.[26] The Bureau believes that the use of its exemption authority is appropriate given the nature of the transactions at issue and would benefit consumers and industry alike. Given that reverse mortgages are unique transactions that are currently addressed by § 1026.33,[27] the Bureau believes it is in the interest of consumers and the public interest to pursue a course involving further review of § 1026.33 and to consider whether new or different protections would be appropriate for reverse mortgages at a later date.[28] In addition, because of the nature of construction-only and bridge loan transactions, the Bureau believes that exempting these transactions is in the interest of consumers and the public interest. In both cases, the payments and amounts of property taxes and hazard insurance will depend on various time-sensitive factors for loan transactions that generally do not exist for more than one or two years, making maintaining

[25] The Bureau may prescribe rules that revise, add to, or subtract from the criteria of section 129D(b) of TILA if the Bureau determines that such rules are in the interest of consumers and the public interest. *See* 15 U.S.C. 1639d note. These exceptions are also justified by section 105(a) of TILA which provides that the Bureau in its regulations to carry out the purposes of TILA may provide for such adjustments and exceptions for all or any class of transactions that the Bureau judges are necessary or proper to effectuate the purposes of TILA, to prevent circumvention or evasion thereof, or to facilitate compliance therewith. *See* 15 U.S.C. 1604(a).

[26] The Bureau notes that open-end credit transactions are excluded from section 129D(a) of TILA under Dodd-Frank Act section 1461. *See* 15 U.S.C. 1639d.

[27] Reverse mortgages are also excluded from section 129D(a) of TILA under Dodd-Frank Act section 1461. *See* 15 U.S.C. 1639d.

[28] *See, e.g.,* Consumer Financial Protection Bureau, *Reverse Mortgages: Report to Congress* (June 28, 2012) available at: *http://files.consumerfinance.gov/a/assets/documents/201206_cfpb_Reverse_Mortgage_Report.pdf.*

an escrow account for a minimum of five years impractical. The recodification of the other exemptions from the escrows requirements is purely for organizational purposes and has no substantive effect. Exemptions from the new appraisal requirements are being finalized separately by the 2013 Interagency Appraisals Final Rule, in § 1026.35(c).

35(b)(2)(i)

The Board's proposed § 226.45(b)(2)(i) would have provided that escrow accounts need not be established for transactions secured by shares in a cooperative, tracking the existing regulation, which is now located at § 1026.35(b)(3)(ii)(A). The Bureau is adopting this proposal with certain conforming changes as § 1026.35(b)(2)(i)(A). The Bureau is adopting the Board's proposed exemption for transactions to finance the initial construction of a dwelling as § 1026.35(b)(2)(i)(B). The Bureau is adopting the Board's proposed exemption for ''bridge'' loan transactions as § 1026.35(b)(2)(i)(C). Finally, the Bureau is adopting the Board's proposed exemption for reverse mortgage transactions as § 1026.35(b)(2)(i)(D) with certain conforming changes. Comment 35(b)(2)(i)–1 clarifies the operation of the exemption for transactions to finance the initial construction of a dwelling under § 1026.35(b)(2)(i)(B) in relation to a construction-to-permanent mortgage transaction, noting that where a transaction is determined to be a higher-priced mortgage loan, only the permanent phase of the transaction is subject to § 1026.35.

35(b)(2)(ii)

As added by section 1461 of the Dodd- Frank Act, new TILA section 129D(e) codifies the current provision stating that escrow accounts that are established in connection with transactions secured by condominium units need not reserve funds to cover mortgage-related insurance, found in existing § 1026.35(b)(3)(ii)(B), and expands it to other, similar ownership arrangements involving governing associations that have an obligation to maintain a master insurance policy. The Board's proposed § 226.45(b)(2)(ii) would have provided that insurance premiums need not be included in escrow accounts for transactions secured by dwellings in condominiums, planned unit developments (PUDs), or similar arrangements in which ownership requires participation in a governing association, where the governing association has an obligation to the dwelling owners to maintain a master policy insuring all dwellings.

Several commenters suggested that even with this expanded definition other ownership structures might not be captured by the Board's proposed exemption. The Bureau is responding to these comments by revising the proposed language to adopt the umbrella term ''common interest community,'' which one commenter had suggested would be sufficiently broad to capture the various arrangements under which a governing association has an obligation to the dwelling owners to maintain a master policy insuring all dwellings. The Bureau is adopting the Board's proposed comment 45(b)(2)(ii)–1 as comment 35(b)(2)(ii)–1, which parallels existing comment 35(b)(3)(ii)(B)–1, but with conforming amendments to reflect the expanded scope of the exemption. The Bureau also is adopting the Board's proposed comment 45(b)(2)(ii)–2 as comment A22b)(2)(ii)–2 to provide details about the nature of PUDs and to clarify that the exemption is available for not only condominiums and PUDs but also any other type of property ownership arrangement that has a governing association with an obligation to maintain a master insurance policy. Following a request from one commenter, the Bureau additionally adds comment 35(b)(2)(ii)–3 to clarify that properties with multiple governing associations would also qualify for the limited exemption provided in § 1026.35(b)(2)(ii).

35(b)(2)(iii)

As adopted by Dodd-Frank Act section 1461, TILA section 129D(c) authorizes the Bureau to exempt from the higher-priced mortgage loan escrow requirement a creditor that: (1) Operates predominantly in rural or underserved areas; (2) together with all affiliates, has total annual mortgage loan originations that do not exceed a limit set by the Bureau; (3) retains its mortgage obligations in portfolio; and (4) meets any asset-size threshold and any other criteria as the Bureau may establish. As discussed above, Dodd-Frank Act section 1412 ability-to-repay provisions contain a similar set of criteria with regard to certain balloon-payment mortgages originated and held in portfolio by creditors that operate predominantly in rural or underserved areas. The statute authorizes the Bureau to issue regulations permitting certain balloon-payment mortgages issued by the specified creditors to receive a presumption of compliance with the ability-to-repay requirements as ''qualified mortgages,'' even though the general qualified mortgage criteria prohibit balloon-payment features. Specifically, in addition to having to meet certain transaction-specific features and underwriting requirements, balloon-payment qualified mortgages may be made only by a creditor that: (1) Operates predominantly in rural or underserved areas; (2) together with all affiliates, has total annual residential mortgage transaction originations that do not exceed a limit set by the Bureau; (3) retains the balloon-payment mortgages in portfolio; and (4) meets any asset-size threshold and any other criteria as the Bureau may establish. *See* TILA section 129C(b)(2)(E), 15 U.S.C. 1639c(b)(2)(E).

The Board interpreted the two provisions as serving similar but not identical purposes, and thus varied certain aspects of the proposals to implement the balloon qualified mortgage and escrow provisions. Specifically, the Board interpreted the escrow provision as being designed to exempt creditors that do not possess economies of scale to offset cost-effectively the burden of establishing escrow accounts by maintaining a certain minimum portfolio size from being required to establish escrow accounts on higher-priced mortgage loans, and the balloon-payment qualified mortgage provision to ensure access to credit in rural and underserved areas where consumers may be able to obtain credit only from community banks offering balloon-payment mortgages. Accordingly, the two Board proposals would have used similar definitions of ''rural'' and ''underserved,'' but did not provide uniformity in calculating and defining various other elements. Specifically, the Board's proposed § 226.45(b)(2)(iii) would have implemented the escrow exemption in TILA section 129D(c) by requiring that the creditor have (1) in the prior year made more than 50 percent of its first-lien higher-priced mortgage loans in rural or underserved areas, (2) together with all affiliates, originated and retained servicing rights to no more than 100 first-lien mortgage obligations in either the current or prior calendar year, and (3) together with all affiliates, not maintained an escrow account on any consumer credit transaction secured by real property or a dwelling that is currently serviced by the creditor or its affiliates. The Board also sought comment on whether to add a requirement for the creditor to meet an asset-size limit and what that size should be.

In contrast, the Board's proposal for balloon qualified mortgages would have required that the creditor (1) in the preceding calendar year, have made more than 50 percent of its balloon-payment mortgages in rural or underserved areas; and (2) have assets that did not exceed $2 billion. The Board proposed two alternatives for qualifications relating to (1) the total annual originations limit; and (2) the retention of balloon-payment mortgages in portfolio.

In both cases, the Board proposed to use a narrow definition of rural based on the Economic Research Service (ERS) of the United States Department of Agriculture's (USDA) ''urban influence codes'' (UICs). The UICs are based on the definitions of ''metropolitan'' and ''micropolitan'' as developed by the Office of Management and Budget, along with other factors reviewed by the ERS that place counties into twelve separately defined UICs depending on the size of the largest city and town in the county. The Board's proposal would have limited the definition of rural to certain ''non-core'' counties, which are areas outside of any metropolitan or micropolitan area, excluding those adjacent to a metropolitan area of at least one million residents or adjacent to a micropolitan area with a town of at least 2,500 residents. This definition corresponded with UICs of 7, 10, 11, and 12, which would have covered areas in which only 2.3 percent of the nation's population lives.

In light of the overlap in criteria between the escrow exemption and balloon qualified mortgage provisions, the Bureau considered comments responding to both proposals in determining how to finalize the particular elements of each rule as discussed further below. With regard to exercising the Bureau's authority to create an escrows exemption in general, the bulk of the comments received asserted that the Bureau should exercise such authority but that the scope of the proposal was too limited and would lead to reduced access to credit or increased costs for consumers in rural areas because of increased compliance costs for creditors. Two industry commenters suggested a blanket exemption for community banks, but did not identify any criteria to define a community bank. Five industry commenters suggested the exemption should be based solely on loan-to-value ratio of the transaction being originated, ranging from 50 percent to 80 percent, without using any of the statutory requirements. Four trade association commenters suggested that the exemption should be based solely on whether the debt obligation was being kept in the creditor's portfolio. One consumer advocacy group stated that the exemption was too broad because, under its reading of section 1461 of the Dodd-Frank Act, the exemption was not meant to protect access to credit but, rather, to protect communities that need credit but cannot find credit with terms better than the terms of higher-priced mortgage loans.

The Bureau believes that escrows generally provide meaningful consumer protections, as consumers may not incorporate recurring costs related to the ownership of a dwelling to their monthly mortgage payments to anticipate the total costs associated with the dwelling. For consumers who struggle with their monthly mortgage payments, there is a higher probability of foreclosure as a result. Based on recent research,[29] consumers that do not have an escrow account in the first year after consummation result in 0.35 percent more foreclosures per year for first-lien, higher-priced mortgages. However, in rural and underserved areas where there are fewer creditors that may be willing to extend higher-priced mortgage loans, the number of providers could be further reduced when additional costs associated with establishing and maintaining escrow accounts are taken into account. The reduction in the number of providers could lead to some consumers being unable to obtain higher-priced mortgage loans, or to increase the costs of the higher-priced mortgage loans as a result of a concentrated market with limited competition to a point where the consumer would be unable to repay the higher-priced mortgage loan.

There are also substantial data suggesting that the small portfolio creditors that are most likely to have difficulty maintaining escrow accounts (or to rely on balloon loan transactions to manage their interest rate risks) have a significantly better track record than larger creditors with regard to the performance of their mortgage transactions. As discussed in more depth in the 2013 ATR Concurrent Proposal, because small portfolio creditors retain a higher percentage of their transactions on their own books, they have strong incentives to engage in thorough underwriting. To minimize performance risk, small community creditors have developed underwriting standards that differ from those employed by larger institutions. Small creditors generally engage in ''relationship banking,'' in which underwriting decisions rely at least in part on qualitative information gained from personal relationships between creditors and consumers. This qualitative information focuses on subjective factors such as consumer character and reliability which ''may be difficult to quantify, verify, and communicate through the normal transmission channels of banking organization.'' [30] While it is not possible to disaggregate the impact of each of the elements of the community banking model, the combined effect is highly beneficial. Moreover, where consumers have trouble paying their mortgage obligations, small portfolio creditors have stronger incentives to work with the consumers to get them back on track, to protect both the creditors' balance sheets and their reputations in their local communities. Market-wide data demonstrate that mortgage delinquency and charge-off rates are significantly lower at smaller banks than at larger banks.[31]

The Bureau believes that Congress carefully weighed these considerations in authorizing the Bureau to establish an exemption in TILA section 129D(c) to ensure access to credit in rural and underserved areas where consumers may be able to obtain credit only from community banks that cannot maintain escrow accounts on a cost-effective basis. Thus, the Bureau concludes that exercising its authority is appropriate, but also that the exemption should implement the statutory criteria to ensure it effectuates Congress's intent. Accordingly, as discussed in more detail below, the Bureau is adopting § 1026.35(b)(2)(iii) largely as proposed, but with certain changes described below, to implement TILA section 129D(c).

In particular, the Bureau has concluded that it is appropriate to make the specific creditor qualifications much more consistent between the balloon-payment qualified mortgage and escrow exemptions than originally proposed by the Board.[32] The Bureau believes that

[29] Nathan B. Anderson and Jane B. Dokko, *Liquidity Problems and Early Payment Default Among Subprime Mortgages,* Finance and Economics Discussion Series, Federal Reserve Board (2011), available at: *http://www.federalreserve.gov/pubs/feds/2011/201109/201109pap.pdf.*

[30] *See* Allen N. Berger and Gregory F. Udell, *Small Business Credit Availability and Relationship Lending: The Importance of Bank Organizational Structure,* Economic Journal (2002).

[31] *See* 2013 ATR Concurrent Proposal; FDIC, Community Banking Study, December 2012, available at: *http://www.fdic.gov/regulations/resources/cbi/report/cbi-full.pdf.*

[32] The Bureau has similarly attempted to maintain consistency between the asset-size limit, annual originations threshold, and requirements concerning portfolio transactions as between the final rules that it is adopting with regard to balloon qualified mortgages and the escrow exemption and its separate proposal to create a new type of qualified mortgage originated and held by small

Continued

this approach is justified by several considerations, including the very similar statutory language, the similar congressional intents underlying the two provisions, and the fact that requiring small creditors operating predominantly in rural or underserved areas to track overlapping but not identical sets of technical criteria for each separate provision could create unwarranted compliance burden that itself would frustrate the intent of the statutes. Although the Bureau has recast and loosened some of the criteria to promote consistency, the Bureau has carefully calibrated the changes to further the purpose of each rulemaking. Further, the Bureau believes that any risk to consumers from the modifications is minimal given the nature of the small creditors' operations and in particular the fact that they are required to hold the affected transactions in portfolio (in this final rule's case, indirectly, by virtue of the requirement that a transaction originated under the escrow exemption not be subject to a forward commitment at consummation). As discussed in more detail below and in the 2013 ATR Concurrent Proposal, which also proposes to adopt several of the criteria to define a new type of qualified mortgage, the creditors at issue have strong motivations to provide vigorous underwriting and high levels of customer service to protect their balance sheets and reputations in their local communities. This motivation is manifest in the fact that they have demonstrably lower credit losses on their mortgage originations than larger institutions.

For the foregoing reasons, the Bureau is adopting § 1026.35(b)(2)(iii) to implement TILA section 129D(c) by providing that a transaction is exempt from the escrow account requirement otherwise applicable to a higher-priced mortgage loan if the creditor: (1) In the preceding calendar year made more than 50 percent of its first-lien covered transactions in counties designated by the Bureau as ''rural'' or ''underserved''; (2) together with all affiliates extended 500 or fewer first-lien covered transactions in the preceding calendar year; and (3) has total assets that are less than $2 billion, adjusted annually for inflation. The final rule also creates greater parallelism with the balloon qualified mortgage provision with regard to the requirement that the affected transactions be held in portfolio by requiring in both rules that the transactions not be subject to a ''forward commitment'' agreement at the time of consummation. These qualifications and the other requirements under the final rule are discussed in more detail below.

portfolio creditors. The Bureau is seeking comment in that proposal on these elements and on whether other adjustments are appropriate to the existing rules to maintain continuity and reduce compliance burden. *See* the 2013 ATR Concurrent Proposal.

35(b)(2)(iii)(A)

''Operates Predominantly in Rural or Underserved Areas''

Under TILA section 129D(c)(1), to qualify for the exemption, a creditor must ''operate predominantly in rural or underserved areas.'' The Board's 2011 Escrows Proposal would have required a creditor to have made during the preceding calendar year more than 50 percent of its first-lien higher-priced mortgage loans in ''rural or underserved'' counties. One industry commenter agreed with the Board's proposal. Numerous commenters to the Board's proposal in this rule and the Board's 2011 ATR Proposal objected to the proposed definition of ''rural or undeserved'' as discussed below, but commenters did not generally dispute the definition of ''predominantly'' as meaning more than 50 percent of originations of its first-lien higher-priced mortgage loans in rural or underserved counties.

The Bureau believes Congress enacted the exemption in TILA section 129D(c)(1) to ensure access to credit in rural and underserved areas where consumers may be able to obtain credit only from community banks or other small creditors serving those areas. The ''operates predominantly in'' requirement serves to limit the exemption to these institutions. To remove this portion of the qualifications of the creditor would be to circumvent Congress's stated requirement that the exemption was intended for creditors operating predominantly in rural or underserved areas. The Bureau believes that ''predominantly'' indicates a portion greater than half, hence the regulatory requirement of more than 50 percent.

Upon further analysis of the differences in the proposals for the escrows exemption and the balloon-payment qualified mortgage provisions, however, the Bureau believes that further harmonization between the two sets of requirements is warranted. The Board's 2011 Escrows Proposal would have required creditors to track first-lien higher-priced mortgage loans by county, while the qualified mortgage proposal would have required creditors to track balloon-payment mortgages. Given that the underlying statutory language regarding ''operates predominantly'' is the same in each instance and that tracking each type of mortgage separately would increase administrative burden, the Bureau believes it is appropriate to base the threshold for both rules on the distribution of all first-lien ''covered transactions'' as defined in § 1026.43(b)(1). As provided in the 2013 ATR Final Rule, a covered transaction is defined in § 1026.43(b)(1) as a consumer credit transaction that is secured by a dwelling, as defined in § 1026.2(a)(19), other than a transaction exempt from coverage under § 1026.43(a). The Bureau believes that counting only first-lien transactions will facilitate compliance, as well as promote consistency in applying to creditors the two exemptions under both rulemakings, since both exemptions relate to first-lien transactions. Balloon-payment mortgages that will meet the qualifications of the balloon-payment qualified mortgage exemption will be first-lien covered transactions, as having subordinate financing along with the balloon-payment mortgage would be rare since it further constrains a consumers' ability to build equity in the property and to refinance the balloon-payment mortgage when it becomes due. Subordinate-lien, higher-priced mortgage loans are not required to establish escrow accounts, as only first-lien higher priced mortgage loans must establish escrow accounts under § 1026.35(b)(1).

Accordingly, § 1026.35(b)(2)(iii)(A) provides that, during the preceding calendar year, a creditor must have made more than 50 percent of its total first-lien covered transactions in counties designated ''rural'' or ''underserved'' as defined by § 1026.35(b)(2)(iv), discussed below. Comment 35(b)(2)(iii)–1.i states that the Bureau publishes annually a list of counties that qualify as rural or underserved.

35(b)(2)(iii)(B)

Total Annual Mortgage Originations

TILA section 129D(c)(3) provides that, to qualify for the exemption, a creditor together with its affiliates must have total annual mortgage originations that do not exceed a limit set by the Bureau. The Board's proposed § 226.45(b)(2)(iii)(B) required that the creditor and its affiliates, during either of the preceding two calendar years, have originated and retained servicing rights to 100 or fewer mortgage obligations secured by a first lien on real property or a dwelling. Although the Dodd-Frank Act requirement to establish escrow accounts applies only to higher-priced mortgage loans that are secured by first liens, the Board reasoned that it was appropriate to base the threshold on all first-lien originations because creditors are free to establish escrow accounts for all of their first-lien mortgages voluntarily to achieve the scale necessary to escrow cost-effectively. The Board estimated that a minimum servicing portfolio size of 500 is necessary to escrow cost-effectively, and assumed that the average life expectancy of a mortgage loan is about five years. Based on this reasoning, the Board believed that creditors would no longer need the benefit of the exemption if they originated and serviced more than 100 first-lien transactions per year. In contrast, the Board did not propose a specific annual originations threshold in connection with the balloon-payment qualified mortgages, but rather sought comment on whether to adopt a threshold based on the number of transactions or dollar volume and what numeric threshold would be appropriate.

In connection with the Board's 2011 Escrows Proposal, trade association and industry commenters generally said that the proposed maximum annual volume of originations would be insufficient to make the escrow accounts cost effective for creditors. No commenters provided information to support their suggestions for alternative thresholds or to refute the Board's analysis that creditors can provide escrow accounts cost-effectively when they annually originate and retain servicing rights to more than 100 mortgage obligations secured by a first lien on real property or a dwelling. Suggestions for higher thresholds ranged from 200 to 1,000 mortgage obligations per year originated and serviced. One consumer advocacy commenter suggested the proposed threshold was too high because it counted only first-lien mortgage transactions, instead of all mortgage obligations, but offered no specific alternative amount. Two industry commenters also suggested that the origination limit should measure only the number of higher-priced mortgage loans originated and serviced by the creditor and its affiliates.

In response to the Board's 2011 ATR Proposal, two trade associations and one group of State bank regulators, argued that other criteria, such as the asset-size limit or portfolio requirement, were sufficient and that neither a volume nor a total annual originations limit would be necessary. One industry trade association suggested combining the proposed alternatives and permitting creditors to elect under which limit they would operate. Other trade group and industry commenters indicated that the total annual originations limit would be preferable because of the varying dollar amount of transactions originated, which would constrain the number of consumers with limited credit options who could obtain balloon-payment mortgages in rural or underserved areas. Four trade group and industry commenters suggested a range for the total annual originations limit of 250 to 1,000 transactions.

The Bureau believes that the requirement of TILA section 129D(c)(2) reflects a recognition that larger creditors have the systems capability and operational scale to establish cost-efficient escrow accounts. Similarly, the Bureau believes the requirement of TILA section 129C(b)(2)(E)(iv)(II) reflects Congress's recognition that larger creditors who operate in rural or underserved areas should be able to make credit available without resorting to balloon-payment mortgages. In light of the strong concerns expressed in both rulemakings about the potential negative impacts on small creditors in rural and underserved areas, the Bureau conducted further analysis to try to determine the most appropriate thresholds, although it was significantly constrained by the fact that data are limited with regard to mortgage originations in rural and underserved areas generally and in particular with regard to originations of balloon-payment mortgages.

The Bureau started with the premise that it would be preferable to use the same annual originations threshold in both rules to reflect the consistent language in both statutory provisions focusing on total annual mortgage loan originations, to facilitate compliance by not requiring institutions to track multiple metrics and to promote consistent application of the two exemptions. This approach requires significant reconciliation between the two proposals, however, because the escrows proposal focused specifically on transactions originated and serviced to gauge creditors' ability to maintain escrow accounts over time, while retention of servicing is not directly relevant to the balloon-payment qualified mortgage. However, to the extent that creditors chose to offer balloon-payment mortgages to manage their interest rate risk without having to undertake the compliance burdens involved in administering adjustable rate mortgages over time, the Bureau believes that both provisions are focused in a broad sense on accommodating creditors whose systems constraints might otherwise cause them to exit the market.

With this in mind, the Bureau ultimately decided to adopt a threshold of 500 or fewer annual originations of first-lien transactions for both rules. The Bureau believes that this threshold will provide greater flexibility and reduce concerns that the specific threshold that had been proposed in the Board's 2011 Escrows Proposal (100 higher-priced mortgage loans originated and serviced annually in either of the preceding two years) would reduce access to credit by excluding creditors that need special accommodations in light of their capacity constraints. At the same time, the increase is not as dramatic as it may first appear because the Bureau's analysis of HMDA data suggests that even small creditors are likely to sell a significant number of their originations in the secondary market. Assuming that most mortgage transactions that are retained in portfolio are also serviced in house, the Bureau estimates that a creditor originating no more than 500 first-lien transactions per year would maintain and service a portfolio of about 670 mortgage obligations over time, assuming an average obligation life expectancy of five years.[33] Thus, the higher threshold will help to ensure that creditors that are subject to the escrow requirement do in fact maintain portfolios of sufficient size to maintain the escrow accounts on a cost efficient basis over time, in the event that the Board's estimate of a minimum portfolio of 500 transactions was too low. However, the Bureau believes that the 500 annual originations threshold in combination with the other requirements will still ensure that the balloon-payment qualified mortgage and escrow exemptions are available only to small creditors that focus primarily on a relationship-lending model and face significant systems constraints.

The Bureau also believes that it is appropriate to focus the annual originations threshold on all first-lien originations. Given that escrow accounts are typically not maintained for transactions secured by subordinate liens, the Bureau does not believe that it makes sense to count such transactions toward the threshold because they would not contribute to a creditor's ability to achieve cost-efficiency. At the same time, the Bureau believes it is appropriate to count all

[33] A review of 2011 HMDA data shows creditors that otherwise meet the criteria of § 1026.43(f)(1)(vi) and originate between 200 and 500 or fewer first-lien covered transactions per year average 134 transactions per year retained in portfolio. Over a five year period, the total portfolio for these creditors would average 670 mortgage obligations.

first-lien transactions toward the threshold because creditors can voluntarily establish escrow accounts for such transactions to increase the cost-effectiveness of their program even though the mandatory account requirements under the Dodd-Frank Act apply only to first-lien, higher-priced mortgage loans. Focusing on all first-lien originations also provides a metric that is useful for gauging the relative scale of creditors' operations for purposes of the balloon-payment qualified mortgages, while focusing solely on the number of higher-priced mortgage loan originations would not. Accordingly, the Bureau adopts § 1026.35(b)(2)(iii)(B) requiring to creditor and its affiliates to have originated 500 or fewer covered transactions secured by a first lien.

35(b)(2)(iii)(C)

Asset-Size Threshold

TILA section 129D(c)(4) provides that, to qualify for the exemption, a creditor must meet any asset-size threshold established by the Bureau. The Board's 2011 Escrows Proposal did not establish an asset-size threshold but did request comment on whether one should be added and, if so, what threshold level would be appropriate. In contrast, the Board proposed a $2 billion threshold for the balloon qualified mortgage exception. This number was based on the limited data available to the Board at the time of the proposal. Based on that limited information, the Board reasoned that none of the entities it identified as operating predominantly in rural or underserved areas had total assets as of the end of 2009 greater than $2 billion, and therefore, the limitation should be set at $2 billion. The Board expressly proposed setting the asset-size threshold at the highest level currently held by any of the institutions that appear to be smaller institutions that served areas with otherwise limited credit options.

In response to the Board's 2011 Escrows Proposal, a group of State bank regulators and a trade association advocated including an asset-size prerequisite in the exemption. The group of State bank regulators suggested that the asset-size prerequisite be the sole requirement to obtain the exemption but did not propose a specific dollar threshold. The industry commenter suggested the asset-size be $1 billion in assets, but did not provide a rationale for the amount.

Based on the Board's 2011 ATR Proposal, one group of State bank regulators suggested that the asset-size threshold be included and be the only requirement for a creditor to qualify for the balloon-mortgage qualified mortgage exemption. Two trade association commenters suggested that a $2 billion asset-size threshold was appropriate, with one also suggesting that the asset-size threshold be the only requirement for a creditor to qualify for the balloon-payment qualified mortgage exemption. One industry commenter suggested that the asset-size threshold be $10 billion.

For reasons discussed above, the Bureau is adopting an annual originations limit as contemplated by the statute. Given that limitation, restricting the asset size of institutions that can claim the exemption is of limited importance. Nonetheless, the Bureau believes that an asset-size limitation is still helpful because very large institutions should have sufficient resources to adapt their systems to make mortgages without a balloon payment and to establish and maintain escrow accounts even if the scale of their mortgage operations is relatively modest. A very large institution with a relatively modest mortgage operation also does not have the same type of reputational and balance-sheet incentives to maintain the same kind of relationship-banking model as a smaller community-based creditor. An asset-size limitation can guard against circumvention of the rule if a larger institution were to elect to enter a rural area to make a limited number of higher-priced mortgage loans or balloon-payment mortgages. Therefore, the Bureau believes that the $2 billion asset limitation proposed by the Board in the Board's 2011 ATR Proposal remains an appropriate limitation and should be adopted in both this final rule and the 2013 ATR Final Rule.[34]

Accordingly, the Bureau adopts § 1026.35(b)(2)(iii)(C) to require creditors to have total assets as of the end of the preceding calendar year that are less than $2 billion and is effectively adopting the same threshold by cross-reference to § 1026.35(b)(2)(iii) for purposes of the balloon-payment qualified mortgage exemption in the 2013 ATR Final Rule. As provided in § 1026.35(b)(2)(iii)(C), this threshold dollar amount will adjust automatically each year based on the year-to-year change in the average of the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI–W), not seasonally adjusted, for each 12-month period ending in November, with rounding to the nearest million dollars. Comment 35(b)(2)(iii)–1.iii recites this initial threshold and further clarifies that a creditor that had total assets below the threshold on December 31 of the preceding year satisfies this criterion for purposes of the exemption during the current calendar year. The comment also notes that the Bureau will publish notice of each year's asset threshold by amending the comment.

35(b)(2)(iii)(D)

Creditor and Affiliates Do Not Maintain Escrows

As adopted by section 1461 of the Dodd-Frank Act, TILA section 129D(c)(4) provides that, to qualify for the exemption, a creditor must meet any other criteria established by the Bureau consistent with the provisions of TILA. The Board's proposed § 226.45(b)(2)(iii)(C) would have required that, to obtain the exemption, the creditor and its affiliates not maintain an escrow account for any mortgage they currently service through at least such mortgage obligation's second installment due date. The Board used the second installment due date as a cutoff point because it recognized that a creditor may sometimes hold a mortgage obligation for a short period after consummation to take steps necessary before transferring and assigning the mortgage debt obligation to the intended investor. The Board recognized that the process of transferring and assigning the mortgage obligation could extend beyond the mortgage obligation's first payment due date, especially when the first payment is due shortly after consummation.

The Board believed this additional condition was necessary to effectuate the purpose of the exemption. The Board reasoned that, if a creditor already establishes and maintains escrow accounts, it has the capacity to escrow and therefore has no need for the exemption. Moreover, the Board concluded that a creditor's capacity to escrow should reflect not only its own activities but those of any affiliate because it assumed that a creditor could rely on its affiliate to help meet the escrow requirement. The Board sought comment, however, on three aspects: first, whether affiliates' capacities to escrow should be considered; second, whether the second payment due date is the appropriate cutoff point for whether a creditor has established an escrow account for purposes of the exemption; and third, whether the proposal should allow some *de minimis* number of

[34] The $2 billion threshold reflects the purposes of the exemption and the structure of the mortgage servicing industry. The Bureau's choice of $2 billion in assets as a threshold for purposes of TILA section 129D(c)(4) does not imply that a threshold of that type or of that magnitude would be an appropriate way to distinguish small firms for other purposes or in other industries.

mortgage obligations for which escrows are maintained and, if so, what that number should be.

Six trade association commenters, five industry commenters and a Federal agency submitted comments noting that many creditors had only begun to establish escrow accounts for mortgage transactions after the Board adopted the 2008 HOEPA Final Rule, which took effect for most transactions in April 2010. Many of the same commenters argued that it would be unfair to deny the exemption in TILA section 129D(c) to those creditors that established escrow accounts only to comply with the current escrow requirements. Two trade association commenters and one industry commenter suggested a *de minimis* number of mortgage obligations ranging from 10 to 50 mortgage obligations to address the exclusion of creditors currently escrowing that would otherwise qualify for the exemption. In addition, one industry commenter suggested that a creditor that establishes escrow accounts for distressed mortgage obligations should still be eligible for the exemption, as these creditors are doing so as an accommodation to the consumer to attempt to avoid foreclosure. No comments were received as to whether the second payment due date is the appropriate cutoff point for whether a creditor has established an escrow account for purposes of the exemption.

The Bureau is adopting the Board's proposal in § 1026.35(b)(2)(iii)(D), with the addition of two exceptions based on comments received. The Bureau agrees with the Board generally that creditors that currently provide escrow accounts can afford to establish and maintain escrow accounts for higher-priced mortgage loans. Thus, to qualify for the exemption, a creditor and its affiliates must not maintain escrow accounts for any extensions of consumer credit secured by real property or a dwelling that the creditor, or its affiliates, currently services through at least the second installment due date. However, the Bureau agrees with commenters that those creditors that would otherwise qualify for the exemption but for their compliance with the current regulation, and creditors that establish escrow accounts as an accommodation to distressed consumers, should still be able to qualify for the exemption in TILA section 129D(c). In particular, the Bureau notes that Congress's decision to codify and expand upon the escrow requirement from the 2008 HOEPA Final Rule while simultaneously providing authority to exempt certain mortgage transactions by creditors operating predominantly in rural or underserved areas suggests that Congress intended to provide relief to creditors that were struggling to meet the existing requirements. Accordingly, the Bureau is adopting § 1026.35(b)(2)(iii)(D)(*1*) and (*2*) to provide exceptions to the exemption's general prerequisite that a creditor and its affiliates not maintain an escrow account.

Comment 35(b)(2)(iii)–1.iv clarifies that the limitation excluding creditors and their affiliates who currently maintain escrow accounts for other mortgage obligations they service applies only to mortgage obligations serviced at the time a transaction purporting to invoke the escrows exemption is consummated. Thus, the exemption still could apply even if the creditor or its affiliates previously established and maintained escrows for mortgage obligations it no longer services. However, if a creditor or an affiliate escrows for mortgage obligations currently serviced, those institutions are ineligible to invoke the escrows exemption until the escrow accounts are no longer maintained. The comment also clarifies that a creditor or its affiliate ''maintains'' an escrow account for a mortgage obligation only if it services the mortgage obligation at least through the due date of the second periodic payment under the terms of the legal obligation.

Comment 35(b)(2)(iii)(D)(*1*)–1 clarifies that escrow accounts created by a creditor and its affiliates established between April 1, 2010, and June 1, 2013 are not counted for purposes of § 1026.35(b)(2)(iii)(D). In addition, the comment clarifies that creditors that continue to maintain escrow accounts that were established between April 1, 2010, and June 1, 2013 until the termination of those escrow accounts will still qualify for the exemption, so long as they or their affiliates do not establish escrow accounts for other mortgage obligations that the creditor and its affiliates service after June 1, 2013 and they otherwise qualify under § 1026.35(b)(2)(iii). Comment 35(b)(2)(iii)(D)(*2*)–1 clarifies that escrow accounts established after consummation for distressed consumers are not considered to be maintaining escrow accounts for purposes of § 1026.35(b)(2)(iii)(D), although creditors that establish escrow accounts after consummation as a regular business practice are considered to be maintaining escrow accounts and cannot qualify for the exception under § 1026.35(b)(2)(iii).

35(b)(2)(iv)

''Rural'' and ''Underserved'' Defined

As adopted in the Dodd-Frank Act, TILA section 129D(c)(1) requires, among other criteria for the escrows exemption, that the creditor operate predominantly in ''rural'' and ''underserved'' areas, but does not define either term. As discussed above, the Board proposed separate definitions for ''rural'' and ''underserved,'' respectively, in both the Board's 2011 Escrows Proposal and the 2011 ATR Proposal, and the definitions for the two terms were similar across the two proposals.

Commenters on the two proposals addressed the specific definitions themselves but not the necessity of creating a definition for ''rural'' that is separate from ''underserved.'' The Bureau is adopting the Board's approach in § 1026.35(b)(2)(iv) which establishes a definition of rural that is separate from underserved. Thus, creditors' activity in either type of area will count toward their eligibility for the escrows exemption and for making balloon-payment qualified mortgages.

''Rural.'' As described above, the Board's proposed definition of rural for purposes of both the balloon-payment qualified mortgage and escrows exemptions would have relied upon the ERS's ''urban influence codes'' (UICs), which in turn are based on the definitions of ''metropolitan statistical area'' and ''micropolitan statistical area.'' [35] The Board's proposal would have limited the definition of rural to certain ''non-core'' counties, which are areas outside of any metropolitan or micropolitan area that are not adjacent to a metropolitan area with at least one million residents or to a micropolitan area with a town of at least 2,500 residents. This definition corresponded to UICs 7, 10, 11, and 12. The counties that would have been covered under the Board's proposed definition contain 2.3 percent of the United States population under the 2000 census. The Board believed this approach limited the definition of ''rural'' to those properties most likely to have only limited sources of mortgage credit because of their remoteness from urban centers and their resources. However, the Board sought comment on all aspects of this approach to defining rural, including whether the definition should be broader or

[35] The ERS places counties into twelve separately defined UICs depending on the size of the largest city or town in the county or in adjacent counties. Descriptions of UICs can be found on the ERS Web site at *http://www.ers.usda.gov/data-products/urban-influence-codes/documentation.aspx.*

narrower or based on information other than UIC codes.

Many commenters to both the 2011 ATR Proposal and the 2011 Escrows Proposal, including more than a dozen trade group commenters, several individual industry commenters, one association of State banking regulators, and a United States Senator, stated that the rural definition was too narrow. The trade association and industry commenters, and the group of State banking regulators, had various proposals to broaden the definition, from the addition of other UICs and a combination of county population and asset size to the adoption of other regulatory definitions of ''rural,'' such as those governing credit unions. The comment from a United States Senator suggested using the eligibility of a property to secure a single-family mortgage under the USDA's Rural Housing Loan program as the definition of a rural property.

The Bureau agrees that a broader definition of ''rural'' is appropriate to ensure access to credit with regard to both the escrows and balloon-payment qualified mortgage exemptions. In particular, the Bureau believes that all ''non-core'' counties should be encompassed in the definition of rural, including counties adjacent to a metropolitan area of at least one million residents or a county with a town of at least 2,500 residents (*i.e.,* counties with a UIC of 4, 6, or 9 in addition to the counties with the UICs included in the Board's definition). The Bureau also believes that micropolitan areas that are not adjacent to a metropolitan area should be included within the definition of rural (*i.e.,* counties with a UIC of 8), as these areas are not located adjacent to metropolitan areas that are served by many creditors. These counties have significantly fewer creditors originating higher-priced mortgage loans and balloon-payment mortgages than other counties.[36] Including these counties within the definition of rural would result in 9.7 percent of the U.S. population being located within rural areas. Under this definition, only counties in metropolitan areas or in micropolitan areas adjacent to metropolitan areas would be excluded from the definition of rural.

The Bureau also considered adopting the definition of rural used to determine the eligibility of a property to secure a single-family mortgage under the USDA's Rural Housing Loan program. This definition subdivides counties into rural and non-rural areas based upon whether certain areas are open country, or contain a town, village, city or place, with certain population criteria, and excludes areas associated with an urban area. Given the size of some counties, particularly in western States, this approach may provide a more nuanced measure of access to credit in some areas than a county-by-county metric. However, use of the Rural Housing Loan metrics would incorporate such significant portions of metropolitan and micropolitan counties that 37 percent of the United States population would be within areas defined as rural. Based on a review of HMDA data and the location of mortgage transactions originated by HMDA reporting entities, the average number of creditors in the areas that would meet the USDA's Rural Housing Loan program definition of rural is ten. The Bureau believes that a wholesale adoption of the Rural Housing Loan definitions would therefore expand the definition of rural beyond the intent of the escrow and balloon-payment qualified mortgage exemptions under sections 1412 and 1461 of the Dodd-Frank Act by incorporating areas in which there is robust access to credit.

Accordingly, the final rule implements § 1026.35(b)(2)(iv)(A) to provide that a county is rural if it is neither in a metropolitan statistical area, nor in a micropolitan statistical area that is adjacent to a metropolitan statistical area. The Bureau intends to continue studying over time the possible selective use of the Rural Housing Loan program definitions and tools provided on the USDA Web site to determine whether a particular property is located within a ''rural'' area. For purposes of initial implementation, however, the Bureau believes that defining ''rural'' to include more UIC categories creates an appropriate balance to preserve access to credit and create a system that is easy for creditors to implement.

''Underserved.'' The Board's proposed § 226.45(b)(2)(iv)(B) would have defined a county as ''underserved'' during a calendar year if no more than two creditors extend credit secured by a first lien on real property or a dwelling five or more times in that county. The definition was based on the Board's judgment that, where no more than two creditors are significantly active, the inability of one creditor to offer a higher-priced mortgage loan would be detrimental to consumers who would have limited credit options because only one creditor, or no creditors, would be left to provide the higher-priced mortgage loan. Essentially, a consumer who could only qualify for a higher-priced mortgage loan would be required to obtain credit from the remaining creditor in that area or would be left with no credit options at all. Most of the same commenters that stated that the proposed definition of rural was too narrow, as discussed above, also stated that this definition of underserved was too narrow. The commenters proposed various different standards, including standards that considered the extent to which the property was in a rural area, as an alternate definition of underserved.

The Bureau agrees with the Board that the purpose of the exemption is to permit creditors to continue to offer credit to consumers, rather than to refuse to make higher-priced mortgage loans if such creditors' withdrawal would significantly limit consumers' ability to obtain mortgage credit. In light of this rationale, the Bureau believes that ''underserved'' should be implemented in a way that protects consumers from losing meaningful access to mortgage credit and that it is appropriate to focus the definition on identifying areas where the withdrawal of a creditor from the market could leave no meaningful competition for consumers' mortgage business. The Bureau notes that the final rule's expanded definition of ''rural,'' as discussed above, will also address concerns about access to credit in many areas. Accordingly, the Bureau is adopting § 1026.35(b)(2)(iv)(B) to define a property as ''underserved'' if it is located in a county where no more than two creditors extend covered transactions secured by a first lien five or more times in that county during a calendar year, substantially consistent with the Board's proposal. As adopted, § 1026.35(b)(2)(iv)(B) also expressly states that the numbers of creditors and of their originations in counties for purposes of this definition is as reported in HMDA data for the year in question.

[36] A review of data from HMDA reporters indicates that there were 700 creditors in 2011 that otherwise meet the requirements of new § 1026.35(b)(2)(iii), of which 391 originate higher-priced mortgage loans in counties that meet the definition of rural, compared to 2,110 creditors that otherwise meet the requirements of § 1026.35(b)(2)(iii) that originate balloon-payment mortgages in counties that would not be rural. The 391 creditors originated 12,921 higher-priced mortgage loans, representing 30 percent of their 43,359 total mortgage loan originations. A review of data from credit unions indicates that there were 830 creditors in 2011 that otherwise meet the requirements of § 1026.35(b)(2)(iii), of which 415 originate balloon-payment and hybrid mortgages in counties that meet the definition of rural, compared to 3,551 creditors that otherwise meet the requirements of § 1026.35(b)(2)(iii) that originate balloon-payment mortgages in counties that would not be rural. The 415 creditors originated 4,980 balloon-payment mortgage originations, representing 20 percent of their 24,968 total mortgage loan originations.

The Bureau adopted this definition based on HMDA data to provide an objective, easily administered rule and one that is consistent with the purpose of preserving credit access in underserved areas. Given that many smaller creditors may not be subject to HMDA reporting requirements, the Bureau recognizes that many counties may be underserved under the definition being adopted, because it is based on HMDA data, yet additional information (if it were available) could reveal that more than two creditors are significantly active in such counties. The Bureau may examine further whether a refinement to the underserved definition is warranted.

Commentary guidance on ''rural'' and ''underserved'' definitions. Comment 35(b)(2)(iv)–1 clarifies that the Bureau will annually update on its Web site a list of counties deemed rural or underserved under the definitions of rural and underserved in § 1026.35(b)(2)(iv). It also clarifies that the definition of rural corresponds to UICs 4, 6, 7, 8, 9, 10, 11, and 12, as determined by the Economic Research Service of the USDA. It further clarifies that the definition of underserved counties is based on HMDA data. Finally, the comment provides that the Bureau also publishes a list of only those counties that are rural but not also underserved, to facilitate compliance with § 1026.35(c).[37] As this final rule takes effect on June 1, 2013, the Bureau expects to publish lists applicable for the current year within approximately four to six weeks after publication of this final rule, but in any event before this final rule takes effect.

35(b)(2)(v)

As established by the Dodd-Frank Act, TILA section 129D(c)(3) requires that the exemption from the escrow requirements apply only where a creditor ''retains its mortgage loan originations in portfolio'' and meets the other statutory requirements. Because the escrow requirements must be applied at the time that a transaction is consummated, while qualified mortgage status may continue for the life of the mortgage obligation, the Board did not propose to implement this requirement consistently with the 2011 ATR Proposal. The Board's proposed § 226.45(b)(2)(v) would have provided that the escrow exemption is not available for certain transactions that, at consummation, are subject to ''forward commitments.'' Forward commitments are agreements entered into at or before consummation of a transaction under which a purchaser is committed to acquire the mortgage obligation from the creditor after consummation. In addition, the Board included a proposed comment to § 226.45(b)(2)(v) which would have clarified that the forward commitment provision would have applied whether the forward commitment refers to the specific transaction or the higher-priced mortgage loan meets prescribed criteria of the forward commitment in order to address a potential method to avoid compliance. The Board's 2011 ATR Proposal, in contrast, proposed two alternatives for comment, either prohibiting a creditor to qualify if it has sold any balloon-payment qualified mortgages at any time or prohibiting a creditor to qualify if it has sold any balloon-payment qualified mortgages in the current or prior calendar year.

The Board considered requiring that a transaction be held in portfolio after consummation as a condition of the escrows exemption, but concluded that this approach would have raised operational problems. Whether a mortgage obligation is held in portfolio can be determined only after consummation, but a creditor making a higher-priced mortgage loan must know by consummation whether it is subject to the escrow requirement. The Board expressed concern that requiring an escrow account to be established sometime after consummation if the creditor in fact sells the mortgage obligation could put a significant burden on consumers, who may not have the money available to make a significant advance payment. In contrast, the Board reasoned that the forward commitment test would be easy to apply at consummation, and would be unlikely to be circumvented by small creditors because they would be reluctant to extend credit for transactions they do not intend to keep in portfolio unless they have the assurance of a committed buyer before extending the credit. Thus, proposed § 226.45(b)(2)(v) would have served as a means of indirectly limiting the exemption to mortgage obligations that are to be held in portfolio. The Board sought comment, however, on whether institutions could easily evade the escrow requirement by making higher-priced mortgage loans without a forward commitment in place and thereafter selling them to non-exempt purchasers and how to address this possibility without relying on post-consummation events.

Among the commenters, there was a divergence of opinion on how this provision would work in practice. One trade association commenter stated that the forward commitment requirement would prevent creditors from selling portfolio mortgage obligations in the future. This appears to be a misreading of the Board's proposal, as it would not have restricted the sale of higher-priced mortgage loans. The Board's proposed § 226.45(b)(2)(v) instead merely provided that, so long as the higher-priced mortgage loan was not subject to a forward commitment at the time of consummation, the higher-priced mortgage loan could later be sold on the secondary market without requiring an escrow account to be established at that time. One consumer advocacy group, concerned about the possibility that creditors would use the provision to skirt the escrow requirements, suggested a blanket rule that higher-priced mortgage loans that are exempt must be maintained in the portfolio of the creditor or, alternatively, that upon sale secondary market purchasers be required to establish escrow accounts for such mortgage obligations.

After reviewing the comments received, the Bureau believes that the Board's proposal is an appropriate method to implement the requirements of TILA section 129D(c)(3), as both creditor and consumer benefit if an escrow account is established at consummation of the transaction, rather than months or years later. Indeed, allowing a consumer to avoid having to make a single large lump-sum payment after consummation is part of the basic purpose of establishing an escrow account. Accordingly, the Bureau is following the approach in the Board's proposal by adopting § 1026.35(b)(2)(v) to require that for a higher-priced mortgage loan to be exempt from the requirements under § 1026.35(b)(1), the higher-priced mortgage loan must not be subject to a forward commitment to be acquired by a creditor that does not satisfy the conditions of § 1026.35(b)(2)(iii). Comment 35(b)(2)(v)–1 clarifies that a higher-priced mortgage loan that is subject to a forward commitment is subject to the escrow requirement under § 1026.35(b)(1), whether the forward commitment refers to the specific transaction or the higher-priced

[37] Section 1026.35(c) is being adopted separately by the Bureau jointly with other Federal agencies, to implement the new appraisal requirements in TILA section 129H, in the 2013 Interagency Appraisals Final Rule, as discussed in part III.C, above. That new section provides an exemption for creditors operating in rural, but not underserved, areas. Consequently, the single, combined list of all counties that are either rural or underserved that the Bureau will publish annually for purposes of the exemption from this final rule's escrow requirement is inadequate for the analogous purpose under the new appraisal requirements in § 1026.35(c).

mortgage loan meets prescribed criteria of the forward commitment, along with an example. As discussed separately in the Bureau's 2013 ATR Final Rule, the Bureau is also adopting language in § 1026.43(f) to provide that qualified mortgage status is not available to balloon-payment mortgages that would otherwise qualify for the exemption if the transactions are subject to a forward commitment at the time of consummation.

35(b)(3) Cancellation

Under TILA section 129D(d), a creditor or servicer of a higher-priced mortgage loan must maintain an escrow account for a minimum of five years following consummation, unless the underlying debt obligation is terminated earlier under certain prescribed circumstances. In addition, even after five years have elapsed, TILA section 129D(d) provides that an escrow account shall remain in existence unless and until the consumer is current on the obligation and has accrued sufficient equity in the dwelling securing the consumer credit transaction ''so as to no longer be required to maintain private mortgage insurance.''

The Board's proposed § 226.45(b)(3) would have implemented TILA section 129D(d) by permitting cancellation of the escrow account only upon the earlier of termination of the legal obligation or five years after consummation, provided that at least 20 percent of the original value of the property securing the underlying debt obligation is unencumbered and the consumer currently is not delinquent or in default on the underlying debt obligation. The Board modeled its proposal after the prerequisites for cancellation of private mortgage insurance coverage under the Homeowners Protection Act of 1998 (HPA), 12 U.S.C. 4901–4910. Under the HPA, the consumer may initiate cancellation of private mortgage insurance (PMI) once the outstanding balance of the mortgage obligation is first scheduled to reach 80 percent of the original value of the property, regardless of the outstanding balance, based on the amortization schedule or actual payments. In addition, servicers must automatically terminate PMI for residential mortgage transactions on the earliest date that the principal balance of the mortgage is first scheduled to reach 78 percent of the original value of the secured property securing the mortgage obligation, where the consumer is current. The Board sought comment on this proposal, as well as whether TILA section 129D(d)(1) should be interpreted narrowly to mean that, among consumers with escrow accounts required pursuant to proposed § 226.45(b)(1), only those that in fact have private mortgage insurance must meet the minimum equity requirement under the HPA as a prerequisite for cancelling their escrow accounts.

Commenters generally agreed with the Board's approach of requiring the 80 percent loan-to-value (LTV) ratio for consumer-requested PMI termination, rather than the 78 percent LTV ratio for automatic PMI termination. Several commenters remarked, however, that the proposed language defining the equity cancellation requirement as ''at least 20% of the original value of the property securing the underlying debt obligation is unencumbered'' was confusing, if not misleading.

The final rule follows the general approach in the Board's proposal by adopting § 1026.35(b)(3) to establish the cancellation criteria for escrow accounts as provided by TILA section 129D(d). In response to comments, § 1026.35(b)(3) contains revised language describing the equity necessary for cancellation as an unpaid principal balance that is less than 80 percent of the original value of the property securing the underlying debt obligation. Additionally, the Bureau is adopting the Board's proposed comment 45(b)(3)–1 as comment 35(b)(3)–1 to clarify that termination of the underlying credit obligation could include, among other things, repayment, refinancing, rescission, and foreclosure. Comment 35(b)(3)–2 clarifies that § 1026.35(b)(3) does not affect the right or obligation of a creditor or servicer, pursuant to the terms of the legal obligation or applicable law, to offer or require an escrow account after the minimum period dictated by § 1026.35(b)(3). Finally, comment 35(b)(3)–3 notes that the term ''original value'' in § 1026.35(b)(3)(ii)(A), as adopted from section 2(12) of the HPA, 12 U.S.C. 4901(12), means the lesser of the sales price reflected in the sales contract for the property, if any, or the appraised value of the property at the time the transaction was consummated.

35(c)

The Board proposed to reserve § 226.45(c) for future use in implementing section 1471 of the Dodd-Frank Act, which creates new TILA section 129H to establish certain appraisal requirements applicable to ''higher-risk mortgages.'' Consistent with that proposal, the Bureau is reserving § 1026.35(c) in this final rule, thus permitting that section to be finalized separately in the 2013 Interagency Appraisals Final Rule, discussed above. As discussed in part III.C, the 2013 Interagency Appraisals Final Rule will take effect subsequent to this final rule.

35(d) Evasion; Open-End Credit

The Board's proposed § 226.45(d) would have paralleled existing § 1026.35(b)(4) in prohibiting a creditor from structuring a home-secured transaction as an open-end plan to evade the requirements of proposed § 226.45 in connection with credit secured by a consumer's principal dwelling that does not meet the definition of open-end credit in § 226.2(a)(20). No comments were received regarding the scope or substance of this proposal. The Bureau has adopted the Board's proposal in § 1026.35(d), with certain technical edits.

VI. Effective Date

As indicated above, this final rule is effective June 1, 2013. Thus, compliance with this final rule will be mandatory over eight months earlier than the January 21, 2014 baseline mandatory compliance date that the Bureau is adopting for most of the Title XIV Rulemakings, as discussed above in part III.C. As that discussion notes, the Bureau is carefully coordinating the implementation of the Title XIV Rulemakings, including their effective dates. The Bureau is including this final rule, however, among a subset of the new requirements of the Title XIV Rulemakings that will have earlier effective dates because they do not present significant implementation burdens for industry. For the following reasons, the Bureau believes that this final rule presents little or no compliance burden for creditors and therefore that an accelerated implementation period is appropriate.

Although the Board's 2011 Escrows Proposal did not expressly solicit comment on an appropriate implementation period, four industry trade associations commented on this question. Of the four, one represents financial services companies, and three represent credit unions. All four expressed concern that sufficient time be afforded industry to implement the new requirements when finalized, either as a general matter or specifically because of system changes that would be required. The trade association representing financial services companies merely stated that sufficient time to implement the final rule would be necessary without stating any specific period. Of the other three trade associations, one recommended an implementation period of one year and two recommend 6 to 12 months. The

Bureau notes, however, that these commenters' concerns regarding the implementation period, particularly those relating to necessary system changes, were largely centered around two aspects of the Board's proposal: (1) The proposed new disclosures, and (2) the new ''transaction coverage rate'' proposed to be used instead of the annual percentage rate for determining whether a transaction is a higher-priced mortgage loan subject to the escrow requirements. As discussed above in the applicable section-by-section analyses, the Bureau is not adopting either of those aspects of the Board's proposal in this final rule.

The final rule does not expand either the universe of transactions to which the escrow requirements apply or the universe of creditors subject to them. Indeed, the new exemption adopted by this final rule for higher-priced mortgage loans extended by small creditors that operate in rural or underserved areas represents a reduction in compliance burden for creditors that meet the exemption's prerequisites. Moreover, the expansion of the partial exemption for condominiums to other property types where the governing association has an obligation to maintain a master policy insuring all dwellings, such as planned unit developments, also represents additional compliance burden relief for creditors.

The only expansion of substantive requirements under this final rule is the extension from one to five years of the minimum duration generally applicable to escrow accounts required by the rule. The Bureau believes that even this expansion of the protection afforded consumers by escrow accounts will impose at most a modest increase in compliance burden for creditors because it simply extends an otherwise already applicable requirement by four additional years. Even this minimal additional burden will not be encountered by any creditor until at least one year after the rule's effective date, when cancellation of mandatory escrow accounts otherwise first would have become permissible for the earliest higher-priced mortgage loans to be made after this final rule takes effect.

The Bureau believes that both the burden relief for certain small creditors and the expanded protection for consumers of maintaining escrows for four additional years warrant expedited implementation to avoid any unnecessary delay of either. Such expedited implementation especially is warranted given that, in particular where the Bureau is not adopting the two aspects of the Board's proposal that commenters identified as requiring significant time to implement, little or no new compliance burden accompanies such implementation. For these reasons, the Bureau is limiting the implementation period for this final rule by making it effective on June 1, 2013.

VII. Dodd-Frank Act Section 1022(b)(2)

A. Overview

In developing the final rule, the Bureau has considered potential benefits, costs, and impacts,[38] and has consulted or offered to consult with the prudential regulators, the U.S. Department of Housing and Urban Development, and the Federal Trade Commission (FTC), including with respect to consistency with any prudential, market, or systemic objectives that may be administered by such agencies. The Bureau is issuing this final rule to finalize the Board's 2011 Escrows Proposal, which the Board issued prior to the transfer of rulemaking authority to the Bureau. As the Board was not subject to Dodd-Frank Act section 1022(b)(2)(B), the Board's 2011 Escrows Proposal did not contain a proposed Dodd-Frank Act section 1022 analysis. The Board did generally request comment on projected implementation and compliance costs, although commenters provided little information in response. As discussed above, the Bureau's final rule implements certain amendments to the Truth in Lending Act made by the Dodd-Frank Act. Specifically, the final rule lengthens the time for which a mandatory escrow account established for a higher-priced mortgage loan must be maintained from a minimum period of one year to five years. In addition, the final rule creates an exemption from the escrow requirement for certain transactions extended by a creditor that meets four conditions. Those conditions are that the creditor: (1) Makes most of its first-lien covered transactions in rural or underserved counties; (2) during the preceding calendar year, together with its affiliates, originated 500 or fewer first-lien covered transactions; (3) has an asset size less than $2 billion; and (4) together with its affiliates, generally does not escrow for any mortgage obligation that it or its affiliates currently services, except in limited circumstances. For eligible creditors, the final rule provides the exemption from the escrow requirements for transactions held in portfolio, but not for transactions that, at consummation, are subject to a forward commitment to be purchased by an investor that does not itself qualify for the exemption.

The analysis below considers the benefits, costs, and impacts of key provisions of the final rule. With respect to these provisions, the analysis considers costs and benefits to consumers and costs and benefits to covered persons. The analysis also considers certain alternative provisions that were considered by the Bureau in the development of the final rule.

Because the Bureau's final rule implements certain self-effectuating amendments to TILA, the costs and benefits of the final rule will arise largely from the statute and not from the final rule that implements them. The Bureau's final rule would provide benefits compared to allowing these TILA amendments to take effect alone, however, by clarifying parts of the statute that call for interpretation and using the Bureau's exemption authority to exempt certain creditors who would otherwise be required to implement the escrow provisions. Greater clarity on these amendments, as provided by the final rule, should reduce the compliance burdens on covered persons by, for example, reducing costs for attorneys and compliance officers as well as potential costs of over-compliance and unnecessary litigation.[39] Exempting certain financial institutions from the escrow requirement should reduce compliance costs and regulatory burdens for such institutions as well as provide greater access to credit for consumers in rural and underserved areas. The Bureau notes that any costs that these provisions impose beyond the statute itself are likely to be minimal.

Section 1022 of the Dodd-Frank Act permits the Bureau to consider the benefits, costs and impacts of the final rule solely compared the effects of the statute taking effect without an implementing regulation. To provide the public better information about the benefits and costs of the statute, however, the Bureau has chosen to consider the benefits, costs, and impacts of these major provisions of the

[38] Section 1022(b)(2) of the Dodd-Frank Act calls for the Bureau to consider the potential benefits and costs of a regulation to consumers and covered persons, including the potential reduction of access by consumers to consumer financial products and services; the impact on depository institutions and credit unions with $10 billion or less in total assets as described in section 1026 of the Dodd-Frank Act; and the impact on consumers in rural areas.

[39] The Bureau notes that it is focused here on the fact that regulatory provisions that clarify statutory provisions mitigate certain compliance costs associated with uncertainty over what the statutory provisions require. While it is possible that some clarifications would put greater burdens on creditors as compared to what the statute would ultimately be found to mandate, the Bureau believes that the rule's clarifying provisions generally mitigate burden.

proposed rule against a pre-statutory baseline (*i.e.,* the benefits, costs, and impacts of the statute and the regulation combined). The Bureau notes at the outset that there are only limited data that are publicly available and representative of the full universe of mortgage credit, including in particular with respect to rural and underserved communities. Additionally, there are limited data regarding the use of escrow accounts subsequent to the Board's 2008 HOEPA Final Rule.

B. Potential Benefits and Costs to Consumers and Covered Persons

Congress enacted sections 1461 and 1462 of the Dodd-Frank Act as amendments to TILA. As amended, TILA requires the establishment of escrow accounts for certain transactions, establishes minimum periods for which such required escrow accounts must be maintained, and requires certain disclosures relating to escrow accounts. The Bureau's final rule implements certain of these requirements. In addition, the amendments authorize the Board, and now the Bureau, to create certain exemptions from the escrow requirements for transactions originated by creditors meeting certain prescribed criteria. These amendments are being adopted in furtherance of the Bureau's charge to prescribe regulations to carry out the purposes of TILA, including promoting consumers' awareness of the cost of credit and their informed use thereof.

The Bureau has relied on a variety of data sources to analyze the potential benefits, costs, and impacts of the final rule. However, in some instances, the requisite data are not available or are quite limited. Data with which to quantify the benefits of the final rule are particularly limited. As a result, portions of this analysis rely in part on general economic principles to provide a qualitative discussion of the benefits, costs, and impacts of the final rule. The primary source of data used in this analysis is HMDA.[40] Because the latest data available are for originations made in calendar year 2011, the empirical analysis generally uses the 2011 market as the baseline. Data from the fourth quarter 2011 bank and thrift Call Reports,[41] the fourth quarter 2011 credit union call reports from the National Credit Union Administration (NCUA), and de-identified data from the National Mortgage Licensing System (NMLS) Mortgage Call Reports (MCR)[42] for the fourth quarter of 2011 were also used to identify financial institutions and their characteristics. The unit of observation in this analysis is the entity: If there are multiple subsidiaries of a parent company, then their originations are summed, and revenues are total revenues for all subsidiaries.

The estimates in this analysis are based upon data and statistical analyses performed by the Bureau. To estimate counts and properties of mortgages for entities that do not report under HMDA, the Bureau has matched HMDA data to Call Report data and MCR data and has statistically projected estimated transaction counts for those depository institutions that do not report these data either under HMDA or on the NCUA call report. The Bureau has projected originations of higher-priced mortgage loans for depositories that do not report HMDA in a similar fashion. These projections use Poisson regressions that estimate transaction volumes as a function of an institution's total assets, employment, mortgage holdings and geographic presence.

The discussion below describes four categories of benefits and costs. First, the Bureau reviews the benefits and costs to consumers whose creditors are subject to the escrow requirement. Second, the Bureau reviews the potential benefits and costs to those consumers whose creditors are exempt from the escrow requirements. Third, the Bureau analyzes the benefits and costs to creditors subject to the Bureau's escrow requirements. Fourth, the Bureau outlines the benefits and costs to creditors exempt from the Bureau's escrow requirements.

1. Potential Costs and Benefits to Consumers of Non-Exempt Creditors

For consumers whose mortgage transactions are originated by non-exempt creditors, the main effect of this final rule is that the creditor generally must provide an escrow account for four additional years, *i.e.,* for five years instead of for one year. The Bureau estimates that these creditors originated 217,260 first-lien higher-priced mortgage loans in 2011. The Bureau believes that the benefits for consumers of having mandatory escrow accounts established include: (1) The convenience of paying one bill instead of several; (2) a budgeting device to enable consumers not to incur a major expense later; and (3) a lower probability of default and possible foreclosure. Mandatory escrow accounts already must be established for higher-priced mortgage loans pursuant to existing Regulation Z requirements adopted in the Board's 2008 HOEPA Final Rule, but to the extent such accounts are beneficial to consumers the extension of the accounts' minimum durations enhances and extends those benefits.

Consumers may find it more convenient to pay one mortgage bill instead of paying a mortgage bill, an insurance bill, and potentially several tax bills. Consumers then can address any questions or concerns about payment to a single company, the mortgage servicer, thus reducing transaction costs, and having a single bill to pay reduces the likelihood that the consumer forget to pay either the insurance or the tax bill. The servicer effectively assumes the burden of tracking whom to pay, how much, and when, across multiple payees. These benefits, and all the benefits and costs listed below unless specified otherwise, last for as long as the escrow account exists. Thus, the final rule simply extends the duration of these benefits and costs from one year to five. The

[40] The Home Mortgage Disclosure Act (HMDA), enacted by Congress in 1975, as implemented by the Bureau's Regulation C requires lending institutions annually to report public loan-level data regarding mortgage originations. For more information, see *http://www.ffiec.gov/hmda.* It should be noted that not all mortgage creditors report HMDA data. The HMDA data capture roughly 90–95 percent of lending by the Federal Housing Administration and 75–85 percent of other first-lien home loan originations, in both cases including first liens on manufactured homes (transactions which also are subject to the final rule). U.S. Department of Housing and Urban Development, Office of Policy Development and Research (2011), *A Look at the FHA's Evolving Market Shares by Race and Ethnicity,* U.S. Housing Market Conditions (May), pp. 6–12, Depository institutions (including credit unions) with assets less than $40 million (in 2011), for example, and those with branches exclusively in non-metropolitan areas and those that make no home purchase originations or originations refinancing a home purchase obligations secured by a first lien on a dwelling are not required to report under HMDA. Reporting requirements for non-depository institutions depend on several factors, including whether the company made fewer than 100 home purchase loans or refinancings of home purchase loans, the dollar volume of mortgage lending as share of total lending, and whether the institution had at least five applications, originations, or purchased loans from metropolitan areas. Robert B. Avery, Neil Bhutta, Kenneth P. Brevoort & Glenn B. Canner, *The Mortgage Market in 2011: Highlights from the Data Reported under the Home Mortgage Disclosure Act,* 98 Fed. Res. Bull., December 2012, n.6.

[41] Every national bank, State member bank, and insured nonmember bank is required by its primary Federal regulator to file consolidated Reports of Condition and Income, also known as Call Reports, for each quarter as of the close of business on the last day of each calendar quarter (the report date). The specific reporting requirements depend upon the size of the bank and whether it has any foreign offices. For more information, see *http://www2.fdic.gov/call_tfr_rpts/.*

[42] The Nationwide Mortgage Licensing System is a national registry of non-depository financial institutions including mortgage loan originators. Portions of the registration information are public. The Mortgage Call Report data are reported at the institution level and include information on the number and dollar amount of loans originated, and the number and dollar amount of loans brokered.

value of this benefit will vary across consumers, and there is no current research to estimate it. An approximation may be found, however, in a recent estimate of around $20 per month per consumer, depending on the household's income, coming from the value of paying the same bill for phone, cable television, and Internet services (the ''Bundle Study'').[43]

Additionally, extending the duration of the mandatory escrow period ensures that the consumer does not face a sizable, unanticipated fee later, for the four additional years of escrow account provision. Recent research suggests that many consumers value the over-withholding of personal income taxes through periodic payroll deductions and receiving a check from the IRS in the spring despite foregoing the interest on the overpaid taxes throughout the previous year.[44] A mortgage escrow account works in a similar fashion; consumers pay the same fixed amount, sometimes interest-free, throughout the year in return for not having to pay a large lump-sum payment in the end. Consequently, consumers with an escrow account are much less likely to experience potentially unexpected cost shocks associated with paying a large property tax and/or home insurance bills, that could lead other consumers to default on their mortgage. Based on recent research on the value of receiving a refund check from the IRS in the spring,[45] the Bureau estimates that the average value of the benefit of over-withholding resulting from the extension of the escrow period for low- to moderate-income households is 2.65 percent of the yearly amount paid for property taxes and insurance. The analogy is not exact because a tax refund can be used for other purposes whereas an escrow account is calibrated to meet only the consumer's insurance and property tax obligations. However, the Bureau believes consumers may experience similar benefit from this forced-savings method because they are likely to use any forced savings from the tax refund for the most pressing needs first, and not paying property taxes on one's dwelling can result in foreclosure. The Bureau recognizes that any benefit may not be the same for all consumers and that some consumers may prefer to manage their own payments.

Finally, the final rule may lead to a lower probability of default (on average) resulting from the budgeting benefits of escrow accounts. However, based on recent research,[46] this benefit may be most valuable in the first year after originating the mortgage and thus is already provided by the existing escrow requirement. The Bureau nevertheless believes that, although difficult to quantify, some further benefit of default and foreclosure avoidance extending into the second through fifth years exists for at least some consumers.

At least for some consumers, the lengthening of the minimum period under which an escrow must be maintained may have certain costs. The Bureau believes these costs may include (1) foregone interest; (2) increased prices resulting from creditors passing-through their costs; and (3) potentially less access to credit.

Under some State regulations, creditors are not required to pay interest on consumers' funds held in escrow accounts. Therefore, consumers may be foregoing interest on such amounts. While, on average, consumers value the budgeting device described above, it is likely that at least some consumers would rather invest their funds and make their tax and insurance payments on their own. The Bureau, however, believes that any returns on amounts that would have been foregone under the escrow requirements are likely to be modest.

The Bureau additionally notes that the servicing costs of maintaining an escrow account may be passed on to consumers, resulting in a greater overall cost to consumers of effecting the proper and timely payment of their tax and insurance obligations. The magnitude of this pass-through should be small, however, because the marginal increase in overall servicing costs resulting specifically from the escrow requirement is likely to be minor compared to those overall servicing costs. Some creditors might mistakenly allocate the fixed costs of escrow provisions (software changes, personnel training, and so on), to each consumer getting an escrow account, even though these costs should not affect the creditor's profit-maximizing price. This results in a less-profitable pricing scheme, hurting both the creditor and the consumers.[47]

Finally, it is possible that some creditors might consider the additional four years for which escrow accounts must be maintained a sufficiently high burden to exit the market for higher-priced mortgage loans altogether. However, given that these creditors already provide escrows for the first year of a higher-priced mortgage loan, the Bureau believes it is unlikely that a significant number of creditors will exit the market for this reason and that, even if a creditor exits the market, consumers generally should be able to find other creditors. The Bureau believes that, overall, the final rule will not materially reduce consumers' access to consumer financial products or services.

2. Potential Costs and Benefits to Consumers of Exempt Creditors

For consumers who get a higher-priced mortgage loan from an exempt creditor, the final rule will result in no escrow account being required, as opposed to the creditor being required to escrow for a year. The Bureau estimates that these creditors originated 50,468 first-lien higher-priced mortgage loans in 2011. The Bureau acknowledges that it is likely some of these transactions were not eligible for the exemption, because they were subject to a forward commitment to be sold. To further its analysis, however, the Bureau conservatively assumes that none of the transactions were subject to a forward commitment.[48]

The Bureau believes these consumers may benefit from less restricted access to credit; lower prices resulting from creditors not passing through the cost of escrowing to the consumers; and the ability to invest their money and earn a return. As noted earlier, a small mortgage originator operating predominantly in rural or underserved areas may be better able to compete with incumbent originators who escrow because it will not have to incur the

[43] H. Liu, P. Chintagunta, & T. Zhu, *Complementarities and the Demand for Home Broadband Internet Services,* Marketing Science, 29(4), 701–720 (2010).

[44] Michael A. Barr & Jane B. Dokko, *Paying to Save: Tax Withholding and Asset Allocation Among Low- and Moderate-Income Taxpayers,* Finance and Economics Discussion Series, Federal Reserve Board (2008), *available at: http://www.federalreserve.gov/pubs/feds/2008/200811/200811pap.pdf.*

[45] *Id.*

[46] Nathan B. Anderson and Jane B. Dokko, *Liquidity Problems and Early Payment Default Among Subprime Mortgages,* Finance and Economics Discussion Series, Federal Reserve Board (2011), available at: *http://www.federalreserve.gov/pubs/feds/2011/201109/201109pap.pdf.*

[47] Nabil Al-Najjar, Sandeep Baliga, & David Besanko. *Market forces meet behavioral biases: cost misallocation and irrational pricing,* RAND Journal of Economics, 39(1), 214–237 (2008), available at: *http://www.kellogg.northwestern.edu/faculty/baliga/htm/sunkcost.pdf.*

[48] While small creditors operating predominantly in rural or underserved areas originate some higher-priced mortgage loans subject to a forward commitment, based on HMDA 2011 the Bureau believes that the magnitude of these transactions is small, relative to the overall higher-priced mortgage loan market. Moreover, if the transaction is subject to a forward commitment, then the creditor is likely to pass-through the escrow cost to the (eventual) buyer, and thus the creditor's cost is not going to be affected significantly. On the other hand, for consumer benefits this is an unambiguously conservative assumption, see below.

costs of establishing and maintaining an escrow account. This may provide an extra incentive for small originators to enter the market, creating greater access to credit for consumers living in rural and underserved areas. The Bureau does not have the data to be able to estimate the magnitude of this effect.

Additionally, the price for such consumers may be reduced as mortgage providers would not pass the costs of providing escrows to consumers. The magnitude of this pass-through should be small, because firms should optimally pass through only the increase in marginal costs that tend to be small for escrow provision, as opposed to the fixed (overhead) costs. However, some creditors might mistakenly spread the overhead costs of escrow provision over all consumers, resulting in higher prices to such consumers, lower mortgage transaction volume for the creditor, and lower creditor profit overall.

Another benefit for consumers may be the ability to invest their money and earn a return on amounts that might, depending on State regulations, be forgone under an escrow. While, as discussed above, on average, consumers value the budgeting device that the escrow provides, it is likely that at least some consumers would rather have flexibility with regard to payment terms. The Bureau believes that any returns on amounts that would have been foregone under the escrow requirements are likely to be modest. The exemption allows certain creditors not to escrow for the first year after mortgage origination, thus the magnitude of this benefit is even smaller because the creditors would have cancelled the escrow right after one year otherwise.

For some consumers, providing an exemption for creditors operating in rural or underserved communities would create certain costs. These costs include: The inconvenience of paying several bills instead of one; the lack of a budgeting device to enable consumers not to incur a major expense later; a higher probability of foreclosure; and the possibility of underestimating the overall cost of maintaining their residence.

Because the consumer must pay not only a mortgage bill, but also an insurance bill and, potentially, several tax bills, there is a higher probability that the consumer may forget or neglect to pay one or more of the bills. Moreover, there may be higher transaction costs for the consumer who no longer has a single organization to consult regarding payments, but rather must deal with several organizations as payment questions arise. The value of this cost will vary across consumers, and there is no current research to estimate it. An approximation is a recent estimate of around $20 per month per consumer, depending on the household's income, coming from the value of paying the same bill for phone, cable television, and Internet services as described in the Bundle Study, noted above.

Additionally, without a budgeting device, consumers will need to self-manage the payment of intermittent large bills. As described above, recent research suggests that many consumers value the over-withholding of personal income taxes through periodic payroll deductions and receiving a check from the IRS in the spring despite foregoing the interest on the overpaid taxes throughout the previous year. A mortgage escrow works in a similar fashion; consumers pay the same fixed amount, sometimes interest-free, throughout the year, without having to pay a large lump-sum payment in the end. Based on the recent research of the value of receiving a refund check from the IRS in the spring, the Bureau estimates the average value of having an escrow for low to moderate income households to be 2.65 percent of the yearly amount paid for property taxes and insurance. The cost will not be the same for all consumers as some consumers could find cost savings in managing payments on their own.

However, for those consumers who do struggle with payments, there is a higher probability of foreclosure (on average) resulting from the lack of a budgeting device. Based on the recent research,[49] consumers not having an escrow account in the first year after mortgage originations will result in 0.35 percent more foreclosures per year for the first-lien higher-priced mortgage loans. Having an escrow account for the first year of the mortgage obligation's term appears to be particularly important for consumer protection considerations because often the consumer has depleted savings as a part of the mortgage origination process and may not have prepared adequately for the upcoming semi-annual or annual property tax and home insurance bills. Both of these effects, and thus the benefits of having (or the costs of not having) an escrow account, appear to diminish after the first year. As noted above, some consumers might be unaware of the amount of the property tax and home insurance that they will have to pay every year. Having an escrow illustrates to consumers exactly how much they have to pay per month for the mortgage, property tax, and home insurance. If consumers underestimate the cost of the property tax and the home insurance, then some consumers will buy a house that they cannot afford, or buy a more expensive house than they would ideally want. The Bureau does not have the data to estimate the magnitude of this cost.

3. Potential Costs and Benefits for Non-Exempt Creditors

For the non-exempt creditors, the main effect of the final rule is that creditors need to provide an escrow account for four additional years: for five years instead of for one year. The Bureau does not have the data on how many creditors do not already provide escrow accounts up to the fifth year after a mortgage origination. The Bureau estimates that there are 7,434 non-exempt creditors who originated any first-lien higher-priced mortgage loans in 2011.[50] A median creditor in this group originated six first-lien higher-priced mortgage loans in 2011.[51] The Bureau notes that some creditors who might otherwise qualify for the Bureau's exemption may decide to continue to provide escrows for first-lien higher-priced mortgage loans. The Bureau cannot estimate the number of these creditors, and conservatively estimates this number to be insignificant. The benefits and costs described in this part of the analysis would also apply to these creditors.

The two main benefits for this group of creditors are: Assurance that consumers have met their obligations; and the potential for interest earnings in the escrow account subject to State regulations. If consumers are late on their property taxes, the government often has the first claim on the dwelling that secures the transaction in case of consumer default. If consumers do not pay their home insurance premiums, then the creditor might end up with nothing if something happens to the dwelling that secures the transaction. Because of this potential, many creditors currently verify whether or not the consumer made the requisite

[49] Nathan B. Anderson and Jane B. Dokko, *Liquidity Problems and Early Payment Default Among Subprime Mortgages,* Finance and Economics Discussion Series, Federal Reserve Board (2011), available at: *http://www.federalreserve.gov/pubs/feds/2011/201109/201109pap.pdf.*

[50] Out of those, there are 3,235banks, 562 thrifts, 1,372 credit unions, and 2,265 non-depository institutions.

[51] A median bank or thrift originated 7 first lien higher-priced mortgage loans, a median credit union originated 3 first lien higher-priced mortgage loans, and a median non-depository institution originated 13 first lien higher-priced mortgage loans.

insurance premiums and tax payments every year even where the consumer did not set up an escrow account. The final rule will allow creditors to forego this verification process as the funds would be escrowed.

Moreover, the creditor may be able to gain returns on the money that the consumers keep in their escrow account. Depending on the State, the creditor might not be required to pay interest on the money in the escrow account. The amount that the consumer is required to have in the consumer's escrow account is generally limited to two months' worth of property taxes and home insurance. However, some States require a fixed interest rate to be paid on escrow accounts, resulting in an additional cost to the creditors. This cost is higher if the required interest rate is not updated frequently and current interest rates are low compared to the rate set by the State.

There are startup and operational costs of providing escrow accounts. Creditors are already required to provide the escrow account for a year, and thus the Bureau believes that there are few startup costs implicated by the final rule or that any startup costs are relatively minor given that these creditors probably have already set up a system capable of escrowing in response to the current regulation. There are, however, operating costs implicated in maintaining an escrow account for an additional four years. These costs vary widely with the size of the institution and the local jurisdictions served. For the bigger creditors, with up-to-date information technology systems, the Bureau believes the cost of maintaining escrows for four additional years is negligible, and that many of these creditors may already do so. For a small creditor, that does not invest as much in technology, and serves a jurisdiction that does not process taxes automatically, the cost of providing the escrow account could be larger.[52] However, the Bureau believes that escrow accounts become cost-effective once operations reach a certain scale, and thus even this operating cost is relatively minor. The Board's calculation and the Bureau's subsequent adjustments to the minimal portfolio size necessary to escrow ensure that the non-exempt creditors with over 500 originations per year can achieve the scale necessary for cost-efficient escrow provision. Additionally, the creditors can outsource escrowing to servicing firms and pass through at least some of these costs to the consumer.

4. Potential Costs and Benefits for Exempt Creditors

For the exempt creditors, the main effect of the final rule is that the creditor does not need to provide an escrow account at all for the first year after mortgage origination. The Bureau estimates that there are 2,612 exempt creditors who originated any first-lien higher-priced mortgage loans in 2011.[53] A median creditor in this group originated 13 first-lien higher-priced mortgage loans in 2011. A median bank or thrift originated 13, a median credit union originated 10, and a median non-depository institution originated 6 mortgage obligations.[54]

The main benefit for this group of creditors is in eliminating or greatly reducing the accounting and compliance costs of providing the escrow accounts. It is not clear whether this saving is significant, resulting from the fact that these creditors already provide escrows for the first year, and thus have already undertaken the effort to set up a system capable of escrowing. The exemption from the final rule is likely to lead to less employee time being devoted to complying with the regulation; however, the Bureau believes that benefit is likely to be negligible resulting from the number of first-lien higher-priced mortgage loans originated at a median institution.

Because the creditors in this group who currently extend higher-priced mortgage loans have already expended the start-up costs of providing escrows, many of these creditors might be willing to continue providing escrows to their consumers if the ongoing costs of providing escrows are low. For these creditors the costs and benefits are akin to those described above for the non-exempt creditors, with the stipulation that the benefits of providing escrows for five years clearly outweigh the costs.

However, there are several costs associated with this group of creditors, including: The uncertainty over whether a consumer has met his obligations, a higher probability of foreclosure, and foregoing the additional funds that escrows may provide. Because creditors that do not provide escrow accounts are not certain whether consumers have paid their property taxes and home insurance, they carry a considerable amount of risk. As noted previously, if consumers are late on their property taxes, the government often has the first claim on the dwelling that secures the transaction in case of consumer default. If consumers do not pay their home insurance premiums, then the creditor might end up with nothing if something happens to the dwelling that secures the transaction.

Moreover, all else being equal, these consumers have a higher probability of defaulting. Consumers, on average, value a budgeting device to enable consumers not to incur a major expense later. As noted above, recent research suggests that many consumers value the over-withholding of personal income taxes through periodic payroll deductions and receiving a check from the IRS in the spring despite foregoing the interest on the overpaid taxes throughout the previous year. A mortgage escrow works in a similar fashion; consumers pay the same fixed amount, sometimes interest-free, throughout the year, without having to pay a large lump-sum payment in the end. As previously noted, research suggests that consumers not having an escrow in the first year after mortgage originations will result in 0.35 percent more foreclosures per year for first-lien higher-priced mortgage loans.

Finally, creditors who do not escrow forego the opportunity to invest the money in the consumers' escrow accounts. Depending on the State, the creditor might not have to pay interest on the money in the escrow account. The excess amount that the consumer is required to have in the consumer's escrow account is generally limited to two months' worth of property taxes and home insurance. However, some States require a fixed interest rate to be paid on escrow accounts. Laws setting rates may not be updated frequently enough, resulting in an additional cost to creditors, especially when the interest rates are exceptionally low.[55]

C. Impact of the Final Rule on Depository Institutions and Credit Unions With $10 Billion or Less in Total Assets, as Described in Section 1026

The discussion below describes certain consequences of the final rule based on the particular characteristics of the creditor. First, the Bureau analyzes the impact of the final rule on creditors with $10 billion or less in total assets,

[52] The Bureau is aware that some jurisdictions still process taxes by hand and/or impose fees on the creditors seeking access to the tax information, significantly adding to the burden of establishing escrow accounts in these jurisdictions.

[53] Out of those, there are 2,112 banks, 141 thrifts, 355 credit unions, and 4 non-depository institutions. The Bureau does not possess the information on whether HMDA non-reporting non-depository institutions are rural, and conservatively assumes that they are not.

[54] A median bank or thrift originated 13, a median credit union originated 10, and a median non-depository institution originated 6 mortgage obligations.

[55] The Bureau acknowledges that this creditor cost is also a consumer benefit. However, as described above, the Bureau believes the benefit per consumer is fairly modest.

which are subject to the Bureau's escrow requirements. Then, the Bureau outlines the impact of the final rule on creditors with $10 billion or less in total assets, which are exempt from the Bureau's escrow requirements. For both of these groups the benefits, the costs, and the median origination counts are identical to the discussion above.

For the non-exempt creditors, the main effect of the final rule is that the creditor needs to provide an escrow account for four additional years: For five years instead of for one year. The Bureau estimates that there are 5,087 non-exempt creditors with $10 billion or less in total assets, who originated any first-lien higher-priced mortgage loans in 2011.[56] These creditors originated 91,142 first-lien higher-price mortgage loans in 2011. The Bureau additionally notes that some creditors who might otherwise qualify for the Bureau's exemption may decide to continue to provide escrows for first-lien higher-priced mortgage loans. The Bureau cannot estimate the number of these creditors, and conservatively estimates this number to be insignificant. The benefits and costs described in this part of the analysis would also apply to these creditors. The impact described below would also apply to these creditors.

For creditors that qualify for the new exemption for creditors that operate predominantly in rural or underserved areas, the regulation will allow them, post-effective date, to avoid having to comply with both the existing requirement to establish escrow accounts for covered higher-priced mortgage loans for at least one year and the new general requirement to establish accounts for at least five years for new consumer transactions if the creditors determine that it is in their best interest to do so. A creditor in this group could voluntarily require an escrow account for five years if they choose to, and thus this rule does not impose any significant costs on this group of creditors. These creditors originated 50,468 first-lien higher-priced mortgage loans in 2011.

D. Impact of the Final Rule on Consumers in Rural Areas

The Bureau expects that for the consumers in rural areas, the costs and benefits are largely the same as for the consumers in the not necessarily rural areas described above. The single biggest difference is the availability of credit; rural consumers have significantly fewer options for getting a higher-priced mortgage loan. Even for the densest counties included in the rural definition (UIC code 8 counties with micropolitans), the median county has only 10 creditors making higher-priced mortgage loans, as opposed to 16 for the least dense UIC code not included in the rural definition (UIC 5). Given the scope of the rural and underserved exemption, the Bureau believes that any rural consumer can, but need not, get a mortgage transaction from an exempt creditor as opposed to getting a mortgage transaction from a non-exempt creditor, and that there will be sufficiently many creditors left in any given market to ensure a proper competitive process. As a result of the final rule, the Bureau believes that consumers in rural areas may benefit from greater access to credit, because there may be more competition between incumbent originators who escrow and smaller mortgage originators who may benefit from the Bureau's exemption requirement. Some consumers might prefer to get a mortgage with an escrow, for all the benefits described above. However, the Bureau conservatively estimates that all rural consumers will choose to get their mortgages from an exempt creditor and that none of these consumers' transactions will be subject to forward commitment.

For these consumers, the final rule will result in no escrow account being required, as opposed to the creditor being required to escrow for a year. The Bureau estimates that there were 50,468 first-lien higher-priced mortgage loans originated in rural areas in 2011.

The Bureau believes these consumers may benefit from less restricted access to credit; lower prices resulting from creditors not passing through the cost of escrowing to the consumers; and the ability to invest their money and earn a return. Because a small mortgage originator operating predominantly in rural or underserved areas will not have to incur the costs of establishing and maintaining escrow accounts for higher-priced mortgage loans, it may be willing to keep making such transactions where it is not willing to do so under the current regulation. This may provide stronger incentives for small originators to continue making higher-priced mortgage loans (or to resume doing so where they have previously decided to stop), creating greater access to credit for consumers living in rural and underserved areas. The Bureau does not have the data to be able to estimate the magnitude of this effect.

E. Consideration of Alternatives

To implement the statutory changes the Bureau considered different definitions of rural and the size exemption, both for the asset size and for the number of originations. As described above, the definition of rural proposed in the Board's 2011 Escrows Proposal included counties with USDA's urban influence codes of 7, 10, 11, and 12. Taking into account the comments received on the proposal, the Bureau believed this definition was too narrow to capture fully Congress's apparent concern regarding access to credit.

In finalizing the rule the Bureau considered using an alternative definition of rural that would have used the same definition as provided under USDA's section 502 Rural Housing program. Under the USDA section 502 Rural Housing definition of "rural", approximately 37 percent of the U.S. population lives in an area considered to be rural, compared to approximately 10 percent according to the definition used in the final rule, which defines rural as counties with UICs 4, 6, 7, 8, 9, 10, 11, and 12. The Bureau considered the trade-off of exempting more creditors and thus potentially mitigating consumer access to credit issues versus exempting fewer creditors and providing more consumers with the consumer protections represented by escrow accounts. The Bureau's analysis of the 2011 HMDA data showed that, even with the definition of rural in the final rule that includes counties with codes of 4, 6, 7, 8, 9, 10, 11, and 12, a median county in the least dense county code that is not exempt (code 5) had 16 creditors that extended any higher-priced mortgage loans in 2011. In light of these data, the Bureau believes that, even if some of these creditors exit the higher-priced mortgage loan market for lack of an exemption, there will still be enough competition in those counties, and therefore the risk of potential access to credit issues for consumers in these areas is mitigated. Consequently, the Bureau believes that expanding the definition of rural in the final rule to the USDA section 502 Rural Housing definition would have allowed creditors to originate mortgage obligations without the escrow protections mandated by the Congress, while access to credit would not be significantly improved. In light of these considerations, the Bureau believes the final rule reflects the Bureau's judgment based upon all of the evidence it has obtained regarding the areas included, such as the urban influence, density of the population, and the number of higher-priced mortgage loan creditors in the county, in how best to effectuate the purposes of the law Congress enacted.

In addition, the Bureau considered alternative origination thresholds. The

[56] These include 3,170 banks, 548 thrifts, and 1,369 credit unions.

Board's proposal extended the exemption to creditors that, together with their affiliates, originate and retain servicing rights to 100 or fewer first-lien mortgage obligations in either of the preceding two years. As discussed more fully above, the Board noted its belief from the available information that the economies of scale necessary to escrow cost-effectively, or else to satisfy the escrow requirement by outsourcing to a sub-servicer, generally exist when a mortgage servicer has a portfolio of at least 500 mortgage obligations. Consequently, the Board proposed setting the cut-off at 100 or fewer first-lien mortgage obligations originated and for which servicing rights are retained, assuming an average of five years until an institution's mortgage obligations are paid off. After reviewing the comments submitted by many creditors in rural areas regarding the adverse conditions they face, such as idiosyncratic accounting systems (including calculations by hand) employed by some of the jurisdictions, the Bureau believes that many such creditors may need a larger number of mortgage obligations in portfolio to be able to provide escrow accounts cost-effectively. The Bureau has expanded the exemption to include creditors that, together with their affiliates, originate 500 or fewer first-lien covered transactions. The Bureau believes that defining the limit in terms of originated transactions, as opposed to transactions originated and serviced, facilitates compliance by not requiring institutions to track multiple metrics for purposes of this final rule and the 2013 ATR Final Rule and to promote consistent application of the two exemptions. However, this change by itself would have severely restricted the scope of the exemption, as there are more creditors that originate and service 100 or fewer transactions than there are creditors that simply originate 100 or fewer.[57] Based on 2011 HMDA data, setting the annual originations limit at 500 ensures that 89.5% of the creditors that originated and serviced 100 transactions are also under the 500 first-lien origination limit.

Because of the changes in the originations limit, the Bureau considered whether an asset-size limit would be appropriate, to prevent larger creditors with sophisticated information technology systems and the capacity to escrow from taking unintended advantage of the exemption. As noted above, in the Board's 2011 Escrows Proposal, no asset-size limit was proposed, although the Board solicited comment on whether such a limit was appropriate. The Bureau initially considered a $1 billion asset-size limit, believing organizations of at least that size had the capacity to implement the escrow requirements. However, in accordance with its goal to harmonize the final rule as much as practicable with the 2013 ATR Final Rule, discussed above, the Bureau has adopted a $2 billion asset-size limit. Based on a review of HMDA data, the Bureau believes that there is an insignificant number of creditors that operate predominantly in rural or underserved areas, have fewer than 500 first-lien originations, and have between $1 and $2 billion in assets. Consequently, the Bureau believes that harmonizing the approaches between the two final rules will simplify compliance and reduce associated compliance costs, while having a negligible impact on the scope of the exemptions.

VIII. Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA) generally requires an agency to conduct an initial regulatory flexibility analysis (IRFA) and a final regulatory flexibility analysis (FRFA) of any rule subject to notice-and-comment rulemaking requirements, unless the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities.[58] The Bureau also is subject to certain additional procedures under the RFA involving the convening of a panel to consult with small business representatives prior to proposing a rule for which an IRFA is required.[59] An entity is considered ''small'' if it has $175 million or less in assets for the banks, and $7 million or less in revenue for non-bank mortgage creditors, mortgage brokers, and mortgage servicers.[60] In the Board's 2011 Escrows Proposal, the Board conducted an initial regulatory flexibility analysis (IRFA) and concluded that the proposed rule would have a significant economic impact on a substantial number of small entities. The Board solicited comments on the number of small entities likely to be affected by the proposal, as well as the costs, compliance requirements, and any changes in operating procedures arising from the application of the proposed rules to small businesses. The Board additionally solicited comments regarding a number of proposed provisions that could minimize compliance burdens on small entities by relying on other disclosure requirements with which they already must comply and/or exempting certain classes of small creditors from the proposed regulations. The Board also welcomed comment on any significant alternatives that would minimize the impact of the proposed rules on small entities.

The Bureau has reviewed the comments on the Board's IRFA and the broader Notice of Proposed Rulemaking addressing the burden imposed by the proposed rule and potential mitigation measures and alternatives. As described further below, the Bureau carefully considered the comments received and performed its own independent analysis of the potential impacts of the final rule on small entities and alternatives to the final rule. Based on the comments received, the Bureau's own analysis, and for the reasons stated in section 4 below, the undersigned certifies that this final rule will not have a significant economic impact on a substantial number of small entities. Nevertheless, to better inform the rulemaking, the Bureau has prepared the following final regulatory flexibility analysis.

1. Statement of the Need for, and Objectives of, the Final Rule

The Bureau is publishing final rules to implement certain amendments to TILA made by the Dodd-Frank Act. Congress enacted TILA based on findings that economic stability would be enhanced and competition among consumer credit providers would be strengthened by the informed use of credit resulting from consumers' awareness of the cost of credit. The Bureau's final rule requires creditors to establish escrow accounts for taxes and insurance for at least five years after consummation. The final rule also creates an exemption from the escrow requirement for certain mortgage transactions extended by a creditor that meets four conditions. Those conditions are that the creditor: (1) Makes most of its first-lien covered transactions in rural or underserved counties; (2)

[57] Consider, for example, a creditor that originates 300 mortgage obligations, but services only 80 of them.

[58] For purposes of assessing the impacts of the final rule on small entities, ''small entities'' is defined in the RFA to include small businesses, small not-for-profit organizations, and small government jurisdictions. 5 U.S.C. 601(6). A ''small business'' is determined by application of Small Business Administration regulations and reference to the North American Industry Classification System (NAICS) classifications and size standards. 5 U.S.C. 601(3). A ''small organization'' is any ''not-for-profit enterprise which is independently owned and operated and is not dominant in its field.'' 5 U.S.C. 601(4). A ''small governmental jurisdiction'' is the government of a city, county, town, township, village, school district, or special district with a population of less than 50,000. 5 U.S.C. 601(5).

[59] 5 U.S.C. 609.

[60] The current SBA size standards are found on SBA's Web site at *http://www.sba.gov/content/table-small-business-size-standards.*

together with all affiliates, has annual originations of 500 or fewer first-lien covered transactions; (3) has an asset size less than $2 billion; and (4) together with its affiliates, does not escrow for any mortgage that it or its affiliates currently services, except in limited instances.

These amendments are intended to improve consumers' understanding of the overall costs of a given higher-priced mortgage loan and, in turn, facilitate their ability to shop for mortgages. Moreover, requiring escrow accounts for certain higher-priced mortgage loans may reduce the likelihood that a consumer faces a sizable, unanticipated fee or increase in payments.

2. Summary of Significant Issues Raised by Comments in Response to the Initial Regulatory Flexibility Analysis

In accordance with section 3(a) of the RFA, 5 U.S.C. 603(a), the Board prepared an IRFA in connection with the proposed rule, and acknowledged that the projected reporting, recordkeeping, and other compliance requirements of the proposed rule on the whole would have a significant economic impact on a substantial number of small entities, including small mortgage creditors and servicers. In addition, the Board recognized that the precise compliance costs would be difficult to ascertain because they would depend on a number of unknown factors, including, among other things, the specifications of the current systems used by small entities to prepare and provide disclosures and/or solicitations and to administer and maintain accounts. The Board sought information and comment on any costs, compliance requirements, or changes in operating procedures arising from the application of the proposed rule to small businesses.

The Bureau reviewed comments submitted by various financial institutions and trade organizations in order to ascertain the economic impact of the proposed rule on small entities. Although only a few commenters focused on the Board's IRFA analysis, such commenters expressed concern that the Board had underestimated the costs of compliance. In one comment letter a trade organization noted that one large creditor implementing the Regulation Z amendments that became effective October 1, 2009, indicated that it required over 70,000 hours to change its systems. Smaller financial institutions also suggested that compliance costs would be significant given the need to change systems and train personnel. In addition, the Office of Advocacy of the U.S. Small Business Administration (Advocacy) submitted a comment on the Board's IRFA.

Advocacy expressed concern about the level of information the Board provided in its IRFA regarding the impact of the proposed rule on small entities and it encouraged the Board to provide additional information. Advocacy also raised concerns concerning the scope of the exception and made suggestions to ease burdens in connection with the proposed disclosures. For the reasons stated below, the Bureau believes that the Board's IRFA complied with the requirements of the RFA and the Bureau has modified certain aspects of the proposal in order to mitigate some of the impact on small entities, including some identified by Advocacy.

Section 3(a) of the RFA requires agencies to publish for comment an IRFA which shall describe the impact of the proposed rule on small entities. *See* 5 U.S.C. 603(a). In addition, section 3(b) requires the IRFA to contain certain information including a description of the projected reporting, recordkeeping and other compliance requirements of the proposed rule, including an estimate of the classes of small entities which will be subject to the requirement and the type of professional skills necessary for preparation of the report or record. *See* 5 U.S.C. 603(b). The Bureau believes that the Board's IRFA complied with the requirements of the RFA. The Board described the impact of the proposed rule on small entities by describing the rule's proposed requirements in detail throughout the supplementary information for the proposed rule. Additionally, the Board described the projected compliance requirements of the rule in its IRFA, noting the need for small entities to update systems, operating procedures, and disclosures under the proposed rule. In the proposal, the Board described the projected impact of the proposed rule and sought comments from small entities specifically regarding the effect the proposed rule would have on their activities. In their comments, small entities have described to varying degrees the increased costs associated with the Board's proposed rules particularly with respect to the proposed disclosure requirements concerning escrow accounts.

As a result of the Bureau's review of Advocacy's and other comments regarding the potential compliance burdens of adopting the disclosure portions of the Board's 2011 Escrows Proposal before resolution of the Bureau's TILA–RESPA integration rulemaking, the final rule does not adopt the Board's proposed disclosures provisions. In addition, as discussed further below, the Bureau has also considered additional measures as suggested by Advocacy to broaden the proposed exemption so that more small entities can qualify.

3. Description and Estimate of Small Entities to Which the Final Rule Would Apply

The final rule applies generally to institutions and entities that engage in originating or extending home-secured credit, as well as servicers of these mortgage obligations. The Board acknowledged in its IRFA the lack of a reliable source for the total number of small entities likely to be affected by the proposal, because the credit provisions of TILA and Regulation Z have broad applicability to individuals and businesses that originate, extend and service even small numbers of home-secured transactions. The Board identified through data from Reports of Condition and Income (Call Reports) approximate numbers of small entities that would be subject to the proposed rules. The summary of institutions considered small according to the criteria described above, regardless of whether they are exempt from the rule, is in the table below.

Category	NAICS Code	Total Entities	Small Entities	Entities That Originate Any Mortgage Transactions[b]	Small Entities that Originate Any Mortgage Transactions
Commercial Banking	522110	6,505	3,601	6,307[a]	3,466[a]
Savings Institutions	522120	930	377	922[a]	373[a]
Credit Unions[c]	522130	7,240	6,296	4,178[a]	3,240[a]
Real Estate Credit[d e]	522292	2,787	2,294	2,787	2,294[a]
Total		17,462	12,568	14,194	9,372

Source: 2011 HMDA, Dec 31, 2011 Bank and Thrift Call Reports, Dec 31, 2011 NCUA Call Reports, Dec 31, 2011 NMLSR Mortgage Call Reports.

[a] For HMDA reporters, transaction counts are from HMDA 2011. For institutions that are not HMDA reporters, transaction counts are projected based on Call Report data fields and counts for HMDA reporters.

[b] Entities are characterized as originating mortgage transactions if they make one or more transaction.

[c] Does not include cooperativas operating in Puerto Rico. The Bureau has limited data about these institutions or their mortgage activity.

[d] NMLSR Mortgage Call Report ("MCR") for 2011. All MCR reporters that originate at least one transaction or that have positive transaction amounts are considered to be engaged in real estate credit (instead of purely mortgage brokers). For institutions with missing revenue values, the probability that the institution was a small entity is estimated based on the count and amount of originations and the count and amount of brokered transactions.

[e] Data do not distinguish nonprofit from for-profit organizations, but Real Estate Credit presumptively includes nonprofit organizations.

The Bureau estimates that there are 3,777 non-exempt creditors who originated any first-lien higher-priced mortgage loans in 2011.[61] A median creditor in this group originated four first-lien higher-priced mortgage loans in 2011.[62] The Bureau does not have data on how many creditors do not already provide escrow accounts up to the fifth year after a mortgage origination. Moreover, no commenters submitted nationally-representative data including this information. The Bureau additionally notes that some creditors who might otherwise qualify for the Bureau's exemption may decide voluntarily to continue to provide escrows for first-lien higher-priced mortgage loans. The Bureau cannot estimate the number of these creditors, and conservatively estimates this number to be insignificant, but notes that the impacts described in this part of the analysis would also apply to these creditors.

4. Reporting, Recordkeeping, and Other Compliance Requirements

The costs to the non-exempt creditors are described in the section 1022 analysis above, and mainly include the ongoing operating costs of extending the escrow account provision from one to four years. For the creditors who are processing escrows in-house, this cost is negligible, given that these creditors probably have already set up a system capable of escrowing in response to the current regulation. For the creditors that outsource escrowing, the fixed cost of contracting has already been incurred. The creditors that operate predominantly in rural or underserved areas are exempted, unless they have reached the scale at which the Bureau believes that it is cost-efficient to set up escrow accounts.

The Bureau does not possess nationally representative information regarding this cost. However, the cost of escrowing is a part of the overall servicing cost of a mortgage obligation. The most recent estimate of the servicing cost of a mortgage obligation is $100 per transaction per year, if the servicing is outsourced.[63] The Bureau does not possess reliable information on what fraction of the $100 is attributable to maintaining escrow accounts. However, none of the several examined industry, regulatory, and academic studies of servicing singled out escrowing as the first or the main component of the overall servicing costs.[64] Thus, the Bureau conservatively assumes that the cost of this rule per transaction is at most $50, and over the four years is at most $200. According to the Bureau's projections, 85 percent of the affected non-exempt small institutions originate less than 14 higher-priced mortgage loans, resulting in an at most a $2800 cost per institution.[65] Therefore, the Bureau believes that the rule will not have a significant impact on small entities. Examining the ratios of these costs to the revenues[66] of the institutions, for 85% of small creditors these costs represent less than 0.3% of their revenues.[67]

If there are creditors who have not already implemented the Board's 2008 HOEPA Final Rule and would not be

[61] This figure includes 1,432 banks, 203 thrifts, 817 credit unions, and 1,325 non-depository institutions.

[62] The median first-lien higher-priced mortgage loan by institution is as follows: 5 for banks and thrifts; 2 for credit unions; and 5 for non-depository institutions.

[63] National Association of Federal Credit Unions, Top 10 Questions about Mortgage Subservicing (Podcast), available at: *http://www.nafcu.org/NSCTertiary.aspx?id=23703.*

[64] Mortgage Bankers Association, *Residential Mortgage Servicing for the 21st Century,* May 2011. Amy Crews Cutts & Richard K. Green, *Innovative Servicing Technology: Smart Enough to Keep People in Their Houses?* Freddie Mac Working Paper #04–03 (2004). Prime Alliance Loan Servicing, *Re-Thinking Loan Servicing,* (2010). Adam Levitin & Tara Twomey, *Mortgage Servicing,* 28 Yale J. on Reg. 1 (2011).

[65] Breaking this down by small creditor type, 85 percent of banks originate less than 14, and 85 percent of thrifts originate less than 9 higher-priced mortgage loans, 85 percent of credit unions originate less than 10 higher-priced mortgage loans, and 85 percent of non-depository institutions originate less than 16 higher-priced mortgage loans.

[66] Revenue has been used in other analyses of economic impacts under the RFA. For purposes of this analysis, the Bureau uses revenue as a measure of economic impact. In the future, the Bureau will consider whether an alternative quantifiable or numerical measure may be available that would be more appropriate for financial firms.

[67] The ratio is below 0.5 percent for 85 percent of the creditors among any of the four small creditor types.

eligible for the exemption for creditors who operate predominantly in rural or underserved areas, there may be a need for the creditors' staff to develop new professional skills and new recordkeeping regimes to comply with the revised requirements. These costs will depend on a number of unknown factors, including, among other things, the specifications of the current systems used by such entities. The Bureau believes that the number of such institutions would be small and does not affect its judgment that the rule will not impose a significant impact on a substantial number of small entities. Finally, as discussed above, the rule allows exempted creditors to stop establishing escrow accounts even for the first year of the mortgage obligation, which will allow creditors to eliminate the compliance costs of their current programs for new loans going forward if they decide it makes sense to do so.

5. Steps Taken To Minimize the Economic Impact on Small Entities

The steps the Bureau has taken to minimize the economic impact and compliance burden on small entities, including the factual, policy, and legal reasons for selecting the alternatives adopted and why each one of the other significant alternatives was not accepted, are described above in the section-by-section analysis, in part VII, and in the summary of issues raised by the public comments in response to the proposal's IRFA. The final rule's modifications from the proposed rule that minimize economic impact on small entities are discussed below. Additionally, the Bureau considered significant alternatives to most of the dimensions of the small creditor exemption: the definition of rural, the transaction origination limit, and the asset-size threshold.

First, the Bureau has declined to implement at this time the amendments to TILA concerning certain new disclosure requirements concerning escrows accounts. The Bureau believes that this decision to coordinate these disclosures with the finalization of the TILA–RESPA integration rulemaking will decrease the economic impact of the final rule on small entities by limiting their compliance costs. Moreover, the Bureau believes that harmonizing certain title XIV required disclosures may provide greater clarity to the market and better fulfill TILA's stated purpose of enabling consumers to better understand the cost of credit.

Second, upon reviewing public comment, the Bureau has expanded the exemption for creditors who operate predominantly in rural or underserved areas to include a broader range of areas than previously identified in the proposal. The Bureau believes that will decrease the number of small entities covered by the regulation. The Bureau considered different definitions of ''rural'' and the size exemption, both for the asset size and for the number of originations.

In finalizing the rule the Bureau considered using an alternative definition of rural that would have used the same definition as provided under USDA's section 502 Rural Housing program. Under the USDA section 502 Rural Housing definition of ''rural'', approximately 37 percent of the U.S. population lives in an area considered to be rural, compared to approximately 10 percent according to the definition used in the final rule, which defines rural as counties with UICs 4, 6, 7, 8, 9, 10, 11, 12. The Bureau considered the trade-off of exempting more creditors and thus potentially mitigating consumer access to credit issues versus exempting fewer creditors and providing consumers with the consumer protections represented by escrow accounts. The Bureau's analysis of the 2011 HMDA data showed that, even with the definition of rural in the final rule that includes counties with codes of 4, 6, 7, 8, 9, 10, 11, and 12, a median county in the least dense county code that is not exempt (code 5) had 16 creditors that extended any higher-priced mortgage loans in 2011. In light of these data, the Bureau believes that, even if some of these creditors exit the higher-priced mortgage loan market for lack of an exemption, there will still be enough competition in those counties, and therefore the risk of potential access to credit issues for consumers in these areas is mitigated. The Bureau believes that the current definition better reflects the intention of the statute's authorization to create a rural exception, and facts about the areas included, such as the urban influence, density of the population, and the number of higher-priced mortgage loan creditors in the county.

In addition, the Bureau considered alternative origination thresholds. The Board's 2011 Escrows Proposal would have extended the exemption to creditors that, together with their affiliates, originated and retained servicing rights to 100 or fewer mortgage obligations secured by a first-lien on real property or a dwelling. In the Board's 2011 Escrows Proposal the Board noted its belief from the available information that the economies of scale necessary to escrow cost-effectively, or else to satisfy the escrow requirement by outsourcing to a sub-servicer, generally exist when a mortgage servicer has a portfolio of at least 500 mortgage obligations. Consequently, the Board proposed setting the cut-off at 100 or fewer first-lien mortgage obligations originated annually and for which servicing rights are retained, assuming an average of five years until an institution's mortgage obligations are paid off. The Bureau has expanded the exemption to include creditors that, together with their affiliates, originate 500 or fewer first-lien covered transactions annually. The Bureau believes that defining the limit in terms of originated transactions, as opposed to transactions originated and serviced, facilitates compliance by not requiring institutions to track multiple metrics for the escrow and qualified mortgage rules and to promote consistent application of the two exemptions. However, this change by itself would have severely restricted the scope of the exemption, as there are more creditors that originate and service less than 100 transactions than there are creditors that simply originate 100 transactions.[68] From the 2011 HMDA data, setting the new limit at 500 transactions ensures that 89.5 percent of the creditors that originated and serviced 100 transactions are under the new 500 first-lien origination limit. However, as discussed more fully above, to prevent larger creditors with sophisticated information technology systems from taking unintended advantage of this exemption and to further the benefits from coordinated compliance across this final rule and the 2013 ATR Final Rule, the Bureau decided to adopt the $2 billion asset-size limit in both final rules.

The Bureau notes that by expanding the exemption for certain transactions and deferring implementation of the escrow disclosure requirements the Bureau has largely addressed the areas where small entity commenters expressed concern about the costs of compliance. The Bureau believes that these changes minimize the economic impact on small entities while still meeting the stated objectives of TILA and the Dodd-Frank Act.

The small creditor exemption is partially designed to mitigate the rule's costs to small creditors. Providing escrows cost-effectively requires a scale that small creditors do not have, and the 500 first-lien origination limit allows the creditors to reach that scale before they are required to provide escrows. This scale might be much lower in more urban areas, but the Bureau believes that

[68] Consider, for example, a creditor who originates 300 transactions, but services only 80 of them.

because many creditors in rural areas face adverse conditions, such as idiosyncratic accounting systems (including calculations by hand) employed by some of the jurisdictions, such institutions would especially need this number of originations, and consequently a large number of mortgage obligations to be able to provide escrow accounts cost-effectively.

6. Impact on Small Business Credit

The Bureau does not believe that the final rule will result in an increase in the cost of business credit for small entities. Instead, the final rule will apply only to mortgage transactions obtained by consumers primarily for personal, family, or household purposes and the final rule will not apply to transactions obtained primarily for business purposes. Given that the final rule does not increase the cost of credit for small entities, the Bureau has not taken additional steps to minimize the cost of credit for small entities.

IX. Paperwork Reduction Act

The Bureau may not conduct or sponsor, and a respondent is not required to respond to, an information collection unless it displays a currently valid OMB control number. The Board's 2011 Escrows Proposal contained information collection requirements under the Paperwork Reduction Act (PRA), which have been previously approved by OMB under the following OMB control number issued to the Board: 7100–0199. There are no new information collection requirements in the Bureau's final rule.

On March 2, 2011, a notice of the proposed rulemaking was published in the **Federal Register**. As discussed above, the Board proposed certain new disclosures for escrow accounts including format, timing, and content requirements as well as proposed certain model forms regarding escrow accounts for closed-end mortgages secured by a first lien on real property or a dwelling. The Board invited comment on: (1) Whether the proposed collection of information is necessary for the proper performance of agency functions, including whether the information has practical utility; (2) the accuracy of the estimate of the burden of the proposed information collection, including the cost of compliance; (3) ways to enhance the quality, utility, and clarity of the information to be collected; and (4) ways to minimize the burden of information collection on respondents, including through the use of automated collection techniques or other forms of information technology. The comment period for the proposed rule expired on May 2, 2011.

The Bureau reviewed the comments received regarding the merits of various aspects of the Board's 2011 Escrows Proposal, including the burden of compliance generally, and whether the proposed disclosure requirements should be finalized. Commenters in particular contended that the new disclosure requirements would be redundant of existing information collections and would likely be of limited utility given the Bureau's mandate to integrate the TILA–RESPA disclosures. Given the potential compliance burden of integrating new disclosures in piecemeal fashion, on November 23, 2012, the Bureau published in the **Federal Register** a rule that delays the implementation of certain disclosure requirements contained in title XIV of the Dodd-Frank Act, including those contained in sections 1461 and 1462. *See* 77 FR 70105 (Nov. 23, 2012). Accordingly, because this final rule does not implement the disclosure amendments, the Bureau has determined that this final rule does not impose any new recordkeeping, reporting or disclosure requirements on covered entities or members of the public that would be collections of information requiring OMB approval under 44 U.S.C. 3501, et seq.

List of Subjects in 12 CFR Part 1026

Advertising, Consumer protection, Mortgages, Recordkeeping requirements, Reporting, Truth in lending.

Authority and Issuance

For the reasons set forth in the preamble, the Bureau amends Regulation Z, 12 CFR part 1026, as set forth below:

PART 1026—TRUTH IN LENDING (REGULATION Z)

■ 1. The authority citation for part 1026 continues to read as follows:

Authority: 12 U.S.C. 2601; 2603–2605, 2607, 2609, 2617, 5511, 5512, 5581; 15 U.S.C. 1601 *et seq.*

Subpart E—Special Rules for Certain Home Mortgage Transactions

■ 2. Section 1026.35 is revised to read as follows:

§ 1026.35 Requirements for higher-priced mortgage loans.

(a) *Definitions.* For purposes of this section:

(1) ''Higher-priced mortgage loan'' means a closed-end consumer credit transaction secured by the consumer's principal dwelling with an annual percentage rate that exceeds the average prime offer rate for a comparable transaction as of the date the interest rate is set:

(i) By 1.5 or more percentage points for loans secured by a first lien with a principal obligation at consummation that does not exceed the limit in effect as of the date the transaction's interest rate is set for the maximum principal obligation eligible for purchase by Freddie Mac;

(ii) By 2.5 or more percentage points for loans secured by a first lien with a principal obligation at consummation that exceeds the limit in effect as of the date the transaction's interest rate is set for the maximum principal obligation eligible for purchase by Freddie Mac; or

(iii) By 3.5 or more percentage points for loans secured by a subordinate lien.

(2) ''Average prime offer rate'' means an annual percentage rate that is derived from average interest rates, points, and other loan pricing terms currently offered to consumers by a representative sample of creditors for mortgage transactions that have low-risk pricing characteristics. The Bureau publishes average prime offer rates for a broad range of types of transactions in a table updated at least weekly as well as the methodology the Bureau uses to derive these rates.

(b) *Escrow accounts*—(1) *Requirement to escrow for property taxes and insurance.* Except as provided in paragraph (b)(2) of this section, a creditor may not extend a higher-priced mortgage loan secured by a first lien on a consumer's principal dwelling unless an escrow account is established before consummation for payment of property taxes and premiums for mortgage-related insurance required by the creditor, such as insurance against loss of or damage to property, or against liability arising out of the ownership or use of the property, or insurance protecting the creditor against the consumer's default or other credit loss. For purposes of this paragraph (b), the term ''escrow account'' has the same meaning as under Regulation X (24 CFR 3500.17(b)), as amended.

(2) *Exemptions.* Notwithstanding paragraph (b)(1) of this section:

(i) An escrow account need not be established for:

(A) A transaction secured by shares in a cooperative;

(B) A transaction to finance the initial construction of a dwelling;

(C) A temporary or ''bridge'' loan with a loan term of twelve months or less, such as a loan to purchase a new dwelling where the consumer plans to sell a current dwelling within twelve months; or

(D) A reverse mortgage transaction subject to § 1026.33(c).

(ii) Insurance premiums described in paragraph (b)(1) of this section need not be included in escrow accounts for loans secured by dwellings in condominiums, planned unit developments, or other common interest communities in which dwelling ownership requires participation in a governing association, where the governing association has an obligation to the dwelling owners to maintain a master policy insuring all dwellings.

(iii) Except as provided in paragraph (b)(2)(v) of this section, an escrow account need not be established for a transaction if, at the time of consummation:

(A) During the preceding calendar year, the creditor extended more than 50 percent of its total covered transactions, as defined by § 1026.43(b)(1), secured by a first lien, on properties that are located in counties designated either ''rural'' or ''underserved'' by the Bureau, as set forth in paragraph (b)(2)(iv) of this section;

(B) During the preceding calendar year, the creditor and its affiliates together originated 500 or fewer covered transactions, as defined by § 1026.43(b)(1), secured by a first lien; and

(C) As of the end of the preceding calendar year, the creditor had total assets of less than $2,000,000,000; this asset threshold shall adjust automatically each year, based on the year-to-year change in the average of the Consumer Price Index for Urban Wage Earners and Clerical Workers, not seasonally adjusted, for each 12-month period ending in November, with rounding to the nearest million dollars (see comment 35(b)(2)(iii)–1.iii for the current threshold); and

(D) Neither the creditor nor its affiliate maintains an escrow account of the type described in paragraph (b)(1) of this section for any extension of consumer credit secured by real property or a dwelling that the creditor or its affiliate currently services, other than:

(*1*) Escrow accounts established for first-lien higher-priced mortgage loans on or after April 1, 2010, and before June 1, 2013; or

(*2*) Escrow accounts established after consummation as an accommodation to distressed consumers to assist such consumers in avoiding default or foreclosure.

(iv) For purposes of paragraph (b)(2)(iii)(A) of this section:

(A) A county is ''rural'' during a calendar year if it is neither in a metropolitan statistical area nor in a micropolitan statistical area that is adjacent to a metropolitan statistical area, as those terms are defined by the U.S. Office of Management and Budget and applied under currently applicable Urban Influence Codes (UICs), established by the United States Department of Agriculture's Economic Research Service (USDA–ERS). A creditor may rely as a safe harbor on the list of counties published by the Bureau to determine whether a county qualifies as ''rural'' for a particular calendar year.

(B) A county is ''underserved'' during a calendar year if, according to Home Mortgage Disclosure Act (HMDA) data for that year, no more than two creditors extend covered transactions, as defined in § 1026.43(b)(1), secured by a first lien five or more times in the county. A creditor may rely as a safe harbor on the list of counties published by the Bureau to determine whether a county qualifies as ''underserved'' for a particular calendar year.

(v) Notwithstanding paragraph (b)(2)(iii) of this section, an escrow account must be established pursuant to paragraph (b)(1) of this section for any first-lien higher-priced mortgage loan that, at consummation, is subject to a commitment to be acquired by a person that does not satisfy the conditions in paragraph (b)(2)(iii) of this section, unless otherwise exempted by this paragraph (b)(2).

(3) *Cancellation*—(i) *General.* Except as provided in paragraph (b)(3)(ii) of this section, a creditor or servicer may cancel an escrow account required in paragraph (b)(1) of this section only upon the earlier of:

(A) Termination of the underlying debt obligation; or

(B) Receipt no earlier than five years after consummation of a consumer's request to cancel the escrow account.

(ii) *Delayed cancellation.* Notwithstanding paragraph (b)(3)(i) of this section, a creditor or servicer shall not cancel an escrow account pursuant to a consumer's request described in paragraph (b)(3)(i)(B) of this section unless the following conditions are satisfied:

(A) The unpaid principal balance is less than 80 percent of the original value of the property securing the underlying debt obligation; and

(B) The consumer currently is not delinquent or in default on the underlying debt obligation.

(c) [Reserved]

(d) *Evasion; open-end credit.* In connection with credit secured by a consumer's principal dwelling that does not meet the definition of open-end credit in § 1026.2(a)(20), a creditor shall not structure a home-secured loan as an open-end plan to evade the requirements of this section.

3. In Supplement I to Part 1026—Official Interpretations:

A. The heading for *Section 1026.35—Prohibited Acts or Practices in Connection with Higher-Priced Mortgage Loans* is revised.

B. Under newly designated *Section 1026.35—Requirements for Higher-Priced Mortgage Loans:*

i. Under *35(a) Higher-Priced Mortgage Loans:*

a. *Paragraph 35(a)(1)* and paragraphs 1, 2, and 3 are added.

b. Under *Paragraph 35(a)(2),* paragraphs 2 and 3 are revised, and paragraph 4 is removed.

ii. The heading for *35(b) Rules for higher-priced mortgage loans* is revised.

iii. Under newly designated *35(b) Escrow accounts:*

a. Paragraph 1 is revised.

b. *35(b)(1) Requirement to escrow for property taxes and insurance* and paragraphs 1, 2, and 3 are added.

c. *35(b)(2) Exemptions* is added.

d. *Paragraph 35(b)(2)(i)* and paragraph 1 are added.

e. *Paragraph 35(b)(2)(ii)* and paragraphs 1, 2, and 3 are added.

f. *Paragraph 35(b)(2)(ii)(C)* and paragraphs 1 and 2 are removed.

g. *Paragraph 35(b)(2)(iii)* and paragraph 1 are added.

h. *Paragraph 35(b)(2)(iii)(D)(1)* and paragraph 1 are added.

i. *Paragraph 35(b)(2)(iii)(D)(2)* and paragraph 1 are added.

j. *Paragraph 35(b)(2)(iv)* and paragraph 1 are added.

k. *Paragraph 35(b)(2)(v)* and paragraph 1 are added.

iv. The heading for *35(b)(3) Escrows* is revised.

v. Under newly designated *35(b)(3) Cancellation:*

a. Paragraphs 1, 2, and 3 are added.

b. *35(b)(3)(i) Failure to escrow for property taxes and insurance* and paragraphs 1, 2, and 3 are removed.

c. *Paragraph 35(b)(3)(ii)(B)* and paragraph 1 are removed.

d. *35(b)(3)(v) ''Jumbo'' loans* and paragraphs 1 and 2 are removed.

The revisions and additions read as follows:

Supplement I to Part 1026—Official Interpretations

* * * * *

Subpart E—Special Rules for Certain Home Mortgage Transactions

* * * * *

§ 1026.35—Requirements for Higher-Priced Mortgage Loans

35(a) Definitions.

Paragraph 35(a)(1).

1. *Comparable transaction.* A higher-priced mortgage loan is a consumer credit transaction secured by the consumer's principal dwelling with an annual percentage rate that exceeds the average prime offer rate for a comparable transaction as of the date the interest rate is set by the specified margin. The table of average prime offer rates published by the Bureau indicates how to identify the comparable transaction.

2. *Rate set.* A transaction's annual percentage rate is compared to the average prime offer rate as of the date the transaction's interest rate is set (or ''locked'') before consummation. Sometimes a creditor sets the interest rate initially and then re-sets it at a different level before consummation. The creditor should use the last date the interest rate is set before consummation.

3. *Threshold for ''jumbo'' loans.* Section 1026.35(a)(1)(ii) provides a separate threshold for determining whether a transaction is a higher-priced mortgage loan subject to § 1026.35 when the principal balance exceeds the limit in effect as of the date the transaction's rate is set for the maximum principal obligation eligible for purchase by Freddie Mac (a ''jumbo'' loan). The Federal Housing Finance Agency (FHFA) establishes and adjusts the maximum principal obligation pursuant to rules under 12 U.S.C. 1454(a)(2) and other provisions of federal law. Adjustments to the maximum principal obligation made by FHFA apply in determining whether a mortgage loan is a ''jumbo'' loan to which the separate coverage threshold in § 1026.35(a)(1)(ii) applies.

Paragraph 35(a)(2).

* * * * *

2. *Bureau table.* The Bureau publishes on the Internet, in table form, average prime offer rates for a wide variety of transaction types. The Bureau calculates an annual percentage rate, consistent with Regulation Z (*see* § 1026.22 and appendix J), for each transaction type for which pricing terms are available from a survey. The Bureau estimates annual percentage rates for other types of transactions for which direct survey data are not available based on the loan pricing terms available in the survey and other information. The Bureau publishes on the Internet the methodology it uses to arrive at these estimates.

3. *Additional guidance on determination of average prime offer rates.* The average prime offer rate has the same meaning in § 1026.35 as in Regulation C, 12 CFR part 1003. See 12 CFR 1003.4(a)(12)(ii). Guidance on the average prime offer rate under § 1026.35(a)(2), such as when a transaction's rate is set and determination of the comparable transaction, is provided in the official commentary under Regulation C, the publication entitled ''A Guide to HMDA Reporting: Getting it Right!'', and the relevant ''Frequently Asked Questions'' on Home Mortgage Disclosure Act (HMDA) compliance posted on the FFIEC's Web site at *http://www.ffiec.gov/hmda.*

35(b) Escrow Accounts.

1. *Principal dwelling.* Section 1026.35(b)(1) applies to principal dwellings, including structures that are classified as personal property under State law. For example, an escrow account must be established on a higher-priced mortgage loan secured by a first lien on a manufactured home, boat, or trailer used as the consumer's principal dwelling. *See* the commentary under §§ 1026.2(a)(19) and(24), 1026.15, and 1026.23. Section 1026.35(b)(1) also applies to a higher-priced mortgage loan secured by a first lien on a condominium if it is in fact used as the consumer's principal dwelling. But see § 1026.35(b)(2) for exemptions from the escrow requirement that may apply to such transactions.

35(b)(1) Requirement to escrow for property taxes and insurance.

1. *Administration of escrow accounts.* Section 1026.35(b)(1) requires creditors to establish an escrow account for payment of property taxes and premiums for mortgage-related insurance required by the creditor before the consummation of a higher-priced mortgage loan secured by a first lien on a principal dwelling. Section 6 of RESPA, 12 U.S.C. 2605, and Regulation X, 12 CFR 1024.17, address how escrow accounts must be administered.

2. *Optional insurance items.* Section 1026.35(b)(1) does not require that an escrow account be established for premiums for mortgage-related insurance that the creditor does not require in connection with the credit transaction, such as earthquake insurance or credit life insurance, even if the consumer voluntarily obtains such insurance.

3. *Transactions not subject to § 1026.35(b)(1).* Section 1026.35(b)(1) requires a creditor to establish an escrow account before consummation of a first-lien higher-priced mortgage loan. This requirement does not affect a creditor's ability, right, or obligation, pursuant to the terms of the legal obligation or applicable law, to offer or require an escrow account for a transaction that is not subject to § 1026.35(b)(1).

35(b)(2) Exemptions.

Paragraph 35(b)(2)(i).

1. *Construction-permanent loans.* Under § 1026.35(b)(2)(ii)(B), § 1026.35 does not apply to a transaction to finance the initial construction of a dwelling. Section 1026.35 may apply, however, to permanent financing that replaces a construction loan, whether the permanent financing is extended by the same or a different creditor. When a construction loan may be permanently financed by the same creditor, § 1026.17(c)(6)(ii) permits the creditor to give either one combined disclosure for both the construction financing and the permanent financing, or a separate set of disclosures for each of the two phases as though they were two separate transactions. *See also* comment 17(c)(6)–2. Section 1026.17(c)(6)(ii) addresses only how a creditor may elect to disclose a construction-permanent transaction. Which disclosure option a creditor elects under § 1026.17(c)(6)(ii) does not affect the determination of whether the permanent phase of the transaction is subject to § 1026.35. When the creditor discloses the two phases as separate transactions, the annual percentage rate for the permanent phase must be compared to the average prime offer rate for a transaction that is comparable to the permanent financing to determine whether the transaction is a higher-priced mortgage loan under § 1026.35(a). When the creditor discloses the two phases as a single transaction, a single annual percentage rate, reflecting the appropriate charges from both phases, must be calculated for the transaction in accordance with § 1026.22(a)(1) and appendix D to part 1026. This annual percentage rate must be compared to the average prime offer rate for a transaction that is comparable to the permanent financing to determine the transaction is a higher-priced mortgage loan under § 1026.35(a). If the transaction is determined to be a higher-priced mortgage loan, only the permanent phase is subject to the requirement of § 1026.35(b)(1) to establish and maintain an escrow account, and the period for which the escrow account must remain in place under § 1026.35(b)(3) is measured from the time the conversion to the permanent phase financing occurs.

Paragraph 35(b)(2)(ii).

1. *Limited exemption.* A creditor is required to escrow for payment of property taxes for all first-lien higher-

priced mortgage loans secured by condominium, planned unit development, or similar dwellings or units regardless of whether the creditor escrows for insurance premiums for such dwellings or units.

2. *Planned unit developments.* Planned unit developments (PUDs) are a form of property ownership often used in retirement communities, golf communities, and similar communities made up of homes located within a defined geographical area. PUDs usually have a homeowners' association or some other governing association, analogous to a condominium association and with similar authority and obligations. Thus, as with condominiums, PUDs often have master insurance policies that cover all units in the PUD. Under § 1026.35(b)(2)(ii), if a PUD's governing association is obligated to maintain such a master insurance policy, an escrow account required by § 1026.35(b)(1) for a transaction secured by a unit in the PUD need not include escrows for insurance. This exemption applies not only to condominiums and PUDs but also to any other type of property ownership arrangement that has a governing association with an obligation to maintain a master insurance policy.

3. *More than one governing association associated with a dwelling.* The limited exemption provided pursuant to § 1026.35(b)(2)(ii) applies to each master insurance policy for properties with multiple governing associations, to the extent each governing association has an obligation to maintain a master insurance policy.

Paragraph 35(b)(2)(iii).

1. *Requirements for exemption.* Under § 1026.35(b)(2)(iii), except as provided in § 1026.35(b)(2)(v), a creditor need not establish an escrow account for taxes and insurance for a higher-priced mortgage loan, provided the following four conditions are satisfied when the higher-priced mortgage loan is consummated:

i. During the preceding calendar year, more than 50 percent of the creditor's total first-lien covered transactions, as defined in § 1026.43(b)(1), on properties located in counties that are either ''rural'' or ''underserved,'' as set forth in § 1026.35(b)(2)(iv). Pursuant to that section, the Bureau determines annually which counties in the United States are rural or underserved and publishes a list of those counties to enable creditors to determine whether they meet this condition for the exemption. Thus, for example, if a creditor originated 90 first-lien covered transactions, as defined by § 1026.43(b)(1), during 2013, the creditor meets this condition for an exemption in 2014 if at least 46 of those transactions are secured by first liens on properties that are located in counties that are on the Bureau's lists of rural or underserved counties for 2013.

ii. The creditor and its affiliates together originated 500 or fewer first-lien covered transactions, as defined in § 1026.43(b)(1), during the preceding calendar year.

iii. As of the end of the preceding calendar year, the creditor had total assets that are less than the asset threshold for the relevant calendar year. For calendar year 2013, the asset threshold is $2,000,000,000. Creditors that had total assets of less than $2,000,000,000 on December 31, 2012, satisfy this criterion for purposes of the exemption during 2013. This asset threshold shall adjust automatically each year based on the year-to-year change in the average of the Consumer Price Index for Urban Wage Earners and Clerical Workers, not seasonally adjusted, for each 12-month period ending in November, with rounding to the nearest million dollars. The Bureau will publish notice of the asset threshold each year by amending this comment.

iv. The creditor and its affiliates do not maintain an escrow account for any mortgage transaction being serviced by the creditor or its affiliate at the time the transaction is consummated, except as provided in § 1026.35(b)(2)(iii)(D)(*1*) and (*2*). Thus, the exemption applies, provided the other conditions of § 1026.35(b)(2)(iii) are satisfied, even if the creditor previously maintained escrow accounts for mortgage loans, provided it no longer maintains any such accounts except as provided in § 1026.35(b)(2)(iii)(D)(*1*) and (*2*). Once a creditor or its affiliate begins escrowing for loans currently serviced other than those addressed in § 1026.35(b)(2)(iii)(D)(*1*) and (*2*), however, the creditor and its affiliate become ineligible for the exemption in § 1026.35(b)(2)(iii) on higher-priced mortgage loans they make while such escrowing continues. Thus, as long as a creditor (or its affiliate) services and maintains escrow accounts for any mortgage loans, other than as provided in § 1026.35(b)(2)(iii)(D)(*1*) and (*2*), the creditor will not be eligible for the exemption for any higher-priced mortgage loan it may make. For purposes of § 1026.35(b)(2)(iii), a creditor or its affiliate ''maintains'' an escrow account only if it services a mortgage loan for which an escrow account has been established at least through the due date of the second periodic payment under the terms of the legal obligation.

Paragraph 35(b)(2)(iii)(D)(1).

1. *Exception for certain accounts.* Escrow accounts established for first-lien higher-priced mortgage loans on or after April 1, 2010, and before June 1, 2013, are not counted for purposes of § 1026.35(b)(2)(iii)(D). On and after June 1, 2013, creditors, together with their affiliates, that establish new escrow accounts, other than those described in § 1026.35(b)(2)(iii)(D)(*2*), do not qualify for the exemption provided under § 1026.35(b)(2)(iii). Creditors, together with their affiliates, that continue to maintain escrow accounts established between April 1, 2010, and June 1, 2013, still qualify for the exemption provided under § 1026.35(b)(2)(iii) so long as they do not establish new escrow accounts for transactions consummated on or after June 1, 2013, other than those described in § 1026.35(b)(2)(iii)(D)(*2*), and they otherwise qualify under § 1026.35(b)(2)(iii).

Paragraph 35(b)(2)(iii)(D)(2).

1. *Exception for post-consummation escrow accounts for distressed consumers.* An escrow account established after consummation for a distressed consumer does not count for purposes of § 1026.35(b)(2)(iii)(D). Distressed consumers are consumers who are working with the creditor or servicer to attempt to bring the loan into a current status through a modification, deferral, or other accommodation to the consumer. A creditor, together with its affiliates, that establishes escrow accounts after consummation as a regular business practice, regardless of whether consumers are in distress, does not qualify for the exception described in § 1026.35(b)(2)(iii)(D)(*2*).

Paragraph 35(b)(2)(iv).

1. *Requirements for ''rural'' or ''underserved'' status.* A county is considered to be ''rural'' or ''underserved'' for purposes of § 1026.35(b)(2)(iii)(A) if it satisfies either of the two tests in § 1026.35(b)(2)(iv). The Bureau applies both tests to each county in the United States and, if a county satisfies either test, the Bureau will include the county on a published list of ''rural'' or ''underserved'' counties for a particular calendar year. To facilitate compliance with § 1026.35(c), the Bureau also creates a list of only those counties that are ''rural'' but not also ''underserved.'' The Bureau will post on its public Web site the applicable lists for each calendar year by the end of that year. A creditor may rely as a safe harbor, pursuant to section 130(f) of the Truth in Lending Act, on the lists of counties published by the Bureau to determine whether a county qualifies as ''rural'' or ''underserved'' for a particular calendar year. A creditor's originations of

covered transactions, as defined by § 1026.43(b)(1), in such counties during that year are considered in determining whether the creditor satisfies the condition in § 1026.35(b)(2)(iii)(A) and therefore will be eligible for the exemption during the following calendar year.

i. Under § 1026.35(b)(2)(iv)(A), a county is rural during a calendar year if it is neither in a metropolitan statistical area nor in a micropolitan statistical area that is adjacent to a metropolitan statistical area. These areas are defined by the Office of Management and Budget and applied under currently applicable Urban Influence Codes (UICs), established by the United States Department of Agriculture's Economic Research Service (USDA–ERS). Specifically, the Bureau classifies a county as ''rural'' if the USDA–ERS categorizes the county under UIC 4, 6, 7, 8, 9, 10, 11, or 12. Descriptions of UICs are available on the USDA–ERS Web site at *http://www.ers.usda.gov/data-products/urban-influence-codes/documentation.aspx.*

ii. Under § 1026.35(b)(2)(iv)(B), a county is underserved during a calendar year if, according to Home Mortgage Disclosure Act (HMDA) data for that year, no more than two creditors extend first-lien covered transactions, as defined in § 1026.43(b)(1), secured by a first lien five or more times in the county. These areas are defined by reference to the specific calendar year's HMDA data. Specifically, a county is ''underserved'' if, in the applicable calendar year's public HMDA aggregate dataset, no more than two creditors have reported five or more first-lien covered transactions with HMDA geocoding that places the properties in that county. For purposes of this determination, because only covered transactions are counted, all first-lien originations (and only first-lien originations) reported in the HMDA data are counted except those for which the owner-occupancy status is reported as ''Not owner-occupied'' (HMDA code 2), the property type is reported as ''Multifamily'' (HMDA code 3), the applicant's or co-applicant's race is reported as ''Not applicable'' (HMDA code 7), or the applicant's or co-applicant's sex is reported as ''Not applicable'' (HMDA code 4). The most recent HMDA data are available at *http://www.ffiec.gov/hmda.*

Paragraph 35(b)(2)(v).

1. *Forward commitments.* A creditor may make a mortgage loan that will be transferred or sold to a purchaser pursuant to an agreement that has been entered into at or before the time the loan is consummated. Such an agreement is sometimes known as a ''forward commitment.'' Even if a creditor is otherwise eligible for the exemption in § 1026.35(b)(2)(iii), a first-lien higher-priced mortgage loan that will be acquired by a purchaser pursuant to a forward commitment is subject to the requirement to establish an escrow account under § 1026.35(b)(1) unless the purchaser is also eligible for the exemption in § 1026.35(b)(2)(iii) or the transaction is otherwise exempt under § 1026.35(b)(2). The escrow requirement applies to any such transaction, whether the forward commitment provides for the purchase and sale of the specific transaction or for the purchase and sale of mortgage obligations with certain prescribed criteria that the transaction meets. For example, assume a creditor that qualifies for the exemption in § 1026.35(b)(2)(iii) makes a higher-priced mortgage loan that meets the purchase criteria of an investor with which the creditor has an agreement to sell such mortgage obligations after consummation. If the investor is ineligible for the exemption in § 1026.35(b)(2)(iii), an escrow account must be established for the transaction before consummation in accordance with § 1026.35(b)(1) unless the transaction is otherwise exempt (such as a reverse mortgage or home equity line of credit).

35(b)(3) Cancellation.

1. *Termination of underlying debt obligation.* Section 1026.35(b)(3)(i) provides that, in general, an escrow account required by § 1026.35(b)(1) may not be cancelled until the underlying debt obligation is terminated or the consumer requests cancellation at least five years after consummation. Methods by which an underlying debt obligation may be terminated include, among other things, repayment, refinancing, rescission, and foreclosure.

2. *Minimum durations.* Section 1026.35(b)(3) establishes minimum durations for which escrow accounts established pursuant to § 1026.35(b)(1) must be maintained. This requirement does not affect a creditor's right or obligation, pursuant to the terms of the legal obligation or applicable law, to offer or require an escrow account thereafter.

3. *Less than eighty percent unpaid principal balance.* The term ''original value'' in § 1026.35(b)(3)(ii)(A) means the lesser of the sales price reflected in the sales contract for the property, if any, or the appraised value of the property at the time the transaction was consummated. In determining whether the unpaid principal balance has reached less than 80 percent of the original value of the property securing the underlying debt, the creditor or servicer shall count any subordinate lien of which it has reason to know. If the consumer certifies in writing that the equity in the property securing the underlying debt obligation is unencumbered by a subordinate lien, the creditor or servicer may rely upon the certification in making its determination unless it has actual knowledge to the contrary.

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Dated: January 10, 2013.

Richard Cordray,

Director, Bureau of Consumer Financial Protection.

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