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12 CFR Part 226

Truth in Lending; Proposed Rule

FEDERAL RESERVE SYSTEM

12 CFR Part 226

[Regulation Z; Docket No. R–1406]

RIN No. 7100–AD 65

Truth in Lending

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Proposed rule; request for public comment.

SUMMARY: The Board is publishing for public comment a proposed rule that would amend 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. Regulation Z currently requires creditors to establish escrow accounts for higher-priced mortgage loans secured by a first lien on a dwelling. The proposal would implement 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. In addition, the proposal would implement the Act's disclosure requirements regarding escrow accounts. The proposal also would exempt certain loans from the statute's escrow requirement. The primary exemption would apply to mortgage loans extended by creditors that operate predominantly in rural or underserved areas, originate a limited number of mortgage loans, and do not maintain escrow accounts for any mortgage loans they service.

DATES: Comments must be received on or before May 2, 2011.

ADDRESSES: You may submit comments, identified by Docket No. R–1406 and RIN No. 7100–AD 65, by any of the following methods:

- *Agency Web Site: http://www.federalreserve.gov*. Follow the instructions for submitting comments at *http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm*.
- *Federal eRulemaking Portal: http://www.regulations.gov*. Follow the instructions for submitting comments.
- *E-mail: regs.comments@federalreserve.gov*. Include the docket number in the subject line of the message.
- *Fax:* (202) 452–3819 or (202) 452–3102.
- *Mail:* Address to Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW., Washington, DC 20551.

All public comments will be made available on the Board's Web site at *http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm* as submitted, unless modified for technical reasons. Accordingly, comments will not be edited to remove any identifying or contact information. Public comments may also be viewed electronically or in paper in Room MP–500 of the Board's Martin Building (20th and C Streets, NW.,) between 9 a.m. and 5 p.m. on weekdays.

FOR FURTHER INFORMATION CONTACT: Samantha Pelosi, Attorney, or Paul Mondor, Senior Attorney, Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, Washington, DC 20551, at (202) 452–2412 or (202) 452–3667. For users of Telecommunications Device for the Deaf (TDD) only, contact (202) 263–4869.

SUPPLEMENTARY INFORMATION:

I. Background

Congress enacted the Truth in Lending Act (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. 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) loan. TILA also contains procedural and substantive protections for consumers. TILA is implemented by the Board's Regulation Z. An Official Staff Commentary interprets the requirements of Regulation Z. By statute, creditors that follow in good faith Board or official staff interpretations 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. 73 FR 44522; July 30, 2008 (the HOEPA Final Rule). Among other things, the HOEPA Final Rule defined a class of higher-priced mortgage loans that are subject to additional protections. A higher-priced mortgage loan is a transaction secured by a consumer's principal dwelling with an annual percentage rate that exceeds the average prime offer rate for a comparable transaction by 1.5 or more percentage points for loans secured by a first lien, or by 3.5 or more percentage points for loans secured by a subordinate lien. The HOEPA Final Rule included a requirement that creditors establish escrow accounts for taxes and insurance on higher-priced mortgage loans secured by a first lien on a principal dwelling. The escrow requirement was effective on April 1, 2010, for loans secured by site-built homes, and on October 1, 2010, for loans secured by manufactured housing.

On August 26, 2009, the Board published a proposed rule to amend Regulation Z. 74 FR 43232; Aug. 26, 2009 (the 2009 Closed-End Proposal). Among other things, the 2009 Closed-End Proposal proposed new staff commentary to address questions that some creditors had raised concerning the determination of the average prime offer rate that is used to determine whether a transaction is a higher-priced mortgage loan covered by the HOEPA Final Rule. No final action has been taken on this proposal.

On July 21, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) was signed into law. 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. The escrow provisions of the Dodd-Frank Act are similar, but not identical, to the provisions adopted by the Board in the HOEPA Final Rule. Sections 1461 and 1462 of the Dodd-Frank Act create new TILA Section 129D, which substantially codifies the Board's escrow requirement for higher-priced mortgage loans but also adds disclosure requirements, lengthens the period for which escrow accounts are required, and adjusts the rate threshold for determining whether escrow accounts are required for "jumbo loans," whose principal amounts exceed the maximum eligible for purchase by Freddie Mac. The new section also authorizes the Board to create an exemption from the escrow requirement for transactions originated by creditors meeting certain prescribed criteria.

On September 24, 2010, the Board published two other proposed rules that would affect the escrow requirement for higher-priced mortgage loans. First, the Board proposed, among other amendments, to replace the APR as the metric a creditor compares to the average prime offer rate to determine whether a transaction is a higher-priced mortgage loan. Creditors instead would use a "transaction coverage rate" that would be closely comparable to the average prime offer rate and would not

be disclosed to consumers. 75 FR 58539; Sept. 24, 2010 (the 2010 Mortgage Proposal). No final action has been taken on this proposal. Second, the Board proposed to implement one of the amendments to the TILA made by the Dodd-Frank Act. That amendment establishes a separate threshold above the average prime offer rate for determining coverage of the escrow requirement for "jumbo" loans, as discussed above. 75 FR 58505; Sept. 24, 2010 (the "Jumbo" Threshold Proposal). Simultaneous with this proposal, the Board is publishing a final rule to adopt the provisions in the "Jumbo" Threshold Proposal (the "Jumbo" Final Rule).

II. Summary of the Proposed Rule

The Board is proposing amendments to Regulation Z's escrow requirement, in accordance with the Dodd-Frank Act. First, the proposed rule would expand the minimum period for mandatory escrow accounts from one to five years, and under certain circumstances longer. Second, the proposed rule would extend the partial exemption for certain loans 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 proposed rule would create an exemption from the escrow requirement for any loan 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 of 100 or fewer first-lien mortgage loans, and does not escrow for any mortgage transaction it services.

The Board also is proposing to establish two new disclosure requirements relating to escrow accounts. One disclosure would be required three business days before consummation of a mortgage transaction for which an escrow account will be established. The Dodd-Frank Act requires such disclosures for higher-priced mortgage loans, for which such an escrow account is required; the Board is proposing to require the same disclosure for all mortgage loans for which an escrow account is established. The disclosure would explain what an escrow account is and how it works. It would state the risk of not having an escrow account. The disclosure would state the estimated amount of the first year's disbursements, the amount to be paid at consummation to fund the escrow account initially, and the amount of the consumer's regular mortgage payments to be paid into the escrow account. Finally, the disclosure would state that the amount of the regular escrow payment may change in the future.

Also, pursuant to the Dodd-Frank Act, the Board is proposing a second disclosure that would be given when a mortgage transaction is entered into without an escrow account or when an escrow account on an existing mortgage loan will be cancelled. The disclosure would be required to be delivered at least three business days before consummation or cancellation of the existing escrow account, as applicable. This disclosure would explain what an escrow account is, how it works, and the risk of not having an escrow account. It also would state the potential consequences of failing to pay home-related costs such as taxes and insurance in the absence of an escrow account. In addition, it would state why there will be no escrow account or why it is being cancelled, as applicable, the amount of any fee imposed for not having an escrow account, and how the consumer can request that an escrow account be established or left in place, along with any deadline for such requests.

III. Consumer Testing for This Proposal

As noted above, the Dodd-Frank Act amended TILA to require new disclosures regarding escrow accounts. Consistent with its practice concerning disclosures required by Regulation Z, the Board conducted consumer testing to develop the disclosures in this proposal. The Board retained ICF Macro, a research and consulting firm that specializes in designing and testing documents, to design and test model disclosure forms for this proposal.

ICF Macro worked closely with the Board to conduct one round of testing (eight interviews) on the Board's proposed disclosures regarding escrow accounts. Interview participants were asked to review model forms and provide their reactions, and they then were asked a series of questions designed to test their understanding of the content. Data were collected on which elements and features of each form were most successful in providing information clearly and effectively. The findings were incorporated in revised model forms, which are included in this proposal.

Key findings of the Board's consumer testing are discussed where relevant in the section-by-section analysis below. ICF Macro prepared a report of the results of the testing, which is available on the Board's public Web site along at: *http://www.federalreserve.gov*.

IV. Section-by-Section Analysis

Section 226.2 Definitions and Rules of Construction

2(a) Definitions

2(a)(6) Business Day

The Board is proposing revisions to § 226.2(a)(6) to define "business day" for purposes of the timing of the new disclosures for escrow account. Currently, § 226.2(a)(6) contains two definitions of business day. Under the general definition, a business day is a day on which the creditor's offices are open to the public for carrying on substantially all of its business functions. *See* comment 2(a)(6)–1. For some purposes, however, a more precise definition of business day applies: All calendar days except Sundays and specified Federal legal holidays.

TILA Section 129D(h) requires creditors to disclose certain information regarding a mandatory escrow account at least three business days before consummation of the transaction giving rise to such account or in accordance with timeframes established by regulation. The Board is proposing to revise § 226.2(a)(6) and comment 2(a)(6)–2 to apply the more precise definition of business day for this purpose. This proposed application of the more precise definition of business day is being made so that the same definition of business day would be used for the three-business-day waiting period proposed in § 226.19(f)(4) as in the seven-business day waiting period for the early disclosures and three-business-day waiting period for the corrected disclosures in § 226.19(a)(2), which should simplify compliance. This proposal would also apply the more precise definition of business day to the requirement in proposed § 229.20(d)(4) that servicers provide disclosures regarding the cancellation of an escrow account at least three business days before closure of the escrow account.

Section 226.19 Certain Transactions Secured by Real Property or a Dwelling 19(f) Escrow Accounts

Requirements of TILA Section 129D

The Board is proposing a new § 226.19(f) to implement the escrow account disclosure requirements of TILA Section 129D, as enacted by Sections 1461 and 1462 of the Dodd-Frank Act. TILA Section 129D(a) contains the statutory requirement that an escrow account be established in connection with the consummation of any consumer credit transaction secured by a first lien on a consumer's principal dwelling (other than an open-end credit

plan or a reverse mortgage). Section 129D(b), however, limits that requirement to four specified circumstances: (1) Where an escrow account is required by federal or state law; (2) where the loan 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 margins; and (4) where an escrow account is "required pursuant to regulation." TILA Section 129D(h) requires certain disclosures when an escrow account mandated by TILA Section 129D(b) is established. TILA Section 129D(j) requires certain other disclosures when an escrow account for a transaction secured by real property is not established or is cancelled.

The Board's Proposal

For a closed-end transaction secured by a first-lien on real property or a dwelling, proposed § 226.19(f) would require the creditor to disclose the information about escrow accounts specified in § 226.19(f)(2)(i) when an escrow account is established and specified in § 226.19(f)(2)(ii) when an escrow account is not established in connection with the consummation. Proposed § 226.19(f) would require the creditor to disclose this information in accordance with the format requirements of § 226.19(f)(1) and the timing requirements of § 226.19(f)(4). In addition, the proposal would provide that for purposes of § 226.19(f), the term "escrow account" has the same meaning as under Regulation X (24 CFR 3500.17(b)), which implements the Real Estate Settlement Procedures Act (RESPA), and is subject to any interpretations by the Department of Housing and Urban Development (HUD). This proposed definition would parallel existing § 226.35(b)(3)(iv). Proposed comment 19(f)–1 would clarify that the term "real property" includes vacant and unimproved land. It also would clarify that the term "dwelling" includes vacation and second homes and mobile homes, boats, and trailers used as residences and refer to additional guidance regarding the term provided by § 226.2(a)(19) and the related commentary.

Secured by a first-lien transaction. Proposed § 226.19(f) would require 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. TILA Sections 129D(a) and (b) require the establishment of an escrow account in connection with only first-lien mortgage loans. TILA Sections 129D(h) and (j) require disclosures when such an escrow account is established or is not established in connection with consummation. Proposed § 226.19(f) would not require disclosures for subordinate-lien mortgages because TILA does not require the establishment of escrow accounts for subordinate-lien mortgages and the Board understands that creditors rarely offer or establish escrow accounts for such mortgages. Nevertheless, the Board seeks comment on whether this approach is appropriate.

Disclosures for establishment of voluntary escrow accounts. Proposed § 226.19(f) would implement the TILA Section 129D(h) disclosure requirements for the establishment of escrow accounts mandated by TILA Section 129D(b) and also would impose disclosure requirements for the establishment of escrow accounts that are not mandated by TILA. Under the proposal, creditors would have to make the same disclosures for any escrow account that will be established in connection with the consummation of a loan secured by a first lien. The proposed disclosure requirement would inform all consumers obtaining an escrow account, whether mandatory or voluntary, about the function and purpose of escrow accounts generally and the funding of their escrow account specifically.

The proposed § 226.19(f) requirement that disclosures be provided for the establishment of both mandatory and voluntary escrow accounts would parallel the TILA Section 129D(j) requirement that disclosures be provided for the non-establishment or cancellation of any type of escrow account. Conforming the types of escrow accounts that trigger the establishment disclosures to those that trigger the non-establishment and cancellation disclosures avoids the anomalous result of a consumer receiving information about escrow accounts when an escrow account is not established or is cancelled, but not when it is established in the first place.

The Board proposes that the TILA Section 129D(h) disclosures be provided for voluntary as well as mandatory escrow accounts pursuant to its authority under TILA Section 105(a). It authorizes the Board to prescribe regulations that contain classifications, differentiations, or other provisions, and may provide for adjustments and exceptions for any class of transactions, to effectuate the purposes of TILA and Regulation Z, to prevent circumvention or evasion, or to facilitate compliance. 15 U.S.C. 1604(a). One purpose of the statute is to assure meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available and avoid the uninformed use of credit. 15 U.S.C. 1601(a). The Board believes that providing disclosures to consumers that will have a voluntary escrow account established would enable those consumers to compare the costs of different mortgage loans available to them more easily and to avoid the uninformed use of credit. The information provided would allow consumers to compare the cost and fees of mortgage loans that have and do not have an escrow account, to identify the premium that different creditors may be charging for a mortgage loan with an escrow account, and to understand the total obligation of the mortgage loan that they ultimately may choose.

Real property or a dwelling. With § 226.19(f), the Board covers real property and principal dwellings as well as dwellings that are not used as a principal residence. TILA Section 129D(h) requires certain disclosures when an escrow account mandated by TILA Section 129D(b) is established in connection with the consummation of a closed-end transaction secured by a consumer's principal dwelling. TILA Section 129D(j) requires certain other disclosures when an escrow account for a transaction secured by real property is not established or is cancelled. Proposed § 226.19(f)(2) implements TILA Section 129D(h) regarding disclosures when an escrow account is established in connection with consummation of a transaction secured by a consumer's principal dwelling, but also covers other dwellings and real property without a dwelling. In addition, proposed § 226.19(f)(2) implements TILA Section 129D(j) regarding disclosures when an escrow account is not established in connection with consummation of a transaction secured by real property, but also covers dwellings that would be considered personal property under state law. The Board believes that coverage of the same types of property under the disclosure requirements for the establishment as well as the non-establishment of an escrow account would promote the informed use of credit by consumers and compliance by creditors. The disclosures for the establishment of an escrow account likely would be just as useful to a consumer entering into a transaction secured by a second or vacation home or vacant or unimproved land as it would to a consumer entering into a transaction secured by a principal dwelling. Similarly, the disclosures for the non-establishment of an escrow

account should cover all dwellings, whether or not they are deemed to be real or personal property under state law. Furthermore, the coverage of all dwellings would eliminate the analysis that creditors would have to undertake to determine whether and which disclosures would be triggered when a transaction will be secured by any one of various types of dwellings.

The Board proposes the § 229.19(f) coverage of real property and dwellings pursuant to its authority under TILA Section 105(a). 15 U.S.C. 1604(a). TILA Section 105(a) authorizes the Board to prescribe regulations that contain classifications, differentiations, or other provisions, and may provide for adjustments and exceptions for any class of transactions, to effectuate the purposes of TILA and Regulation Z, to prevent circumvention or evasion, or to facilitate compliance. 15 U.S.C. 1604(a). One purpose of the statute is to assure meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available and avoid the uninformed use of credit. 15 U.S.C. 1601(a). The class of transactions that would be affected is transactions secured by real property or a dwelling. As mentioned above, providing disclosures regarding an escrow account to consumers entering into a transaction secured by real estate or a dwelling would both educate consumers and ease compliance burdens for creditors.

19(f)(1) Format Requirements

Proposed § 226.19(f)(1) contains format requirements for the disclosures required by § 226.19(f)(2). Proposed § 226.19(f)(1)(i) requires that creditors provide the § 226.19(f)(2) disclosures in a minimum 10-point font, grouped together on the front side of a one-page document, separate from all other material, with the headings, content, order, and format substantially similar to Model Form H–24 (when an escrow account is established) or Model Form H–25 (when an escrow account is not established) in Appendix H. Consumer testing has shown that the location and order in which information was presented affected consumers' ability to locate and comprehend the information disclosed. Proposed comment 19(f)(1)(i)–1 clarifies that the disclosures required by § 226.19(f)(2) and any optional information permitted by § 226.19(f)(3) must be grouped together on the front side of a separate one-page document that contains no other material. The proposed comment also clarifies that the § 226.19(f)(2)(i) disclosures may not appear in the same document as the escrow disclosures required under § 226.18 or under RESPA or Regulation X. Proposed comment 19(f)(1)(i)–2 clarifies that the notice containing the disclosures required by § 226.19(f)(2) and any optional information permitted by § 226.19(f)(3) must be in writing in a form that the consumer may keep.

Proposed § 226.19(f)(1)(ii) would require that the heading "Information About Your Mortgage Escrow Account" required by § 226.19(f)(2)(i) or the heading "Required Direct Payment of Property Taxes and Insurance" required by § 226.19 (f)(2)(ii) be more conspicuous than and precede the other disclosures. The heading would be required to be outside the table that is required by proposed § 226.19(f)(1)(iii).

Proposed § 226.19(f)(1)(iii) would require the creditor to provide the disclosures regarding the establishment of an escrow account under § 226.19(f)(2)(i) in the form of a table containing four rows or the non-establishment of an escrow account under § 226.19(f)(2)(ii) in the form of a table containing no more than seven rows. The disclosures regarding the non-establishment of an escrow account under § 226.19(f)(2)(ii) would be in the form of a table containing five rows when the creditor does not offer the option of having an escrow account. In such a case, the creditor would be required by to omit the §§ 226.19(f)(2)(ii)(D) and (G) disclosures from the table because they would be inapplicable. Only the information required or permitted by § 226.19(f)(2)(i) or (ii) would be allowed to appear in the table. Proposed § 226.19(f)(1)(iv) would require the creditor to present the disclosures in the format of a question and answer in a manner substantially similar to Model Form H–24 or H–25 in Appendix H. Consumer testing has shown that using a tabular, question and answer format improved participants' ability to identify and understand key information. Proposed § 226.19(f)(1)(iv) also would require the creditor to present the disclosures appearing in the table in the order listed in § 226.19(f)(2)(i)(A)–(D) or (ii)(A)–(G), as applicable. This order would ensure that consumers receive the disclosed information in a logical progression.

Proposed § 226.19(f)(1)(v) would require the creditor to highlight certain disclosures because consumer testing has shown that such emphasis allows consumers to locate and identify important information more quickly. The Board proposes that all dollar amounts be presented in bold font. It also proposes implementation of the requirement in TILA Section 129D(j)(2)(B) that the notice regarding the non-establishment of an escrow account contain a "prominent" statement of the consumer's responsibility for covering home-related costs through potentially large semi-annual or annual payments by requiring presentation of that information in bold format.

19(f)(2) Content Requirements

19(f)(2)(i) Establishment of Escrow Account

Proposed § 226.19(f)(2)(i) would implement TILA Section 129D(h) by setting forth the required content for the disclosure notice regarding the establishment of an escrow account before the end of the 45-day period following consummation of a transaction subject to § 226.19(f). The proposed 45-day period reflects the requirement in § 3500.17(g)(1) of Regulation X, which implements RESPA, that the servicer submit an initial escrow account statement to the borrow at settlement or within 45 calendar days of settlement for escrow accounts that are established as a condition of the loan. The Board solicits comment on whether the 45-day period is appropriate for deeming an account to be established in connection with consummation of a mortgage transaction. Proposed comment 19(f)(2)(i)–2 would clarify that neither creditors nor servicers are required to provide the § 226.19(f)(2)(i) disclosures when an escrow account is established solely in connection with the consumer's delinquency or default on the underlying debt obligation.

Proposed § 226.19(f)(2)(i) also would require the disclosures to be made clearly and conspicuously. Proposed comment 19(f)(2)(i)–1 would clarify that, to meet the clear and conspicuous standard, disclosures must be made in a reasonably understandable form and readily noticeable to the consumer. Proposed § 226.19(f)(2)(i) also would require the disclosure notice to bear the heading "Information About Your Mortgage Escrow Account."

19(f)(2)(i)(A) Purpose of Notice

Proposed § 226.19(f)(2)(i)(A) would require a statement that the purpose of the notice is to inform the consumer that the consumer's mortgage with the creditor will have an escrow account. This proposed provision would implement the requirement of TILA Section 129D(h)(1) that the creditor disclose the fact that an escrow account will be established.

19(f)(2)(i)(B) Explanation of Escrow Account

Proposed § 226.19(f)(2)(i)(B) would require the creditor to provide a statement that an escrow account is an account used to pay home-related costs such as property taxes and insurance together with a statement that an escrow account is sometimes called an "impound" or "trust" account. This information would be followed by a statement that the consumer will pay into the escrow account over time and that the creditor will take money from the account to pay costs as needed. The Board is proposing these statements explaining an escrow account, the other names sometimes used for an escrow account, and how an escrow account works pursuant to its authority under TILA Section 129D(h)(6) to prescribe regulations requiring the creditor to disclose such other information as the Board determines necessary for the protection of the consumer. The Board believes that informing consumers of the other names for an escrow account would prevent consumers in Western regions of the country from confusing an escrow account for the payment of home-related costs such as property taxes and insurance premiums with the escrow that is commonly used for the closing and settlement of a credit transaction. The Board also believes that the basic information explaining what an escrow account is and how it works provides needed context for the other disclosures in the notice.

Proposed § 226.19(f)(2)(i)(B) also would require a statement of the estimated dollar amount that the consumer's home-related costs will total for the first year of the mortgage. TILA Section 129D(h)(3) requires creditors establishing an escrow account in connection with a transaction to disclose the amount, in the initial year after consummation, of the estimated taxes and hazard insurance. The statement regarding the total dollar amount of the estimated home-related costs would implement the TILA Section 129D(h)(3) requirement. Proposed comment 19(f)(2)(i)–1 states that the creditor may comply with the numerical content requirement of § 226.19(f)(2)(i)(B) by using the amount derived from the escrow account analysis conducted pursuant to Regulation X.

19(f)(2)(i)(C) Risk of Not Having Escrow Account

Proposed § 226.19(f)(2)(i)(C) would require a statement that, if the consumer did not have an escrow account, the consumer would be responsible for directly paying home-related costs through potentially large semi-annual or annual payments. This is consistent with the requirements of TILA Section 129D(h)(5). The Board is proposing the statement regarding the consumer's direct responsibility, in the absence of an escrow account, for paying home-related costs through potentially large payments to implement TILA Section 129D(h)(5) and to conform the disclosure with the similar disclosure required by TILA Section 129D(j)(2)(B) regarding the non-establishment of an escrow account.

19(f)(2)(i)(D) Funding of Escrow Account

Proposed § 226.19(f)(2)(i)(D) would implement TILA Section 129D(h)(2) by requiring a statement of the dollar amount that the consumer will be required to deposit at closing to initially fund the escrow account. Proposed § 226.19(f)(2)(i)(D) also would implement TILA Section 129D(h)(4) by requiring a statement of the dollar amount that the consumer's periodic mortgage payments will include for deposit into the escrow account. In addition, proposed § 226.19(f)(2)(i)(D) would require a third statement that the amount of this escrow payment may change in the future. The Board is proposing to require this last statement pursuant to its authority under TILA Section 129D(h)(6) to prescribe regulations requiring the creditor to disclose such other information as the Board determines necessary for the protection of the consumer. This information notifies a consumer that his or her periodic mortgage payment could change with an increase or decrease in property tax or hazard insurance costs. Proposed comment 19(f)(2)(i)–1 states that the creditor may comply with the numerical content requirement of § 226.19(f)(2)(i)(D) by using the amount derived from the escrow account analysis conducted pursuant to Regulation X.

19(f)(2)(ii) Non-Establishment of Escrow Account

Proposed § 226.19(f)(2)(ii) would implement TILA Section 129D(j)(2) by setting forth the required content for the disclosure notice regarding escrow accounts when an escrow account will not be established before the end of the 45-day period following consummation of a transaction subject to § 226.19(f).

Proposed § 226.19(f)(2)(ii) would require that the disclosures be made clearly and conspicuously. Proposed comment 19(f)(2)(ii)–1 refers to comment 19(f)(2)(i)–1, which clarifies that, to meet the clear and conspicuous standard, disclosures must be made in a reasonably understandable form and readily noticeable to the consumer. Proposed § 226.19(f)(2)(ii) also would require the disclosure notice to bear the heading "Required Direct Payment of Property Taxes and Insurance."

19(f)(2)(ii)(A) Purpose of Notice

Proposed § 226.19(f)(2)(ii)(A) would require a statement that the purpose of the notice is to inform the consumer that the consumer's mortgage with the creditor will not have an escrow account and to explain the risk of not having an escrow account. The Board is proposing these disclosures pursuant to the Board's authority under TILA Section 129D(j)(2)(D) to include in the notice such other information as the Board determines necessary for the protection of the consumer. The Board believes that these disclosures are necessary to draw the consumer's attention to the fact that his or her mortgage will not have an escrow account and the implications of such absence.

19(f)(2)(ii)(B) Explanation of Escrow Account

Proposed § 226.19(f)(2)(ii)(B) would require the creditor to provide a statement that an escrow account is an account that is used to pay home-related costs such as property taxes and insurance together with a statement that an escrow account is sometimes called an "impound" or "trust" account. This information would be followed by a statement that the borrower pays into the escrow account over time and that the creditor takes money from the account to pay costs as needed. The Board is proposing these statements explaining an escrow account, the other names sometimes used for an escrow account, and how an escrow account works pursuant to its authority under TILA Section 129D(h)(6) to prescribe regulations requiring the creditor to disclose such other information as the Board determines necessary for the protection of the consumer. The Board believes that informing consumers of the other names for an escrow account would prevent consumers in Western regions of the country from confusing an escrow account for the payment of home-related costs such as property taxes and insurance premiums with the escrow that is commonly used for the closing and settlement of a credit transaction. The Board also believes that the basic information explaining what an escrow account is and how it works provides needed context for the other disclosures in the notice.

19(f)(2)(ii)(C) Reason Why Mortgage Will Not Have an Escrow Account

Proposed § 226.19(f)(2)(ii)(C) would require a statement that the consumer was given the option of having an escrow account but that the consumer waived it or a statement that the creditor does not offer the option of having an escrow account, as applicable. The Board is proposing this disclosure pursuant to the Board's authority under TILA Section 129D(j)(2)(D) to include in the notice such other information as the Board determines necessary for the protection of the consumer. This disclosure would provide the consumer with the background information necessary to understand the disclosure required by § 226.19(f)(2)(ii)(G) at the end of the notice as to whether the consumer has an option to request the establishment of an escrow account.

19(f)(2)(ii)(D) Fee for Choosing Not To Have Escrow Account

Proposed § 226.19(f)(2)(ii)(D) would implement TILA Section 129D(j)(2)(A) by requiring disclosure of any fee charged for not establishing an escrow account. Proposed § 226.19(f)(2)(ii)(D) would require, if the consumer waives establishment of an escrow account, a statement of the dollar amount of any fee that the consumer will be charged for choosing not to have an escrow account, or a statement that the consumer will not be charged a fee. If the creditor is not establishing an escrow account because it does not offer escrow accounts to consumers, proposed § 226.19(f)(2)(ii)(D) would require the creditor to omit this disclosure from the table.

The Board understands that creditors only charge a fee for the non-establishment of an escrow account when the creditor usually offers and establishes escrow accounts for all first-lien transactions, but a particular consumer requests that an escrow account not be established for his or her transaction. A creditor that offers and establishes escrow accounts for all first-lien transactions typically benefits from this practice because the funds in the escrow accounts provide interest income to the creditor and additional capital reserves. The Board believes that a creditor that is asked by a consumer not to engage in its usual practice of establishing an escrow account for his or her particular transaction may charge that consumer a fee for foregoing such financial benefits with respect the transaction. Creditors that do not regularly offer or establish escrow accounts do not charge consumers for the non-establishment of an escrow account, because those creditors are not foregoing a financial benefit. The proposal would require creditors that do not offer escrow accounts to omit the disclosure regarding a fee because the Board understands that those creditors do not charge these fees and that the disclosure, therefore, would be inapplicable. Nevertheless, the Board seeks comment on this approach.

19(f)(2)(ii)(E) Risk of Not Having Escrow Account

Proposed § 226.19(f)(2)(ii)(E) would require a statement that the consumer will be responsible for directly paying home-related costs through potentially large semi-annual or annual payments. TILA Section 129D(j)(2)(B) requires a clear and prominent statement that the consumer is responsible for personally and directly paying the non-escrowed items, in addition to paying the mortgage loan payment, in the absence of an escrow account, and that the costs for taxes and insurance can be substantial. Proposed § 226.19(f)(2)(ii)(E) would implement these TILA Section 129D(j)(2)(B) requirements.

19(f)(2)(ii)(F) Consequences of Failure To Pay Home-Related Costs

Proposed § 226.19(f)(2)(ii)(F) would require a statement that, if the consumer does not pay the applicable home-related costs, the creditor could require an escrow account on the mortgage or add the costs to the loan balance. This information would be followed by a statement that the creditor could also require the consumer to pay for insurance that the creditor buys on the consumer's behalf and a statement that this insurance would likely be more expensive and provide fewer benefits than traditional homeowner's insurance. TILA Section 129D(j)(2)(C) requires an explanation of the consequences of any failure to pay non-escrowed items, including the possible requirement for the forced placement of insurance and the potentially higher cost or reduced coverage for the consumer for such insurance. Proposed § 226.19(f)(2)(ii)(F) would implement TILA Section 129D(j)(2)(C) by providing examples of the possible consequences of a failure to pay home-related costs, such as a decision by the creditor to require an escrow account, to add the home-related costs to the loan balance, or to purchase "forced-placed" insurance. Proposed § 226.19(f)(2)(ii)(F) would require a description of "forced-placed" insurance, rather than use of that term, because consumer testing showed that consumers were unfamiliar with the term and that the term itself distracted consumers from recognizing the other possible consequences of a failure to pay home-related costs.

19(f)(2)(ii)(G) Option To Establish Escrow Account

Proposed § 226.19(f)(2)(ii)(G) would require disclosure of the telephone number that the consumer can use to request an escrow account and the latest date by which the consumer can make the request. The Board is proposing this disclosure pursuant to its authority under TILA Section 129D(j)(2)(D) to include in the notice such other information as it determines necessary for the protection of the consumer. The Board believes that, after considering the risks of not having an escrow account as disclosed in the notice, a consumer who originally waived the establishment of an escrow account may wish to set one up. The information to contact the creditor with a request to establish an escrow account should be readily available to such consumers in the notice. The proposed rule would not require a creditor to obtain a toll-free telephone number that consumers may use to request the establishment of an escrow account. The Board proposes that a creditor disclose the telephone number that it has obtained for consumers to contact it regarding a variety of issues and that also may be used to request establishment of an escrow account. If the creditor does not offer the option of having an escrow account, proposed § 226.19(f)(2)(ii)(G) would require the creditor to omit this disclosure from the table.

The proposal does not require a creditor to disclose whether a fee will be charged when a consumer changes his or her decision and asks for an escrow account to be established. The Board understands that a creditor that usually offers and establishes escrow accounts for all first-lien transactions would not charge a consumer for changing his or her decision. The Board seeks comment on this approach.

19(f)(3) Optional Information

Proposed § 226.19(f)(3) would permit the creditor, at its option, include the creditor's name or logo, or the consumer's name, property address, or loan number on the disclosure notice, outside of the table. Proposed comment 19(f)(3)–1 clarifies that § 226.19(f)(3) lists the information that the creditor may, at its option, include on the disclosure notice, outside of the table described in § 226.19(f)(1)(iii) that contains the required content of § 226.19(f)(2).

19(f)(4) Waiting Period for Disclosures

Proposed § 226.19(f)(4) would require the creditor to provide the disclosures regarding the establishment or the non-establishment of an escrow account, as applicable, so that the consumer receives them no later than three business days prior to consummation. This proposed provision would implement the requirement of TILA Section 129D(h) for disclosures regarding the establishment of an escrow account three business days before consummation and the requirement of TILA Section 129D(j)(1)(A) for disclosures regarding the non-establishment of an escrow account in a "timely" manner. Proposed § 226.19(f)(4) would conform the timing requirement of TILA Section 129D(j)(1)(A) to that of TILA Section 129D(h) so that a consumer that will not have an escrow account would have sufficient time to consider the attendant responsibilities and risks before consummating the transaction.

Proposed comment 19(f)(4)–1 would clarify that, for purposes of § 226.19(f)(4), "business day" means all calendar days except for Sundays and specified legal public holidays. The Board believes that the definition of business day that excludes Sundays and public holidays is more appropriate than the more general definition because consumers should not be presumed to have received disclosures in the mail on a day on which there is no mail delivery. Proposed comment 19(f)(4)–2 would provide guidance regarding the timing requirement with an example that states if consummation is to occur on Thursday, June 11, the consumer must receive the disclosures on or before Monday, June 8, assuming there are no legal public holidays.

19(f)(5) Timing of Receipt

Proposed § 226.19(f)(5) states that, if the disclosures are mailed to the consumer or delivered by a means other than in person, the consumer is considered to have received the disclosures three business days after they are mailed or delivered. Proposed comment 19(f)(5)–1 states that, if the creditor provides the disclosures to the consumer in person, consummation may occur any time on the third business day following delivery. If the creditor provides the disclosures by mail, receipt is presumed three business days after they are placed in the mail, for purposes of determining when the three-business-day waiting period required under § 226.19(f)(4) begins. The proposed comment also permits creditors that use electronic mail or courier to follow this approach. Whatever method is used to provide disclosures, creditors may rely on documentation of receipt in determining when the waiting period begins.

19(f)(6) Consumer's Waiver of Waiting Period Before Consummation

Proposed § 226.19(f)(6) would permit consumers to modify or waive the three-business-day waiting period following receipt of the escrow account disclosures required by § 226.19(f)(2) for *bona fide* personal financial emergencies. Proposed § 226.19(f)(6) would require the consumer waiving the waiting period to give the creditor a dated, written statement that describes the emergency, specifically modifies or waives the waiting period, and bears the signature of all the consumers primarily liable on the legal obligation. Proposed § 226.19(f)(6) would prohibit the use of printed forms to effectuate a waiver.

Proposed comment 19(f)(6)–1 would provide additional guidance regarding the waiver procedure. For example, the proposed comment would clarify that a consumer may modify or waive the waiting period only after receiving the required disclosures. It also would clarify that a waiver is effective only if each consumer primarily liable on the legal obligation signs a waiver statement. Where there are multiple consumers, they may sign the same waiver statement. Proposed comment 19(f)(6)–1 would allow the consumer to include the waiver statement that specifically waives or modifies the three-business-day waiting period required by § 226.19(f)(4) in the same document that contains a waiver statement that specifically waives or modifies the seven-business-day waiting period for early disclosures or the three-business-day waiting period for corrected disclosures required by § 226.19(a)(2).

Proposed comment 19(f)(5)–2 would clarify that, to qualify as a *bona fide* personal financial emergency, the situation must require disbursement of loan proceeds before the end of the waiting period. Proposed comment 19(f)(5)–2 would further clarify that a *bona fide* personal financial emergency typically, but not always, will involve imminent loss of or harm to a dwelling or harm to the health and safety of a natural person. It also would provide that a waiver is not effective if the consumer's statement is inconsistent with facts known to the creditor.

The Board proposes this waiver provision pursuant to the Board's authority under TILA Section 105(f). 15 U.S.C. 1604(f). TILA Section 105(f) generally authorizes the Board to exempt all or any class of transactions from coverage under TILA and Regulation Z if the Board determines that coverage under that part does not provide a meaningful benefit to consumers in the form of useful information or protection. 15 U.S.C. 1604(f)(1). The Board is proposing to exempt closed-end transactions secured by a first lien on real property or a dwelling from the three-business-day waiting period required by TILA Section 129D(h) and § 226.19(f)(4) when the consumer determines that the loan proceeds are needed before the waiting period ends to meet a *bona fide* personal financial emergency. TILA Section 105(f) directs the Board to make the determination of whether coverage of such transactions under TILA Section 129D(h) and § 226.19(f)(4) provides a meaningful benefit to consumers in light of specific factors. 15 U.S.C. 1604(f)(2). These factors are (1) the amount of the loan and whether the provision provides a benefit to consumers who are parties to such transactions; (2) the extent to which the requirement complicates, hinders, or makes more expensive the credit process for the class of transactions; (3) the status of the borrower, including any related financial arrangements of the borrower, the financial sophistication of the borrower relative to the type of transaction, and the importance to the borrower of the credit, related supporting property, and coverage under TILA and Regulation Z; (4) whether the loan is secured by the principal residence of the borrower; and (5) whether the exemption would undermine the goal of consumer protection.

The Board has considered each of these factors carefully and, based on that review, believes that the proposed exemption is appropriate. Generally, a first-lien mortgage is the largest loan that a consumer will obtain. The waiting period would harm consumers experiencing a *bona fide* personal financial emergency because those consumers would need access to the proceeds of their loans during that period. The waiting period would hinder the credit process for consumers experiencing a *bona fide* personal financial emergency by forcing them to wait three business days before consummating the loan. For consumers experiencing a *bona fide* personal financial emergency, the proceeds of the mortgage loan will be extremely important in meeting other financial obligations. Most first-lien mortgage loans are secured by the consumer's principal dwelling. The exemption

would not undermine the goal of consumer protection because the disclosure required by § 226.19(f)(2) must be provided to the consumer before the consumer may modify or waive the waiting period. Delivery of the disclosure itself promotes the informed use of credit. In addition, § 226.19(f)(5) would require a consumer wishing to modify or waive the waiting period to provide the creditor with a dated, written statement that describes the emergency, specifically modifies or waives the waiting period, and bears the consumer's signature. The use of a printed form as the written statement would be prohibited.

The Board's exemption authority under Section 105(f) does not apply in the case of a mortgage referred to in Section 103(aa), which are high-cost mortgages generally referred to as "HOEPA loans." The Board does not believe that this limitation restricts its ability to apply the proposed waiver provision to all closed-end transactions secured by a first lien on real property or a dwelling when the consumer is experiencing a *bona fide* personal financial emergency, including HOEPA loans. This limitation on the Board's general exemption authority is a necessary corollary to the decision of the Congress, as reflected in TILA Section 129(*l*)(1), to grant the Board more limited authority to exempt HOEPA loans from the prohibitions applicable only to HOEPA loans in Section 129(c) through (i) of TILA. *See* 15 U.S.C. 1639(*l*)(1). In this case, the Board is not proposing any exemptions from the HOEPA prohibitions. This limitation does raise a question as to whether the Board could use its exemption authority under Section 105(f) to exempt HOEPA loans, but not other types of mortgage loans, from other, generally applicable TILA provisions. That question, however, is not implicated by this proposal.

The Board proposes to apply its general exemption authority for all first lien loans secured by real property or a dwelling where a consumer is experiencing a *bona fide* personal financial emergency, including both HOEPA and non-HOEPA loans, to permit the modification or waiver of the pre-consummation waiting period because the waiting period does not benefit consumers in such circumstances. It would not be consistent with the statute or with Congressional intent to interpret the Board's authority under Sections 105(f) in such a way that the proposed waiver provision could apply only to mortgage loans that are not subject to HOEPA. Reading the statute in a way that would require HOEPA borrowers who are experiencing a *bona fide* personal financial emergency to wait three business days before consummating the transaction that will provide the needed proceeds is not a reasonable construction of the statute.

The Board solicits comment on all aspects of this proposal, including the cost, burden, and benefits to consumers and to industry regarding the proposed disclosures regarding escrow accounts. The Board also requests comment on any alternatives to the proposal that would further the purposes of TILA and provide consumers with more useful disclosures.

Section 226.20 Subsequent Disclosure Requirements

20(d) Cancellation of Escrow Account

Requirements of TILA Section 129D(j)

The Board is proposing 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.

The Board's Proposal

For a closed-end transaction secured by a first lien on real property or a dwelling for which an escrow account was established and will be cancelled, proposed § 226.20(d) would require the creditor or servicer to disclose the information about escrow accounts specified in § 226.20(d)(2). Proposed § 226.20(d) would require the creditor to disclose this information in accordance with the format requirements of § 226.20(d)(1) and the timing requirements of § 226.20(d)(4). In addition, the proposal would provide that for purposes of § 226.20(d), the term "escrow account" and the term "servicer" have the same respective meanings as under §§ 3500.17(b) and 3500.2(b) of Regulation X, which implements RESPA, and is subject to any interpretations by HUD. These proposed definitions would parallel existing § 226.35(b)(3)(iv) and § 226.36(c)(3), respectively. Proposed comment 20(d)–1 would clarify that the term "real property" includes vacant and unimproved land. It also would clarify that the term "dwelling" includes vacation and second homes and mobile homes, boats, and trailers used as residences and refer to additional guidance regarding the term provided by § 226.2(a)(19) and the related commentary.

Secured by a first-lien transaction. Proposed § 226.20(d) would require disclosures for the cancellation of an escrow account that was established in connection with consummation of a transaction secured by a first lien, but not a subordinate lien. TILA Sections 129D(a) and (b) require the establishment of an escrow account in connection with only first-lien mortgage loans. TILA Section 129D(j) requires disclosures when such an escrow account is established and later cancelled. Proposed § 226.20(d) would not require disclosures for cancellation of an escrow account that was established in connection with a subordinate-lien mortgages because TILA does not require the establishment of escrow accounts for such mortgages. In addition, the Board understands that, in practice, creditors rarely offer or establish escrow accounts for such mortgages and therefore, the cancellation disclosures seldom would be triggered. Nevertheless, the Board seeks comment on whether this approach is appropriate.

Real property or a dwelling. With § 226.20(d), the Board covers real property and dwellings. Proposed § 226.20(d) implements TILA Section 129D(j), which requires disclosures when an escrow account that was established in connection with a transaction secured by real property will be cancelled. But, the proposal also covers cancellation of an escrow account that was established in connection with a transaction secured by a dwelling that is considered to be personal property under state law. The coverage of the proposal would parallel the coverage of proposed § 226.19(f), which would require disclosures for the establishment or non-establishment of an escrow account. Board believes this coverage would promote informed use of credit by consumers and compliance by creditors. The information disclosed when an escrow account will be cancelled likely would be just as useful to a consumer who has a loan secured by a mobile home as it would to a consumer who has a mortgage loan secured by a single-family home. Similarly, the disclosures should cover all dwellings, whether or not they are deemed personal rather than real property under state law. Furthermore, the coverage of all dwellings would eliminate the analysis that creditors would have to undertake to determine whether the cancellation of the escrow account established for a loan secured by a particular type of dwelling would trigger the disclosures.

The Board proposes the § 229.19(f) coverage of real property and dwellings pursuant to its authority under TILA Section 105(a). 15 U.S.C. 1604(a). TILA Section 105(a) authorizes the Board to prescribe regulations that contain classifications, differentiations, or other provisions, and may provide for adjustments and exceptions for any class of transactions, to effectuate the purposes of TILA and Regulation Z, to prevent circumvention or evasion, or to facilitate compliance. 15 U.S.C. 1604(a). One purpose of the statute is to assure meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available and avoid the uninformed use of credit. 15 U.S.C. 1601(a). The class of transactions that would be affected is transactions secured by real property or a dwelling. For the reasons set forth in the above discussion regarding proposed § 226.19(f), the Board believes that coverage of transactions secured by a dwelling as well as real property would provide promote the informed use of credit by consumers.

Creditor's or servicer's independent decision to cancel escrow account. TILA Section 129D(j)(1)(B) requires a creditor or servicer to provide the TILA Section 129D(j)(2) cancellation disclosures when the consumer chooses and provides written notice the choice to close his or her escrow account in accordance with any statute, regulation, or contractual agreement. Proposed § 226.20(d) would implement TILA Section 129D(j)(1)(B), but also would require provision of the cancellation disclosures when the creditor or servicer decides independently to cancel an escrow account. The Board believes that a consumer whose escrow account will be closed should be informed of the risks attendant with not having an escrow account, even if the consumer is not requesting the cancellation of the account.

The Board proposes this requirement pursuant to its authority under TILA Section 105(a). 15 U.S.C. 1604(a) and (f). TILA Section 105(a) authorizes the Board to prescribe regulations that contain classifications, differentiations, or other provisions, and may provide for adjustments and exceptions for any class of transactions, to effectuate the purposes of TILA and Regulation Z, to prevent circumvention or evasion, or to facilitate compliance. 15 U.S.C. 1604(a). One purpose of the statute is to assure meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available and avoid the uninformed use of credit. 15 U.S.C. 1601(a). The Board believes provision of the cancellation disclosures when creditors and servicers independently make decisions to close escrow accounts will help consumers to avoid the uninformed use of credit. The cancellation disclosures would consumers of their responsibility to personally and directly pay property taxes and insurance premiums and of the consequences for failure to do so. Indirectly, the disclosure would inform consumers that they would need to budget or save to meet these potentially large obligations when due, but that the total amount of their regular periodic mortgage payments would decrease.

20(d)(1) Format Requirements

Proposed § 226.20(d)(1) contains format requirements for the disclosures required by § 226.20(d)(2). Proposed § 226.20(d)(1)(i) would require that the creditor or servicer provide the § 226.20(d)(2) disclosures in a minimum 10-point font, grouped together on the front side of a one-page document, separate from all other material, with the headings, content, order, and format substantially similar to Model Form H–26 in Appendix H. Consumer testing has shown that the location and order in which information was presented affected consumers' ability to locate and comprehend the information disclosed. Proposed comment 20(d)(1)(i)–1 clarifies that the disclosures required by § 226.20(d)(2) and any optional information permitted by § 226.20(d)(3) must be grouped together on the front side of a separate one-page document that contains no other material. Proposed comment 20(d)(1)(i)–2 clarifies that the notice containing the disclosures required by § 226.20(d)(2) and any optional information permitted by § 226.20(d)(3) must be in writing in a form that the consumer may keep.

Proposed § 226.20(d)(1)(ii) would require that the heading "Required Direct Payment of Property Taxes and Insurance" required by § 226.20(d)(2) be more conspicuous than and precede the other disclosures. The heading would be required to be outside of the table that is required by proposed § 226.20(d)(1)(iii).

Proposed § 226.20(d)(1)(iii) would require the creditor or servicer to provide the disclosures regarding the cancellation of an escrow account under § 226.20(d)(2) in the form of a table containing no more than seven rows. The disclosures would be in the form of a table containing six rows when the creditor or servicer makes a unilateral decision to close an escrow account and does not impose a fee for closure. In such a case, the creditor or servicer would be required to omit the § 226.20(d)(2)(iv) disclosure from the table because it would be unnecessary. Only the information required or permitted by § 226.20(d)(2) would be permitted in the table. Proposed § 226.20(d)(1)(iv) would require the creditor or servicer to present the disclosures in the format of a question and answer in a manner substantially similar to Model Form H–26 in Appendix H. Consumer testing has shown that using a tabular, question and answer format improved participants' ability to identify and understand key information. Proposed § 226.20(d)(1)(iv) also would require the creditor or servicer to present the disclosures appearing in the table in the order listed in § 226.20(d)(2)(i)–(vii). This order would ensure that consumers receive the disclosed information in a logical progression.

Proposed § 226.20(d)(1)(v) would require the creditor or servicer to highlight certain disclosures because consumer testing has shown that such emphasis allows consumers to locate and identify important information more quickly. The Board proposes that the dollar amount in the disclosure required by § 226.20(d)(2)(iv) be presented in bold font. It also proposes implementation of the requirement in TILA Section 129D(j)(2)(B) that the notice regarding the cancellation of an escrow account contain a "prominent" statement of the consumer's responsibility for covering home-related costs through potentially large semi-annual or annual payments by requiring presentation of that information in bold format.

20(d)(2) Content Requirements

Proposed § 226.20(d)(2) would implement TILA Section 129D(j)(2) by setting forth the required content for the disclosure notice regarding the cancellation of an escrow account that was established in connection with consummation of a transaction subject to § 226.20(d). Proposed comment 20(d)(2)–2 would clarify that neither creditors nor servicers are required to provide the § 226.20(d)(2) disclosures if an escrow account established solely in connection with the consumer's delinquency or default on the underlying debt obligation will be cancelled. Proposed comment 20(d)(2)–3 would clarify that neither creditors nor servicers are required to provide the disclosures when the underlying debt obligation for which an escrow account was established is terminated, including by repayment, refinancing, rescission, or foreclosure.

Proposed § 226.20(d)(2) also would require that the disclosures be made clearly and conspicuously. Proposed comment 20(d)(2)–1 would clarify that, to meet the clear and conspicuous standard, disclosures must be made in a reasonably understandable form and readily noticeable to the consumer. Proposed § 226.20(d)(2) also would require the disclosure notice to bear the heading "Required Direct Payment of Property Taxes and Insurance."

20(d)(2)(i) Purpose of Notice

Proposed § 226.20(d)(2)(i) would require a statement that the purpose of the notice is to inform the consumer that the escrow account on the consumer's mortgage with the creditor or servicer is being closed and to explain the risk of not having an escrow account. The Board is proposing these disclosures pursuant to its authority under TILA Section 129D(j)(2)(D) to include in the notice such other information as it determines necessary for the protection of the consumer. The Board believes that these disclosures are necessary to draw the consumer's attention to the fact that the absence of an escrow account will carry some risk.

20(d)(2)(ii) Explanation of Escrow Account

Proposed § 226.20(d)(2)(ii) would require the creditor or servicer to provide a statement that an escrow account is an account that is used to pay home-related costs such as property taxes and insurance together with a statement that an escrow account is sometimes called an "impound" or "trust" account. This information would be followed by a statement that the consumer pays into the escrow account over time and that the creditor or servicer takes money from the account to pay costs as needed. The Board is proposing these statements explaining an escrow account, the other names sometimes used for an escrow account, and how an escrow account works pursuant to its authority under TILA Section 129D(j)(2)(D) to include in the notice such other information as the Board determines necessary for the protection of the consumer. The Board believes that informing consumers of the other names for an escrow account would prevent consumers in Western regions of the country from confusing an escrow account for the payment of home-related costs such as property taxes and insurance premiums with the escrow that is commonly used for the closing and settlement of a credit transaction. The Board also believes that the basic information explaining what an escrow account is and how it works provides needed context for the other disclosures in the notice.

20(d)(2)(iii) Reason Why Mortgage Will Not Have an Escrow Account

Proposed § 226.20(d)(2)(iii) would require a statement that the consumer had an escrow account but, as applicable, the consumer asked the creditor or servicer to close it or the creditor or servicer independently decided to cancel it. The Board is proposing this disclosure pursuant to the Board's authority under TILA Section 129D(j)(2)(D) to include in the notice such other information as the Board determines necessary for the protection of the consumer. This disclosure would provide the consumer with the background information necessary to understand the disclosure required by § 226.20(d)(2)(vii) at the end of the notice as to whether the consumer has an option to keep the escrow account.

20(d)(2)(iv) Fee for Closing Escrow Account

Proposed § 226.20(d)(2)(iv) would implement TILA Section 129D(j)(2)(A) by requiring disclosure of any fee charged for closing an escrow account. Proposed § 226.20(d)(2)(iv) would require, if the consumer has asked the creditor or servicer to close the escrow account, a statement of the dollar amount of any fee that the consumer will be charged in connection with the closure or a statement that the consumer will not be charged a fee. If the creditor or servicer independently decided to cancel the escrow account, rather than agreeing to close it pursuant to the request of the consumer, and does not charge a fee in connection with the cancellation, proposed § 226.20(d)(2)(iv) would require the creditor or servicer to omit this disclosure from the table.

20(d)(2)(v) Risk of Not Having Escrow Account

Proposed § 226.20(d)(2)(v) would require a statement that the consumer will be responsible for directly paying home-related costs through potentially large semi-annual or annual payments. TILA Section 129D(j)(2)(B) requires a clear and prominent statement that the consumer is responsible for personally and directly paying the non-escrowed items, in addition to paying the mortgage loan payment, in the absence of an escrow account, and that the costs for taxes and insurance can be substantial. Proposed § 226.20(d)(2)(v) would implement these TILA Section 129D(j)(2)(B) requirements.

20(d)(2)(vi) Consequences of Failure To Pay Home-Related Costs

Proposed § 226.20(d)(2)(vi) would require a statement that, if the consumer does not pay the applicable home-related costs, the creditor or servicer could require an escrow account on the mortgage or add the costs to the loan balance. This information would be followed by a statement that the creditor or servicer could also require the consumer to pay for insurance that the creditor or servicer buys on the consumer's behalf and a statement that this insurance would likely be more expensive and provide fewer benefits than traditional homeowner's insurance. TILA Section 129D(j)(2)(C) requires provision of a clear explanation of the consequences of any failure to pay non-escrowed items, including the possible requirement for the forced placement of insurance and the potentially higher cost or reduced coverage for the consumer for such insurance. Proposed § 226.20(d)(2)(vi) would implement TILA Section 129D(j)(2)(C) by providing examples of the possible consequences of a failure to pay home-related costs, such as a decision by the creditor to require an escrow account, to add the home-related costs to the loan balance, or to purchase "forced-placed" insurance. Proposed § 226.20(d)(2)(vi) would require a description of "forced-placed" insurance, rather than use of that term, because consumer testing showed that consumers were unfamiliar with the term and that the term itself distracted consumers from recognizing the other possible consequences of a failure to pay home-related costs.

20(d)(2)(vii) Option To Keep Escrow Account

Proposed § 226.20(d)(2)(vii) would require, as applicable, a statement of the telephone number that the consumer can use to request that the escrow account be kept open and the latest date by which the consumer can make the request, or a statement that the creditor or servicer does not offer the option of keeping the escrow account. The Board is proposing this disclosure pursuant to its authority under TILA Section 129D(j)(2)(D) to include in the notice such other information as it determines necessary for the protection of the consumer. The Board believes that, after considering the risks of not having an escrow account as disclosed in the notice, a consumer who originally requested cancellation of his or her escrow account may wish to keep it. The information to contact the creditor or servicer with a request to keep the escrow account should be readily

available to such consumers in the notice. The proposed rule would not require a creditor to obtain a toll-free telephone number that consumers may use to request the establishment of an escrow account. The Board proposes that a creditor disclose the telephone number that it has obtained for consumers to contact it regarding a variety of issues and that also may be used request establishment of an escrow account.

The Board is not proposing that creditors disclose whether a fee will be charged when a consumer changes his or her decision to cancel and requests to keep the escrow account. The Board understands that creditors do not charge a fee in such circumstances because the creditor has yet to expend resources in closing the escrow account. The Board seeks comment on this approach.

20(d)(3) Optional Information

Proposed § 226.20(d)(3) would permit the creditor or servicer providing the disclosure notice, at its option, to include its name or logo, or the consumer's name, property address, or loan number on the disclosure notice, outside of the table. Proposed comment 20(d)(3)–1 clarifies that § 226.20(d)(3) lists the information that the creditor or servicer may, at its option, include on the disclosure notice, outside of the table described in § 226.20(d)(1)(iii) that contains the required content of § 226.20(d)(2).

20(d)(4) Waiting Period for Disclosures

Proposed § 226.20(d)(4) would require the creditor or servicer to provide the disclosures regarding the cancellation of an escrow account so that the consumer receives them no later than three business days prior to closure of the escrow account. This proposed provision would implement the requirement of TILA Section 129D(j)(1)(B) for disclosures regarding cancellation of an escrow account in a "timely" manner. The waiting period in proposed § 226.20(d)(4) would parallel the waiting period in proposed § 226.19(f)(4) and would serve a similar purpose of providing a consumer sufficient time to consider the attendant responsibilities and risks of not having an escrow account.

Proposed comment 20(d)(4)–1 would clarify that, for purposes of § 226.20(d)(4), "business day" means all calendar days except for Sundays and specified legal public holidays. The Board believes that the definition of business day that excludes Sundays and public holidays is more appropriate than the more general definition because consumers should not be presumed to have received disclosures in the mail on a day on which there is no mail delivery. Proposed comment 20(d)(4)–2 would provide guidance regarding the timing requirement with an example that states if consummation is to occur on Thursday, June 11, the consumer must receive the disclosures on or before Monday, June 8, assuming there are no legal public holidays.

20(d)(5) Timing of Receipt

Proposed § 226.20(d)(5) also states that, if the disclosures are mailed to the consumer or delivered by means other than in person, the consumer is deemed to have received the disclosures three business days after they are mailed or delivered. Proposed comment 20(d)(5)–1 states that, if the creditor or servicer provides the disclosures in person, the escrow account may be closed any time on the third business day following delivery. If the creditor or servicer provides the disclosures by mail, receipt is presumed three business days after they are placed in the mail, for purposes of determining when the three-business-day waiting period required under § 226.20(d)(4) begins. The proposed comment also permits creditors or servicers that use electronic mail or courier to follow this approach. Whatever method is used to provide disclosures, creditors or servicers may rely on documentation of receipt in determining when the waiting period begins.

Section 226.34 Prohibited Acts or Practices in Connection With Credit Subject to § 226.32

34(a) Prohibited Acts or Practices for Loans Subject to § 226.32

34(a)(4) Repayment Ability

34(a)(4)(i) Mortgage-Related Obligations

The Board is proposing conforming amendments to § 226.34(a)(4)(i) and staff comment 34(a)(4)(i)–1. Both provisions contain cross-references to § 226.35(b)(3)(i). As discussed below, this proposal would remove and reserve § 226.35(b)(3)(i) and would preserve the substance of that provision in proposed new § 226.45(b)(1). This proposal would revise the two cross-references accordingly.

Section 226.35 Prohibited Acts or Practices in Connection With Higher-Priced Mortgage Loans

35(b) Rules for Higher-Priced Mortgage Loans

35(b)(3) Escrows

The Board is proposing to remove and reserve § 226.35(b)(3), which currently contains the Board's escrow requirement for higher-priced mortgage loans. As discussed below, the escrow provisions of the Dodd-Frank Act would be implemented under this proposal by the addition of new § 226.45(b). To prevent duplication with new proposed § 226.45(b), this proposal would remove § 226.35(b)(3) and its accompanying commentary, including the special threshold for "jumbo" loans, as implemented by the "Jumbo" Final Rule in § 226.35(b)(3)(v). As discussed below, however, proposed § 226.45(a)(1) would preserve the "jumbo" threshold.

The Dodd-Frank Act also establishes new TILA provisions concerning a consumer's ability to repay and prepayment penalties that apply to all closed-end mortgage loans (other than loans secured by a timeshare), not just higher-priced mortgage loans. *See* TILA Sections 129C(a) and 129C(c). For higher-priced mortgage loans, those two matters currently are addressed by § 226.35(b)(1) and (2). The provisions of the Dodd-Frank Act regarding repayment ability and prepayment penalties will be implemented through future rulemakings. To preserve those existing protections for higher-priced mortgage loans until such future rulemakings are completed, however, the Board is not proposing to remove § 226.35(b)(1) and (2) at this time.

Section 226.45 Escrow Requirements for Higher-Priced Mortgage Loans

45(a) Higher-Priced Mortgage Loans

45(a)(1)

Proposed § 226.45(a)(1) would provide that a higher-priced mortgage loan is a consumer credit transaction secured by the consumer's principal dwelling that has a loan pricing benchmark that exceeds the applicable threshold as of the date the transaction's rate is set. This definition tracks the meaning of "higher-priced mortgage loan" in current § 226.35(a)(1), with two differences. First, consistent with the 2010 Mortgage Proposal, the loan pricing benchmark would be the transaction coverage rate rather than the annual percentage rate. The transaction coverage rate is discussed in more detail below. Second, the applicable thresholds would be revised to reflect the special, separate coverage threshold for "jumbo" loans, as provided by the Dodd-Frank Act.

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 loans that exceed the maximum principal balance eligible for sale to Freddie Mac. In general, the coverage thresholds are 1.5 percentage points above the average prime offer rate for first-lien loans and 3.5 percentage points above the average prime offer rate for subordinate-lien loans. Under the Dodd-Frank Act, the threshold is 2.5 percentage points above the average prime offer rate for "jumbo" loans.

The "Jumbo" Final Rule implements this special coverage test for "jumbo" loans by amending § 226.35(b)(3), which contains the Board's existing escrow requirement for higher-priced mortgage loans. This proposal would incorporate the threshold for "jumbo" loans contained in § 226.35(b)(3)(v) in proposed § 226.45(a)(1) because, after other provisions of the Dodd-Frank Act are implemented, the thresholds in existing § 226.35 will be necessary only to implement the escrow account requirement and certain appraisal-related requirements.[1] Accordingly, this proposal would implement the coverage test for higher-priced mortgage loans established by the Dodd-Frank Act, including the special coverage threshold for "jumbo" loans, in new § 226.45(a)(1).

45(a)(2) Definitions

Proposed § 226.45(a)(2) would define "transaction coverage rate" and "average prime offer rate." The latter definition, in § 226.45(a)(2)(ii), would be identical to the existing definition in current § 226.35(a)(2). This is consistent with the provisions of the Dodd-Frank Act, which codify the regulation's existing definition of "average prime offer rate." *See* TILA Section 129D(b)(3).

The definition of "transaction coverage rate" is the same definition included in the Board's 2010 Mortgage Proposal, discussed above. Accordingly, proposed § 226.45(a)(1) provides that the transaction coverage rate, rather than the annual percentage rate, is the metric used to determine whether a transaction is a higher-priced mortgage loan subject to § 226.45.

Under the proposal, the transaction coverage rate is a transaction-specific rate that would be used solely for coverage determinations; it would not be disclosed to consumers. The creditor would calculate the transaction coverage rate based on the rules in Regulation Z for calculation of the annual percentage rate, with one exception: The creditor would make the calculation using a modified value for the prepaid finance charge, as discussed below.

In the 2010 Mortgage Proposal, the Board explained the background and rationale for the proposed transaction coverage rate. *See* 75 FR 58539, 58660–61; Sept. 24, 2010. Briefly, the Board recognized that the use of the annual percentage rate as the coverage metric for the higher-priced mortgage loan protections poses a risk of over-inclusive coverage, which was intended to be limited to the subprime market. The Board noted that the average prime offer rate, against which the coverage metric is compared to determine whether a transaction is a higher-priced mortgage loan, is based on Freddie Mac's Primary Mortgage Market Survey® (PMMS). The PMMS surveys creditors for the loan pricing they currently offer consumers with low-risk transaction terms and credit profiles. The data the PMMS obtains, and therefore on which the average prime offer rate is based, are limited to contract interest rates and points. Annual percentage rates, on the other hand, are based on a broader set of charges, including some third-party charges such as mortgage insurance premiums. The Board also recognized that, under the 2009 Closed-End Proposal, the annual percentage rate would be based on a finance charge that includes most third-party fees in addition to points, origination fees, and any other fees the creditor retains. Thus, that proposal would expand the existing difference between fees included in the annual percentage rate and fees included in the average prime offer rate.

For the same reasons, the Board again is proposing to require creditors to compare the transaction coverage rate, rather than the annual percentage rate, to the average prime offer rate to determine whether a transaction is covered by the protections for higher-priced mortgage loans. The Board is making this proposal pursuant to its authority under Section 1461(b) of the Dodd-Frank Act to "prescribe rules that revise, add to, or subtract from the criteria of section 129D(b) of the Truth in Lending Act if the Board determines that such rules are in the interest of consumers and in the public interest." TILA Section 129D(b)(3) applies the escrow requirement to transactions with annual percentage rates that exceed the applicable thresholds. For the reasons discussed above, however, the Board believes that it is in the interest of consumers and the public to revise the coverage metric so that the protections for higher-priced mortgage loans are not inappropriately extended to prime loans, which may result in more limited credit availability where those protections are not warranted.

As noted above, the transaction coverage rate would be calculated according to the rules in Regulation Z for the calculation of the annual percentage rate, with one difference: The creditor would use a modified value for the prepaid finance charge in making this calculation. Under proposed § 226.45(a)(2)(i), the prepaid finance charge for purposes of calculating the transaction coverage rate would include only prepaid finance charges that will be retained by the creditor, a mortgage broker, or an affiliate of either. As discussed in the 2010 Mortgage Proposal, this test would make the coverage metric more similar to the average prime offer rate, which is based on contract interest rates and points only. This test also would avoid any uncertainty about what is included and would prevent creditors from evading coverage by shifting points into other charges or to affiliated third parties.

The Board also is proposing the same guidance in staff commentary under proposed § 226.45(a)(2) as currently exists under § 226.35(a) and as was proposed in the 2010 Mortgage Proposal. Proposed comment 45(a)(2)(i)–1 would clarify that the transaction coverage rate is not the annual percentage rate that is disclosed to the consumer and that it would be solely for coverage determination purposes. Proposed comment 45(a)(2)(i)–2 would clarify that the inclusion of charges retained by a mortgage broker would be limited to compensation that otherwise constitutes a prepaid finance charge and would illustrate this principle with an example. Proposed comments 45(a)(2)(ii)–1 through –4 would duplicate existing comments 35(a)(2)–1 through –4 with no substantive change.

Proposed comment 45(a)(2)(ii)–5 would be added to direct creditors to additional guidance on the average prime offer rate that is available in the staff commentary under Regulation C (Home Mortgage Disclosure) and other related authorities. This proposed

[1] Sections 1411, 1412, and 1414 of the Dodd-Frank Act create new TILA Section 129C, which establishes requirements for all residential mortgage loans relating to ability to repay and prepayment penalties. As these requirements are not limited to higher-priced mortgage loans, when implemented by rulemaking, they will leave the scope of existing § 226.35 limited to the escrow requirement. Section 1471 of the Dodd-Frank Act also creates new TILA Section 129H, which establishes certain new appraisal requirements, applicable to "higher-risk mortgages." New TILA Section 129H(f) defines "higher-risk mortgages" identically to the higher-priced mortgage loan definition in existing § 226.35(a)(1), with the addition of the separate threshold for "jumbo" loans. Thus, ultimately, the scope of the requirements applicable to "higher-risk mortgages" and the identically defined "higher-priced mortgage loans" will consist of the escrow and appraisal requirements.

comment is identical to guidance the Board proposed in the 2009 Closed-End Proposal. *See* 74 FR 43232, 43279; Aug. 26, 2009.

45(a)(3)

Proposed § 226.45(a)(3) would provide that a "higher-priced mortgage loan" does not include a transaction to finance the initial construction of a dwelling, a temporary or "bridge" loan 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 § 226.35(a)(3). In addition, the Board is proposing to adopt comment 45(a)(3)–1 to clarify how § 226.45 applies to cases where a creditor that extends financing for the initial construction of a dwelling also may permanently finance the home purchase. The proposed comment states that the construction phase is not a higher-priced mortgage loan, as provided in § 226.45(a)(3), regardless of the creditor's election to disclose such cases as either a single transaction or as separate transactions, pursuant to § 226.17(c)(6)(ii). This guidance would track the same guidance the Board proposed in the 2010 Mortgage Proposal. *See* 75 FR 58539, 58662–63; Sept. 24, 2010.

45(b) Escrow Accounts

45(b)(1) Requirement To Escrow for Property Taxes and Insurance

Proposed § 226.45(b)(1) would provide that 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. This provision parallels existing § 226.35(b)(3)(i). Proposed comments 45(b)(1)–1 through –3 parallel existing comments 35(b)(3)(i)–1 through –3. In addition, the Board is proposing comment 45(b)(1)–4 to clarify that the requirement to establish an escrow account for a first-lien higher-priced mortgage loan 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 for a transaction that is not subject to § 226.45(b)(1).

Proposed § 226.45(b)(1) would implement TILA Section 129D(b)(3), as added by Section 1461 of 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 consumer's principal dwelling (other than an open-end credit plan or a reverse mortgage). 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 loan 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 by regulation." This proposal would implement 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. The thresholds in proposed § 226.45(a)(1) for determining whether a transaction is a higher-priced mortgage loan, discussed above, reflect the amounts over the average prime offer rate that trigger coverage of the statutory escrow requirement in TILA Section 129D(b)(3).

Proposed § 226.45(b)(1) also would state that, for purposes of § 226.45(b), "escrow account" has the same meaning as under Regulation X. This proposed provision would parallel existing § 226.35(b)(3)(iv).

45(b)(2) Exemptions

45(b)(2)(i)

Proposed § 226.45(b)(2)(i) would provide that escrow accounts need not be established for loans secured by shares in a cooperative. This provision would track existing § 226.35(b)(3)(ii)(A). It also is consistent with new TILA Section 129D(e), as added by Section 1461 of the Dodd-Frank Act.

45(b)(2)(ii)

Proposed § 226.45(b)(2)(ii) would provide that insurance premiums need not be included in escrow accounts for loans 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. This provision would parallel existing § 226.35(b)(3)(ii)(B), with respect to condominium units. It also would implement new TILA Section 129D(e), as added by Section 1461 of the Dodd-Frank Act. That provision codifies the exemption for condominiums and also expands it to other, similar ownership arrangements involving associations that have an obligation to maintain a master insurance policy, such as PUDs. The Board is proposing comment 45(b)(2)(ii)–1 to parallel existing comment 35(b)(3)(ii)(B)–1 but with conforming amendments to reflect the expanded scope of the exemption. The Board is also proposing comment 45(b)(2)(ii)–2 to provide details about the nature of PUDs and to clarify that the exemption is available for not only condominium and PUD units but also any other type of property ownership arrangement that has a governing association with an obligation to maintain a master insurance policy.

45(b)(2)(iii)

Under TILA Section 129D(c), the Board is authorized to exempt from the 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 Board; (3) retains its mortgage loan originations in portfolio; and (4) meets any asset-size threshold and any other criteria the Board may establish. Proposed § 226.45(b)(2)(iii) would provide an exemption consistent with that provision. Under proposed § 226.45(b)(2)(iii), the escrow requirement would not apply to a higher-priced mortgage loan 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," together with its affiliates originates and services 100 or fewer first-lien mortgage loans, and together with its affiliates does not escrow for any mortgage loan it services.

Operates Predominantly in Rural or Underserved Areas

Under proposed § 226.45(b)(2)(iii)(A), to obtain the exemption, a creditor must have made during the preceding calendar year more than 50% of its total first-lien, higher-priced mortgage loans in counties designated by the Board as "rural or underserved." Proposed comment 45(b)(2)(iii)–1 would state that the Board publishes annually a list of counties that qualify as "rural" or "underserved." The Board's annual determinations would be based on the criteria set forth in proposed § 226.45(b)(2)(iv), discussed below.

"*Areas.*" In determining what is a rural or underserved area, the Board is proposing to use counties as the relevant area. The Board believes that the county level is the most appropriate area for this purpose, even though the sizes of counties can vary. In determining the relevant area for consumers who are shopping for

mortgage loans, census tracts would be too small, while states generally would be too large. Because a single standard nationwide would facilitate compliance, the Board is proposing to use counties for all geographic areas. The Board seeks comment on the appropriateness of this approach.

"*Operates predominantly.*" As noted, the proposed rule requires a creditor to have made during the preceding calendar year more than 50% of its total first-lien higher-priced mortgage loans in "rural or underserved" counties. The Board believes that "predominantly" indicates a portion greater than half, hence the proposed regulatory requirement of more than 50%. The Board proposes to implement "operates" consistently with the scope of the escrow requirement. Thus, because the escrow requirement applies only to first-lien higher-priced mortgage loans, only those loans would be counted toward this element of the exemption. The Board solicits comment on the appropriateness of both of these proposed interpretations.

Total Annual Mortgage Loan Originations

As noted above, the Dodd-Frank Act authorizes the Board to establish an annual limit on loans originated in adopting any exemption. Under proposed § 226.45(b)(2)(iii)(B), to obtain the exemption, a creditor and its affiliates together during either of the preceding two calendar years must have originated and retained the servicing rights to 100 or fewer loans secured by a first lien on real property or a dwelling. The Board is also establishing three criteria not specified in the statute: (1) A requirement that the lender retain servicing rights in addition to originating loans; (2) the establishment of 100 or fewer as the originations limit; and (3) the use of either of the preceding two calendar years.

Retention of servicing rights. Proposed § 226.45(b)(2)(iii)(B) would provide that the creditor, together with any affiliates, must have originated and retained the servicing rights to 100 or fewer loans. As noted above, the statute does not include retention of the servicing rights in this condition of the exemption. The Board is proposing this adjustment to the requirement for an annual-originations limit pursuant to its authority under TILA Section 105(a), 15 U.S.C. 1604(a), to provide for such adjustments and exceptions as are necessary or proper to effectuate the purposes of TILA. The Board believes that, to effectuate meaningfully the purpose of the exemption, this test should include only those loans both made and serviced by the creditor and its affiliates.

The Board believes the purpose of the exemption is to recognize that maintaining escrow accounts is burdensome, and not cost-effectively feasible, unless a servicer maintains at least a certain minimum portfolio size. The proposed exemption thus permits creditors that do not possess these economies of scale to continue to offer credit to consumers, rather than leave the higher-priced mortgage loan market, provided the other criteria for the exemption also are satisfied. But the economies of scale needed to escrow cost-effectively are achieved only to the extent a creditor actually services its originations. Accordingly, the Board's proposal would base the exemption on only originations for which the creditor (or its affiliates) retained the servicing rights.

100 or fewer loans. TILA Section 129D(c)(2) requires the Board to establish a limit on annual originations for purposes of the exemption. As discussed above, in approaching this element of the exemption, the Board seeks to limit the exemption to creditors that maintain servicing portfolios too small to be able to escrow cost-effectively. Based on a review of mortgage subservicers' fee schedules, the Board estimates that, on average, the monthly cost per loan to outsource servicing (including escrowing) is $17 for a 500-loan portfolio and $21 for a 250-loan portfolio. Data obtained from the Mortgage Bankers Association's Quarterly Mortgage Bankers Performance Report for the third quarter of 2008 indicate that the average monthly cost per loan to service a portfolio in-house (including but not limited to escrowing), for portfolios averaging 472 loans, is approximately $20; this figure represents ongoing costs, including personnel, technology, equipment, and similar recurring costs, but it does not include initial set-up costs. The Board believes 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 loans.

TILA Section 129D(c)(2) calls for an annual-originations limit, however, as opposed to a portfolio-size limit. In light of the statutory provision, to effectuate the purpose of the exemption, the Board is proposing to set the cut-off for this element of the exemption at 100 or fewer mortgage loans originated and serviced; an assumed average of five years until an institution's loans are paid off would suggest that originating (and retaining the servicing rights to) 100 or fewer mortgages per year should correspond to servicing 500 or fewer loans. The Board seeks comment on the validity of this assumption and whether some other number of originations might better serve the purpose of the exemption.

Either of the preceding two calendar years. The Board is proposing that the test be satisfied as long as the creditor's (and its affiliates') servicing-retained originations do not exceed 100 during either of the preceding two calendar years. Under this two-year "look back," an institution that has been exempt would not have to begin complying with the escrow requirement until at least one full year after it first exceeds the threshold. Proposed comment 45(b)(2)(iii)–1 would clarify that a creditor would lose the exemption if it exceeds the threshold for two consecutive calendar years and would illustrate this rule with an example.

As indicated above, the Board believes the purpose of the exemption is to permit creditors that lack the economies of scale necessary to escrow cost-effectively to continue to offer credit to consumers, rather than leave the higher-priced mortgage loan market, provided the other criteria for the exemption also are satisfied. The Board recognizes that the originations limit, if applied for only one year, could cause operational problems when institutions first exceed the threshold. An institution that was exempt and becomes subject to the requirement because it first originates and services over 100 loans could not establish escrow accounts retroactively on its existing portfolio without the agreement of its existing customers. Such an institution then would face the prospect of establishing escrows for the small number of loans it makes going forward and still would not have achieved the necessary economies of scale. The proposed two-year coverage test should afford an institution sufficient time after first exceeding the threshold to acquire an escrowing capacity. The Board solicits comment on the appropriateness of this two-year coverage test.

Creditor and Affiliates Do Not Maintain Escrows

Under proposed § 226.45(b)(2)(iii)(C), to obtain the exemption, the creditor and its affiliates must not maintain an escrow account for any mortgage loan they currently service. The Board is proposing this provision pursuant to its authority in TILA Section 129D(c)(4) to include in this exemption "any other criteria the Board may establish." The

Board believes this additional condition is necessary to effectuate the purpose of the exemption.

If a creditor already establishes or maintains escrow accounts, it has the capacity to escrow and therefore has no need for the exemption. Moreover, a creditor's capacity to escrow should reflect not only its own activities but those of any affiliate. The Board believes a creditor's affiliate that has the capacity to escrow can enable the creditor to meet the escrow requirement. The Board seeks comment, however, on whether an affiliate's capacity to escrow should be considered. Proposed comment 45(b)(2)(iii)–1 would explain that this restriction applies only to mortgage loans serviced by the creditor and its affiliates at the time a transaction is consummated. Thus, the exemption still could apply even if, in the past, any of them has established and maintained escrows for mortgage loans it no longer services. If a creditor or an affiliate escrows for loans currently serviced, however, they all would become ineligible for the exemption on higher-priced mortgage loans that they make thereafter.

The Board recognizes that a creditor sometimes may hold a loan for a short period after consummation to take the steps necessary before transferring and assigning it to its intended investor. This period on occasion may extend even beyond the loan's first installment due date, especially if the first payment due date comes shortly after consummation. The proposed rule would recognize that, in such cases, a creditor that establishes an escrow account for the investor is not deemed to have established an escrow account in connection with a loan for which it retains the servicing rights. Accordingly, proposed comment 45(b)(2)(iii)–1 also would clarify that a creditor or its affiliate "maintains" an escrow account for a loan only if it services the mortgage loan at least through the due date of the second periodic payment under the terms of the legal obligation. The Board seeks comment on whether the second payment due date is the appropriate cut-off point for this purpose.

Under § 226.45(b)(2)(iii)(C), as proposed, a creditor would not be eligible for the exemption if it escrows for even a single loan. A creditor that lacks the capacity to escrow cost-effectively and does not maintain escrow accounts as a general matter nevertheless may undertake to escrow for one customer, or possibly only a few customers, as an accommodation to those customers at their request. The Board therefore solicits comment on whether this provision instead should allow some *de minimis* number of loans for which escrows are maintained and, if so, what that number should be. For example, would a limit of not more than five loans for which escrows are currently maintained be appropriate?

Asset-Size Threshold Not Proposed

The Board is not proposing an asset-size threshold as a condition of the exemption, even though TILA Section 129D(c)(4) authorizes the Board to do so. As discussed above, the Board believes that a creditor's ability to establish escrow accounts, and thus continue offering higher-priced mortgage loans, depends mainly on whether the creditor services enough mortgage loans to make escrow accounts a cost-effective option. The annual originations test discussed above serves as a proxy for having a small servicing portfolio. Mortgage creditors with limited assets likely also would satisfy the annual originations test. Nevertheless, the Board believes that a relatively large creditor (based on asset size) might make and service only a small number of mortgage loans. If such a creditor may cease making higher-priced mortgage loans because it lacks the necessary economies of scale to escrow for so few mortgage loans, the Board believes the creditor should not be denied the exemption merely because it happens to have substantial non-mortgage assets. Thus, the Board solicits comment on whether such a condition should be established and, if so, what asset-size threshold would be appropriate.

45(b)(2)(iv)

Proposed § 226.45(b)(2)(iv) would set out the criteria for a county to be designated by the Board as "rural or underserved" for purposes of § 226.45(b)(2)(iii)(A), discussed above. Under that section, a creditor's originations of first-lien higher-priced mortgage loans in all counties designated as "rural or underserved" during a calendar year are measured as a percentage of the creditor's total such originations during that calendar year to determine whether the creditor may be eligible for the exemption during the following calendar year. If the creditor's first-lien higher-priced mortgage loan originations in "rural or underserved" counties during a calendar year exceeds 50% of the creditor's total such originations in that calendar year, the creditor satisfies § 226.45(b)(2)(iii)(A) for purposes of the following calendar year.

Proposed § 226.45(b)(2)(iv) would establish separate criteria for both "rural" and "underserved," thus a county could qualify for designation by the Board under either definition. Under proposed § 226.45(b)(2)(iv)(A), a county would be designated as "rural" during a calendar year if it is not in a metropolitan area or a micropolitan area and either (1) it is not adjacent to any metropolitan or micropolitan area; or (2) it is adjacent to a metropolitan area with fewer than one million residents or adjacent to a micropolitan area, and it contains no town with 2500 or more residents. Under proposed § 226.45(b)(2)(iv)(B), a county would be designated as "underserved" during a calendar year if 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. These two definitions are discussed in more detail below.

"Rural"

The Board is proposing to limit the definition of "rural" areas to those areas most likely to have only limited sources of mortgage credit. The test for "rural" in proposed § 226.45(b)(2)(iv)(A), described above, is 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. The ERS devised the urban influence codes to reflect such factors as counties' relative population sizes, degrees of "urbanization," access to larger communities, and commuting patterns.[2] The four codes captured in the proposed "rural" definition represent the most remote rural areas, where ready access to the resources of larger, more urban communities and mobility are most limited. Proposed comment 45(b)(2)(iv)–1 would state that the Board classifies a county as "rural" if it is categorized under ERS urban influence code 7, 10, 11, or 12. The Board seeks comment on all aspects of this approach to designating "rural" counties, including whether the definition should be broader or narrower, as well as whether the designation should be based on information other than the ERS urban influence codes.

"Underserved"

In determining what areas should be considered "underserved," the Board has considered the minimum number of creditors that must be engaged in significant mortgage operations in an area for consumers to have meaningful access to mortgage credit. The test for "underserved" in proposed § 226.45(b)(2)(iv)(B), described above, is

[2] *See http://www.ers.usda.gov/briefing/Rurality/UrbanInf/.*

based on the Board's judgment that, where no more than two creditors are significantly active (measured by extending mortgage credit at least five times in a year), the inability of one creditor to offer a higher-priced mortgage loan would be detrimental to consumers who would have limited credit options. Thus, proposed § 226.45(b)(2)(iv)(B) would designate a county as "underserved" during a calendar year if 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. Proposed comment 45(b)(2)(iv)–1 would state that the Board bases its determinations of whether counties are "rural" for purposes of § 226.45(b)(2)(iii)(A) by reference to data submitted by mortgage lenders under the Home Mortgage Disclosure Act (HMDA).

The Board believes the purpose of the exemption is to permit creditors that lack the economies of scale necessary to escrow cost-effectively to continue to offer credit to consumers, rather than leave the higher-priced mortgage loan market, if such creditors' withdrawal would significantly limit consumers' ability to obtain mortgage credit. In light of this rationale, the Board believes that "underserved" should be implemented in a way that protects consumers from losing meaningful access to mortgage credit. The Board is proposing to do so by designating as "underserved" only those areas where the withdrawal of a creditor from the market could leave no meaningful competition for consumers' mortgage business. The Board seeks comment on the appropriateness of both the proposed use of two or fewer existing competitors to delineate areas that are "underserved" and the proposed use of five or more first-lien mortgage originations to identify competitors with a significant presence in a market.

45(b)(2)(v)

Proposed § 226.45(b)(2)(v) would provide that the exemption is not available for certain transactions that, at consummation, are subject to "forward commitments," which are agreements entered into at or before consummation of a transaction under which a purchaser is committed to acquire the loan from the creditor after consummation. Mortgage creditors often make loans for which they already have obtained such a commitment from a purchaser, which may be obligated to purchase the specific loan or to purchase loans meeting prescribed criteria. In the latter case, if a transaction meets the criteria, it is subject to the purchaser's forward commitment. The Board is proposing this provision to implement TILA Section 129D(c)(3), which requires that a creditor retain its mortgage loan originations in portfolio to qualify for the exemption from the escrow requirement.

The Board considered requiring that a transaction be held in portfolio as a condition of the exemption. This approach, however, would raise operational problems. Whether a loan 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 expects that a creditor would be reluctant to make a loan it does not intend to keep in portfolio unless it has the assurance of a committed buyer before extending the credit. Thus, proposed § 226.45(b)(2)(v) would serve as a means of indirectly limiting the exemption to loans that are to be held in portfolio.

The Board believes that the rationale for the exemption is not present when a loan will be acquired pursuant to a forward commitment by a purchaser that does not qualify for the exemption, even if the creditor making the loan is exempt. Accordingly, under proposed § 226.45(b)(2)(v), the escrow requirement would apply to a higher-priced mortgage loan that, at consummation, is subject to a forward commitment to be acquired by a person that is not exempt. Proposed comment 45(b)(2)(v)–1 would clarify that the transaction is not exempt, whether the forward commitment provides for the purchase and sale of the specific transaction or for the purchase and sale of loans with certain criteria that the transaction meets.

The Board seeks comment 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. The Board also seeks comment on how it might address this possibility without relying on post-consummation events as part of the test. For instance, should the Board include a provision making it a violation of the escrow requirement to engage in a pattern or practice of making higher-priced mortgage loans without escrows under the exemption (with no forward commitment in place) and then selling them within some defined period after consummation?

45(b)(3) Cancellation

Proposed § 226.45(b)(3) would establish minimum durations for escrow accounts required by § 226.45(b)(1). Proposed § 226.45(b)(3)(i) would implement TILA Section 129D(d)(4) by requiring the creditor or servicer to maintain an escrow account established pursuant to proposed § 226.45(b)(1) for a minimum of five years following consummation, unless the underlying debt obligation is terminated earlier. Proposed § 226.45(b)(3)(i) would allow, but not require, a creditor or servicer to cancel the escrow account after five years upon receipt of a request from the consumer. Proposed § 226.45(b)(3)(ii) would implement TILA Sections 129D(d)(1)–(3) by prohibiting the cancellation of an escrow account pursuant to a consumer's request under proposed § 226.45(b)(3)(i) unless at least 20% 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. Assuming the requirements of § 226.45(b)(3) were met, a creditor could, but would not be required to, cancel consumer's escrow account pursuant to the consumer's request, even if the consumer had been delinquent in making mortgage payments in the past. As long as the consumer brought his or her account current and had been making timely payments when the request was made, the creditor could close the escrow account.

The Board's proposed provisions to implement TILA Section 129D(d)(1)–(3) are modeled after the prerequisites for borrower cancellation of private mortgage insurance coverage under the Homeowners Protection Act of 1998 (HPA), 12 U.S.C. 4901–4910. The Board seeks comment on the appropriateness of those standards, in light of the language used in TILA Section 129D(d)(1)–(3). In particular, TILA Section 129D(d)(1) states that an escrow account mandated by TILA Section 129D(b) must remain in existence, even if five years have elapsed, unless and until the "borrower has sufficient equity in the dwelling securing the consumer credit transaction so as to no longer be required to maintain private mortgage insurance." The Board seeks comment on 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.

Proposed comment 45(b)(3)–1 would clarify that termination of the underlying credit obligation could include, among other things, repayment,

refinancing, rescission, and foreclosure. Proposed comment 45(b)(3)–2 would clarify that proposed § 226.45(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 § 226.45(b)(3).

Proposed comment 45(b)(3)–3 would clarify that the term "original value" in § 226.45(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. This meaning of "original value" is adopted from Section 2(12) of the HPA. 12 U.S.C. 4901(12). The Board is cognizant of the recent nation-wide decline of property values. The Board recognizes that, under the proposal, a creditor or servicer may honor a consumer's request to cancel their escrow account when the consumer has met all of the pre-conditions of § 226.45(b)(3) even when the consumer does not have 20% equity in their home because of depressed property values at the time. The Board believes that using some method other than the HPA as a model for determining when a borrower has sufficient equity in the property would prove too complicated and create uncertainty. However, the Board solicits comment on the proposed approach.

Proposed comment 45(b)(3)–3 also would clarify that, in determining whether 20% of the original value of the property securing the underlying debt obligation is unencumbered, the creditor or servicer must count any subordinate lien of which it has reason to know. The proposed comment would further state that, if the consumer certifies in writing that the equity in the property is unencumbered by a subordinate lien, the creditor or servicer may rely upon the certification in making its determination. This approach is derived from Section 3(a)(4)(B) of the HPA, 12 U.S.C. 4902(a)(4)(B). Under that provision, the mortgagor must certify that there is no subordinate lien on the property as a prerequisite for cancellation of private mortgage insurance. The Board is proposing a modified version of this approach. Under the proposal, an escrow account could be cancelled, provided that all liens do not exceed 80% of the property's original value. The Board seeks comment on whether this approach is appropriate. Alternatively, the Board solicits comment on whether subordinate-lien loans should be disregarded when calculating the consumer's equity.

45(c)

The Board is proposing 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."

45(d) Evasion; Open-End Credit

Proposed § 226.45(d) would provide that, 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), a creditor shall not structure a home-secured loan as an open-end plan to evade the requirements of § 226.45. This proposed provision would parallel existing § 226.35(b)(4).

Appendices G and H—Open-End and Closed-End Model Forms and Clauses

The Board is proposing to revise staff comment App. G and H–1 to provide guidance on permissible changes to the new model forms the Board is proposing. Appendices G and H set forth model forms, model clauses and sample forms that may be used to comply with the requirements of Regulation Z. Appendix G contains model forms, model clauses and sample forms applicable to open-end plans. Appendix H contains model forms, model clauses and sample forms applicable to closed-end loans. Although use of the model forms and clauses is not required, proper use will be deemed to be in compliance with the regulation with regard to those disclosures. As discussed above, the Board proposes to add several model forms to Appendix H for the disclosure requirements applicable to the establishment, non-establishment, and cancellation of escrow accounts. The new model forms are discussed above in the section-by-section analysis applicable to the regulatory provisions to which the forms relate. *See* discussion under §§ 226.19(f) (establishment or non-establishment of escrow account at consummation) and 226.20(d) (cancellation of escrow account after consummation).

Existing comment App. G and H–1 discusses changes that may be made to the model forms and clauses. The comment also lists the models to which formatting changes may not be made because the disclosures must be made in a form substantially similar to that in the models to retain the safe harbor from liability. The Board is proposing to add Model Forms H–24 (establishment of escrow account at consummation), H–25 (non-establishment of escrow account at consummation), and H–26 (cancellation of an escrow account after consummation) to the list of forms to which formatting changes may not be made. As discussed in more detail in the section-by-section analysis to proposed § 226.19(f)(1), proposed § 226.19(f)(1)(i) requires that creditors provide the § 226.19(f)(2) disclosures with the headings, content, order, and format substantially similar to Model Form H–24 or H–25. As discussed in more detail in the section-by-section analysis to proposed § 226.20(d)(1), proposed § 226.20(d)(1)(i) requires that servicers provide the § 226.20(d)(2) disclosures with the headings, content, order, and format substantially similar to Model Form H–26.

Appendix H—Closed-End Model Forms and Clauses

The Board is proposing to add three new model forms to Appendix H for use in complying with the new disclosure requirements discussed above. Appendix H to part 226 sets forth model forms, model clauses and sample forms that may be used to comply with requirements of Regulation Z for closed-end credit. Although use of the model forms and clauses generally is not required, proper use is deemed to be in compliance with the regulation with regard to those disclosures.

The proposed new model forms could be used by creditors to comply with the disclosure requirements of proposed § 226.19(f) regarding the establishment or non-establishment of an escrow account and of proposed § 226.20(d) regarding the cancellation of an escrow account established in connection with a closed-end transaction secured by a first lien on real property or a dwelling. Accordingly, the Board proposes to add Model Form H–24 Establishment of Escrow Account; Model Form H–25 Non-Establishment of Escrow Account; and Model Form H–26 Cancellation of Escrow Account to illustrate the disclosures required under proposed §§ 226.19(f) and 226.20(d).

The Board also proposes new comment App. H–29, which would provide guidance on how to use Model Forms H–24 through H–26. Proposed comment App. H–29.i states that the model forms illustrate, in the tabular format, the disclosures required by proposed §§ 226.19(f) and 226.20(d). Proposed comment App. H–29.ii specifies that a creditor satisfies § 226.19(f)(2) if it provides the appropriate model form (H–24 or H–25) and a servicer satisfies § 226.20(d)(2) if it provides Model Form H–26, or a substantially similar notice, which is properly completed with the disclosures

required by § 226.19(f)(2) or § 226.20(d)(2), respectively. Proposed comment App. H–29.iii provides that, although creditors are not required to use a certain paper size in disclosing the rescission notice required under §§ 226.19(f) and 226.20(d), Model Forms H–24 through H–26 are designed to be printed on an 8½ x 11 inch sheet of paper. In addition, proposed comment App. H–29.iii provides details of the formatting techniques that were used in presenting the information in the model forms to ensure that the information is readable.

Proposed comment App. H–29.iv states that, while the regulation does not require creditors or servicers to use the formatting techniques described in comment App. H–29.iii (except for the 10-point minimum font requirement), creditors and servicers are encouraged to consider these techniques when deciding how to disclose information in the notice to ensure that the information is presented in a readable format. Proposed comment App. H–29.v clarifies that creditors and servicers may use color, shading and similar graphic techniques with respect to the notice, so long as the notice remains substantially similar to the model forms in Appendix H.

V. Paperwork Reduction Act

In accordance with the Paperwork Reduction Act (PRA) of 1995 (44 U.S.C. 3506; 5 CFR part 1320 appendix A.1), the Board reviewed the proposed rule under the authority delegated to the Board by the Office of Management and Budget (OMB). The collection of information that is required by this proposed rule is found in 12 CFR part 226. The Board may not conduct or sponsor, and an organization is not required to respond to, this information collection unless the information collection displays a currently valid OMB control number. The OMB control number is [7100–0199].

This information collection is required to provide benefits for consumers and is mandatory (15 U.S.C. 1601 *et seq.*). Since the Board does not collect any information, no issue of confidentiality arises. The respondents/recordkeepers are creditors and other entities subject to Regulation Z.

TILA and Regulation Z are intended to ensure effective disclosure of the costs and terms of credit to consumers. For open-end credit, creditors are required to, among other things, disclose information about the initial costs and terms and to provide periodic statements of account activity, notice of changes in terms, and statements of rights concerning billing error procedures. Regulation Z requires specific types of disclosures for credit and charge card accounts and home equity plans. For closed-end loans, such as mortgage and installment loans, cost disclosures are required to be provided prior to consummation. Special disclosures are required in connection with some products, such as reverse mortgages, certain variable-rate loans, and certain mortgages with rates and fees above specified thresholds. TILA and Regulation Z also contain rules concerning credit advertising. Creditors are required to retain evidence of compliance for twenty-four months, § 226.25, but Regulation Z identifies only a few specific types of records that must be retained.[3]

Under the PRA, the Board accounts for the paperwork burden associated with Regulation Z for the state member banks and other creditors supervised by the Federal Reserve that engage in consumer credit activities covered by Regulation Z and, therefore, are respondents under the PRA. Appendix I of Regulation Z defines the Federal Reserve-regulated institutions as: State member banks, branches and agencies of foreign banks (other than Federal branches, Federal agencies, and insured state branches of foreign banks), commercial lending companies owned or controlled by foreign banks, and organizations operating under section 25 or 25A of the Federal Reserve Act. Other Federal agencies account for the paperwork burden imposed on the entities for which they have administrative enforcement authority. The current total annual burden to comply with the provisions of Regulation Z is estimated to be 1,497,362 hours for the 1,138 Federal Reserve-regulated institutions that are deemed to be respondents for the purposes of the PRA. A detailed discussion of revised burden is presented in the following two paragraphs. To ease the burden and cost of complying with Regulation Z (particularly for small entities), the Board provides model forms, which are appended to the regulation.

As discussed in the preamble, the Board proposes the addition of format, timing, and content requirements for the new disclosures regarding escrow accounts for closed-end mortgages secured by a first lien on real property or a dwelling that shall be provided three business days before consummation or before closure of an escrow account. The proposed rule would impose a one-time increase in the total annual burden under Regulation Z for all respondents regulated by the Federal Reserve by 45,520 hours, from 1,497,362 to 1,542,882 hours. In addition, the Board estimates that, on a continuing basis, the proposed rule would increase the total annual burden by 109,248 hours from 1,497,362 to 1,606,610 hours.[4]

The Board estimates that the 1,138 respondents regulated by the Federal Reserve would take, on average, 40 hours (one business week) to update their systems and internal procedure manuals and to provide training for relevant staff to comply with the new disclosure requirements in §§ 226.19(f) and 226.20(d). This one-time revision will increase the burden by 45,520 hours. On a continuing basis, the Board estimates that 1,138 respondents regulated by the Federal Reserve will take, on average, 8 hours a month to comply with the new disclosure requirements and that the new requirements will increase the ongoing burden by 109,248 hours from 304,756 to 353,276 hours. To ease the burden and cost of complying with the new requirements under Regulation Z, the Board is adding several model forms to Appendix H.

The total estimated burden increase, as well as the estimates of the burden increase associated with each major section of the proposed rule as set forth below, represents averages for all respondents regulated by the Federal Reserve. The Board expects that the amount of time required to implement each of the proposed changes for a given institution may vary based on the size and complexity of the respondent.

The other Federal financial agencies—Office of the Comptroller of the Currency (OCC), Office of Thrift Supervision (OTS), the Federal Deposit Insurance Corporation (FDIC), and the National Credit Union Administration (NCUA)—are responsible for estimating and reporting to OMB the total paperwork burden for the domestically chartered commercial banks, thrifts, and Federal credit unions and U.S. branches and agencies of foreign banks for which they have primary administrative enforcement jurisdiction under TILA Section 108(a), 15. U.S.C. 1607(a). These agencies are permitted, but are not required, to use the Board's burden

[3] *See* comments 25(a)–3 and –4.

[4] The burden estimate for this rulemaking does not include the burden addressing changes to implement the following provisions announced in separate rulemakings:

1. Closed-End Mortgages (Docket No. R–1366) (74 FR 43232);

2. Home-Equity Lines of Credit (Docket No. R–1367) (74 FR 43428); or

3. Mortgage Disclosure Improvement Act (Docket No. R–1366).

estimation methodology. Using the Board's method, the total current estimated annual burden for the approximately 16,200 domestically chartered commercial banks, thrifts, and Federal credit unions and U.S. branches and agencies of foreign banks supervised by the Federal Reserve, OCC, OTS, FDIC, and NCUA under TILA would be approximately 21,813,445 hours. The proposed rule would impose a one-time increase in the estimated annual burden for such institutions by 648,000 hours to 22,461,445 hours. On a continuing basis the proposed rule would impose an increase in the estimated annual burden by 1,555,200 to 23,368,645 hours. The above estimates represent an average across all respondents; the Board expects variations between institutions based on their size, complexity, and practices.

Comments are invited on: (1) Whether the proposed collection of information is necessary for the proper performance of the Board's functions; including whether the information has practical utility; (2) the accuracy of the Board's 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. Comments on the collection of information should be sent to Cynthia Ayouch, Acting Federal Reserve Board Clearance Officer, Division of Research and Statistics, Mail Stop 95–A, Board of Governors of the Federal Reserve System, Washington, DC 20551, with copies of such comments sent to the Office of Management and Budget, Paperwork Reduction Project ([7100–0199]), Washington, DC 20503.

VI. Regulatory Flexibility Act

In accordance with section 3(a) of the Regulatory Flexibility Act (RFA), 5 U.S.C. 601–612, the Board is publishing an initial regulatory flexibility analysis for the proposed amendments to Regulation Z. The RFA requires an agency either to provide an initial regulatory flexibility analysis with a proposed rule or to certify that the proposed rule will not have a significant economic impact on a substantial number of small entities. Under regulations issued by the Small Business Administration (SBA), an entity is considered "small" if it has $175 million or less in assets for banks and other depository institutions, and $7 million or less in revenues for non-bank mortgage lenders and loan servicers.[5]

Based on its analysis and for the reasons stated below, the Board believes that this proposed rule will have a significant economic impact on a substantial number of small entities. A final regulatory flexibility analysis will be conducted after consideration of comments received during the public comment period. The Board requests public comment in the following areas.

A. Reasons for the Proposed Rule

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. One of the stated purposes of TILA is providing a 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) loan. TILA also contains procedural and substantive protections for consumers. TILA is implemented by the Board's Regulation Z.

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, provides for certain exemptions from the requirement, establishes minimum periods for which such required escrow accounts must be maintained, and requires certain disclosures relating to escrow accounts. The proposed amendments to Regulation Z would implement those requirements. These amendments are proposed in furtherance of the Board's responsibility to prescribe regulations to carry out the purposes of TILA, including promoting consumers' awareness of the cost of credit and their informed use thereof.

B. Statement of Objectives and Legal Basis

Part IV of the **SUPPLEMENTARY INFORMATION** contains a detailed statement of the proposed rule's objectives and legal basis. In summary, the proposed amendments to Regulation Z are intended (1) to implement the definition of "higher-priced mortgage loan" and the requirement that creditors establish escrow accounts for such loans, in §§ 226.45(a) and 226.45(b)(1); (2) to provide exemptions from the escrow requirement for loans secured by shares in a cooperative, for insurance premiums for loans secured by dwellings in condominiums, planned-unit developments, and similar arrangements, and for loans made by certain small creditors that operate predominantly in rural or underserved areas, in § 226.45(b)(2); (3) to revise the rules setting the minimum durations for which required escrow accounts must be maintained, in § 226.45(b)(3); and (4) to require that creditors provide consumers with certain disclosures regarding escrow accounts, in §§ 226.19(f) and 226.20(d). All of these proposed provisions are pursuant to amendments to TILA adopted by the Dodd-Frank Act. The legal basis for the proposed rule is in TILA Sections 105(a), 105(f), and 129D. 15 U.S.C. 1604(a), 1604(f), and 1638D.

C. Description of Small Entities to Which the Proposed Rule Would Apply

The proposed regulations would apply to all institutions and entities that engage in originating or extending home-secured credit, as well as servicers of these loans. The Board is not aware of a reliable source for the total number of small entities likely to be affected by the proposal, and 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 credit. *See* § 226.1(c)(1).[6] All small entities that originate, extend, or service closed-end loans secured by real property or a dwelling potentially could be subject to at least some aspects of the proposed rules.

The Board can, however, identify through data from Reports of Condition and Income ("Call Reports") approximate numbers of small depository institutions that would be subject to the proposed rules. According to September 2010 Call Report data, approximately 8,669 small depository institutions would be subject to the rule. Approximately 15,627 depository institutions in the United States filed Call Report data, approximately 10,993 of which had total domestic assets of $175 million or less and thus were

[5] 13 CFR 121.201; *see also* SBA, Table of Small Business Size Standards Matched to North American Industry Classification System Codes, *available at http://www.sba.gov/idc/groups/public/documents/sba_homepage/serv_sstd_tablepdf.pdf.*

[6] Regulation Z generally applies to "each individual or business that offers or extends credit when four conditions are met: (i) The credit is offered or extended to consumers; (ii) the offering or extension of credit is done regularly, (iii) the credit is subject to a finance charge or is payable by a written agreement in more than four installments, and (iv) the credit is primarily for personal, family, or household purposes." § 226.1(c)(1).

considered small entities for purposes of the RFA. Of the 3,788 banks, 507 thrifts, 6,632 credit unions, and 66 branches of foreign banks that filed Call Report data and were considered small entities, 3,667 banks, 479 thrifts, 4,520 credit unions, and 3 branches of foreign banks, totaling 8,669 institutions, extended mortgage credit. For purposes of this Call Report analysis, thrifts include savings banks, savings and loan entities, co-operative banks and industrial banks. Further, 1,303 non-depository institutions (independent mortgage companies, subsidiaries of a depository institution, or affiliates of a bank holding company) filed HMDA reports in 2010 for 2009 lending activities. Based on the small volume of lending activity reported by these institutions, most are likely to be small entities.

Certain parts of the proposed rule would also apply to mortgage servicers. The Board is not aware, however, of a source of data for the number of small mortgage servicers. The available data are not sufficient for the Board realistically to estimate the number of mortgage servicers that would be subject to the proposed rules and that are small as defined by SBA.

D. Projected Reporting, Recordkeeping, and Other Compliance Requirements

The compliance requirements of the proposed rules are described in part III of the **SUPPLEMENTARY INFORMATION**. The effect of the proposed revisions to Regulation Z on small entities is unknown. Some small entities would be required, among other things, to implement the new disclosures and processes for delivery thereof, as well as their systems for determining which transactions are subject to the escrow requirement, to comply with the revised rules. The precise costs to small entities of updating their systems and disclosures are difficult to predict. These costs will depend on a number of unknown factors, including, among other things, the specifications of the current systems used by such entities to prepare and provide disclosures and to administer and maintain escrow accounts.

Small entities would have broader exemptions from the escrow requirement potentially available, thus enjoying cost savings. The proposed rule also would provide creditors with additional guidance on the determination of the average prime offer rate for a comparable transaction and clarification of the higher-priced mortgage loan protections' applicability to construction-permanent financing, accordingly lowering compliance costs for small entities.

The proposed rule would require creditors to determine whether a loan is a higher-priced mortgage loan by comparing the loan's rate without third-party fees (the "transaction coverage rate") to the average prime offer rate. The transaction coverage rate would be calculated using the loan's interest rate and the points and any other origination charges the creditor keeps for itself, and thus would be more closely comparable to the average prime offer rate. The precise costs to small entities of updating their systems to implement this change are difficult to predict. The proposal would reduce potential compliance burden for all entities, including small entities, by ensuring that prime loans are not erroneously classified as higher-priced mortgage loans subject to the special protections for such loans.

The Board believes that costs of the proposed rule as a whole will have a significant economic effect on small entities, including small mortgage creditors and servicers. The Board seeks information and comment on any costs, compliance requirements, or changes in operating procedures arising from the application of the proposed rules to small businesses.

E. Identification of Duplicative, Overlapping, or Conflicting Federal Rules

Duplicative and Conflicting Federal Rules

The Board has not identified any Federal rules that conflict with the proposed revisions to Regulation Z.

Overlap With RESPA

Regulation X, which implements the Real Estate Settlement Procedures Act (RESPA), includes rules governing the administration of escrow accounts and requires certain periodic escrow analyses and delivery of escrow account statements to consumers. *See* 24 CFR 3500.17. The escrow account statements required by Regulation X must include dollar amounts representing, among other things, the amount required initially to fund the escrow account, the periodic payment amount required to maintain the escrow account, and the annual amounts estimated to be paid out of the account for items covered by the escrow account such as taxes and insurance. These items overlap with dollar amounts that would be required as part of the disclosures this proposed rule would adopt. To ease compliance, the proposed rule would provide that creditors comply with the requirement to disclose those amounts if they use the same amounts determined in accordance with Regulation X.

F. Identification of Duplicative, Overlapping, or Conflicting State Laws

State Equivalents to TILA and HOEPA

Many states regulate consumer credit through statutory disclosure schemes similar to TILA. Under TILA Section 111, the proposed rules would not preempt such state laws except to the extent they are inconsistent with the proposal's requirements. 15 U.S.C. 1610.

The Board also is aware that many states regulate "high-cost" or "high-priced" mortgage loans under laws that resemble HOEPA. Many of these state laws involve coverage tests that partly depend on the APR of the transaction. The proposed rules would overlap with these laws by requiring lenders to determine whether a loan is a higher-priced mortgage loan by comparing the loan's transaction coverage rate to the average prime offer rate. Such state laws would not be affected, however, by the proposed transaction coverage rate approach to coverage of the Board's protections for higher-priced mortgage loans.

State Laws Regulating Escrow Accounts

Some state laws deal with escrow account administration, including laws that require the payment to consumers of interest on required escrow accounts and laws that prohibit a creditor from requiring an escrow account under specified circumstances. The proposed rules would not preempt such state laws except to the extent they are inconsistent with the proposal's requirements. *Id.*

The Board seeks comment regarding any state or local statutes or regulations that would duplicate, overlap, or conflict with the proposed rules.

G. Discussion of Significant Alternatives

The steps the Board 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 **SUPPLEMENTARY INFORMATION**. The Board has provided a different standard for defining higher-priced mortgage loans to correspond more accurately to mortgage market conditions and to exclude from the definition some prime loans that might otherwise have been classified as higher-priced. The Board believes that this standard will decrease the economic impact of the proposed rules on small entities by limiting their

compliance costs for prime loans that the Board does not intend to cover under the higher-priced mortgage loan rules. In addition, as noted above, the Board has proposed to provide that creditors may comply with certain disclosure content requirements by using the same amounts determined for purposes of overlapping RESPA disclosure requirements. The Board expects that this approach will minimize compliance burden on small entities by relying on another disclosure requirement with which they already must comply.

The Board welcomes comments on any significant alternatives, consistent with the requirements of TILA, that would minimize the impact of the proposed rules on small entities.

List of Subjects in 12 CFR Part 226

Advertising, Consumer protection, Federal Reserve System, Mortgages, Reporting and recordkeeping requirements, Truth in lending.

Text of Proposed Revisions

Certain conventions have been used to highlight the proposed revisions. New language is shown inside bold arrows, and language that would be deleted is set off with bold brackets.

Authority and Issuance

For the reasons set forth in the preamble, the Board proposes to amend Regulation Z, 12 CFR part 226, as set forth below:

PART 226—TRUTH IN LENDING (REGULATION Z)

1. The authority citation for part 226 continues to read as follows:

Authority: 12 U.S.C. 3806; 15 U.S.C. 1604, 1637(c)(5), and 1639(l); Pub. L. 111–24 § 2, 123 Stat. 1734.

Subpart A—General

2. Section 226.2 is amended by revising paragraph (a)(6) to read as follows:

§ 226.2 Definitions and rules of construction.

(a) * * *

(6) *Business day* means a day on which the creditor's offices are open to the public for carrying on substantially all of its business functions. However, for purposes of rescission under §§ 226.15 and 226.23, and for purposes of § 226.19(a)(1)(ii), § 226.19(a)(2), ►§ 226.19(f)(4), § 226.20(d)(4), ◄ § 226.31, and § 226.46(d)(4), the term means all calendar days except Sundays and the legal public holidays specified in 5 U.S.C. 6103(a), such as New Year's Day, the Birthday of Martin Luther King, Jr., Washington's Birthday, Memorial Day, Independence Day, Labor Day, Columbus Day, Veterans Day, Thanksgiving Day, and Christmas Day.

* * * * *

Subpart C—Closed-End Credit

3. Section 226.19 is amended by revising the heading and adding paragraph (f) to read as follows:

§ 226.19 [Certain mortgage and variable-rate transactions.]►Certain transactions secured by real property or a dwelling.◄

* * * * *

►(f) *Disclosures for escrow accounts.* For a closed-end transaction secured by a first lien on real property or a dwelling, the creditor shall disclose the information about escrow accounts as specified in paragraph (f)(2) of this section in accordance with the format requirements in paragraph (f)(1) of this section and the timing requirements in paragraph (f)(4) of this section. For purposes of this § 226.19(f), the term "escrow account" has the same meaning as under Regulation X (24 CFR 3500.17(b)), which implements the Real Estate Settlement Procedures Act (RESPA), and is subject to any interpretations by the Department of Housing and Urban Development (HUD).

(1) *Format requirements*—(i) *General.* The disclosures required by paragraph (f)(2) of this section shall be provided in a minimum 10-point font, grouped together on the front side of a one-page document, separate from all other material, with the headings, content, order, and format substantially similar to Model Form H–24 in Appendix H to this part, if an escrow account is established, or Model Form H–25 in Appendix H to this part, if an escrow account is not established.

(ii) *Disclosure of heading.* The disclosure of the heading required by paragraph (f)(2)(i) or (ii) of this section shall be more conspicuous than, and shall precede, the other disclosures required by paragraph (f)(2)(i) or (ii) of this section and shall be located outside the table, as required by paragraph (f)(1)(iii) of this section, containing those other disclosures.

(iii) *Form of disclosures; tabular format.* The creditor shall provide the disclosures required by paragraphs (f)(2)(i)(A) through (D) or (f)(2)(ii)(A) through (G) of this section in the form of a table. The table shall contain only the information required or permitted by paragraphs (f)(2)(i)(A) through (D) or (f)(2)(ii)(A) through (G) of this section, as applicable. The table containing the disclosures required by paragraphs (f)(2)(i)(A) through (D) of this section shall consist of four rows while the table containing the disclosures required by paragraphs (f)(2)(ii)(A) through (G) of this section shall consist of no more than seven rows.

(iv) *Question and answer format.* The creditor shall provide the disclosures required by paragraphs (f)(2)(i)(A) through (D) or (f)(2)(ii)(A) through (G) of this section in the format of a question and answer and in the order listed, as applicable.

(v) *Highlighting.* The dollar amounts required to be disclosed in paragraphs (f)(2)(i)(B), (f)(2)(i)(D), and (f)(2)(ii)(D) of this section and the disclosure required by paragraph (f)(2)(ii)(E) of this section shall appear in bold-face font.

(2) *Content requirements*—(i) *Establishment of escrow account.* If an escrow account will be established before the end of the 45-day period following consummation of a transaction subject to this § 226.19(f), the creditor shall clearly and conspicuously disclose, under the heading "Information About Your Mortgage Escrow Account," the following information:

(A) *Purpose of notice.* A statement that the notice is to inform the consumer that the consumer's mortgage with the creditor, which shall be identified by name, will have an escrow account.

(B) *Explanation of escrow account.* A statement that an escrow account is an account that is used to pay home-related costs such as property taxes and insurance together with a statement that an escrow account is sometimes called an "impound" or "trust" account. A statement that the consumer will pay into the escrow account over time and that the creditor will take money from the account to pay costs as needed. A statement of the estimated dollar amount that the consumer's home-related costs will total for the first year of the mortgage.

(C) *Risk of not having escrow account.* A statement that, if the consumer did not have an escrow account, the consumer would be responsible for directly paying home-related costs through potentially large semi-annual or annual payments.

(D) *Funding of escrow account.* A statement of the dollar amount that the consumer will be required to deposit at closing to initially fund the escrow account. A statement of the additional dollar amount that the consumer's regular mortgage payments will include for deposit into the escrow account. A statement that the amount of this escrow payment may change in the future.

(ii) *Non-establishment of escrow account.* If an escrow account will not be established before the end of the 45-day period following consummation of a transaction subject to this § 226.19(f), the creditor shall clearly and conspicuously disclose, under the heading "Required Direct Payment of Property Taxes and Insurance," the following information:

(A) *Purpose of notice.* A statement that the notice is to inform the consumer that the consumer's mortgage with the creditor, which shall be identified by name, will not have an escrow account and to explain the risk of not having an escrow account.

(B) *Explanation of escrow account.* A statement that an escrow account is an account that is used to pay home-related costs such as property taxes and insurance together with a statement that an escrow account is sometimes called an "impound" or "trust" account. A statement that the borrower pays into an escrow account over time and that the creditor takes money from the account to pay costs as needed.

(C) *Reason why mortgage will not have an escrow account.* As applicable, a statement that the consumer was given the option of having an escrow account but the consumer told the creditor that the consumer did not want one, or a statement that the creditor does not offer the option of having an escrow account.

(D) *Fee for choosing not to have escrow account.* If the consumer has chosen not to have an escrow account, a statement of the dollar amount of any fee that the consumer will be charged for choosing not to have an escrow account, or a statement that the consumer will not be charged a fee. If the creditor does not offer the option of having an escrow account, the creditor shall omit this disclosure from the table.

(E) *Risk of not having escrow account.* A statement that the consumer will be responsible for paying home-related costs through potentially large semi-annual or annual payments.

(F) *Consequences of failure to pay home-related costs.* A statement that, if the consumer does not pay the applicable home-related costs, the creditor could require an escrow account on the mortgage or add the costs to the loan balance. A statement that the creditor could also require the consumer to pay for insurance that the creditor buys on the consumer's behalf and a statement that this insurance likely would be more expensive and provide fewer benefits than traditional homeowner's insurance.

(G) *Option to establish escrow account.* The telephone number that the consumer can use to request an escrow account and the latest date by which the consumer can make the request. If the creditor does not offer the option of having an escrow account, the creditor shall omit this disclosure from the table.

(3) *Optional information.* The creditor may, at its option, include the creditor's name or logo, or the consumer's name, property address, or loan number on the disclosure notice required by this § 226.19(f), outside of the table described in § 226.19(f)(1)(iii) that contains the required content of § 226.19(f)(2).

(4) *Waiting period for disclosures.* The creditor shall provide the disclosures required by paragraph (f)(2) of this section so that the consumer receives them no later than three business days before consummation.

(5) *Timing of receipt.* If the disclosures required by paragraph (f)(2) of this section are mailed to the consumer or delivered by means other than in person, the consumer is considered to have received the disclosures three business days after they are mailed or delivered.

(6) *Consumer's waiver of waiting period before consummation.* The consumer may modify or waive the three-business-day waiting period required by paragraph (f)(4) of this section, after receiving the disclosures required by paragraph (f)(2) of this section, if the consumer determines that the loan proceeds are needed before the waiting period ends to meet a *bona fide* personal financial emergency. To modify or waive a waiting period, each consumer primarily liable on the obligation shall give the creditor a dated, written statement that describes the emergency, specifically modifies or waives the waiting period, and bears the consumer's signature. Printed forms for this purpose are prohibited.◄

4. Section 226.20 is amended by adding paragraph (d) to read as follows:

§ 226.20 Subsequent disclosure requirements.

* * * * *

►(d) *Cancellation of escrow account.* For a closed-end transaction secured by a first lien on real property or a dwelling for which an escrow account was established and will be cancelled, the creditor or servicer shall disclose the information about escrow accounts as specified in paragraph (d)(2) of this section in accordance with the format requirements in paragraph (d)(1) of this section and the timing requirements in paragraph (d)(4) of this section. For purposes of this § 226.20(d), the term "escrow account" and the term "servicer" have the same respective meanings as under §§ 3500.17(b) and 3500.2(b) of Regulation X, which implements the Real Estate Settlement Procedures Act (RESPA), and is subject to any interpretations by the Department of Housing and Urban Development (HUD).

(1) *Format requirements*—(i) *General.* The disclosures required by paragraph (d)(2) of this section shall be provided in a minimum 10-point font, grouped together on the front side of a one-page document, separate from all other material, with the headings, content, order, and format substantially similar to Model Form H–26 in Appendix H to this part.

(ii) *Disclosure of heading.* The disclosure of the heading required by paragraph (d)(2) of this section shall be more conspicuous than, and shall precede, the other disclosures required by paragraph (d)(2) of this section and shall be located outside the table, as required by paragraph (d)(1)(iii) of this section, containing those other disclosures.

(iii) *Form of disclosures; tabular format.* The creditor or servicer shall provide the disclosures required by paragraphs (d)(2)(i) through (vii) of this section in the form of a table. The table shall contain only the information required or permitted by paragraphs (d)(2)(i) through (vii) of this section and shall consist of no more than seven rows.

(iv) *Question and answer format.* The creditor or servicer shall provide the disclosures required by paragraphs (d)(2)(i) through (vii) of this section in the format of a question and answer and in the order listed.

(v) *Highlighting.* The dollar amount required to be disclosed in paragraph (d)(2)(iv) of this section and the disclosure required by paragraph (d)(2)(v) of this section shall appear in bold-face font.

(2) *Content requirements.* If an escrow account was established in connection with consummation of a transaction subject to this § 226.20(d) and the escrow account will be cancelled, the creditor or servicer shall clearly and conspicuously disclose, under the heading "Required Direct Payment of Property Taxes and Insurance," the following information:

(i) *Purpose of notice.* A statement that the notice is to inform the consumer that the escrow account on the consumer's mortgage with the creditor or servicer, which shall be identified by name, is being closed and to explain the risk of not having an escrow account.

(ii) *Explanation of escrow account.* A statement that an escrow account is an account that is used to pay home-related costs such as property taxes and

insurance together with a statement that an escrow account is sometimes called an "impound" or "trust" account. A statement that the consumer pays into an escrow account over time and that the creditor or the servicer takes money from the account to pay costs as needed.

(iii) *Reason why mortgage will not have an escrow account.* A statement that the consumer had an escrow account but, as applicable, the consumer asked to close it or the creditor or servicer independently decided to cancel it.

(iv) *Fee for closing escrow account.* If the consumer has asked the creditor or servicer to close the escrow account, a statement of the dollar amount of any fee that the consumer will be charged in connection with the closure, or a statement that the consumer will not be charged a fee. If the creditor or servicer independently decided to cancel the escrow account, rather than agreeing to close it at the request of the consumer, and does not charge a fee in connection with the cancellation, the creditor or servicer shall omit this disclosure from the table.

(v) *Risk of not having escrow account.* A statement that the consumer will be responsible for paying home-related costs through potentially large semi-annual or annual payments.

(vi) *Consequences of failure to pay home-related costs.* A statement that, if the consumer does not pay the applicable home-related costs, the creditor or servicer could require an escrow account on the mortgage or add the costs to the loan balance. A statement that the creditor or servicer could also require the consumer to pay for insurance that the creditor or servicer buys on the consumer's behalf and a statement that this insurance likely would be more expensive and provide fewer benefits than traditional homeowner's insurance.

(vii) *Option to keep escrow account.* As applicable, the telephone number that the consumer can use to request that the escrow account be kept open and the latest date by which the consumer can make the request, or a statement that the creditor or servicer does not offer the option of keeping the escrow account.

(3) *Optional information.* The creditor or servicer providing the disclosure notice may, at its option, include its name or logo, or the consumer's name, property address, or loan number on the disclosure notice required by this § 226.20(d), outside of the table described in § 226.20(d)(1)(iii) that contains the required content of § 226.20(d)(2).

(4) *Waiting period for disclosures.* The creditor or servicer shall provide the disclosures required by paragraph (d)(2) of this section so that the consumer receives them no later than three business days before closure of the escrow account.

(5) *Timing of receipt.* If the disclosures required by paragraph (d)(2) of this section are mailed to the consumer or delivered by means other than in person, the consumer is considered to have received the disclosures three business days after they are mailed or delivered.◄

Subpart E—Special Rules for Certain Home Mortgage Transactions

5. Section 226.34 is amended by revising paragraph (a)(4)(i) to read as follows:

§ 226.34 Prohibited acts or practices in connection with credit subject to § 226.32.

(a) * * *

(4) * * *

(i) *Mortgage-related obligations.* For purposes of this paragraph (a)(4), mortgage-related obligations are expected property taxes, premiums for mortgage-related insurance required by the creditor as set forth in ►§ 226.45(b)(1),◄ [§ 226.35(b)(3)(i),] and similar expenses.

* * * * *

6. Section 226.35 is amended by revising paragraph (b)(3) to read as follows:

§ 226.35 Prohibited acts or practices in connection with higher-priced mortgage loans.

* * * * *

(b) * * *

(3) ►[Reserved]◄ [*Escrows*—(i) *Failure to escrow for property taxes and insurance.* Except as provided in paragraph (b)(3)(ii) of this section, a creditor may not extend a loan secured by a first lien on a 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.

(ii) *Exemptions for loans secured by shares in a cooperative and for certain condominium units*—(A) Escrow accounts need not be established for loans secured by shares in a cooperative; and

(B) Insurance premiums described in paragraph (b)(3)(i) of this section need not be included in escrow accounts for loans secured by condominium units, where the condominium association has an obligation to the condominium unit owners to maintain a master policy insuring condominium units.

(iii) *Cancellation.* A creditor or servicer may permit a consumer to cancel the escrow account required in paragraph (b)(3)(i) of this section only in response to a consumer's dated written request to cancel the escrow account that is received no earlier than 365 days after consummation.

(iv) *Definition of escrow account.* For purposes of this section, "escrow account" shall have the same meaning as in 24 CFR 3500.17(b) as amended.]

* * * * *

7. Section 226.45 is added to read as follows:

►§ 226.45 Escrow requirements for higher-priced mortgage loans.

(a) *Higher-priced mortgage loans*—(1) For purposes of this section, except as provided in paragraph (a)(3) of this section, a higher-priced mortgage loan is a consumer credit transaction secured by the consumer's principal dwelling that has a transaction coverage 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 a loan secured by a first lien on a dwelling, except as provided in paragraph (a)(1)(ii) of this section;

(ii) By 2.5 or more percentage points for a loan secured by a first lien on a dwelling, if the principal balance at consummation 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 a loan secured by a subordinate lien on a dwelling.

(2) *Definitions*—(i) "Transaction coverage rate" means the rate used to determine whether a transaction is a higher-priced mortgage loan subject to this section. The transaction coverage rate is determined in accordance with the applicable rules of this part for the calculation of the annual percentage rate for a closed-end transaction, except that the prepaid finance charge for purposes of calculating the transaction coverage rate shall include only the amount of the prepaid finance charge that will be retained by the creditor, a mortgage broker, or an affiliate of either.

(ii) "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 Board 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 Board uses to derive these rates.

(3) Notwithstanding paragraph (a)(1) of this section, the term "higher-priced mortgage loan" does not include a transaction to finance the initial construction of a dwelling, a temporary or "bridge" loan with a 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, a reverse-mortgage transaction subject to § 226.33, or a home equity line of credit subject to § 226.5b.

(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 § 226.45(b), the term "escrow account" has the same meaning as under Regulation X (24 CFR 3500.17(b)), which implements the Real Estate Settlement Procedures Act (RESPA), and is subject to any interpretations by the Department of Housing and Urban Development (HUD).

(2) *Exemptions*—(i) Escrow accounts need not be established for loans secured by shares in a cooperative.

(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 similar arrangements 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, paragraph (b)(1) of this section does not apply to a transaction if, at the time of consummation:

(A) During the preceding calendar year, the creditor extended more than 50% of its total first-lien higher-priced mortgage loans in counties designated by the Board as "rural or underserved" under paragraph (b)(2)(iv) of this section;

(B) During either of the preceding two calendar years, the creditor and its affiliates together originated and retained the servicing rights to 100 or fewer loans secured by a first lien on real property or a dwelling; and

(C) 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.

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

(A) A county is "rural" during a calendar year if it is not in a metropolitan statistical area or a micropolitan statistical area, as those terms are defined by the U.S. Office of Management and Budget, and:

(*1*) it is not adjacent to any metropolitan area or micropolitan area; or

(*2*) it is adjacent to a metropolitan area with fewer than one million residents or adjacent to a micropolitan area, and it contains no town with 2500 or more residents.

(B) A county is "underserved" during a calendar year if no more than two creditors extend consumer credit five or more times secured by a first lien on real property or a dwelling during the calendar year in the county.

(v) Notwithstanding paragraph (b)(2)(iii) of this section, the requirement to establish an escrow account in paragraph (b)(1) of this section applies to a 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.

(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.* 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) At least 20% of the original value of the property securing the underlying debt obligation is unencumbered; 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 § 226.2(a)(20), a creditor shall not structure a home-secured loan as an open-end plan to evade the requirements of this section.◄

8. Appendix H to part 226 is amended by:

A. Adding entries for H–24, H–25, and H–26 in the table of contents at the beginning of the appendix; and

B. Adding new Model Forms H–24, H–25, and H–26 in numerical order.

Appendix H to Part 226—Closed-End Model Forms and Clauses

►H–24—Establishment of Escrow Account Model Form (§ 226.19(f)(2)(i))

H–25—Non-Establishment of Escrow Account Model Form (§ 226.19(f)(2)(ii))

H–26—Cancellation of Escrow Account Model Form (§ 226.20(d))◄

* * * * *

►H–24—Establishment of Escrow Account Model Form (§ 226.19(f)(2)(i))

BILLING CODE 6210–01–P

Information About Your Mortgage Escrow Account

What is the purpose of this notice?	This notice is to inform you that your mortgage with (Creditor's Name) will have an escrow account.

What is an escrow account?	An escrow account (sometimes called an "impound" or "trust" account) is an account that is used to pay home-related costs such as property taxes and insurance. You will pay into the escrow account over time, and we will take money from the account to pay costs as needed. We estimate that your home-related costs will total **$_____** for the first year of your mortgage.
What would be the risk of not having an escrow account?	If you did not have an escrow account, you would be responsible for directly paying your home-related costs through potentially large semi-annual or annual payments.
How will I pay into my escrow account?	At closing you will make an initial deposit of **$_____** into your escrow account. After that, your regular mortgage payments will include an additional **$_____** that will be deposited into your escrow account. The amount of this escrow payment may change in the future.

H-25—Non-Establishment of Escrow Account Model Form (§ 226.19(f)(2)(ii))

Required Direct Payment of Property Taxes and Insurance

What is the purpose of this notice?	This notice is to inform you that your mortgage with (Creditor's Name) will not have an escrow account. It also describes the risk of not having an escrow account.

What is an escrow account?	An escrow account (sometimes called an "impound" or "trust" account) is an account that is used to pay home-related costs such as property taxes and insurance. A borrower pays into the escrow account over time, and the creditor takes money from the account to pay costs as needed.
Why won't my mortgage have an escrow account?	[You were given the option of having an escrow account, but you told us that you didn't want one.][We do not offer the option of having an escrow account.]
[Will I be charged a fee for choosing not to have an escrow account?	[Yes. For choosing not to have an escrow account, you will be charged a fee of $_____.][No.]]
What is the risk of not having an escrow account?	**You will be responsible for directly paying your home-related costs through potentially large semi-annual or annual payments.**
What could happen if I don't pay my home-related costs?	If you don't pay these costs, we could require an escrow account on your mortgage or add the costs to your loan balance. We could also require that you pay for insurance that we buy on your behalf. This insurance likely would be more expensive and provide fewer benefits than traditional homeowner's insurance.
[Can I set up an escrow account on my mortgage?	Yes. If you want to set up an escrow account on your mortgage, contact us at (telephone number) by (date).]

H-26—Cancellation of Escrow Account Model Form (§ 226.20(d))

Required Direct Payment of Property Taxes and Insurance

What is the purpose of this notice?	This notice is to inform you that the escrow account on your mortgage with (Creditor's or Servicer's Name) is being closed. It also describes the risk of not having an escrow account.

What is an escrow account?	An escrow account (sometimes called an "impound" or "trust" account) is an account that is used to pay home-related costs such as property taxes and insurance. You pay into the escrow account over time, and we take money from the account to pay costs as needed.
Why won't my mortgage have an escrow account?	You had an escrow account, but [you asked us to close][we are cancelling] it.
[Will I be charged a fee for closing my escrow account?	[Yes. For closing your escrow account, you will be charged a fee of **$**____.][No.]]
What is the risk of not having an escrow account?	**You will be responsible for directly paying your home-related costs through potentially large semi-annual or annual payments.**
What could happen if I don't pay my home-related costs?	If you don't pay these costs, we could require an escrow account on your mortgage or add the costs to your loan balance. We could also require that you pay for insurance that we buy on your behalf. This insurance likely would be more expensive and provide fewer benefits than traditional homeowner's insurance.
Can I keep the escrow account on my mortgage?	[Yes. If you want to keep the escrow account on your mortgage, contact us at (telephone number) by (date).][No, we do not offer that option.]

◄

BILLING CODE 6210–01–C

9. In Supplement I to Part 226:

A. Under *Section 226.2—Definitions and Rules of Construction, 2(a) Definitions, 2(a)(6) Business day,* paragraph 2 is revised.

B. Under *Section 226.19—Certain Mortgage and Variable-Rate Transactions,* the heading is revised and *19(f) Disclosures for escrow accounts* is added.

C. Under *Section 226.20—Subsequent Disclosure Requirements,* new *20(d) Cancellation of escrow account* is added.

D. Under *Section 226.34—Prohibited Acts or Practices in Connection with Credit Subject to § 226.32, 34(a) Prohibited acts or practices for loans subject to § 226.32, 34(a)(4) Repayment*

ability, 34(a)(4)(i) Mortgage-related obligation, paragraph 1 is revised.

E. Under *Section 226.35—Prohibited Acts or Practices in Connection With Higher-Priced Mortgage Loans, 35(b) Rules for higher-priced mortgage loans,* the heading 35(b)(3) *Escrows,* the heading *Paragraph 35(b)(3)(i)* and paragraphs 1 through 3 thereunder, the heading *Paragraph 35(b)(3)(ii)(B)* and paragraph 1 thereunder, and the heading 35(b)(3)(v) "*Jumbo*" *loans* and paragraphs 1 and 2 thereunder are removed.

F. New *Section 226.45—Requirements for Higher-Priced Mortgage Loans* is added.

G. Under Appendices G and H—Open-End and Closed-End Model Forms and Clauses, paragraph 1 is revised.

H. Under Appendix H—Closed-End Model Forms and Clauses, new paragraph 29 is added.

The revisions and additions read as follows:

Supplement I to Part 226—Official Staff Interpretations

* * * * *

Subpart A—General

* * * * *

Section 226.2—Definitions and Rules of Construction

* * * * *

2(a) Definitions.

* * * * *

2(a)(6) Business day.

* * * * *

2. *Rule for rescission, disclosures for certain mortgage transactions, and private education loans.* A more precise rule for what is a business day (all calendar days except Sundays and the Federal legal holidays specified in 5 U.S.C. 6103(a)) applies when the right of rescission, the receipt of disclosures for certain [dwelling-secured] mortgage transactions under §§ 226.19(a)(1)(ii), 226.19(a)(2), ►226.19(f)(4), 226.20(d)(4),◄ 226.31(c), or the receipt of disclosures for private education loans under § 226.46(d)(4) is involved. Four Federal legal holidays are identified in 5 U.S.C. 6103(a) by a specific date: New Year's Day, January 1; Independence Day, July 4; Veterans Day, November 11; and Christmas Day, December 25. When one of these holidays (July 4, for example) falls on a Saturday, Federal offices and other entities might observe the holiday on the preceding Friday (July 3). In cases where the more precise rule applies, the observed holiday (in the example, July 3) is a business day.

* * * * *

Subpart C—Closed-End Credit

* * * * *

Section 226.19—[Certain Mortgage and Variable-Rate Transactions]►Certain Transactions Secured by Real Property or a Dwelling◄

* * * * *

►*19(f) Disclosures for escrow accounts.*

1. *Real property or a dwelling.* The term "real property" includes vacant and unimproved land. The term "dwelling" includes vacation and second homes and mobile homes, boats, and trailers used as residences. *See* § 226.2(a)(19) and related commentary for additional guidance regarding the term "dwelling."

19(f)(1) Format requirements.

19(f)(1)(i) General.

1. *Grouped and separate.* The disclosures required by § 226.19(f)(2) and any optional information permitted by § 226.19(f)(3) must be grouped together on the front side of a separate one-page document that contains no other material. The § 226.19(f)(2)(i) disclosures may not appear in the same document as the escrow disclosures required under § 226.18 or under RESPA or Regulation X.

2. *Notice must be in writing in a form that the consumer may keep.* The notice containing the disclosures required by § 226.19(f)(2) and any optional information permitted by § 226.19(f)(3) must be in writing in a form that the consumer may keep. *See* § 226.17(a).

19(f)(2) Content requirements.

1. *Clear and conspicuous standard.* The clear and conspicuous standard generally requires that disclosures be in a reasonably understandable form and readily noticeable to the consumer.

19(f)(2)(i) Establishment of escrow account.

1. *Reliance on Regulation X escrow account analysis.* Regulation X, 24 CFR 3500.17(c)(2), requires the mortgage servicer to conduct an escrow account analysis before establishing an escrow account. Disclosures comply with the numerical content requirements of § 226.19(f)(2)(i)(B) and (D) if the creditor uses the amounts derived from the escrow account analysis to provide the total dollar amount of estimated taxes and insurance for the initial year following consummation, the dollar amount for the initial escrow deposit at closing, and the additional dollar amount for escrow included in the regular mortgage payments.

2. *Escrow accounts established in connection with consumer's delinquency or default.* Neither creditors nor servicers are required to provide the § 226.19(f)(2)(i) disclosures when an escrow account is established solely in connection with the consumer's delinquency or default on the underlying debt obligation.

19(f)(3) Optional information.

1. Section 226.19(f)(3) lists information that the creditor may, at its option, include on the disclosure notice outside of the table that is required by § 226.19(f)(1)(iii).

19(f)(4) Waiting period for disclosures.

1. *Business day definition.* For purposes of § 226.19(f)(4), "business day" means all calendar days except Sundays and the legal public holidays referred to in § 226.2(a)(6). *See* comment 2(a)(6)–2.

2. *Timing.* The creditor must provide the disclosures required by § 226.19(f)(2) so that the consumer receives them not later than the third business day before consummation. For example, for consummation to occur on Thursday, June 11, the consumer must receive the disclosures on or before Monday, June 8, assuming there are no legal public holidays.

19(f)(5) Timing of receipt.

1. *General.* If the creditor delivers the disclosures required by § 226.19(f)(2) to the consumer in person, consummation may occur any time on the third business day following the day of delivery. If the creditor provides the disclosures required by § 226.19(f)(2) by mail, the consumer is considered to have received them three business days after they are placed in the mail, for purposes of determining when the three-business-day waiting period required under § 226.19(f)(4) begins. Creditors that use electronic mail or a courier to provide disclosures may also follow this approach. Whatever method is used to provide disclosures, creditors may rely on documentation of receipt in determining when the three-business-day waiting period begins.

19(f)(6) Consumer's waiver of waiting period before consummation.

1. *Procedure.* A consumer may modify or waive the right to a waiting period required by § 226.19(f)(4) only after the consumer receives the disclosures required by § 226.19(f)(2). After receiving the required disclosures, the consumer may waive or modify the waiting period by giving the creditor a dated, written statement that specifically waives or modifies the waiting period and describes the bona fide personal financial emergency. A waiver is effective only if each consumer primarily liable on the legal obligation signs a waiver statement. Where there are multiple such consumers, the consumers may, but need not, sign the same waiver statement. The consumer may, but need not, include the waiver statement that specifically waives or modifies the three-business-day waiting period required by § 226.19(f)(4) in the same document that contains a waiver statement that specifically waives or modifies the seven-business-day waiting period for early disclosures or the three-business-day waiting period for corrected disclosures required by § 226.19(a)(2).

2. *Bona fide personal financial emergency.* To modify or waive the waiting period required by § 226.19(f)(4), there must be a *bona fide* personal financial emergency that requires disbursement of loan proceeds before the end of the waiting period. Whether there is a *bona fide* personal financial emergency is determined by the facts surrounding individual circumstances. A *bona fide* personal financial emergency typically, but not always, will involve imminent loss of or harm to a dwelling or harm to the health or safety of a natural person. A waiver is not effective if the consumer's statement is inconsistent with facts known to the creditor.◄

Section 226.20—Subsequent Disclosure Requirements

* * * * *

►*20(d) Cancellation of escrow account.*

1. *Real property or a dwelling.* The term "real property" includes vacant and unimproved land. The term "dwelling" includes vacation and second homes and mobile homes, boats, and trailers used as residences. *See* § 226.2(a)(19) and related commentary for additional guidance regarding the term "dwelling."

20(d)(1) Format requirements.

20(d)(1)(i) General.

1. *Grouped and separate.* The disclosures required by § 226.20(d)(2) and any optional information permitted by § 226.20(d)(3) must be grouped together on the front side of a separate one-page document that contains no other material.

2. *Notice must be in writing in a form that the consumer may keep.* The notice containing the disclosures required by § 226.20(d)(2) and any optional information permitted by § 226.20(d)(3) must be in writing in a form that the consumer may keep. *See* § 226.17(a).

20(d)(2) Content requirements.

1. *Clear and conspicuous standard.* The clear and conspicuous standard generally requires that disclosures be in a reasonably understandable form and readily noticeable to the consumer.

2. *Escrow account established in connection with consumer's delinquency or default.* Neither creditors nor servicers are required to provide the § 226.20(d)(2) disclosures when an escrow account that was established solely in connection with the consumer's delinquency or default on the underlying debt obligation will be cancelled.

3. *Termination of underlying debt obligation.* Neither creditors nor servicers are required to provide the § 226.20(d)(2) disclosures when the underlying debt obligation for which an escrow account was established is terminated, including by repayment, refinancing, rescission, and foreclosure.

20(d)(3) Optional information.

1. Section 226.20(d)(3) lists information that the creditor or servicer may, at its option, include on the disclosure notice outside of the table that is required by § 226.20(d)(1)(iii).

20(d)(4) Waiting period for disclosures.

1. *Business day definition.* For purposes of § 226.20(d)(4), "business day" means all calendar days except Sundays and the legal public holidays referred to in § 226.2(a)(6). See comment 2(a)(6)–2.

2. *Timing.* The creditor or servicer must provide the disclosures required by § 226.20(d)(2) so that the consumer receives them not later than the third business day before consummation. For example, for consummation to occur on Thursday, June 11, the consumer must receive the disclosures on or before Monday, June 8, assuming there are no legal public holidays.

20(d)(5) Timing of receipt.

1. *General.* If the creditor or servicer delivers the disclosures required by § 226.20(d)(2) to the consumer in person, the escrow account may be closed any time on the third business day following the date of delivery. If the creditor or servicer provides the disclosures required by § 226.20(d)(2) by mail, the consumer is considered to have received them three business days after they are placed in the mail, for purposes of determining when the three-business-day waiting period required under § 226.20(d)(4) begins. Creditors and servicers that use electronic mail or a courier to provide disclosures may also follow this approach. Whatever method is used to provide disclosures, creditors and servicers may rely on documentation of receipt in determining when the three-business-day waiting period begins.◄

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Subpart E—Special Rules for Certain Home Mortgage Transactions

* * * * *

34(a)(4)(i) Mortgage-related obligations.

1. *Mortgage-related obligations.* A creditor must include in its repayment ability analysis the expected property taxes and premiums for mortgage-related insurance required by the creditor as set forth in ►§ 226.45(b)(1),◄ [§ 226.35(b)(3)(i),] as well as similar mortgage-related expenses. Similar mortgage-related expenses include homeowners' association dues and condominium or cooperative fees.

* * * * *

[*35(b)(3) Escrows.*

Paragraph 35(b)(3)(i).

1. Section 226.35(b)(3) 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 mobile home, boat or a trailer used as the consumer's principal dwelling. See the commentary under §§ 226.2(a)(19), 226.2(a)(24), 226.15 and 226.23. Section 226.35(b)(3) also applies to higher-priced mortgage loans secured by a first lien on a condominium or a cooperative unit if it is in fact used as principal residence.

2. *Administration of escrow accounts.* Section 226.35(b)(3) requires creditors to establish before the consummation of a loan secured by a first lien on a principal dwelling an escrow account for payment of property taxes and premiums for mortgage-related insurance required by creditor. Section 6 of RESPA, 12 U.S.C. 2605, and Regulation X address how escrow accounts must be administered.

3. *Optional insurance items.* Section 226.35(b)(3) does not require that escrow accounts be established for premiums for mortgage-related insurance that the creditor does not require in connection with the credit transaction, such as an earthquake insurance or debt-protection insurance.

Paragraph 35(b)(3)(ii)(B).

1. *Limited exception.* A creditor is required to escrow for payment of property taxes for all first lien loans secured by condominium units regardless of whether the creditors escrows insurance premiums for condominium unit.]

* * * * *

►*Section 226.45—Requirements for Higher-Priced Mortgage Loans*

45(a) Higher-priced mortgage loans.

Paragraph 45(a)(1).

1. *Threshold for "jumbo" loans.* Section 226.45(a)(1)(ii) provides a separate threshold for determining whether a transaction is a higher-priced mortgage loan subject to § 226.45 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 § 226.45(a)(1)(ii) applies.

45(a)(2) Definitions.

Paragraph 45(a)(2)(i).

1. *Transaction coverage rate.* The transaction coverage rate is calculated solely for purposes of determining whether a transaction is subject to § 226.45. The creditor is not required to disclose the transaction coverage rate to the consumer. The creditor determines the transaction coverage rate in the same manner as the transaction's annual percentage rate, except that, for purposes of calculating the transaction coverage rate and determining coverage under § 226.45, the amount of the prepaid finance charge is modified in accordance with § 226.45(a)(2)(i). Under § 226.45(a)(2)(i), only the amount of the prepaid finance charge retained by the creditor, a mortgage broker, or an affiliate of either is included in calculating the transaction coverage rate; any other fees or charges included in the prepaid finance charge for purposes of calculating the annual percentage rate are disregarded. For example, assume a transaction in which, at consummation, one discount point is paid to the creditor, an underwriting fee is paid to an affiliate of the creditor, an origination fee is paid to a mortgage broker, and a mortgage insurance premium is paid to a mortgage insurer that is not affiliated with the creditor or the mortgage broker. For purposes of the annual percentage rate disclosed to the consumer, all of the listed charges are included in the prepaid finance charge; for purposes of calculating the transaction coverage rate, however, the mortgage insurance premium is excluded from the modified prepaid finance charge. The transaction coverage rate that results from these special rules must be compared to the average prime offer rate to determine whether the transaction is subject to § 226.45.

2. *Inclusion of finance charges in modified prepaid finance charge; mortgage broker charges.* For purposes of the special rules under § 226.45(a)(2)(i), only charges that are included in the prepaid finance charge to calculate the annual percentage rate are included in the modified prepaid finance charge to calculate the transaction coverage rate. Compensation paid by the creditor to a mortgage broker that comes from a "yield spread premium" is not included in the modified prepaid finance charge because such compensation is not a prepaid finance charge. See comment 4(a)(3)–3.

Paragraph 45(a)(2)(ii).

1. *Average prime offer rate.* Average prime offer rates are annual percentage rates

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. Other pricing terms include commonly used indices, margins, and initial fixed-rate periods for variable-rate transactions. Relevant pricing characteristics include a consumer's credit history and transaction characteristics such as the loan-to-value ratio, owner-occupant status, and purpose of the transaction. To obtain average prime offer rates, the Board uses a survey of creditors that both meets the criteria of § 226.45(a)(2)(ii) and provides pricing terms for at least two types of variable-rate transactions and at least two types of non-variable-rate transactions. An example of such a survey is the Freddie Mac Primary Mortgage Market Survey®.

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

3. *Rate set.* A transaction's transaction coverage 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.

4. *Board table.* The Board publishes on the FFIEC's Web site, in table form, average prime offer rates for a wide variety of transaction types. *See http://www.ffiec.gov/hmda.* The Board calculates an annual percentage rate, consistent with Regulation Z (see § 226.22 and appendix J), for each transaction type for which pricing terms are available from a survey. The Board 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 Board publishes on the FFIEC's Web site the methodology it uses to arrive at these estimates.

5. *Additional guidance on determination of average prime offer rates.* The average prime offer rate has the same meaning in § 226.45 as in Regulation C, 12 CFR part 203. *See* 12 CFR 203.4(a)(12)(ii). Guidance on the average prime offer rate under § 226.45(a)(2)(ii), such as when a transaction's rate is set and determination of the comparable transaction, is provided in the staff commentary under Regulation C, the Board's *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.*

Paragraph 45(a)(3).

1. *Construction-permanent loans.* Under § 226.45(a)(3), § 226.45 does not apply to a transaction to finance the initial construction of a dwelling. Section 226.45 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, § 226.17(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 226.17(c)(6)(ii) addresses only how a creditor may elect to disclose a construction-permanent transaction. Which disclosure option a creditor elects under § 226.17(c)(6)(ii) does not affect the determination of whether the permanent phase of the transaction is subject to § 226.45. Whether the creditor discloses the two phases as a single transaction or as two separate transactions, a single transaction coverage rate, reflecting the appropriate charges from both phases, must be calculated in accordance with § 226.45(a)(2)(i). The transaction coverage rate must be compared to the average prime offer rate for a comparable transaction to determine coverage under § 226.45. If the transaction is determined to be a higher-priced mortgage loan, only the permanent phase is subject to the requirements of § 226.45. Thus, for example, the requirement under § 226.45(b) to establish an escrow account prior to consummation of a higher-priced mortgage loan secured by a first lien on a principal dwelling applies only to the permanent phase and not to the construction phase. Accordingly, the escrow account must be established by the time the transaction converts from the construction phase to the permanent phase, even though the permanent phase may have been consummated earlier, and the period for which the escrow account must remain in place under § 226.45(b)(3) is measured from the time the conversion to the permanent phase occurs.

45(b) Escrow accounts.

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

1. *Principal dwelling.* Section 226.45(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 mobile home, boat, or trailer used as the consumer's principal dwelling. *See* the commentary under §§ 226.2(a)(19), 226.2(a)(24), 226.15 and 226.23. Section 226.45(b)(1) also applies to a higher-priced mortgage loan secured by a first lien on a condominium or a cooperative unit if it is in fact used as the consumer's principal dwelling. *But see* § 226.45(b)(2) for exemptions from the escrow requirement that may apply to such transactions.

2. *Administration of escrow accounts.* Section 226.45(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 address how escrow accounts must be administered.

3. *Optional insurance items.* Section 226.45(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.

4. *Transactions not subject to § 226.45(b)(1).* Section 226.45(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 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 § 226.45(b)(1).

45(b)(2) Exemptions.

Paragraph 45(b)(2)(ii).

1. *Limited exception.* 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 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 § 226.45(b)(2)(ii), if a PUD's governing association is obligated to maintain such a master insurance policy, an escrow account required by § 226.35(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.

Paragraph 45(b)(2)(iii).

1. *Requirements for exemption.* Under § 226.45(b)(2)(iii), except as provided in § 226.45(b)(2)(v), a creditor need not establish an escrow account for taxes and insurance for a higher-priced mortgage loan, provided the following three conditions are satisfied when the higher-priced mortgage loan is consummated:

i. The creditor extended over 50% of its total first-lien higher-priced mortgage loans during the preceding calendar year in counties that are "rural or underserved," as defined in § 226.45(b)(2)(iv). Pursuant to that section, the Board 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 higher-priced mortgage loans during 2010, the creditor meets this condition for an exemption in 2011 if at least 46 of those loans are secured

by properties located in one or more counties that are on the Board's list for 2010.

ii. The creditor and its affiliates together extended and serviced 100 or fewer first-lien mortgage loans during either of the preceding two calendar years. Thus, a creditor becomes ineligible for the exemption if it exceeds the threshold for two consecutive calendar years. For example, if a creditor extends and retains the servicing rights to 100 first-lien mortgage loans in 2008 and then 110 in each of 2009 and 2010, the creditor must comply with § 226.45(b)(1) beginning in 2011. On the other hand, if the same creditor extended and retained the servicing rights to only 100 first-lien mortgage loans in 2010, it would remain eligible for the exemption in 2011 notwithstanding its 110 originations in 2009, assuming it continues to satisfy the other conditions of § 226.45(b)(2)(iii).

iii. The creditor, or its affiliate, does not maintain an escrow account for any mortgage loan being serviced by the creditor or its affiliate at the time the transaction is consummated. Thus, the exemption applies, provided the other conditions of § 226.45(b)(2)(iii) are satisfied, even if the creditor previously maintained escrow accounts for mortgage loans, provided it no longer maintains any such accounts. Once a creditor or its affiliate begins escrowing for loans currently serviced, however, the creditor and its affiliate become ineligible for the exemption in § 226.45(b)(2)(iii) on higher-priced mortgage loans they make thereafter. Thus, as long as a creditor (or its affiliate) services and maintains escrow accounts for any mortgage loans, the creditor will not be eligible for the exemption for any higher-priced mortgage loan it may make. For purposes of § 226.45(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 45(b)(2)(iv).

1. *Requirements for "rural or underserved" status.* A county is considered "rural or underserved" for purposes of § 226.45(b)(2)(iii)(A) if it satisfies either of the two tests in § 226.45(b)(2)(iv). The Board applies both tests to each county in the United States and, if a county satisfies either test, includes that county on the annual list of "rural or underserved" counties. The Board publishes on its public Web site the applicable list for each calendar year by the end of that year. A creditor's first-lien higher-priced mortgage loan originations in such counties during that year are considered for purposes of whether the creditor satisfies the condition in § 226.45(b)(2)(iii)(A) and therefore is eligible for the exemption during the following calendar year. The Board determines whether each county is "rural" by reference to the currently applicable Urban Influence Codes (UICs), established by the United States Department of Agriculture's Economic Research Service (USDA–ERS). Specifically, the Board classifies a county as "rural" if the USDA–ERS categorizes the county under UIC 7, 10, 11, or 12. The Board determines whether each county is "underserved" by reference to data submitted by mortgage lenders under the Home Mortgage Disclosure Act (HMDA).

Paragraph 45(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." 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 § 226.45(b)(1) unless the purchaser is eligible for the exemption in § 226.45(b)(2)(iii). 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 loans with certain prescribed criteria that the transaction meets. For example, assume a creditor that qualifies for the exemption in § 226.45(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 loans after consummation. If the investor currently escrows for any mortgage loans it services, making the investor ineligible for the exemption in § 226.45(b)(2)(iii), an escrow account must be established for the transaction before consummation in accordance with § 226.45(b)(1).

45(b)(3) Cancellation.

1. *Termination of underlying debt obligation.* Methods by which an underlying debt obligation may be terminated include, among other things, repayment, refinancing, rescission, and foreclosure.

2. *Minimum durations.* Section 226.45(b)(3) establishes minimum durations for which escrow accounts established pursuant to § 226.45(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. *Twenty percent equity.* The term "original value" in § 226.45(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 20% of the original value of the property securing the underlying debt obligation is unencumbered, 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 debit obligation is unencumbered by a subordinate lien, the creditor or servicer may rely upon the certification in making its determination.◄

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Appendices G and H—Open-End and Closed-End Model Forms and Clauses

1. *Permissible changes.* Although use of the model forms and clauses is not required, creditors using them properly will be deemed to be in compliance with the regulation with regard to those disclosures. Creditors may make certain changes in the format or content of the forms and clauses and may delete any disclosures that are inapplicable to a transaction or a plan without losing the act's protection from liability, except formatting changes may not be made to model forms and samples in H–18, H–19, H–20, H–21, H–22, H–23, ►H–24, H–25, H–26,◄G–2(A), G–3(A), G–4(A), G–10(A)–(E), G–17(A)–(D), G–18(A) (except as permitted pursuant to § 226.7(b)(2)), G–18(B)–(C), G–19, G–20, and G–21, or to the model clauses in H–4(E), H–4(F), H–4(G), and H–4(H). Creditors may modify the heading of the second column shown in Model Clause H–4(H) to read "first adjustment" or "first increase," as applicable, pursuant to § 226.18(s)(2)(i)(C). The rearrangement of the model forms and clauses may not be so extensive as to affect the substance, clarity, or meaningful sequence of the forms and clauses. Creditors making revisions with that effect will lose their protection from civil liability. Except as otherwise specifically required, acceptable changes include, for example:

i. Using the first person, instead of the second person, in referring to the borrower.

ii. Using "borrower" and "creditor" instead of pronouns.

iii. Rearranging the sequences of the disclosures.

iv. Not using bold type for headings.

v. Incorporating certain state "plain English" requirements.

vi. Deleting inapplicable disclosures by whiting out, blocking out, filling in "N/A" (not applicable) or "0," crossing out, leaving blanks, checking a box for applicable items, or circling applicable items. (This should permit use of multipurpose standard forms.)

vii. Using a vertical, rather than a horizontal, format for the boxes in the closed-end disclosures.

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Appendix H—Closed-End Model Forms and Clauses

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►29. *Models H–24 through H–26.* Model Form H–24 contains the disclosures for the establishment of an escrow account, Model Form H–25 contains the disclosures for the non-establishment of an escrow account, and Model Form H–26 contains the disclosures for the cancellation of an escrow account established in connection with a closed-end transaction secured by a first lien on real property or a dwelling.

i. These model forms illustrate, in the tabular format, the disclosures required generally by §§ 226.19(f) and 226.20(d).

ii. A creditor satisfies § 226.19(f)(2) if it provides the appropriate model form (H–24 or H–25) and a creditor or servicer satisfies § 226.20(d)(2) if it provides Model Form H–26, or a substantially similar notice, which is properly completed with the disclosures required by § 226.19(f)(2) or § 226.20(d)(2), respectively.

iii. Although creditors and servicers are not required to use a certain paper size in disclosing the information under §§ 226.19(f) and 226.20(d), Model Forms H–24 through H–26 are designed to be printed on an 8½ × 11 inch sheet of paper. In addition, the following formatting techniques were used in presenting the information in the model

forms to ensure that the information is readable:

A. A readable font style and font size (10-point Arial font style);

B. Sufficient spacing between lines of the text;

C. Standard spacing between words and characters. In other words, the text was not compressed to appear smaller than 10-point type;

D. Sufficient white space around the text of the information in each row, by providing sufficient margins above, below and to the sides of the text;

E. Sufficient contrast between the text and the background. Generally, black text was used on white paper.

iv. While the regulation does not require creditors or servicers to use the above formatting techniques in presenting information in the tabular format (except for the 10-point minimum font requirement), creditors and servicers are encouraged to consider these techniques when deciding how to disclose information in the notice to ensure that the information is presented in a readable format.

v. Creditors and servicers may use color, shading and similar graphic techniques with respect to the notice, so long as the notice remains substantially similar to the model forms in Appendix H.◄

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By order of the Board of Governors of the Federal Reserve System, February 23, 2011.

Jennifer J. Johnson,

Secretary of the Board.

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