APRIL 18, 2013

TILA Escrow Rule

SMALL ENTITY COMPLIANCE GUIDE

Consumer Financial Protection Bureau

Please refer to the May 2013 Final Rule and October 2013 Final Rule, the 2013 and 2014 lists of rural and underserved counties, and the CFPB website for updates to the information contained in this guide. The Bureau plans to update this guide as appropriate.

Table of Contents

1. Introduction

In response to the recent mortgage crisis, Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) that, among other things, expanded protections for consumers receiving higher-priced mortgage loans.

Before passage of the Dodd-Frank Act, creditors were required under rules issued by the Federal Reserve Board to set up and administer escrow accounts for a minimum of one year for property taxes and required mortgage-related insurance premiums for higher-priced mortgage loans secured by a first lien on a principal dwelling.

This one-year escrow requirement became effective on April 1, 2010, for transactions secured by site-built homes, and on October 1, 2010, for transactions secured by manufactured housing.

This small entity compliance guide discusses the Escrow Requirements under the Truth in Lending Act (Regulation Z) Rule. This rule implements statutory changes made by the Dodd-Frank Act that lengthen the time creditors must collect and manage escrows for higher-priced mortgage loans. The rule is referred to in this guide as the TILA Escrow Rule.

The TILA Escrow Rule helps ensure consumers set aside funds to pay property taxes, homeowner's insurance premiums, and other mortgage-related insurance required by the creditor.

The final TILA Escrow Rule, which takes effect for applications received on or after June 1, 2013, has three main elements:

1. After you originate a higher-priced mortgage loan secured by a first lien on a principal dwelling, you must establish and maintain an escrow account for at least five years regardless of loan-to-value ratio. You must maintain the escrow account until one of the following occurs: 1) the underlying debt obligation is terminated or 2) after the five-year period, the consumer requests that the escrow account be canceled. However, if you are canceling the escrow account at the consumer's request, the loan's unpaid principal balance must be less than 80 percent of the original value of the property securing the underlying debt obligation, and the consumer must not be currently delinquent or in default on the underlying obligation.

2. You do not have to escrow for insurance premiums for homeowners whose properties are located in condominiums, planned unit developments, and other common interest communities where the homeowners must participate in governing associations that are required to purchase master insurance policies.

3. If you operate predominantly in rural or underserved areas and meet certain asset size and other requirements, you may be eligible for an exemption from this rule for certain loans you hold in portfolio.

I. What is the purpose of this guide?

The purpose of this guide is to provide an easy-to-use summary of the TILA Escrow Rule. This guide also highlights issues that small creditors and their business partners might find helpful to consider when implementing the rule.

This guide also meets the requirements of Section 212 of the Small Business Regulatory Enforcement Fairness Act of 1996, which requires the Bureau to issue a small entity compliance guide to help small businesses comply with the new regulation.

The Bureau believes that responsible creditors are already escrowing as required by the existing escrow provisions of Regulation Z. You will find the final rule does not expand the universe of transactions to which you must apply the escrow requirements. In fact, it creates an exemption for certain loans made by certain creditors operating predominantly in rural or underserved counties, thus reducing the compliance burden for creditors that meet the exemption's prerequisites.

Moreover, the final rule provides additional compliance burden relief for creditors by expanding the partial exemption in the existing rule for condominiums to other property types where the governing association has an obligation to maintain a master policy insuring all dwellings, such as planned unit developments.

The compliance burden on creditors for maintaining escrow accounts for additional time for loans where no exemptions apply should be minimal. Since creditors are already maintaining escrow accounts for a larger set of transactions for a shorter period of time under the current rule, the Bureau anticipates that to comply with this rule, many creditors will generally have to make only modest changes to their servicing systems and processes, internal controls, subservicer contracts, or other aspects of their business operations.

The focus of this guide is the TILA Escrow Rule. This guide does not discuss other federal or state laws that may apply to the maintenance and administration of escrow accounts or other rules to implement other requirements of the Dodd-Frank Act.

The guide summarizes the TILA Escrow Rule, but it is not a substitute for the rule. Only the rule and its Official Interpretations can provide complete and definitive information regarding its requirements. The discussions below provide citations to the sections of the rule on the subject being discussed. Keep in mind that the Official Interpretations, which provide detailed explanations of many of the rule's requirements, are found after the text of the rule and its appendices. The interpretations are arranged by rule section and paragraph for ease of use. The complete rule, including the Official Interpretations, is available at http://www.consumerfinance.gov/regulations/escrow-requirements-under-the-truth-in-lending-act-regulation-z/. At the end of this guide, there is a list of additional rule resources.

II. Who should read this guide?

If your organization originates higher-priced mortgage loans secured by principal dwellings, you may find this guide helpful. This guide will help you determine whether the mortgage loans you originate are regulated by this rule, and if so, what your compliance obligations are.

It discusses exceptions that might apply to you, including special rules for loans made by certain small creditors operating predominantly in rural or underserved markets, as well as special rules for loans secured by properties in common interest communities such as condominiums and planned unit developments.

This guide may also be helpful to servicing market participants, software providers, and other companies that serve as business partners to creditors.

III. Who can I contact about this guide or the TILA Escrow Rule?

For more information on the rule, please contact the Bureau's Office of Regulations at 202-435-7700 or email questions to CFPB_reginquiries@cfpb.gov.

Email comments about the guide to CFPB_TitleXIVRules@cfpb.gov. Your feedback is crucial to making sure the guide is as helpful as possible. The Bureau appreciates hearing your suggestions for improvements and your thoughts on the guide's usefulness and readability.

The Bureau is particularly interested in feedback relating to:

- ☐ How useful you found this guide for understanding the rule
- ☐ How useful you found this guide for implementing the rule at your business
- ☐ Suggestions you have for improving the guide, such as additional implementation tips

2. What is the TILA Escrow Rule?

I. What is the purpose of the TILA Escrow Rule?

As directed by Congress, the TILA Escrow Rule **lengthens to a minimum of five years** the required period most creditors must maintain an escrow account for higher-priced mortgage loans.

Before passage of the Dodd-Frank Act, creditors were required under rules issued by the Federal Reserve Board to set up and administer escrow accounts for property taxes and required mortgage-related insurance premiums for higher-priced mortgage loans secured by a first lien on a principal dwelling for a minimum of one year.

This one-year escrow requirement became effective on April 1, 2010, for transactions secured by site-built homes, and on October 1, 2010, for transactions secured by manufactured housing.

Title XIV of the Dodd-Frank Act amended TILA to expand this minimum escrow requirement from one year to five years. *(See "What do I have to do to comply with this rule?" on page 8 for additional requirements.)*

The TILA Escrow Rule also **clarifies that you do not need to escrow** for property insurance premiums for mortgages on properties in planned unit developments and other common interest communities where homeowners must participate in a governing association that is required to purchase a master policy insuring all dwellings.

Finally, the rule **offers regulatory relief** for certain small creditors operating predominantly in rural or underserved markets.

II. When do I have to start following this rule?

You must follow the TILA Escrow Rule's provisions for applications received on or after June 1, 2013. This is a delay from January 21, 2013, when the new escrow requirements and other new mortgage requirements under Title XIV of the Dodd-Frank Act would have been effective in the absence of regulations.

Note that the TILA Escrow Rule goes into effect before the January 10, 2014, effective date for most rules implementing other Title XIV requirements. The Bureau believes this expedited effective date is warranted because it provides additional consumer protections while imposing at most a modest increase in compliance burden for creditors that already have to provide escrow accounts under existing rules.

III. What do I have to do to comply with this rule?

You must establish and maintain escrow accounts for first-lien higher-priced mortgage loans for at least five years, subject to the requirements of the rule and any applicable exceptions. *(See "What are the exemptions to the TILA Escrow Rule?" on page 11.)*

This means that instead of being required to maintain mandatory escrow accounts for those loans until at least the one-year anniversary of origination (for instance, on September 1, 2014, for a loan originated on September 1, 2013), you will be required by this regulation to maintain the accounts until at least the five-year anniversary date (for instance, until at least September 1, 2018, for a loan originated on September 1, 2013).

You must maintain the escrow account until one of the following occurs: 1) the underlying debt obligation is terminated or 2) after the five-year period, the consumer requests that the escrow account be canceled. However, if you are canceling the escrow account at the consumer's request, the loan's unpaid principal balance must be less than 80 percent of the original value of the property securing the underlying debt obligation, and the consumer must not be currently delinquent or in default on the underlying obligation – so if these conditions are not met, you will need to maintain the escrow account beyond five years.

See Regulation X (12 CFR 1024.17(b)) for the definition of "escrow account."

IV. What loans does the TILA Escrow Rule cover? (§ 1026.35(b)(1))

The TILA Escrow Rule applies generally to first-lien, higher-priced mortgage loans *(see "What is a higher-priced mortgage loan (HPML)?" on page 15)* secured by a consumer's principal dwelling, subject to certain exceptions described below.

V. What loans are not covered by the TILA Escrow Rule? (§ 1026.35(b)(2))

Under the TILA Escrow Rule, escrow accounts do not need to be established for:

- ☐ Transactions secured by shares in a cooperative
- ☐ Transactions to finance the initial construction of a dwelling
- ☐ Temporary or "bridge" transactions with terms of 12 months or less
- ☐ Reverse mortgages
- ☐ Subordinate liens
- ☐ Open-end credit (such as a home equity line of credit)
- ☐ Insurance premiums the consumer purchases that you do not require

Loans held in portfolio by an organization that operates predominantly in rural or underserved counties and meets certain size and operational criteria may be exempt from the TILA Escrow Rule. *(See "What are the exemptions to the TILA Escrow Rule?" on page 11.)*

3. What are the important changes in the TILA Escrow Rule compared with existing regulations?

I. What are the three primary changes made by this rule?

These are the three primary changes this rule makes compared with existing regulations:

1. It lengthens to at least five years the required minimum period most creditors must maintain an escrow account for first-lien higher-priced mortgage loans secured by a consumer's principal dwelling. You must maintain the escrow account until one of the following occurs: 1) the underlying debt obligation is terminated or 2) after the five-year period, the consumer requests that the escrow account be canceled. However, if you are canceling the escrow account at the consumer's request, the loan's unpaid principal balance must be less than 80 percent of the original value of the property securing the underlying debt obligation, and the consumer must not be currently delinquent or in default on the underlying obligation.

2. It clarifies that you do not have to escrow insurance payments for homeowners in common interest communities where the governing body is required to purchase master insurance policies.

3. It exempts from the escrow requirement loans made by certain small creditors that operate predominantly in rural or underserved counties, as long as they are not subject to forward commitments for sale to nonexempt creditors.

4. What are the exemptions to the TILA Escrow Rule?

I. Is there an exemption for small creditors under this rule?

There is an exemption available for loans originated by certain small creditors that make more than half their loans to consumers in rural or underserved counties. The loans must not be subject to forward commitments for sale to nonexempt creditors.

You may qualify for the exemption for creditors operating in rural or underserved counties based on your lending activity in rural counties, underserved counties, or a combination of the two. You must also meet other operational requirements. *(See "What are the loan volume and size requirements to qualify for the exemption for creditors operating predominantly in rural or underserved counties?" below, "How do I determine if my institution operates predominantly in rural or underserved counties?" on page 12, and "What are the other requirements and conditions to qualify for the exemption for small creditors operating predominantly in rural or underserved counties?" on page 13.)*

II. What are the <u>loan volume and asset size requirements</u> to qualify for the exemption for creditors operating predominantly in rural or underserved areas?

To qualify, you must meet a two-part test:

1. Your organization, together with its affiliates, cannot originate more than 500 first-lien covered transactions during the preceding calendar year.

2. Your organization must have less than $2 billion in assets. This asset threshold will adjust automatically each year, based on the year-to-year change in November in the average of the Consumer Price Index for Urban Wage Earners and Clerical Workers rounded to the nearest million dollars. If your organization meets the asset threshold on December 31 of the preceding year, it satisfies this criterion for the current calendar year.

You must still meet other requirements in addition to asset size and loan volume to be exempt from the TILA Escrow Rule. *(See "How do I determine if my institution operates predominantly in rural or underserved areas?" below and "What are the other requirements and conditions to qualify for the exemption for small creditors operating predominantly in rural or underserved counties?" on page 13).*

III. How do I determine if my institution operates predominantly in rural or underserved areas? (§§ 1026.35(b)(2)(iii)(A) and 1026.35(b)(2)(iv)(B))

To qualify for the exemption, your organization must operate predominantly in rural or underserved counties, meaning that it made more than half of its first-lien covered transactions last year in rural counties (equivalent to the U.S. Department of Agriculture's Economic Research Service Urban Influence Codes 4, 6, 7, 8, 9, 10, 11, or 12) or underserved counties (where no more than two creditors extend five or more first-lien covered transactions in a calendar year).

The Bureau has posted a preliminary list of counties on its website, which are based on proposed revisions to the rule the Bureau issued on April 12, 2013. See http://www.consumerfinance.gov/blog/exemption-from-escrow-requirement-for-small-creditors-in-rural-or-underserved-counties/. The Bureau expects to post the official list of rural or underserved counties for 2013 on its website prior to June 1, 2013.

You do **not** have to qualify based solely on your activity in rural or underserved counties. **You can use loans in both types of counties together to qualify**.

Therefore, on a calendar-year basis, if the number of your organization's first-lien covered transactions in rural counties, plus the number of your first-lien covered transactions in underserved counties account for more than 50 percent of your total first-lien covered transactions, your organization is a rural or underserved creditor.

Base your 50 percent rural or underserved calculation on the number of first-lien covered transactions you originate and not on your overall loan volume.

You must still meet other asset size, loan volume and operational requirements to be exempt from the TILA Escrow Rule. *(See "What are the loan volume and asset size requirements to qualify for the exemption for creditors operating predominantly in rural or underserved counties?" on page 11 and "What are the other requirements and conditions to qualify for the exemption for small creditors operating predominantly in rural or underserved counties?" below.)*

IV. What are the other requirements and conditions to qualify for the exemption for small creditors operating predominantly in rural or underserved counties?

For creditors that meet the loan volume and size and the rural or underserved requirements to qualify for the exemption, there is one additional requirement. You and your affiliates cannot maintain escrows on or beyond the second installment due date for any loans you service, with two exceptions **(Comment 1026.35(b)(2)(iii)-1.iv)**:

Implementation Tip: Qualifying creditors are generally escrowing today for loans that would be covered by this rule, just for a shorter time period. If your organization is currently escrowing but will otherwise qualify for the exemption when the TILA Escrow Rule becomes effective, plan how you will wind down your current escrow program for applications received on or after June 1, 2013 for loans covered by this rule so that you do not lose the exemption by establishing new escrow accounts for transactions that result from those applications (other than as permitted to by the TILA Escrow Rule for distressed consumers).

1. Existing escrow accounts you or your affiliates maintain to comply with the Federal Reserve Board's 2008 final rule implementing changes to Regulation Z pursuant to authority granted under the Home Ownership and Equity Protection Act (2008 HOEPA final rule), **as long as you and your affiliates do not escrow for transactions covered by the TILA Escrow Rule** for which you receive an application on or after June 1, 2013 (other than for distressed consumers as noted below)

2. Escrow accounts you or your affiliates establish after consummation for distressed consumers

If your organization is eligible for the exemption for small creditors operating in rural or underserved counties, but you originate a loan under a forward commitment for sale (*i.e.,* your organization will not hold the loan in portfolio), you must establish an escrow account unless the loan is otherwise exempt (for example, it is a reverse mortgage) or the acquirer is also eligible for the exemption. **(§ 1026.35(b)(2)(v))**

V. Why did the Bureau exempt certain loans by certain creditors operating predominantly in rural or underserved counties from the TILA Escrow Rule? (§ 1026.35(b)(2)(iv))

The Bureau believes the loan exemption mitigates risk to consumers while ensuring the flow of credit to counties served by creditors that may find it too difficult or expensive to maintain escrows.

VI. What does the rule say about escrowing for property insurance in common interest communities? (§ 1026.33(b)(1))

You do not need to escrow homeowner's insurance premiums for loans secured by properties in condominiums, planned unit developments, or other common interest communities where the consumer must participate in a governing association that is required to purchase a master policy insuring all dwellings.

5. What definitions do I need to know?

I. What is a dwelling? (§ 1026.2(a)(19))

A dwelling is a residential structure that contains one to four units, whether or not that structure is attached to real property. Individual condominium units, cooperative units, mobile homes, and trailers used as residences are also dwellings.

II. What is a higher-priced mortgage loan (HPML)? (§ 1026.35(a)(1))

A mortgage loan is **"higher-priced"** if:

- ☐ It is a first-lien mortgage with an annual percentage rate (APR) that exceeds the Average Prime Offer Rate (APOR) by 1.5 percentage points or more.
- ☐ It is a first-lien mortgage with an APR that exceeds the APOR by 2.5 percentage points or more, if the principal amount of the mortgage exceeds Freddie Mac's limit for mortgages it will purchase ("jumbo loan") in effect as of the date the interest rate for the transaction is set.

For example, if the APOR is 5 percent, a first-lien mortgage is higher-priced if it has an APR of 6.5 percent or more and is not a jumbo loan.

The APOR is published at http://www.ffiec.gov/ratespread.

When comparing the transaction's APR to APOR, use the rate in effect on the last date you set (or lock) the interest rate before consummation.

6. What else do I need to know?

I. Can I structure a closed-end loan as open-end credit to evade this rule? (§ 1026.35(d))

No. You are prohibited from structuring a closed-end loan as open-end credit to evade this rule.

You may wish to consider the definition of open-end credit as you check compliance with this provision. It includes three characteristics:

1. You expect the consumer to take repeated draws.

2. You may charge the consumer a finance charge or charges on the unpaid principal balance.

3. The amount of credit available to the consumer (up to any limit you set) changes as the consumer takes and repays advances.

II. Can consumers cancel their escrow accounts before the deadlines set in the rule? (§ 1026.35(b)(3))

If you are required to set up an escrow account by this rule, you cannot cancel the account prior to the fifth year after consummation unless the underlying mortgage has been terminated. A consumer may request cancelation five years after consummation. Under this circumstance, you may cancel the escrow account only if two conditions are met:

1. The unpaid principal balance is less than 80 percent of the original value of the property securing the underlying debt obligation

2. The consumer currently is neither delinquent nor in default on the debt

7. Practical implementation and compliance considerations

You may want to consult with legal counsel or your compliance officer to understand your obligations under the rule and to plan for compliance with the rule's requirements. In general, since creditors are already complying with the rule for a larger set of transactions for a shorter period of time, the Bureau anticipates that to comply with this rule, most creditors will generally have to make only modest changes to their servicing systems and processes, internal controls, subservicer contracts, or other aspects of their business operations.

How you comply with the rule may depend upon your business model. When mapping out your compliance plan, you should consider practical implementation issues in addition to understanding your obligations under the rule. Your implementation and compliance plan may include:

1. Identifying affected products, departments, and staff

Your organization may offer some, or all, of the loan products discussed in the TILA Escrow Rule. You may find it useful to identify all affected products, departments, and staff.

2. Identifying the business-process, operational, and technology changes that will be necessary for compliance

Fully understanding the changes required may involve a review of your existing business processes and recordkeeping regimes, as well as the hardware and software that you, your agents, or other business partners use.

The new requirements may affect a number of parts of your business systems and processes. For example, the servicing department will need to calculate termination dates for escrow accounts for higher-priced mortgage loans covered by the rule. Your organization may also seek to evaluate ways to transition out of escrowing for such loans for applications received on or after June 1, 2013, so your organization can meet that part of the test for the small-creditor exemption (if you otherwise qualify for the exemption, and other than for distressed consumers, under the TILA Escrow Rule).

The forms and processes you use to communicate internally and externally may be affected by the need to verify whether your applicants live in communities that purchase master insurance policies. You will also want to adjust your systems and processes so they no longer escrow for insurance premiums for loans secured by dwellings in common interest communities where dwellings owners must participate in a governing association that is required to maintain a master property insurance policy insuring all dwellings, to the extent that those premiums were being escrowed to comply with the 2008 HOEPA final rule.

3. Identifying critical impacts on key service providers or business partners

Software providers, or other vendors and business partners, may offer compliance solutions that can assist with making the changes. These key partners will depend on your business model. For example, banks and credit unions may find it helpful to talk to their correspondent banks, secondary market partners, and technology vendors. In some cases, you may find it useful to negotiate revised or new contracts with these parties, or seek a different set of services.

If you seek the assistance of vendors or business partners, make sure you understand the extent of the assistance they provide. For example, if you use subservicers, are they prepared to follow the new TILA Escrow Rule?

4. Identifying training needs

Consider what training will be necessary for your loan administration, processing, compliance, and quality-control staff as well as anyone else involved in servicing. Training may also be required for other individuals you employ.

5. Considering other Title XIV rules

The TILA Escrow Rule is just one component of the Bureau's Dodd-Frank Act Title XIV rulemakings.

Other Title XIV rules include:

- ☐ Ability-to-Repay and Qualified Mortgage Rule
- ☐ 2013 HOEPA Rule
- ☐ ECOA Valuations Rule

- ☐ TILA Higher-Priced Mortgage Loans Appraisal Rule
- ☐ Loan Originator Rule
- ☐ Mortgage Servicing Rules

Each of these rules affects aspects of the mortgage industry and its regulation. Many of these rules intersect with one or more of the others. Therefore, the compliance considerations for these rules may overlap in your organization. You will find copies of these rules online at http://www.consumerfinance.gov/regulations.

8. Other resources

I. Where can I find a copy of the TILA Escrow Rule and get more information about it?

You will find the rule on the Bureau's website at http://www.consumerfinance.gov/regulations/escrow-requirements-under-the-truth-in-lending-act-regulation-z/.

In addition to a complete copy of the rule, that web page also contains:

- ☐ The preamble, which explains why the Bureau issued the rule; the legal authority and reasoning behind the rule; responses to comments; and analysis of the benefits, costs, and impacts of the rule
- ☐ Official Interpretations of the rule
- ☐ A detailed summary of the rule

For email updates about Bureau regulations and when additional Dodd-Frank Act Title XIV implementation resources become available, please submit your email address within the "Email updates" box at http://www.consumerfinance.gov/regulations/.