

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

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

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

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

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

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

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

iii. Under revised *35(b) Escrow accounts*:

a. Paragraph 1 is revised.

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

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

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

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

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

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

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

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

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

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

iv. *35(b)(3) Escrows* is revised.

v. Under revised *35(b)(3) Cancellation*:

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

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

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

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

The revisions, additions, and removals read as follows:

SUPPLEMENT I TO PART 1026—OFFICIAL INTERPRETATIONS

* * * * *

SUBPART E—SPECIAL RULES FOR CERTAIN HOME MORTGAGE TRANSACTIONS

* * * * *

Section 1026.35—Requirements for Higher-Priced Mortgage Loans

35(a) Definitions.

Paragraph 35(a)(1).

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

2. *Rate set.* A transaction’s annual percentage rate is compared to the average prime offer rate as of the date the transaction’s interest rate is set (or “locked”) before consummation.

Sometimes a creditor sets the interest rate initially and then re-sets it at a different level before consummation. The creditor should use the last date the interest rate is set before consummation.

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

Paragraph 35(a)(2).

* * * * *

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

3. *Additional guidance on determination of average prime offer rates.* The average prime offer rate has the same meaning in § 1026.35 as in Regulation C, 12 CFR part 1003. See 12 CFR 1003.4(a)(12)(ii). Guidance on the average prime offer rate under § 1026.35(a)(2), such as when

a transaction's rate is set and determination of the comparable transaction, is provided in the official commentary under Regulation C, the publication entitled "A Guide to HMDA Reporting: Getting it Right!", and the relevant "Frequently Asked Questions" on Home Mortgage Disclosure Act (HMDA) compliance posted on the FFIEC's website at <http://www.ffiec.gov/hmda>.

35(b) Escrow accounts.

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

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

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

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

insurance, even if the consumer voluntarily obtains such insurance.

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

35(b)(2) Exemptions.

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

1. *Construction-permanent loans*. Under § 1026.35(b)(2)(ii)(B), § 1026.35 does not apply to a transaction to finance the initial construction of a dwelling. Section 1026.35 may apply, however, to permanent financing that replaces a construction loan, whether the permanent financing is extended by the same or a different creditor. When a construction loan may be permanently financed by the same creditor, § 1026.17(c)(6)(ii) permits the creditor to give either one combined disclosure for both the construction financing and the permanent financing, or a separate set of disclosures for each of the two phases as though they were two separate transactions. *See also* comment 17(c)(6)-2. Section 1026.17(c)(6)(ii) addresses only how a creditor may elect to disclose a construction-permanent transaction. Which disclosure option a creditor elects under § 1026.17(c)(6)(ii) does not affect the determination of whether the permanent phase of the transaction is subject to § 1026.35. When the creditor discloses the two phases as separate transactions, the annual percentage rate for the permanent phase must be compared to the average prime offer rate for a transaction that is comparable to the permanent financing to determine whether the transaction is a higher-priced mortgage loan under § 1026.35(a). When the creditor discloses the two phases as a single transaction, a single annual

percentage rate, reflecting the appropriate charges from both phases, must be calculated for the transaction in accordance with § 1026.22(a)(1) and appendix D to part 1026. This annual percentage rate must be compared to the average prime offer rate for a transaction that is comparable to the permanent financing to determine the transaction is a higher-priced mortgage loan under § 1026.35(a). If the transaction is determined to be a higher-priced mortgage loan, only the permanent phase is subject to the requirement of § 1026.35(b)(1) to establish and maintain an escrow account, and the period for which the escrow account must remain in place under § 1026.35(b)(3) is measured from the time the conversion to the permanent phase financing occurs.

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

1. *Limited exemption.* A creditor is required to escrow for payment of property taxes for all first-lien higher-priced mortgage loans secured by condominium, planned unit development, or similar dwellings or units regardless of whether the creditor escrows for insurance premiums for such dwellings or units.

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

but also to any other type of property ownership arrangement that has a governing association with an obligation to maintain a master insurance policy.

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

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

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

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

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

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

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

the due date of the second periodic payment under the terms of the legal obligation.

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

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

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

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

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

1. *Requirements for “rural” or “underserved” status.* A county is considered to be

“rural” or “underserved” for purposes of § 1026.35(b)(2)(iii)(A) if it satisfies either of the two tests in § 1026.35(b)(2)(iv). The Bureau applies both tests to each county in the United States and, if a county satisfies either test, the Bureau will include the county on a published list of “rural” or “underserved” counties for a particular calendar year. To facilitate compliance with § 1026.35(c), the Bureau also creates a list of only those counties that are “rural” but not also “underserved.” The Bureau will post on its public website the applicable lists for each calendar year by the end of that year. A creditor may rely as a safe harbor, pursuant to section 130(f) of the Truth in Lending Act, on the lists of counties published by the Bureau to determine whether a county qualifies as “rural” or “underserved” for a particular calendar year. A creditor’s originations of covered transactions, as defined by § 1026.43(b)(1), in such counties during that year are considered in determining whether the creditor satisfies the condition in § 1026.35(b)(2)(iii)(A) and therefore will be eligible for the exemption during the following calendar year.

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

ii. Under § 1026.35(b)(2)(iv)(B), a county is underserved during a calendar year if, according to Home Mortgage Disclosure Act (HMDA) data for that year, no more than two

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

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

1. *Forward commitments.* A creditor may make a mortgage loan that will be transferred or sold to a purchaser pursuant to an agreement that has been entered into at or before the time the loan is consummated. Such an agreement is sometimes known as a "forward commitment." Even if a creditor is otherwise eligible for the exemption in § 1026.35(b)(2)(iii), a first-lien higher-priced mortgage loan that will be acquired by a purchaser pursuant to a forward commitment is subject to the requirement to establish an escrow account under § 1026.35(b)(1) unless the purchaser is also eligible for the exemption in § 1026.35(b)(2)(iii) or the transaction is otherwise exempt under § 1026.35(b)(2). The escrow requirement applies to any such transaction, whether the forward commitment provides for the purchase and sale of the specific transaction or for the purchase and sale of mortgage obligations with certain prescribed criteria

that the transaction meets. For example, assume a creditor that qualifies for the exemption in § 1026.35(b)(2)(iii) makes a higher-priced mortgage loan that meets the purchase criteria of an investor with which the creditor has an agreement to sell such mortgage obligations after consummation. If the investor is ineligible for the exemption in § 1026.35(b)(2)(iii), an escrow account must be established for the transaction before consummation in accordance with § 1026.35(b)(1) unless the transaction is otherwise exempt (such as a reverse mortgage or home equity line of credit).

35(b)(3) Cancellation.

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

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

3. *Less than eighty percent unpaid principal balance.* The term "original value" in § 1026.35(b)(3)(ii)(A) means the lesser of the sales price reflected in the sales contract for the property, if any, or the appraised value of the property at the time the transaction was consummated. In determining whether the unpaid principal balance has reached less than 80 percent of the original value of the property securing the underlying debt, the creditor or servicer shall count any subordinate lien of which it has reason to know. If the consumer certifies in

writing that the equity in the property securing the underlying debt obligation is unencumbered by a subordinate lien, the creditor or servicer may rely upon the certification in making its determination unless it has actual knowledge to the contrary.

* * * * *