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Regulation Z Escrow Requirements for HPMLs

The Consumer Financial Protection Bureau (CFPB) has amended Regulation Z, establishing new requirements for escrow accounts on Higher-Priced Mortgage Loans (HPMLs). These revisions implement statutory changes made by the Dodd-Frank Act that affect the timeframe for mandated escrow accounts, as well as exemptions. The rules apply to transactions for which applications are received on or after June 1, 2013.

Updated Alert Date: November 6, 2015

Status: General rule effective June 1, 2013
Various adjustments & asset threshold change effective January 1, 2014
New Asset Threshold Adjustment effective January 1, 2015
New Definition of Small Creditor effective January 1, 2016

Links: [Final Rule - 01/10/2013](#) [Final Rule - 05/23/2013](#)
[Final Rule - 07/10/2013](#) [Final Rule - 09/13/2013](#)
[Final Rule - 12/30/2013](#) [Final Rule - 12/29/2014](#)
[Final Rule - 10/02/2015](#)

On January 10, 2013, pursuant to the Dodd-Frank Act, the CFPB issued a final rule amending Regulation Z. While Regulation Z already required the establishment of escrow accounts for certain HPMLs, this amendment revises and expands those requirements. This amendment also outlines specific criteria whereby a creditor can qualify for an exemption. These changes affect 12 CFR 1026.35. The CFPB also issued various amendments in throughout 2013. On December 30, 2013, a new amendment adjusted the asset size threshold for certain creditors to qualify for an escrow account exemption from \$2 billion to \$2.028 billion. On December 29, 2014, it was announced that this threshold is adjusted from \$2.028 billion to \$2.060 billion effective January 1, 2015. Therefore, creditors with assets less than \$2.060 billion on 12/31/14 may be exempt from establishing escrow accounts for HPMLs in 2015 (if other requirements are met).

At a high level, the 2013 rules address three key areas. First, the length of time an escrow account must be maintained for covered HPMLs is extended. Second, the rule creates an exemption for “small creditors” that meet specific eligibility criteria. Last, the rule provides an expansion of the existing insurance premium escrow exemption for condominium units to also include other circumstances where a property is covered by a master insurance policy.

In October 2015, a new final rule was issued which included amendments relating to small creditors and rural or underserved areas.

How long must an escrow account be maintained?

Prior to the 2013 rule, HPMLs secured by first liens require the borrower to maintain an escrow account for a minimum of one year. Effective June 1, 2013, the mandatory escrow must be maintained for a minimum of **five years** or until the loan is terminated, whichever occurs first.

The rule also contains a “delayed cancellation” requirement. Regardless of how long the escrow account has been maintained, it cannot be cancelled unless two conditions are satisfied:

- The unpaid principal balance is less than 80% of the original value of the property, and
- The consumer is currently not delinquent or in default on the debt.

How will an institution know if it is exempt from these escrow requirements?

The rule creates an exemption from the HPML escrow requirements for “small creditors” that operate predominately in rural or underserved areas. The CFPB outlines four specific criteria that must be met in order to be eligible for the exemption, which were amended in the **October 2015** rule. Effective **January 1, 2016**, certain amendments become effective which provide that an escrow account need not be established for a transaction if, at the time of consummation, the following criteria are met:

- **Rural/Underserved Areas:** During the preceding calendar year, or, if the application for the transaction was received before April 1 of the current calendar year, during either of the 2 preceding calendar years, the creditor extended more than 50% of its total covered, 1st lien mortgages in rural or underserved areas.

- **Originations:** During the preceding calendar year, or, if the application for the transaction was received before April 1 of the current calendar year, during either of the 2 preceding calendar years, the creditor and its affiliates, have originated no more than 2,000 covered transactions, secured by 1st liens, that were sold, assigned, or otherwise transferred to another person, or that were subject at the time of consummation to a commitment to be acquired by another person.
- **Asset Size:** As of the preceding December 31st, or, if the application for the transaction was received before April 1 of the current calendar year, as of either of the two preceding December 31sts, the creditor and its affiliates that regularly extended covered transactions, secured by 1st liens, together, had total assets of less than the designated asset threshold. *Note: For calendar year 2014 the asset threshold was \$2.028 billion; for the calendar year 2015 the asset threshold was \$2.060 billion.*

and

- **Escrow Practices:** Neither the creditor nor its affiliates, maintains an escrow account for any consumer credit secured by real property or a dwelling that it or its affiliates currently services, other than:
 - Escrow accounts established for 1st lien HPMLs on or after **April 1, 2010** and before **January 1, 2016**; or
 - Escrow accounts established **post-closing as an accommodation to help distressed consumers**

The CFPB defines “rural” and “underserved” and provides lists of such counties on their website.

However, if a mortgage is originated subject to a commitment to sell to an investor that does not qualify for the “small creditor” exemption, an escrow account must be established at consummation even if is originated by an otherwise exempt small creditor.

How is the escrow account exemption information organized?

Prior to the 2013 rule, HPML escrow accounts were not required for loans secured by shares in a cooperative or for insurance premiums on condominium units that are covered by a master policy. In addition, open-end credit is exempt from the requirement.

Under the 2013 rule, this exemption information has been recodified and provides a “more tailored approach” in specifying transactions that are exempt. In summary, escrow accounts are not required for:

- Transactions secured by shares in a cooperative;
- Transactions to finance the initial construction of a dwelling;
- Temporary or “bridge” loans with a term of 12 months or less; or
- Reverse mortgages.
- In addition, insurance premiums do not need to be escrowed for loans secured by dwellings in condominium units, planned unit developments or other “common interest communities”, where the dwelling is covered by a master policy to insure all dwellings.

Are there new disclosure requirements contained in the 2013 rule?

No, not in the 2013 rule. In the analysis leading up to this final rule, the CFPB reviewed comments regarding the merits of finalizing certain proposed disclosure requirements at the same time. They determined that the integration of new mortgage-related disclosures in a piecemeal fashion would pose an undue burden. Therefore, this final rule does not include any new disclosure amendments.

Recommendations for Next Steps

For the 2013 Rules:

1. Review Truth in Lending and/or other mortgage lending-related policies as they relate to escrow accounts for Higher-Priced Mortgage Loans. Resolve inconsistencies and update the requirements as outlined in the final rule.
2. Determine whether your institution meets the criteria for exemption from the escrow account requirements.
 - a. If your institution does qualify as exempt, implement formal, periodic monitoring to determine if/when your institution no longer qualifies for the exemption (for example when assets grow to exceed the asset threshold).
 - b. If your institution does not qualify, proceed with the remaining steps.

3. Review escrow account-related procedures and update to address the new requirements. Make certain applicable procedures ensure:
 - a. Required escrow account timeframe is extended from 1 year to 5 years
 - b. Required escrow accounts that have been maintained for 5 years are not cancelled when the loan does not meet the loan-to-value threshold or is in default
 - c. Expand reference to the exclusion for escrowing insurance premiums for condominiums to also include planned unit developments and other “common interest communities”
4. Train applicable staff on the revised requirements and on any adjustments to internal policies and procedures related to escrow accounts.
5. While no disclosure requirements are included in the rule at this time, review other non-compliance related disclosures and items for inconsistencies. For example, review any template communications that might reference the establishment of an escrow account for a certain length of time.

For the October 2015 Rule - by January 1, 2016:

1. Review Truth in Lending and/or other mortgage lending-related policies as they relate to escrow accounts for Higher-Priced Mortgage Loans. Resolve inconsistencies and update the requirements as outlined in the final rule.
2. As needed, determine whether your institution meets the amended criteria for exemption from the escrow requirements.