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To: Clients and Friends

From: David F. Dulock

Subject: New Escrow Account Requirements for Higher-Priced Mortgage Loans

In the January 22, 2013, issue of the *Federal Register* (Vol. 78, Pages 4726 – 4757, click [here](#)) the Bureau of Consumer Financial Protection (CFPB) published a final rule amending the escrow account requirement for first lien higher-priced mortgage loans under §1026.35 of Regulation Z.

This final rule is effective June 1, 2013, and applicable to higher-priced mortgage loans for which creditors receive applications on or after June 1, 2013.

The final rule make three major changes to the escrow account requirement in existing §1026.35:

1. It extends the required escrow account period for first lien higher-priced mortgage loans to a minimum of five years after origination. It adds the following requirements that must be met after that period for the escrow account to be cancelled: (i) the unpaid principal balance of the loan (including any subordinate financing of which the creditor has reason to know) is less than 80% of the original value of the property, and (ii) the consumer currently is not delinquent or in default on the loan.
2. It creates an exemption from the escrow account requirement for a creditor who: (i) during the preceding calendar year, made more than 50% of its first lien mortgages in rural or underserved counties, as defined in §1026.35(b)(iv)(A) and (B), respectively, of the final rule; (ii) as of the end of the preceding calendar year, had an asset size less than \$2 billion; (iii) during the preceding calendar year, together with its affiliates, originated 500 or fewer first lien mortgages; and (iv) together with its affiliates, does not escrow for any mortgage it or its affiliates currently services, except for (x) existing higher-priced mortgage loans or (y) post-consummation established escrow accounts as an accommodation to assist distressed consumers in avoiding default or foreclosure. It provides, however, that eligible creditors need not establish escrow accounts for first lien higher-priced mortgage loans intended at consummation to be held in portfolio, but must establish escrow accounts for first lien higher-priced mortgage loans that, at consummation, are subject to a forward commitment to be purchased by an investor that does not itself qualify for the exemption.
3. It expands the existing exemption from escrowing for insurance premiums (though not for property taxes) for condominium units to include planned unit developments and other common interest communities in which the governing association is obligated to maintain a master insurance policy insuring all dwellings.

In addition, the final rule makes the following changes to the higher-priced mortgage loan provisions in existing §1026.35 of Regulation Z:

1. The final rule modifies the definition of “higher-priced mortgage loan” in §1026.35(a)(1) by adding the words “closed-end,” so that the definition applies only to closed-end consumer credit transactions, and by moving the “jumbo loans” provision from existing §1026.35(b)(3)(v) to the definition in §1026.35(a)(1).
2. The final rule deletes existing §1026.35(a)(3) that exempts from the higher-priced mortgage loan definition transactions to finance the initial construction of a dwelling, temporary or “bridge” loans with a term of twelve months or less, reverse mortgage transactions, and home equity lines of credit. It recodifies these exemptions (except for a home equity line of credit) as exemptions from coverage of the escrow account requirement in addition to the existing escrow account exemption for a transaction secured by shares in a cooperative.
3. The final rule deletes the restrictions on repayment ability and prepayment penalties in existing §1026.35(b)(1) and (b)(2).
4. The final rule makes conforming changes to the Official Interpretation to §1026.35 contained in Supplement I to Regulation Z.

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