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MEMORANDUM

TO: Clients and Friends of the Firm

FROM: Aaron Polasek

DATE: June 26, 2013

SUBJECT: New Escrow Requirements for Higher Priced Mortgage Loans and Prohibition of Mandatory Arbitration for Mortgage Loans

As the Dodd-Frank Wall Street Reform and Consumer Protection Act mandates continue to steamroll the mortgage market we are beginning to see some of the substantive changes beginning to take effect. As of June 1, 2013, two new changes will take effect (one change originally slated to take effect has been delayed to early 2014). A brief summary of these developments follows for your consideration. All statutory sections referenced herein refer to 12 CFR part 1026, "Regulation Z", unless otherwise specified.

A. NEW ESCROW REQUIREMENTS FOR HIGHER-PRICED MORTGAGE LOANS

Effective for loan applications received on or after June 1, 2013, section 1026.35 creates new requirements for the establishment and maintenance of escrow accounts for "higher-priced mortgage loans." The amendments generally 1) extend the minimum term of escrow accounts required by 1026.35 from one year to five years, 2) create an exemption for certain small creditors operating predominantly in rural or underserved areas and 3) expand upon the existing exemption of mandatory insurance premium escrow accounts for properties covered by a master insurance policy.

General Rule

Section 1026.35(b)(1) imposes a prohibition on creditors from extending a higher-priced mortgage loan secured by a first- lien on a consumer's principal dwelling unless an escrow account for the payment of taxes and insurance is established before consummation. A "higher-priced mortgage loan" ("HPML"), as applicable, is defined in section 1026.35(a) as a closed-end consumer credit transaction secured by a consumer's principal dwelling with an annual percentage rate that exceeds the average prime offer rate¹

¹ The average prime offer rate (APOR) is 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 Consumer Financial Protection Bureau publishes average prime offer rates weekly which can be found at:
<http://www.ffiec.gov/ratespread/aportables.htm>

for a comparable transaction as of the date the interest rate is set by 1.5 or more percentage points or by 2.5 or more percentage points for a “jumbo” 1st lien².

Exemptions

Exempted by section 1026.35(b)(2) from the escrow requirement are 1) loans secured by shares in a cooperative, 2) loans to finance the initial construction of a dwelling³, 3) temporary or bridge loans with a term of twelve months or less and 4) reverse mortgages. In addition, insurance premiums are not required to be escrowed for loans secured by a dwelling located in a common interest community where dwelling ownership requires participation in a governing association that has an obligation to maintain a master policy insuring all dwellings.

Further, 1026.35(b)(2)(iii) creates an exemption for small creditors who operate predominantly in rural or underserved areas. To qualify for this exemption a creditor must have total assets less than \$2 billion and, together with all affiliates, have originated 500 or fewer first- lien mortgages during the preceding calendar year, made more than half of all first- mortgage loans (not just HPMLs) in areas designated by the Bureau as “rural” or “underserved”⁴ and, together with all affiliates, the creditor must not escrow for any mortgage that it or its affiliates currently service, except in limited circumstances⁵. Eligible creditors need not establish escrow accounts at consummation for any mortgage subject to a forward commitment to be purchased by an investor that does not itself qualify for the “small, rural” creditor exemption.

Cancellation

Pursuant to section 1026.35(b)(3), an escrow account required by section 1026.35(b)(1) may be cancelled by the creditor or servicer only upon the earlier of 1) termination of the underlying obligation or 2) receipt no earlier than five years after consummation of a consumer’s request to cancel the account. Such a request can only be granted if the unpaid principal balance of the underlying obligation is less than 80% of the original value of the property and the consumer is not delinquent or in default.

B. PROHIBITION OF MANDATORY ARBITRATION APPLICABLE TO HOME LOANS

Effective as of June 1, 2013, section 1026.36(h) prohibits the inclusion in a mortgage loan agreement of a mandatory arbitration agreement or other similar required non-judicial dispute resolution process for controversies or claims arising out of a consumer credit transaction secured by a dwelling, including a home equity line of credit. This section further disallows any interpretation of terms in an applicable loan agreement as requiring any form of non-judicial dispute resolution. This section does not prohibit a creditor, or assignee thereof, and consumer from mutually agreeing, after a dispute or claim under the transaction arises, to settle or use arbitration or other form of non-judicial resolution.

² A “jumbo” loan is a lien with a loan amount in excess of the limit eligible for purchase by Freddie Mac, which as of the date of this memorandum is \$417,000.00

³ In a construction –to-permanent financing transaction only the permanent piece is subject to section 1026.35(b)(1) if it is a higher priced mortgage loan

⁴ For a definition of “rural” and “underserved” see Reg. Z section 1026.35(b)(2)(iv)

⁵ Section 1026.35(b)(2)(iii)(D) excepts from this prohibition escrow accounts established for first-lien HPMLs on or after April 1, 2010 and before June 1, 2013 and escrow accounts established after consummation as an accommodation to distressed consumers to assist in avoiding default or foreclosure

**C. DELAYED IMPLEMENTATION OF PROHIBITION AGAINST FINANCING SINGLE-PREMIUM CREDIT
INSURANCE**

Section 1026.36(i) prohibits a creditor from financing, directly or indirectly, any premiums or fees for credit insurance in connection with a consumer credit transaction secured by a dwelling, including a home equity line of credit. This prohibition was to take effect as of June 1, 2013, but upon further review the implementation date has been delayed until January 10, 2014.

This memorandum is provided for your general information and is not intended as specific legal advice. You should not place reliance on this general information alone but should consult legal counsel regarding the application of the laws and regulations in this memorandum to your specific case or circumstances.