

Client Alert.

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Final Rule on Escrow Accounts for First Lien Jumbo Higher-Priced Mortgage Loans

By Joseph Gabai

On February 21, 2011, the Federal Reserve Board (“Board”) finalized its earlier proposal for escrow accounts for first lien higher-priced mortgage loans and issued a proposed rule to implement other aspects of the mandatory escrow account provisions of the Wall Street Reform and Consumer Financial Protection Act of 2010 (“Dodd-Frank Act”). This Client Alert summarizes the final rule. A later Client Alert will summarize the proposed rule.

BACKGROUND

The proposal was issued on August 16, 2010. In essence, the proposal conformed the mandatory escrow account standard for first lien higher-priced mortgage loans (“HPMLs”) to the standard contained in the Dodd-Frank Act. A discussion of the Board’s proposed rule is found at <http://www.mofo.com/files/Uploads/Images/100818Escrow.pdf>

CURRENT RULE

Section 226.35 of Regulation Z imposes mandatory escrow account and other requirements on HPMLs. An HPML is a consumer credit transaction secured by the consumer’s principal dwelling with an annual percentage rate (“APR”) that exceeds the average prime offer rate (“APOR”) for a comparable transaction as of the date that the interest rate is set by 1.5% or more for a first lien loan, or 3.5% for a subordinate lien loan. The current rule defines an HPML without regard to the dollar amount of the loan. All first lien HPMLs are subject to a mandatory escrow account rule, with certain exceptions. See Section 226.35(b)(3) of Regulation Z.

ANALYSIS

- For the most part, the final rule implements the Board’s proposal. A first lien loan that is a “jumbo” loan—that is, a loan with a principal balance at consummation that exceeds the maximum principal obligation in effect as of the date that the interest rate is set for the loan to be eligible for purchase by Freddie Mac—will be subject to the mandatory escrow account rule only if the APR exceeds the applicable APOR for a comparable transaction as of the date that the interest rate is set by 2.5% or more. A copy of the final rule can be found at <http://edocket.access.gpo.gov/2011/pdf/2011-4384.pdf>
- The final rule is effective on April 1, 2011. It applies to all covered loans for which an application is received by a creditor on or after that date. The final rule does not mandate the termination of any existing escrow account.
- The final regulation conforms the mandatory escrow account rule for first lien HPMLs in Regulation Z to the standard mandated by Section 1461 of the Dodd-Frank Act.

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- The current Freddie Mac conforming loan limit is \$417,000 for a single-family loan that is not located in any of the various designated high-cost areas. The Federal Reserve Commentary clarifies that the maximum principal obligation eligible for purchase by Freddie Mac is established and adjusted by the Federal Housing Finance Agency (“FHFA”) under 12 U.S.C. Section 1454(a)(2) and other applicable federal laws. If the FHFA adjusts the maximum principal obligation eligible for purchase by Freddie Mac, that adjustment also will dictate the definition of a “jumbo loan” for purposes of the new 2.5% threshold.
- While the final rule applies a 2.5% threshold for purposes of the mandatory escrow account requirement for first lien jumbo loans, the threshold for the applicability of all other provisions of Regulation Z for HPMLs remains at 1.5% over the applicable APOR. For example, a first lien loan whose APR is 2.25% over the applicable HPML, will be not be subject to the mandatory escrow account requirement in Section 226.35. However, the loan will be subject to all of the other requirements for HPMLs, including the ability to repay rule and the restrictions on prepayment penalties. All subordinate lien loans with APRs of 3.5% or more above the applicable APOR will continue to qualify as HPMLs, although the mandatory escrow requirement is not applicable to subordinate lien loans.
- The summary of the final rule contained in the Supplementary Information published in the Federal Register states that where a creditor makes a jumbo loan with an APR below the new 2.5% threshold, the creditor has the option to elect to continue to use the 1.5% threshold for requiring an escrow account. A better way of stating this is that the new 2.5% threshold does not, by itself, preclude a creditor from requiring an escrow account for a jumbo loan meeting the 1.5% threshold. However, other applicable laws may prohibit the creditor from requiring such an escrow account.
- Other provisions of law, including Section 1461 of the Dodd-Frank Act, impose a mandatory escrow account requirement in a variety of other circumstances. As noted above, the Board’s proposed regulation to implement other requirements of Section 1461 will be addressed in a later Client Alert.
- The final rule is limited to Regulation Z. The Board’s Regulation C requires financial institutions to report the difference between the APR and the APOR of an originated loan subject to Regulation Z if that difference is 1.5% or more for a first lien loan, or 3.5% or more for a subordinate lien loan, as of the date the interest rate is set. See Section 203.4(a)(12) of Regulation C. At present, there is no proposal to amend this provision of Regulation C.

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