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## Part III

### Bureau of Consumer Financial Protection

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12 CFR Part 1026

2012 Truth in Lending Act (Regulation Z) Mortgage Servicing;  
Proposed Rule

**BUREAU OF CONSUMER FINANCIAL PROTECTION****12 CFR Part 1026**

[Docket No. CFPB–2012–0033]

RIN 3170–AA14

**2012 Truth in Lending Act (Regulation Z) Mortgage Servicing****AGENCY:** Bureau of Consumer Financial Protection.**ACTION:** Proposed rule with request for public comment.

**SUMMARY:** The Bureau of Consumer Financial Protection (the Bureau or CFPB) is proposing to amend Regulation Z, which implements the Truth in Lending Act (TILA), and the official interpretation of the regulation. The proposed amendments implement the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act or DFA) provisions regarding mortgage loan servicing. Specifically, this proposal implements Dodd-Frank Act sections addressing initial rate adjustment notices for adjustable-rate mortgages (ARMs), periodic statements for residential mortgage loans, and prompt crediting of mortgage payments and response to requests for payoff amounts. The proposed revisions also amend current rules governing the scope, timing, content, and format of current disclosures to consumers occasioned by the interest rate adjustments of their variable-rate transactions.

Published elsewhere in today's **Federal Register**, the Bureau proposes companion regulations regarding mortgage servicing through amendments to Regulation X, which implements the Real Estate Settlement Procedures Act (RESPA).

**DATES:** Comments must be received on or before October 9, 2012, except that comments on the Paperwork Reduction Act analysis in part IX of the Federal Register notice must be received on or before November 16, 2012.

**ADDRESSES:** You may submit comments identified by Docket No. CFPB–2012–0033 or RIN 3170–AA14, by any of the following methods:

- *Electronic:* <http://www.regulations.gov>. Follow the instructions for submitting comments.
- *Mail/Hand Delivery/Courier:* Monica Jackson, Office of the Executive Secretary, Bureau of Consumer Financial Protection, 1700 G Street NW., Washington, DC 20552.

*Instructions:* All submissions must include the agency name and docket number or Regulatory Information

Number (RIN) for this rulemaking. In general, all comments received will be posted without change to <http://www.regulations.gov>. In addition, comments will be available for public inspection and copying at 1700 G Street NW., Washington, DC 20552 on official business days between the hours of 10 a.m. and 5 p.m. Eastern Time. You can make an appointment to inspect the documents by telephoning (202) 435–7275.

All comments, including attachments and other supporting materials, will become part of the public record and subject to public disclosure. Sensitive personal information, such as account numbers or social security numbers, should not be included. Comments will not be edited to remove any identifying or contact information.

**e-Rulemaking Initiative**

The Bureau is working with the Cornell e-Rulemaking Initiative (CeRI) on a pilot project, Regulation Room, to use different Web technologies and approaches to enhance public understanding and participation in Bureau rulemakings and to evaluate the advantages and disadvantages of these techniques. The TILA and RESPA proposed rulemakings on mortgage servicing are the subject of the project. The Bureau has undertaken this project to increase effective public involvement in the rulemaking process and strongly encourages all parties interested in this rulemaking to visit the Regulation Room Web site, <http://www.regulationroom.org>, to learn about the Bureau's proposed mortgage servicing rules and the rulemaking process, to discuss the issues in the rules with other persons and groups, and to participate in drafting a summary of that discussion that CeRI will submit to the Bureau.

Note that Regulation Room is sponsored by CeRI, and is not an official United States Government Web site. Participating in the discussion on that site will not result in individual formal comments that will be included in the Bureau's rulemaking record. If you would like to add a formal comment, please do so through the means identified above. The Bureau anticipates that CeRI will submit to the Bureau's rulemaking docket a summary of the discussion that occurs on the Regulation Room site and that participants will have a chance to review a draft and suggest changes before the summary is submitted. For questions about this project, please contact Whitney Patross, Attorney, Office of Regulations, at (202) 435–7700.

**FOR FURTHER INFORMATION CONTACT:**

*Regulation Z (TILA):* Whitney Patross, Attorney and Marta Tanenhaus, Senior Counsel at (202) 435–7700; Office of Regulations; Division of Research, Markets, and Regulations; Bureau of Consumer Financial Protection; 1700 G Street NW., Washington, DC 20552.

*Regulation X (RESPA):* Jane Gao, Mitchell E. Hochberg, and Michael Scherzer, Counsels at (202) 435–7700; Office of Regulations; Division of Research, Markets, and Regulations; Bureau of Consumer Financial Protection; 1700 G Street NW., Washington, DC 20552.

**SUPPLEMENTARY INFORMATION:****I. Overview***A. Background*

The recent financial crisis exposed pervasive consumer protection problems across major segments of the mortgage servicing industry. As millions of borrowers fell behind on their loans, many servicers failed to provide the level of service necessary to serve the needs of those borrowers. Many servicers simply had not made the investments in resources and infrastructure necessary to service large numbers of delinquent loans. Existing weaknesses in servicer practices, including inadequate recordkeeping and document management and lack of oversight of service providers, made it harder to sort out borrower problems to achieve optimal results. In addition, many servicers took short cuts that made things even worse. As one review of fourteen major servicers found, companies “emphasize[d] speed and cost efficiency over quality and accuracy” in their foreclosure processes.<sup>1</sup>

The Dodd-Frank Act (Pub. L. 111–203, July 21, 2010) adopts several new servicing protections.<sup>2</sup> The Bureau has the authority to promulgate regulations to implement the new servicing protections. These changes will significantly improve disclosures to make it easier for consumers to monitor their mortgage loans and servicers' activities. The changes also address critical servicer practices, including error resolution, prompt crediting of payments, and “force-placing” insurance where borrowers have

<sup>1</sup> Federal Reserve System, Office of the Comptroller of the Currency, & Office of Thrift Supervision, *Interagency Review of Foreclosure Policies and Practices*, at 5 (Apr. 2011) (Interagency Foreclosure Report), available at <http://www.occ.gov/news-issuances/news-releases/2011/nr-occ-2011-47a.pdf>.

<sup>2</sup> See Dodd-Frank Act sections 1418, 1420, 1463, and 1464.

allowed their hazard insurance policies to lapse.

The Dodd-Frank Act also gives the Bureau discretionary authority to develop additional servicing rules. The Bureau proposes to use this authority to adopt requirements relating to reasonable information management policies and procedures, early intervention with delinquent borrowers, continuity of contact, and procedures for evaluating and responding to loss mitigation applications when the servicer makes loss mitigation options available in the ordinary course of business. These proposals address fundamental problems that underlie many consumer complaints and recent regulatory and enforcement actions. The Bureau believes these changes will reduce avoidable foreclosures and improve general customer service. The proposals cover nine major topics, as summarized below.

The Bureau's proposal is split into two parts because Congress imposed some requirements under TILA and some under RESPA.<sup>3</sup> This proposed rule would amend Regulation Z, which implements TILA, to implement provisions concerning adjustable-rate mortgage (ARM) disclosures, payoff statements, and payment crediting under sections 1418, 1420, and 1464 of the Dodd-Frank Act and to harmonize similar existing requirements.

#### *B. Scope of Coverage*

The proposed rules generally apply to closed-end mortgage loans, with certain exceptions. Under the proposed amendments to Regulation X, open-end lines of credit and certain other loans, such as construction loans and business-purpose loans, are excluded. Under the proposed amendments to Regulation Z, the periodic statement and ARMs disclosure provisions apply only to closed-end mortgage loans, but the prompt crediting and payoff statement provisions apply both to open-end and closed-end mortgage loans. In addition, reverse mortgages and timeshares are excluded from the periodic statement requirement, and certain construction loans are excluded from the ARM disclosure requirements. As discussed below, the Bureau is seeking comment on whether to exempt small servicers from certain requirements or modify certain requirements for small servicers.

#### *C. Summary*

The proposals cover nine major topics, summarized below. More details can be found in the proposed rules, which are split into two notices issued under TILA and RESPA, respectively.

1. *Periodic billing statements.* The Dodd-Frank Act generally mandates that servicers of closed-end residential mortgage loans (other than reverse mortgages) must send a periodic statement for each billing cycle. These statements must meet the timing, form, and content requirements provided for in the rule. The proposal contains sample forms that servicers could use. The periodic statement requirement generally would not apply for fixed-rate loans if the servicer provides a coupon book, so long as the coupon book contains certain information specified in the rule and certain other information is made available to the consumer. The proposal also includes an exception for small servicers that service 1,000 or fewer mortgage loans and service only mortgage loans that they originated or own.

2. *Adjustable-rate mortgage interest-rate adjustment notices.* Servicers would have to provide a consumer whose mortgage has an adjustable rate with a notice 60 to 120 days before an adjustment which causes the payment to change. The servicer would also have to provide an earlier notice 210 to 240 days prior to the first rate adjustment. This first notice may contain an estimate of the rate and payment change. Other than this initial notice, servicers would no longer be required to provide an annual notice if a rate adjustment does not result in an increase in the monthly payment. The proposal contains model and sample forms that servicers could use.

3. *Prompt payment crediting and payoff payments.* As required by the Dodd-Frank Act, servicers must promptly credit payments from borrowers, generally on the day of receipt. If a servicer receives a payment that is less than a full contractual payment, the payment may be held in a suspense account. When the amount in the suspense account covers a full installment of principal, interest, and escrow (if applicable), the proposal would require the servicer to apply the funds to the oldest outstanding payment owed. A servicer also would be required to send an accurate payoff balance to a consumer no later than seven business days after receipt of a written request from the borrower for such information.

4. *Force-placed insurance.* As required by the Dodd-Frank Act, servicers would not be permitted to

charge a borrower for force-placed insurance coverage unless the servicer has a reasonable basis to believe the borrower has failed to maintain hazard insurance and has provided required notices. One notice to the borrower would be required at least 45 days before charging for forced-place insurance coverage, and a second notice would be required no earlier than 30 days after the first notice. The proposal contains model forms that servicers could use. If a borrower provides proof of hazard insurance coverage, then the servicer would be required to cancel any force-placed insurance policy and refund any premiums paid for periods in which the borrower's policy was in place. In addition, if a servicer makes payments for hazard insurance from a borrower's escrow account, a servicer would be required to continue those payments rather than force-placing a separate policy, even if there is insufficient money in the escrow account. The rule would also provide that charges related to forced place insurance (other than those subject to State regulation as the business of insurance or authorized by federal law for flood insurance) must relate to a service that was actually performed. Additionally, such charges would have to bear a reasonable relationship to the servicer's cost of providing the service.

5. *Error resolution and information requests.* Pursuant to the Dodd-Frank Act, servicers would be required to meet certain procedural requirements for responding to information requests or complaints of errors. The proposal defines specific types of claims which constitute an error, such as a claim that the servicer misapplied a payment or assessed an improper fee. A borrower could assert an error either orally or in writing. Servicers could designate a specific phone number and address for borrowers to use. Servicers would be required to acknowledge the request or complaint within five days. Servicers would have to correct or respond to the borrower with the results of the investigation, generally within 30 to 45 days. Further, servicers generally would be required to acknowledge borrower requests for information and either provide the information or explain why the information is not available within a similar amount of time. A servicer would not be required to delay a scheduled foreclosure sale to consider a notice of error unless the error relates to the servicer's improperly proceeding with a foreclosure sale during a borrower's evaluation for alternatives to foreclosure.

6. *Information management policies and procedures.* Servicers would be

<sup>3</sup> Note that TILA and RESPA differ in their terminology. Consumers and creditors are the defined terms used in Regulation Z. Borrowers and lenders are the defined terms used in Regulation X.

required to establish reasonable information management policies and procedures. The reasonableness of a servicer's policies and procedures would take into account the servicer's size, scope, and nature of its operations. A servicer's policies and procedures would satisfy the rule if the servicer regularly achieves the document retention and servicing file requirements, as well as certain objectives specified in the rule. Examples of such objectives include providing accurate and timely information to borrowers and the courts or enabling servicer personnel to have prompt access to documents and information submitted in connection with loss mitigation applications. In addition, a servicer must retain records relating to each mortgage until one year after the mortgage is discharged or servicing is transferred, and must create a mortgage servicing file for each loan containing certain specified documents and information.

**7. Early intervention with delinquent borrowers.** Servicers would be required to make good faith efforts to notify delinquent borrowers of loss mitigation options. If a borrower is 30 days late, the proposal would require servicers to make a good faith effort to notify the borrower orally and to let the borrower know that loss mitigations options may be available. If the borrower is 40 days late, the servicer would be required to provide the borrower with a written notice with certain specific information, including examples of loss mitigation options available, if applicable, and information on how to obtain more information about loss mitigation options. The notice would also provide information to the borrower about the foreclosure process. The rule contains model language servicers could use for these notices.

**8. Continuity of contact with delinquent borrowers.** Servicers would be required to provide delinquent borrowers with access to personnel to assist them with loss mitigation options where applicable. The proposal would require servicers to assign dedicated contact personnel for a borrower no later than five days after providing the early intervention notice. Servicers would be required to establish reasonable policies and procedures designed to ensure that the servicer personnel perform certain specified functions where applicable, such as access the borrower's records and provide the borrower with information about how and when to apply for a loss mitigation option and about the status of the application.

**9. Loss mitigation procedures.** Servicers that offer loss mitigation options to borrowers would be required to implement procedures to ensure that complete loss mitigation applications are reasonably evaluated before proceeding with a scheduled foreclosure sale. The proposal would require servicers to exercise reasonable diligence to secure information or documents required to make an incomplete loss mitigation application complete. In certain circumstances, this could include notifying the borrower within five days of receiving an incomplete application. Within 30 days of receiving a borrower's complete application, the servicer would be required to evaluate the borrower for all available options, and, if the denial pertains to a requested loan modification, notify the borrower of the reasons for the servicer's decision, and provide the borrower with at least a 14-day period within which to appeal the decision. The proposal would require that appeals be decided within 30 days by different personnel than those responsible for the initial decision. A servicer that receives a complete application for a loss mitigation option could not proceed with a foreclosure sale unless (i) the servicer had denied the borrower's application and the time for any appeal had expired; (ii) the servicer had offered a loss mitigation option which the borrower declined or failed to accept within 14 days of the offer; or (iii) the borrower failed to comply with the terms of a loss mitigation agreement. The proposal would require that deadlines for submitting an application for a loss mitigation option be no earlier than 90 days before a scheduled foreclosure sale.

#### **D. Small Servicers**

As discussed below, the Bureau convened a Small Business Regulatory Enforcement Fairness Act (SBREFA) panel to assess the impact of the possible rules on small servicers and to help the Bureau determine to what extent it may be appropriate to consider adjusting these standards for small servicers, to the extent permitted by law. Informed by this process, this proposal contains an exemption from the periodic statement requirement for certain small servicers. The Bureau seeks comment on whether other exemptions might be appropriate for small servicers.

#### **E. Effective Date**

As discussed below, the Bureau is seeking comment on when this final rule should be effective. Because the

final rule will provide important benefits to consumers, the Bureau seeks to make it effective as soon as possible. However, the Bureau understands that the final rules will require servicers to make revisions to their software and to retrain their staff. In addition, some entities will be required to implement other Dodd-Frank Act provisions, which are subject to separate rulemaking deadlines under the statute and will have separate effective dates. Therefore, the Bureau is seeking comment on how much time industry needs to make these changes.

## **II. Background**

### **A. Overview of the Mortgage Servicing Market and Market Failures**

The mortgage market is the single largest market for consumer financial products and services in the United States, with approximately \$10.3 trillion in loans outstanding.<sup>4</sup> Mortgage servicers play a vital role within the broader market by undertaking the day-to-day management of mortgage loans on behalf of lenders who hold the loans in their portfolios or (where a loan has been securitized) investors who are entitled to the loan proceeds.<sup>5</sup> Over 60% of mortgage loans are serviced by mortgage servicers for investors.

Servicers' duties typically include billing borrowers for amounts due, collecting and allocating payments, maintaining and disbursing funds from escrow accounts, reporting to creditors or investors, and pursuing collection and loss mitigation activities (including foreclosures and loan modifications) with respect to delinquent borrowers. Indeed, without dedicated companies to perform these activities, it is

<sup>4</sup> Inside Mortgage Finance, Outstanding 1–4 Family Mortgage Securities, Mortgage Market Statistical Annual (2012). For general background on the market and the recent mortgage crisis, see the 2012 TILA–RESPA Proposal available at <http://www.consumerfinance.gov/knowbeforeyouowe/>.

<sup>5</sup> As of the end of 2011, approximately 33% of outstanding mortgage loans were held in portfolio, 57% of mortgage loans were owned through mortgage-backed securities issued by government sponsored enterprises (GSEs), and 11% of loans were owned through private label mortgage-backed securities. Inside Mortgage Finance, Issue 2012:13, at 11 (March 30, 2012). A securitization results in the economic separation of the legal title to the mortgage loan and a beneficial interest in the mortgage loan obligation. In a securitization transaction, a securitization trust is the owner or assignee of a mortgage loan. An investor is a creditor of the trust and is entitled to cash flows that are derived from the proceeds of the mortgage loans. In general, certain investors (or an insurer entitled to act on behalf of the investors) may direct the trust to take action as the owner or assignee of the mortgage loans for the benefit of the investors or insurers. See, e.g., Adam Levitin & Tara Twomey, *Mortgage Servicing*, 28 Yale J. on Reg., 1, 11 (2011) (Levitin & Twomey).

questionable whether a secondary market for mortgage-backed securities would exist in this country.<sup>6</sup>

Several aspects of the mortgage servicing business make it uniquely challenging for consumer protection purposes. Given the nature of their activities, servicers can have a direct and profound impact on borrowers. However, industry compensation practices and the structure of the mortgage servicing industry create wide variations in servicers' incentives to provide effective customer service to borrowers. Also, because borrowers cannot choose their own servicers, it is particularly difficult for them to protect themselves from shoddy service or harmful practices.

Mortgage servicing is performed by banks, thrifts, credit unions, and non-bank servicers under a variety of business models. In some cases, creditors service mortgage loans that they originate or purchase and hold in portfolio. Other creditors sell the ownership of the underlying mortgage loan, but retain the mortgage servicing rights in order to retain the relationship with the borrower, as well as the servicing fee and other ancillary income. In still other cases, servicers have no role at all in origination or loan ownership, but rather purchase mortgage servicing rights on securitized loans or are hired to service a portfolio lender's loans.<sup>7</sup>

These different servicing structures can create difficulties for borrowers if the servicer makes mistakes, fails to invest sufficient resources in its servicing operations, or does not properly service the borrower's loan. Although the mortgage servicing industry has numerous participants, the industry is highly concentrated, with the five largest servicers servicing approximately 55% percent of outstanding mortgage loans in this country.<sup>8</sup> Small servicers generally operate in discrete segments of the market, for example, by specializing in

servicing delinquent loans, or by servicing loans that they originate.<sup>9</sup>

Contracts between the servicer and the mortgage loan owner specify the rights and responsibilities of each party. In the context of securitized loans, the contracts may require the servicer to balance the competing interests of different classes of investors when borrowers become delinquent. Certain provisions in servicing contracts may limit the servicer's ability to offer certain types of loan modifications to borrowers. Such contracts also may limit the circumstances under which investors can transfer servicing rights to a different servicer.

Compensation structures vary somewhat for loans held in portfolio and securitized loans,<sup>10</sup> but have tended to make pure mortgage servicing (where the servicer has no role in origination) a high-volume, low-margin business in which servicers have little incentive to invest in customer service. A servicer will expect to recoup its investment in purchasing mortgage servicing rights and earn a profit through a net servicing fee (which is expressed as a constant rate assessed on unpaid mortgage balances),<sup>11</sup> fees assessed on borrowers, interest float on payment accounts between receipt and disbursement, and cross-marketing other products and services to borrowers. Under this business model, servicers act primarily as payment collectors and processors, and provide minimal customer service to ensure profitability. Servicers also have an incentive to look for opportunities to impose fees on borrowers to enhance revenues and are generally not subject to market

discipline because consumers have no opportunity to switch providers. Additionally, servicers may have financial incentives to foreclose rather than engage in loss mitigation.<sup>12</sup>

These attributes of the servicing market created problems for certain borrowers even prior to the national mortgage crisis. For example, borrowers experienced problems with mortgage servicers even during regional mortgage market downturns that preceded the mortgage crisis.<sup>13</sup> Borrowers were subjected to improper fees that servicers had no reasonable basis to impose on borrowers, improper force-placed insurance practices, and improper foreclosure and bankruptcy practices.<sup>14</sup>

When the mortgage crisis erupted, many servicers were ill-equipped to handle the high volumes of delinquent mortgages, loan modification requests, and foreclosures they were required to process. These servicers lacked the infrastructure, trained staff, controls, and procedures needed to manage effectively the flood of delinquent mortgages they were forced to handle. Consumer harm has manifested in many different areas, and major servicers have entered into significant settlement agreements with Federal and State governmental authorities. For example, in April 2011, the Office of the Comptroller of the Currency (OCC) and the Federal Reserve Board (the Board) undertook formal enforcement actions against several major servicers for unsafe and unsound residential mortgage loan servicing practices.<sup>15</sup>

<sup>12</sup> *Why Servicers Foreclose When They Should Modify and Other Puzzles of Servicer Behavior*, NCLC p.v (October 2009), ("Servicers, unlike investors or homeowners, do not generally lose money on foreclosure. Servicers may even make money on a foreclosure."), Diane Thompson, *The Need for National Mortgage Servicing Standards* (May 12, 2011), at 15 ("\* \* \* modification will also likely reduce future income, cost more in the present in staffing, and delay recovery of expenses. Moreover, the foreclosure process itself generates significant income for servicers.")

<sup>13</sup> *See Problems in Mortgage Servicing from Modification to Foreclosure: Hearings Before the Comm. on Banking, Housing and Urban Affairs, S. Hrg. 111-987, 111th Cong. 53-54* (2010) (statement of Thomas J. Miller, Iowa Attorney General) (Miller Testimony). *See also*, Kurt Eggert, *Limiting Abuse and Opportunism by Mortgage Servicers 15:3 Housing Policy Debate* (2004), available at <http://ssrn.com/abstract=992095>.

<sup>14</sup> *See* Kurt Eggert, *Limiting Abuse and Opportunism by Mortgage Servicers 15:3 Housing Policy Debate* (2004), available at <http://ssrn.com/abstract=992095> (collecting cases).

<sup>15</sup> OCC Press Release, *OCC Takes Enforcement Action Against Eight Servicers for Unsafe and Unsound Foreclosure Practices* (April 13, 2011), available at <http://www.occ.treas.gov/news-issuances/news-releases/2011/nr-occ-2011-47.html>, and Federal Reserve Board Press Release, *Federal Reserve Issues Enforcement Actions Related to Deficient Practices in Residential Mortgage Loan*

Continued

<sup>6</sup> *See, e.g.*, Levitin & Twomey at 11 ("All securitizations involved third-party servicers \* \* \* [m]ortgage servicers provide the critical link between mortgage borrowers and the SPV and RMBS investors, and servicing arrangements are an indispensable part of securitization.")

<sup>7</sup> *See, e.g.*, Diane Thompson, *Foreclosing Modifications: How Servicer Incentives Discourage Loan Modifications*, 86 Wash. L. Rev. 755, 763 (2011) (Thompson), available at: <http://digital.law.washington.edu/dspace-law/bitstream/handle/1773.1/1074/86WLR755.pdf>.

<sup>8</sup> *See, e.g.*, *Top Mortgage Servicers in 2011* (Inside Mortg. Fin., Bethesda, Md.), Mar. 30, 2012, at 12. As of the end of the fourth quarter of 2011, the top 5 largest servicers serviced \$5.66 trillion of mortgage loans. *See id.*

<sup>9</sup> *See, e.g.*, Fitch Ratings, *U.S. Residential and Small Balance Commercial Mortgage Servicer Rating Criteria*, at 14-15 (Jan. 31, 2011), available at [www.fitchratings.com](http://www.fitchratings.com).

<sup>10</sup> At securitization, the cash flow that was part of interest income is bifurcated between the loan and the mortgage servicing right (MSR). The MSR represents the present value of all the cash flows, both positive and negative, related to servicing a mortgage. Prime MSRs are largely created by the GSE minimum servicing fee rate, which is calculated as 25 basis points (bps) per annum. The servicing fee rate is typically paid to the servicer monthly and the monthly amount owed is calculated by multiplying the pro rata portion of the servicing fee rate by the stated principal balance of the mortgage loan at the payment due date. Accounting rules require that a capitalized asset be created if the "compensation" for servicing (including float/ancillary) exceeds "adequate compensation." For loans held in portfolio, there is no bifurcation of the interest income from the loan. The owner of the loan simply negotiates pricing, terms, and standards with the servicer, which, at larger institutions, is typically a separate affiliate or subsidiary of the owner of the loans. PowerPoint Presentation, Keefe, Bruyette & Woods, Inc., *KBW Mortgage Matters: Mortgage Servicing Primer*, 3 (April 17, 2012).

<sup>11</sup> *See, e.g.*, Thompson, 86 Wash. L. Rev. 755, 767.

These enforcement actions generally focused on practices relating to (1) filing of foreclosure documents without, for example, proper affidavits or notarizations; (2) failing to always ensure that loan documents were properly endorsed or assigned and, if necessary, in the possession of the appropriate party at the appropriate time; (3) failing to devote sufficient financial, staffing, and managerial resources to ensure proper administration of foreclosure processes; (4) failing to devote adequate oversight, internal controls, policies and procedures, compliance risk management, internal audit, third party management, and training to foreclosure processes; and (5) failing to sufficiently oversee outside counsel and other third-party providers handling foreclosure-related services.<sup>16</sup> Congress has held significant detailed hearings on the issue of servicer “robo-signing” of foreclosure related documentation.<sup>17</sup>

Servicers have also misled, or failed to communicate with, borrowers, lost or mishandled borrower-provided documents supporting loan modification requests, and generally provided inadequate service to delinquent borrowers. These problems became pervasive in broad segments of the mortgage servicing industry and had profound impacts on borrowers, particularly delinquent borrowers.<sup>18</sup>

The Bureau further understands from mortgage investors that there is a pervasive belief that servicers are making discretionary decisions based on the best interests of the servicer rather than to achieve results that will benefit owners or assignees of mortgages loans. When servicers hold a second lien that is behind a first lien owned by a different owner or assignee, one study has found a lower likelihood of liquidation and modification, and a higher likelihood of inaction by a

servicer.<sup>19</sup> Specifically, “liquidation and modification of securitized first mortgages are 60% [to] 70% less likely respectively and no action is 13% more likely when the servicer of that securitized first mortgage holds on its portfolio the second lien attached to the first mortgage.”<sup>20</sup> These failures to take actions that may benefit both consumers and owners or assignees of first lien mortgage loans harm consumers.

The mortgage servicing industry, however, is not monolithic. Some servicers provide high levels of customer service. Some of these servicers may be compensated by investors in a way that incentivizes them to provide high levels of customer service in order to optimize investor outcomes. Other servicers provide high levels of customer service because they rely on providing other products and services to consumers and thus have an interest in preserving their reputations and relationships with their consumers. For example, as discussed further below, small servicers that the Bureau consulted as part of a process required under SBREFA described their businesses as requiring a “high touch” model of customer service both to ensure loan performance and maintain a strong reputation in their local communities.<sup>21</sup>

#### *B. Mortgage Servicing Consumer Protection Regulation Before the Recent Crisis*

Prior to the adoption of the Dodd-Frank Act, the mortgage servicing industry was subject to limited Federal consumer financial protection regulation. RESPA set forth basic protections with respect to mortgage servicing that were implemented by the U.S. Department of Housing and Urban Development (HUD). These included required disclosures at application concerning whether the lender intended to service the mortgage loan and disclosures upon an actual transfer of servicing rights.<sup>22</sup> RESPA further imposed substantive and disclosure requirements for escrow account management and required servicers to respond to “qualified written requests”—written error resolution or information requests relating to a

restricted definition of the “servicing” of the borrower’s mortgage loan.<sup>23</sup>

TILA set forth requirements on creditors that were implemented by servicers, including disclosures regarding interest rate adjustments on adjustable rate mortgage loans. Regulation Z, which implements TILA, was amended by the Board to include certain limited requirements directly on servicers, such as requirements to timely credit payments, provide payoff balances and prohibit pyramiding of late fees.<sup>24</sup> Servicers also had some obligations under other Federal laws, including, for example, the Servicemembers Civil Relief Act.<sup>25</sup>

Although TILA and RESPA did not impose many requirements on servicers, servicers were still required to navigate overlapping requirements governing their servicing responsibilities. In addition to Federal law, servicers were required to consider the impact of State and even local regulation on mortgage servicing. Servicers also had to comply with investor requirements to the extent they serviced loans owned or guaranteed by various types of entities. These include (1) servicing guidelines required by Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac), together known as the government-sponsored enterprises (GSEs), as well as servicing guidelines required by the Government National Mortgage Association (Ginnie Mae); (2) government insured program guidelines issued by the Federal Housing Administration (FHA), Department of Veterans Affairs (VA), and the Rural Housing Service; (3) contractual agreements with investors (such as pooling and servicing agreements and subservicing contracts); and (4) bank or institution policies. All those requirements remain in effect today and going forward.

#### *C. The National Mortgage Settlement and Other Regulatory Actions*

In response to the unprecedented mortgage crisis and pervasive problems in mortgage servicing, including the systemic violation of State foreclosure laws by many of the largest servicers, State and Federal regulators have engaged in a number of individual servicing related enforcement and regulatory actions over the last few years and have begun discussions about comprehensive national standards.

Servicing (April 13, 2011), available at <http://www.federalreserve.gov/newsevents/press/enforcement/20110413a.htm>, and accompanying documents. In addition to enforcement actions against major servicers, Federal agencies have also undertaken formal enforcement actions against major service providers to mortgage servicers. See *id.*

<sup>16</sup> See *id.* None of the servicers admitted or denied the OCC’s or Federal Reserve Board’s findings.

<sup>17</sup> See, e.g., *Problems in Mortgage Servicing from Modification to Foreclosure: Hearings Before the Comm. on Banking, Housing and Urban Affairs*, S. Hrg. 111–987, 111th Cong. 53–54 (2010) (statement of Diane E. Thompson, NCLC) (Thompson Testimony).

<sup>18</sup> See U.S. Government Accountability Office, *Troubled Asset Relief Program: Further Actions Needed to Fully and Equitably Implement Foreclosure Mitigation Actions*, at 14–16 (June 2010); Miller Testimony at 54.

<sup>19</sup> Sumit Agarwal et. Al, Second Liens and the Holdup Problem in First Mortgage Renegotiation (December 2011), available at <http://ssrn.com/abstract=2022501>.

<sup>20</sup> *Id.*

<sup>21</sup> See U.S. Consumer Fin. Prot., Bureau, *Final Report of the Small Business Review Panel on CFPB’s Proposals Under Consideration for Mortgage Servicing Rulemaking* (June 11, 2012) (“SBREFA Final Report”), available at: <http://www.consumerfinance.gov>.

<sup>22</sup> See 12 U.S.C. 2605(a)–(e).

<sup>23</sup> See 12 U.S.C. 2605(e) and 2609.

<sup>24</sup> See 12 CFR 1026.36(c).

<sup>25</sup> See 50 U.S.C. App. 501 *et seq.*

For example, 49 State attorneys general,<sup>26</sup> joined by numerous Federal agencies including the Bureau, entered into a National Mortgage Settlement (National Mortgage Settlement) with the nation's five largest servicers in February 2012.<sup>27</sup> The National Mortgage Settlement applies to loans held in portfolio and serviced by the five largest servicers. Loans owned by GSEs, private investors, or smaller servicers are not covered by the settlement.

Exhibit A to each of the settlements is a Settlement Term Sheet, which sets forth standards that each of the five largest servicers must follow to comply with the terms of the settlement.<sup>28</sup> The settlement standards contained in the Settlement Term Sheet are sub-divided into the following eight categories: (1) Foreclosure and bankruptcy information and documentation; (2) third-party provider oversight; (3) bankruptcy; (4) loss mitigation; (5) protections for military personnel; (6) restrictions on servicing fees; (7) force-placed insurance; and (8) general servicer duties and prohibitions.

In addition to the settlement, other Federal regulatory agencies have issued guidance on mortgage servicing and loan modifications,<sup>29</sup> conducted coordinated reviews of the nation's largest servicers,<sup>30</sup> and taken enforcement actions against individual companies.<sup>31</sup> The Bureau and other

Federal agencies have also engaged since spring 2011 in informal discussions about the potential development of national mortgage servicing standards through regulations and guidance.

The Bureau's proposed rules under Regulation Z and X represent another important step towards establishing uniform minimum national standards. When adopted in final form, the Bureau's rules will apply to all mortgage servicers, whether depository institutions or non-depository institutions, and to all segments of the mortgage market, regardless of the ownership of the loan. The proposals focus both on implementing the specific mortgage servicing requirements of the Dodd-Frank Act and on addressing broader systemic problems that the Bureau believes are critical to ensure that the mortgage servicing market functions to serve consumer needs. To that end, the proposed TILA and RESPA mortgage servicing rules incorporate elements from four categories of the National Mortgage Settlement—(1) Foreclosure and bankruptcy information and documentation, (4) loss mitigation, (6) restrictions on servicing fees, and (7) force-placed insurance. In addition, the proposed requirement to maintain reasonable information management policies and procedures addresses oversight of service providers, which impacts category (2) of the settlement.

The Bureau continues to consider whether to incorporate other settlement standards into rules or guidance, either alone or in conjunction with other Federal regulatory agencies; certain requests for comment in this proposal reflect these considerations. The Bureau is also continuing ongoing discussions with other regulators to ensure appropriate coordination of rulemaking and other initiatives relating to mortgage servicing issues.

#### *D. The Statutory Requirements and Additional Proposals*

The Dodd-Frank Act mandates several protections for homeowners in the servicing of their loans. The Act requires new disclosures, specifically periodic statements (unless coupon books are provided in certain circumstances), notices prior to the reset of adjustable-rate mortgages, and force-placed insurance notices. These disclosures are designed to provide consumers with comprehensive and comprehensible information when they need it and in a form they can use, so

they can better manage their obligations and avoid unnecessary problems.

The Dodd-Frank Act also imposes new requirements on servicers to respond in a timely way to borrowers who assert that their servicer made an error. The statute also requires servicers to respond in a timely way to borrower requests for information.

The Dodd-Frank Act contains requirements relating to the prompt crediting of payments, so that consumers are not wrongly penalized with late fees or other fees because servicers did not credit their payments quickly. The statute also requires servicers to provide timely responses to consumer requests for payoff amounts, so consumers can get this information when they need it, such as when refinancing.

The Bureau is proposing additional standards to improve the way servicers treat all borrowers, including delinquent borrowers. Some servicers have made it very difficult for delinquent borrowers to explore and take advantage of potential alternatives to foreclosure. For example, servicers have frequently neglected to reach out or respond to such borrowers to discuss alternatives to foreclosure, lost or misplaced the documents of borrowers who have sought modifications or other relief, failed to keep track of borrower communications, and forced borrowers who have invested substantial time communicating with an employee of the servicer to repeat the process with a different employee.<sup>32</sup>

To address these concerns, the Bureau is proposing new servicing standards in four areas. First, servicers would have to establish and maintain reasonable information management policies and procedures. These policies and procedures would have to be reasonably designed to achieve certain objectives and address certain obligations, including accessing and providing accurate information, evaluating borrowers for loss mitigation options, facilitating oversight of, and compliance by, service providers, and facilitating servicing transfers.

Second, servicers would have to intervene early with delinquent borrowers to provide them with information about, and encourage them to explore, available alternatives to foreclosure.

Third, servicers would have to provide delinquent borrowers with a point of contact that provides continuity

<sup>26</sup> Oklahoma elected not to join the settlement.

<sup>27</sup> The National Mortgage Settlement is available at <http://www.nationalmortgagesettlement.com/>. The five servicers subject to the settlement are Bank of America, JP Morgan Chase, Wells Fargo, CitiMortgage, and Ally/GMAC.

<sup>28</sup> See <http://www.nationalmortgagesettlement.com/>.

<sup>29</sup> Office of the Comptroller of the Currency, Bulletin 2011–29 (June 30, 2011), available at: <http://www.occ.gov/news-issuances/bulletins/2011/bulletin-2011-29.html>; Letter from Edward J. DeMarco, Acting Director of FHFA, to Hon. Elijah E. Cummings, Ranking Member, Committee on Oversight and Government Reform, U.S. House of Representatives (Jan. 20, 2012), available at <http://www.fhfa.gov/webfiles/23056/PrincipalForgivenessltr12312.pdf>; Guidance, Home Affordable Modification Program, available at: <https://www.hmpadmin.com/portal/programs/guidance.jsp>. FHFA, Frequently Asked Questions—Servicing Alignment Initiative, available at: <http://www.fhfa.gov/webfiles/21191/FAQs42811Final.pdf>.

<sup>30</sup> See Interagency Foreclosure Report, a joint review of foreclosure processing of 14 federally regulated mortgage servicers during the fourth quarter of 2010 by the Federal Reserve System, Office of the Comptroller of the Currency, and Office of Thrift Supervision.

<sup>31</sup> See Interagency Foreclosure Report at 5; Federal Reserve Board, Press Release (May 24, 2012), available at: <http://www.federalreserve.gov/newsevents/press/enforcement/20120524a.htm>; Federal Reserve Board, Press Release (February 27, 2012), available at: <http://www.federalreserve.gov/newsevents/press/enforcement/20120227a.htm>; Office of the Comptroller of the Currency, News Release 2011–47 (April 13, 2011), available at:

<http://www.occ.gov/news-issuances/news-releases/2011/nr-occ-2011-47.html>.

<sup>32</sup> See, e.g., Larry Cordell et al., *The Incentives of Mortgage Servicers: Myths and Realities*, at 9 (Federal Reserve Board, Working Paper No. 2008–46, Sept. 2008).

in the borrowers' dealings with the servicer. At such point of contact, staff must have access to complete records about that borrower, including records of prior communications with the borrower, and be able to assist the borrower in pursuing loss mitigation options.

Fourth, servicers that offer loss mitigation options in the ordinary course of business would be required to follow certain procedures to ensure that borrowers' completed loss mitigation applications are evaluated in a timely manner, that borrowers are notified of the results, and that borrowers have a right to appeal the denial of a loan modification option. Servicers would also be required to provide borrowers who submit incomplete loss mitigation applications with timely notice about the additional documents or information needed to make a loss mitigation application complete.

The Bureau recognizes that a one-size-fits-all approach may not be optimal with regard to either the mandated or additional requirements. As discussed below, the Bureau seeks comment on to what extent it may be appropriate to adjust these standards for small servicers.

### III. Summary of Statute and Rulemaking Process

#### A. Overview of the Statute

The Dodd-Frank Act imposes certain new requirements related to mortgage servicing. Some of these new requirements are amendments to TILA addressed in this proposal and others are amendments to RESPA, addressed in the 2012 RESPA Servicing Proposal.

**TILA amendments.** There are three new mortgage servicing requirements under TILA. First, for closed-end credit transactions secured by a consumer's principal residence, section 1418 of the Dodd-Frank Act adds a new section 128A to TILA. TILA section 128A states that, for hybrid ARMs with a fixed interest rate for an introductory period that adjusts or resets to a variable interest rate at the end of such period, a notice must be provided six months prior to the initial adjustment of the interest rate for closed-end credit transactions secured by a consumer's principal residence. Section 1418 of the Dodd-Frank Act permits the Bureau to extend this requirement to ARMs that are not hybrid ARMs.

Second, section 1420 of the Dodd-Frank Act, which adds section 128(f) to TILA, requires the creditor, assignee, or servicer of any residential mortgage loan to transmit to the borrower, for each billing cycle, a periodic statement that

sets forth certain specified information in a conspicuous and prominent manner. The statute also gives the Bureau the authority to require additional content to be included in the periodic statement. The statute provides an exception to the periodic statement requirement for fixed-rate loans where the borrower is given a coupon book containing substantially the same information as the statement.

Third, section 1464 of the Dodd-Frank Act adds sections 129F and 129G to TILA, which generally codify existing Regulation Z requirements for the prompt crediting of mortgage payments received by servicers in connection with consumer credit transactions secured by a consumer's dwelling. The statute also generally codifies the Regulation Z requirement on accurate and timely responses to borrower requests for payoff amounts.

**RESPA amendments.** Section 1463 of the Dodd-Frank Act imposes a number of new servicing related requirements under RESPA that broadly relate to force-placed insurance and error resolution/responses to requests for information. First, the statute prohibits a servicer from obtaining force-placed hazard insurance, unless there is a reasonable basis to believe the borrower has failed to comply with the loan contract's requirement to maintain property insurance. A servicer may not impose any charge on any borrower for force-placed insurance with respect to any property secured by a federally related mortgage, unless the servicer sends, by first-class mail, two written notices to the borrower, at least 30 days apart. The notices must remind borrowers of their obligation to maintain hazard insurance on the property, alert borrowers to the servicer's lack of evidence of insurance coverage, tell borrowers what they must do to demonstrate that they have coverage, and state that the servicer may obtain coverage at the borrower's expense if the borrower fails to provide evidence of coverage. Servicers must terminate force-placed insurance coverage and refund to borrowers any premiums charged during any period when the borrower had private insurance coverage. The statute also provides that all charges imposed on the borrower related to force-placed insurance, apart from charges subject to State regulation as the business of insurance, must be bona fide and reasonable.

Second, the statute prohibits certain acts and practices by servicers of federally related mortgages with regard to resolving errors and responding to requests for information. Specifically, the statute prohibits servicers of

federally related mortgages from charging fees for responding to valid qualified written requests. The statute also provides that a servicer of a federally related mortgage must not fail to take timely action to respond to a borrower's requests to correct errors relating to: Allocation of payments, final balances for purposes of paying off the loan, avoiding foreclosure, or other standard servicer duties.

Finally, the statute requires a servicer of a federally related mortgage to respond within ten business days to a request from a borrower to provide the identity, address, and other relevant contact information about the owner or assignee of the loan. The statute also reduces the amount of time that servicers of federally related mortgages have to correct errors and respond to inquiries generally, as well as refund escrow accounts upon payoff.<sup>33</sup>

In addition, the statute provides that a servicer of a federally related mortgage must "comply with any other obligation found by the Consumer Financial Protection Bureau, by regulation, to be appropriate to carry out the consumer protection purposes of this Act."<sup>34</sup> This provision gives the Bureau broad authority to adopt additional regulations to govern the conduct of servicers of federally related mortgage loans. In light of the systemic problems in the mortgage servicing industry, the Bureau is proposing to exercise this authority to require servicers of federally related mortgages to: Establish reasonable information management policies and procedures; undertake early intervention with delinquent borrowers; provide delinquent borrowers with continuity of contact with staff equipped to assist them; and require servicers that offer loss mitigation options in the ordinary course of business to follow certain procedures when evaluating loss mitigation applications.

The statute also requires a creditor or servicer to send accurate and timely responses to borrower requests for payoff amounts for home loans.

The statutory provisions with enumerated mortgage servicing requirements become effective on January 21, 2013, unless final rules are issued on or before that date.

#### B. Outreach and Consumer Testing

The Bureau has conducted extensive outreach in developing the mortgage servicing proposals. Bureau staff met

<sup>33</sup> Other changes in section 1463 of the Dodd-Frank Act relate to increases in penalties for violations. These provisions are not addressed in this rulemaking.

<sup>34</sup> 12 U.S.C. 2605(k)(1)(E).

with mortgage servicers, force-placed insurance carriers, industry trade associations, consumer advocates, other Federal regulatory agencies, and other interested parties to discuss various aspects of the statute and the servicing industry.

In preparing this proposed rule, the Bureau solicited input from small servicers through a Small Business Review Panel (SBREFA Panel) with the Chief Counsel for Advocacy of the Small Business Administration (SBA) and the Administrator of the Office of Information and Regulatory Affairs within the Office of Management and Budget (OMB).<sup>35</sup> The Small Business Review Panel's findings and recommendations are contained in the Final Report of the Small Business Review Panel on CFPB's Proposals Under Consideration for Mortgage Servicing Rulemaking (SBREFA Final Report).<sup>36</sup>

The Bureau also engaged in other meetings and roundtables with a variety of other stakeholders to gather factual information about the servicing industry and to discuss various elements of the Bureau's proposals as they were being developed. As discussed above and in connection with section 1022 of the Dodd-Frank Act below, the Bureau has also consulted with relevant Federal regulators both regarding the Bureau's specific proposals and the need for and potential contents of national mortgage servicing standards in general. As it considers public comment and works to develop final rules on mortgage servicing, the Bureau will continue to seek input from all interested parties.

In addition, the Bureau engaged ICF Macro (Macro), a research and consulting firm that specializes in designing disclosures and consumer testing, to conduct one-on-one cognitive interviews regarding disclosures connected with mortgage servicing. During the first quarter of 2012, the Bureau and Macro worked closely to develop and test disclosures that would satisfy the requirements of the Dodd-Frank Act and provide information to consumers in a manner that would be understandable and useful. These disclosures related to the ARM notices, the force-placed insurance notices, and the periodic statements. Macro conducted three rounds of one-on-one

cognitive interviews with a total of 31 participants in the Baltimore, Maryland metro area (Towson, Maryland), Memphis, Tennessee, and Los Angeles, California. Participants were all consumers who held a mortgage loan and represented a range of ages and education levels. Efforts were made to recruit a significant number of participants who had trouble making mortgage payments in the last two years. During the interviews, participants were shown disclosure forms for periodic statements, ARM interest rate adjustment notices for the new disclosures required by Dodd-Frank Act section 1418, and force-placed insurance notices. Participants were asked specific questions to test their understanding of the information presented in each of the disclosures, how easily they could find various pieces of information presented in each of the disclosures, as well as to learn about how they would use the information presented in each of the disclosures. The disclosures were revised after each round of testing. Specific findings from the consumer testing are discussed in detail throughout the **SUPPLEMENTARY INFORMATION** where relevant.<sup>37</sup>

#### *C. Other Dodd-Frank Act Mortgage-Related Rulemakings*

Including this proposal, the Bureau currently is engaged in seven rulemakings relating to mortgage credit to implement requirements of the Dodd-Frank Act:

- **TILA-RESPA Integration:** On July 9, 2012, the Bureau released proposed rules and forms combining the TILA mortgage loan disclosures with the Good Faith Estimate (GFE) and settlement statement required under RESPA, pursuant to DFA section 1032(f) as well as sections 4(a) of RESPA and 105(b) of TILA, as amended by DFA sections 1098 and 1100A, respectively. 12 U.S.C. 2603(a); 15 U.S.C. 1604(b) (the 2012 TILA-RESPA Proposal).<sup>38</sup>

- **HOEPA:** On July 9, 2012, the Bureau released proposed rules to implement Dodd-Frank Act requirements expanding protections for "high-cost" mortgage loans under HOEPA, pursuant to TILA sections 103(bb) and 129, as amended by DFA sections 1431 through 1433. 15 U.S.C.

1602(bb) and 1639.<sup>39</sup> Such loans have requirements on servicers related to payoff statements, late fees, prepayment penalties, and fees for loan modifications or deferrals.

- **Loan Originator Compensation:** The Bureau is in the process of developing a proposal to implement provisions of the Dodd-Frank Act requiring certain creditors and mortgage loan originators to meet duty of care qualifications and prohibiting mortgage loan originators, creditors, and the affiliates of both from receiving compensation in various forms (including based on the terms of the transaction) and from sources other than the consumer, with specified exceptions, pursuant to TILA section 129B as established by DFA sections 1402 through 1405. 15 U.S.C. 1639b.

- **Appraisals:** The Bureau, jointly with Federal prudential regulators and other Federal agencies, is in the process of developing a proposal to implement Dodd-Frank Act requirements concerning appraisals for higher-risk mortgages, appraisal management companies, and automated valuation models, pursuant to TILA section 129H as established by DFA section 1471, 15 U.S.C. 1639h, and sections 1124 and 1125 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) as established by Dodd-Frank Act sections 1473(f), 12 U.S.C. 3353, and 1473(q), 12 U.S.C. 3354, respectively. In addition, the Bureau is developing rules to implement section 701(e) of the Equal Credit Opportunity Act (ECOA), as amended by DFA section 1474, to require that creditors provide applicants with a free copy of written appraisals and valuations developed in connection with applications for loans secured by a first lien on a dwelling. 15 U.S.C. 1691(e).

- **Ability to Repay:** The Bureau is in the process of finalizing a proposal issued by the Board to implement provisions of the Dodd-Frank Act requiring creditors to determine that a consumer can repay a mortgage loan and establishing standards for compliance, such as by making a "qualified mortgage," pursuant to TILA section 129C as established by Dodd-Frank Act sections 1411 and 1412 (ATR Rulemaking). 15 U.S.C. 1639c.

- **Escrows:** The Bureau is in the process of finalizing a proposal issued by the Board to implement provisions of the Dodd-Frank Act requiring certain escrow account disclosures and exempting from the higher-priced mortgage loan escrow requirement loans made by certain small creditors, among

<sup>35</sup> The Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA) requires the Bureau to convene a Small Business Review Panel before proposing a rule that may have a substantial economic impact on a significant number of small entities. See Public Law 104-121, tit. II, 110 Stat. 847, 857 (1996) (as amended by Pub. L. 110-28, sec. 8302 (2007)).

<sup>36</sup> See SBREFA Final Report, *supra* note 22.

<sup>37</sup> ICF Macro International, Inc., *Summary of Findings: Design and Testing of Mortgage Servicing Disclosures* (Aug. 2012), available at: <http://www.consumerfinance.gov/notice-and-comment/> (report on consumer testing submitted to the U.S. Consumer Fin. Prot. Bureau).

<sup>38</sup> Available at <http://www.consumerfinance.gov/notice-and-comment/>.

<sup>39</sup> *Id.*

other provisions, pursuant to TILA section 129D as established by Dodd-Frank Act sections 1461 and 1462. 15 U.S.C. 1639d.

With the exception of the requirements being implemented in the 2012 TILA-RESPA Proposal, the Dodd-Frank Act requirements referenced above generally will take effect on January 21, 2013, unless final rules implementing those requirements are issued on or before that date and provide for a different effective date. To provide an orderly, coordinated, and efficient comment process, the Bureau is generally setting the deadlines for comments on this and other proposed mortgage rules based on the date the proposal is issued, instead of the date this notice is published in the **Federal Register**. Therefore, the Bureau is providing 60 days for comment on those proposals, which will ensure that the Bureau receives comments with sufficient time remaining to issue final rules by January 21, 2013. Because the precise date this notice will be published cannot be predicted in advance, setting the deadlines based on the date of issuance will allow interested parties that intend to comment on multiple proposals to plan accordingly.

The Bureau regards the foregoing rulemakings as components of a larger undertaking; many of them intersect with one or more of the others. Accordingly, the Bureau is coordinating carefully the development of the proposals and final rules identified above. Each rulemaking will adopt new regulatory provisions to implement the various Dodd-Frank Act mandates described above. In addition, each of them may include other provisions the Bureau considers necessary or appropriate to ensure that the overall undertaking is accomplished efficiently and that it ultimately yields a regulatory scheme for mortgage credit that achieves the statutory purposes set forth by Congress, while avoiding unnecessary burdens on industry.

Thus, many of the rulemakings listed above involve issues that extend across two or more rulemakings. In this context, each rulemaking may raise concerns that might appear unaddressed if that rulemaking were viewed in isolation. For efficiency's sake, however, the Bureau is publishing and soliciting comment on a proposed approach to certain issues raised by two or more of its mortgage rulemakings in whichever rulemaking is most appropriate, in the Bureau's judgment, for addressing each specific issue. Accordingly, the Bureau urges the public to review this and the other mortgage proposals identified

above, including those previously published by the Board, together. Such a review will ensure a more complete understanding of the Bureau's overall approach and will foster more comprehensive and informed public comment on the Bureau's several proposals, including provisions that may have some relation to more than one rulemaking but are being proposed for comment in only one of them.

#### *D. Small Servicers*

The small entity representatives (SERs) who provided feedback to the SBREFA panel generally emphasized that their business models required a "high touch" approach to customer service and that they did not engage in many of the practices that contributed to the mortgage market process. The SERs indicated that they take a proactive approach to providing consumer information, resolving errors and working with delinquent borrowers to find alternatives to foreclosure. Nevertheless, they indicated that some elements of the proposals under consideration were not consistent with their current business practices and expressed concern about the need to begin providing extensive documentation to prove compliance with the proposed standards. The SERs urged the Bureau to adopt standards that would allow small servicers to stay in the market and provide choices to consumers with the new compliance burdens.<sup>40</sup> The SERs were particularly concerned about the costs and burdens of complying with the periodic statement requirements, as well as certain aspects of the process for resolving errors and responding to inquiries.<sup>41</sup>

Informed by this process, the Bureau is proposing to exempt certain small servicers from the periodic statement requirement. The Bureau is also proposing that certain requirements, such as the requirement to maintain reasonable information management policies and procedures under Regulation X, should be applied in light of the scale of the servicer's operations as well as other contextual factors. The Bureau does not believe that these provisions, described more fully below in the section-by-section analysis of the applicable proposal, would impair consumer protection. The Bureau is also seeking comment more broadly on whether other exemptions or adjustments for small servicers would be warranted to reduce regulatory

burden while appropriately balancing consumer protections.

#### *E. Request for Comment on Effective Date*

The Bureau specifically requests comment on the appropriate effective date for each of the servicing-related rules contained in this proposal and the 2012 RESPA Servicing Proposal. As discussed above, the Dodd-Frank Act servicing requirements take effect automatically on January 21, 2013, unless final rules are issued on or before that date.<sup>42</sup> Where rules are required to be issued, the Dodd-Frank Act permits the Bureau to provide up to 12 months for implementation. For all other rules, the implementation period is left to the discretion of the Bureau.

Given the significant consumer benefits offered by the proposals and the challenges faced by delinquent borrowers in dealing with their servicers, the Bureau generally believes that the final rules should be made effective as soon as possible. However, the Bureau understands that various elements of the final rules would require servicers to adopt or revise existing software to generate compliant disclosures, retrain staff, assess and revise policies and procedures, and/or take other implementation measures. The Bureau therefore seeks detailed comment on the nature and length of implementation process for each individual servicing rule and in light of interactions between the rules. The Bureau is particularly interested in analyzing the impacts on both consumers and servicers of a staggered implementation sequence as compared to imposing a single date by which all rules must be implemented.

The Bureau also notes that some companies may also need to implement other new requirements under other parts of the Dodd-Frank Act, as described above. The Bureau believes based on conversations and analysis to date that there is more overlap and interaction among the various proposals relating to mortgage origination than there is between the servicing proposals and the origination proposals. However, the Bureau seeks comment specifically on this issue and on whether the general cumulative burden on entities that are subject to both sets of rules will complicate implementation.

Finally, the Bureau seeks comment on any particular implementation challenges faced by small servicers, and on whether an extended implementation period would be

<sup>40</sup> SBREFA Final Report, *supra* note 22, at 16, 21.

<sup>41</sup> SBREFA Final Report, *supra* note 22, at 16–19, 21, and 23–24.

<sup>42</sup> Public Law 111–203, 124 Stat. 1376, section 1400(c) (2010).

appropriate or useful. For instance, to the extent that small servicers rely heavily on outside software vendors, the Bureau seeks comment on whether a delayed effective date would provide significant relief if the vendors will have to develop software solutions for larger servicers on a shorter timeline anyway. The Bureau also seeks comment on the impacts of delayed implementation on consumers and on other market participants.

#### IV. Discussion of Major Proposed Revisions

The proposed amendments to Regulation Z implement sections 1418 (initial ARM interest rate adjustment notice), 1420 (periodic statements) and 1464 (prompt crediting and provision of payoff statements) of the Dodd-Frank Act, which in turn amend TILA. The amendment also proposes to revise current Regulation Z ARM disclosure rules for consistency with DFA section 1418. The proposed revision eliminates the ARM interest rate adjustment notice required at least once each year during which an interest rate adjustment is implemented without resulting in a corresponding payment change.

##### A. Current and Proposed Interest Rate Adjustment Disclosures

To implement DFA section 1418, the Bureau is proposing to revise § 1026.20(d) to require that creditors, assignees, or servicers provide notices to consumers six to seven months prior to the first time the interest rate of their adjustable-rate mortgages adjusts. In contrast to this one-time disclosure, Regulation Z currently requires notice to consumers regarding each adjustment of their adjustable-rate mortgages.

Under current rule § 1026.20(c), creditors must provide consumers with a notice of interest rate adjustment for variable-rate transactions subject to § 1026.19(b) at least 25, but no more than 120, calendar days before a payment at a new level is due. For the reasons discussed below, the Bureau is proposing in § 1026.20(c), among other things, to change the minimum time for providing advance notice to consumers from 25 days to 60 days before payment at a new level is due. The maximum time for advance notice would remain the same: 120 days prior to the due date of the first payment at a new level.

Current § 1026.20(c) also requires creditors to provide consumers with an adjustment notice at least once each year during which an interest rate adjustment is implemented without resulting in a corresponding payment change. The Bureau is proposing to eliminate this provision. As explained

in more detail below in the section-by-section analysis, the Bureau believes that certain Dodd-Frank Act amendments to TILA and the Bureau's proposed amendments that would implement those provisions provide consumers with much of the information contained in the annual notice, thereby greatly minimizing its value for consumers.

In the interest of harmonizing the two proposed ARM disclosures, the coverage, content, and format of proposed § 1026.20(c) and (d) closely track one another and incorporate most of the content currently required by § 1026.20(c).

*Historic context of § 1026.20(c) rate adjustment disclosures.* The Board adopted the rule that is current § 1026.20(c) in 1987, as part of a larger revision of Regulation Z.<sup>43</sup> In 2009, the Board proposed to revise regulations governing ARM disclosures as part of a larger revision of closed-end provisions in Regulation Z (2009 Closed-End Proposal). In that proposal, the Board said that, in 1987, it set the minimum time for providing notice of a rate adjustment at 25 days before payment at new level is due in order to track the rules of the OCC and to provide creditors with flexibility in giving adjustment notices for a variety of ARMs.<sup>44</sup> It also noted that, as of 2009, neither the OCC nor any other Federal financial institution supervisory agency had any comprehensive disclosure requirements for ARMs.<sup>45</sup>

Since 1987, the popularity of ARMs has increased, especially during the period from 2002 to 2007.<sup>46</sup> Beginning in 2007, ARM growth began to slow as consumers experienced difficulty repaying such loans and concerns grew about the risk of payment shock that ARMs pose.<sup>47</sup> According to Freddie Mac, "[i]n June 2004, ARMs hit a peak share of 40% of the home-purchase market but by early 2009, that share had fallen to just 3%, according to the Federal Housing Finance Agency."<sup>48</sup> Generally, ARMs are financing just over 10% of new home-purchase loans but are expected to rise to a 14% share of that market in 2012.<sup>49</sup>

For many consumers, the current era of declining interest rates has reduced

the incidence of the significant payment increases that can accompany ARM interest rate adjustments. Anecdotal evidence from mortgage servicers with which the Bureau has conducted outreach supports this conclusion. To the extent interest rates rise in the future, ARM interest rate adjustments may result in significant payment increases for many consumers. The popularity of adjustable-rate mortgages, which provide the opportunity for reduced interest rates, also may increase along with the advent of higher interest rates.

Regardless of current market conditions, ARMs can pose a risk of payment shock. Therefore, it is critical that consumers receive advance notice of ARM payment changes so that, if their rates increase, they can prepare to make higher mortgage payments or pursue alternative plans, such as seeking to refinance their loans.

*Timing of current and proposed ARM regulations.* DFA section 1418 requires that interest rate adjustment disclosures be provided to consumers six to seven months before the interest rate adjusts for the first time (which is equivalent to 210 to 240 days before payment at a new level is due). Generally, this much advance notice will require disclosure of an estimated new interest rate and payment instead of exact amounts. This is because ARM contracts generally require an index value published closer to the adjustment date to calculate the adjusted interest rate and new payment. Nevertheless, the consumer would be put on notice of upcoming changes and would have ample time to refinance or pursue other alternatives if the estimate indicates a potential increase in payments that the consumer cannot afford.

Current § 1026.20(c) requires notice of rate adjustments resulting in a corresponding payment change at least 25 days prior to when payment at a new level is due. This notice, unlike the one required under DFA section 1418, provides the actual, not estimated, new interest rate and payment. Twenty-five days likely does not provide sufficient time for consumers to refinance, pursue other alternatives, or adjust their finances to make higher payments. Research conducted for the years 2004 through 2007 also suggested that a requirement to provide ARM adjustment disclosures 60, rather than 25, days before payment at a new level is due more closely reflects the time needed for

<sup>43</sup> 52 FR 48665 (Dec. 24, 1987).

<sup>44</sup> 74 FR 43232, 43269 (Aug. 26, 2009) (citing 52 FR 48665, 48668 (Dec. 24, 1987)).

<sup>45</sup> *Id.* at 43272.

<sup>46</sup> *Id.* at 43269.

<sup>47</sup> *Id.*

<sup>48</sup> Press Release, Freddie Mac, *Freddie Mac Releases 28th Annual ARM Survey Results* (January 18, 2012), available at: <http://freddiemac.mediaroom.com/index.php?s=12329&item=109996>.

<sup>49</sup> *Id.*

consumers to refinance a loan.<sup>50</sup> In the current market, the nation's biggest mortgage lenders take an average of more than 70 days to complete a refinance.<sup>51</sup>

For these reasons, proposed § 1026.20(c) revises the time frame for providing the ARM adjustment notice from the current 25 to 120 days to 60 to 120 days before payment at a new level is due. Under the proposed rule, consumers will know the actual amount of their new interest rate and payment at least 60 days before the new payment is due. Most existing ARMs will be able to comply with this proposed timing. The Bureau proposes grandfathering existing ARMs that contractually will not be able to comply with the new timing, *i.e.*, those with look-back periods of less than 45 days. *See* section-by-section analysis for proposed § 1026.20(c) for a full discussion of timing and look-back periods.

*Content of current and proposed ARM regulations.* The Bureau is generally proposing to retain the content required by current § 1026.20(c). Proposed § 1026.20(c) would require additional information such as a statement that the consumer's interest rate is scheduled to adjust, the adjustment may change the mortgage payment, the time period the current interest rate has been in effect, and the dates of the future rate adjustments; the date when the new payment is due after the adjustment; any interest rate or payment limits; any unapplied carryover interest and the earliest date it could be applied; additional amortization information for negatively-amortizing and interest-only loans; and the amount and expiration date of any prepayment penalty. Much of this additional content was proposed by the Board's 2009 Closed-End Proposal to amend Regulation Z's payment change interest rate adjustment disclosures.<sup>52</sup>

The initial interest rate adjustment notices proposed by § 1026.20(d) include much of the same information listed above for proposed § 1026.20(c). The content of the two proposed notices in § 1026.20(c) and (d) closely track one another in order to promote consistency and simplify compliance. However, proposed § 1026.20(c), which applies to the ongoing disclosures at each interest rate adjustment that results in a

corresponding payment change, would not require some of the disclosures mandated for the initial interest rate adjustment notices by DFA section 1418. These disclosures include a list of alternatives consumers may pursue, including refinancing, renegotiation of loan terms, payment forbearance, and pre-foreclosure sales; contact information for the appropriate State housing finance agency; and information on how to access a list of government-certified counseling agencies and programs. The Bureau believes it is not necessary to provide this information in § 1026.20(c) notices because much of it will be provided to consumers through other mortgage servicing measures implemented by the Dodd-Frank Act. For example, new TILA section 128(f), which would be implemented by proposed rule § 1026.41 for periodic statements, each billing cycle would provide information on how to contact the appropriate State housing finance authority and how to access a list of government-certified counseling agencies and programs. Also, the early intervention provisions of the 2012 RESPA Servicing Proposal would require this same information as well as examples of alternatives consumers may want to consider. Finally, consumers will have received this information pursuant to § 1026.20(d) the first time their adjustable-rate mortgages adjust.

The model forms proposed for § 1026.20(c) and (d) closely track one another and disclose virtually the same information, except for the additional information proposed for § 1026.20(d), as discussed above, and the reference to estimates in the proposed § 1026.20(d) notices. The Bureau believes that harmonizing the two proposed rules regarding ARM interest rate adjustment disclosures would ease the burden of compliance for creditors, assignees, and servicers while providing consumers with consistent information in similar notices.

The Bureau is proposing model and sample forms<sup>53</sup> for both § 1026.20(c) and (d). The Bureau worked with Macro to design and test the forms for § 1026.20(d), but did not specifically test § 1026.20(c) notices. *See* Part II.B above. Because of the similarity in the model forms for both proposed rules, the results of the testing of § 1026.20(d) forms is relevant for proposed

§ 1026.20(c) as well. Thus, throughout the section-by-section analysis for § 1026.20(c), the Bureau refers to the testing results for § 1026.20(d) where the information and concepts tested are identical in the model forms for both proposed § 1026.20(c) and (d).

#### *B. Proposed Rule Regarding Prompt Crediting of Mortgage Payments and Response to Requests for Payoff Amounts*

DFA section 1464(a) codifies the existing Regulation Z requirements in § 1026.36(c)(1)(i) on prompt crediting of payments. The proposed modifications to § 1026.36(c) would clarify the handling of partial payments. The proposal would limit application of the current prompt crediting provision, existing § 1026.36(c)(1)(i), to full contractual payments (as opposed to all payments), and add a new provision, § 1026.36(c)(1)(ii), to address the handling of partial payments (anything less than a full contractual payment).

DFA section 1464(b) generally codifies the existing Regulation Z requirement in § 1026.36(c)(3) to provide payoff statements, with modifications relating to the scope and timing of the requirement, and the need for the request to be written. Proposed modifications to § 1026.36(c) reflect these changes.

As part of implementing these changes, the Bureau is proposing a reorganization of the requirements in § 1026.36(c).

#### *C. Proposed Rule Regarding Periodic Statements*

DFA section 1420 establishes new TILA section 128(f), requiring periodic statements for residential mortgage loans to be provided each billing cycle. The statute requires that a creditor, assignee, or servicer disclose certain information in the periodic statement, along with "such other information as the Bureau may prescribe in regulations."<sup>54</sup> The statute requires the Bureau to develop and prescribe a standard form for this disclosure, taking into account that the required statements may be transmitted in writing or electronically.<sup>55</sup> The statute also provides an exemption to the periodic statement requirement for fixed-rate loans where the creditor, assignee, or servicer provides the obligor with a coupon book which provides substantially the same information as the periodic statement.<sup>56</sup>

<sup>50</sup> Robert B. Avery, Kenneth P. Brevoort, & Glenn B. Canner, *The 2007 HMDA Data*, 94 Fed. Reserve Bull. A107 (Dec. 23, 2008).

<sup>51</sup> Nick Timiraos & Ruth Simon, *Borrowers Face Big Delays in Refinancing Mortgages*, Wall St. J., May 9, 2012, at A1, available at: <http://online.wsj.com/article/SB10001424052702303459004577364102737025584.html>.

<sup>52</sup> 74 FR 43232, 43269–73 (Aug. 26, 2009).

<sup>53</sup> The Bureau proposes four model forms for the ARM adjustment notices: Two forms for the § 1026.20(c) ARM payment change notices, one labeled a model form and the other a sample form and two forms for the § 1026.20(d) ARM initial interest rate adjustment notices, one labeled a model form and the other a sample form. *See* Appendix H–4(D)(1)–(4).

<sup>54</sup> TILA section 128(f)(1)(H).

<sup>55</sup> TILA section 128(f)(2).

<sup>56</sup> TILA section 128(f)(3).

Proposed § 1026.41 contains the periodic statement requirement. Paragraph (a) establishes the general requirement for creditors, assignees, or servicers to provide a periodic statement. Paragraphs (b)–(d) establish requirements for the timing, form, content, and layout of the statement. Paragraph (e) sets forth exemptions from the periodic statement requirement.

The periodic statement is designed to serve a variety of purposes, including informing consumers of their payment obligations, providing the consumer with information about their mortgage in an easily readable and understandable format, creating a record of the transaction to aid in error detection and resolution, and providing information to certain delinquent borrowers.

The Bureau is proposing sample forms in accordance with TILA section 129(f)(2). The Bureau examined several forms used today by various servicers, considered how these forms met the needs of consumers, and identified changes that would benefit consumers. As discussed above in part II.B, the Bureau worked with Macro to design and test sample forms.

The proposed periodic statement is designed to provide information to consumers in a format they can easily understand and use. As such, the proposed regulation would require certain related pieces of information to be grouped together. The proposed formatting requirements of the periodic statement are discussed in detail in the section-by-section analysis for proposed § 1026.41(d).

The proposed periodic statement is also designed to provide additional information to consumers in several potentially confusing scenarios: Partial payments, payment-option loans, and delinquency. First, the handling of partial payments would be clarified on the periodic statement, both on the transaction activity line and in the past payment breakdown. Additionally, if funds are held in a suspense or unapplied funds account, the proposed rule would require a message on what must be done to release the funds. Second, payments for payment-option loans would be clarified by listing the options in the Amount Due section, and providing details about each of the options in the Explanation of Amount Due section. Finally, delinquent consumers would receive information in several places on the periodic statement. The overdue amount would be stated in the Explanation of Amount Due section, and any fees would be listed in the Transaction Activity section. The breakdown of past payments will help

the consumer understand how past payments were applied, which can be confusing. Additionally, consumers who are more than 45 days delinquent will have a delinquency information included in the periodic statement providing specific information about their loan. These requirements are discussed in greater detail in the section-by-section analysis on proposed § 1026.41 below.

Finally, the proposal contains several exemptions from the periodic statement requirement. One exemption is for fixed-rate loans using coupon books that meet certain requirements, as set forth in TILA 128(f)(3). Another exemption clarifies that timeshares are not subject to the periodic statement requirement as per the definition of “residential mortgage loan.”<sup>57</sup> The Bureau is also proposing exemptions for reverse mortgages and certain small servicers.

#### V. Legal Authority

The Bureau is issuing this proposed rule pursuant to its authority under TILA and the Dodd-Frank Act. Section 1061 of the Dodd-Frank Act transferred to the Bureau the “consumer financial protection functions” previously vested in certain other Federal agencies, including the Board. The term “consumer financial protection function” is defined to include “all authority to prescribe rules or issue orders or guidelines pursuant to any Federal consumer financial law, including performing appropriate functions to promulgate and review such rules, orders, and guidelines.”<sup>58</sup> TILA, Title X of the Dodd-Frank Act, and certain subtitles and provisions of Title XIV of the Dodd-Frank Act, are Federal consumer financial laws.<sup>59</sup> Accordingly, the Bureau has authority to issue regulations pursuant to TILA, Title X, and the enumerated subtitles and provisions of Title XIV, including to implement the additions and amendments to TILA’s mortgage servicing requirements made by Title XIV of the Dodd-Frank Act.

Sections 1418, 1420 and 1464 of the Dodd-Frank Act create new requirements under TILA in new sections 128A, 128(f), and 129F and 129G, respectively. Section 1418 of the

Dodd-Frank Act amends Regulation Z to require that certain disclosures be provided to consumers with hybrid adjustable-rate mortgages secured by the consumer’s principal residence the first time the interest resets or adjusts. Additionally, the savings clause in TILA section 128A(c) allows the Bureau to require this notice for adjustable-rate mortgage loans that are not hybrid adjustable-rate loans. DFA section 1420 requires that a periodic statement be provided to consumers for each billing cycle of a consumer’s closed-end mortgage secured by a dwelling, except for fixed-rate loans with coupon books containing substantially the same information. The statute requires a list of specific information that must be included in the periodic statement. Additionally, pursuant to TILA section 128(f)(1)(H), the periodic statement must also include such information as the Bureau may require in regulations. DFA section 1464 generally requires the prompt crediting of mortgage payments in connection with consumer credit transactions secured by a consumer’s principal dwelling and an accurate timely response to requests for payoff amounts for home loans. In addition to proposing rules to implement these TILA provisions of the Dodd-Frank Act, the Bureau proposes amending current TILA interest rate adjustment disclosures required by § 1026.20(c) as proposed § 1026.20(c).

The proposed rule also relies on the rulemaking and exception authorities specifically granted to the Bureau by TILA and the Dodd-Frank Act, including the authorities discussed below:

#### *The Truth in Lending Act*

*TILA section 105(a).* As amended by the Dodd-Frank Act, TILA section 105(a), 15 U.S.C. 1604(a), directs the Bureau to prescribe regulations to carry out the purposes of TILA, and provides that such regulations may contain additional requirements, classifications, differentiations, or other provisions, and may provide for such adjustments and exceptions for all or any class of transactions, that the Bureau judges are necessary or proper to effectuate the purposes of TILA, to prevent circumvention or evasion thereof, or to facilitate compliance. The purposes of TILA are “to assure a meaningful disclosure of credit terms so that the consumers will be able to compare more readily the various credit terms available and avoid the uninformed use of credit” and to protect consumers against inaccurate and unfair credit billing practices. TILA section 102(a); 15 U.S.C. 1601(a).

<sup>57</sup> TILA section 103(cc)(5).

<sup>58</sup> 12 U.S.C. 5581(a)(1).

<sup>59</sup> Dodd-Frank Act section 1002(14), 12 U.S.C. 5481(14) (defining “Federal consumer financial law” to include the “enumerated consumer laws” and the provisions of title X of the Dodd-Frank Act); Dodd-Frank Act section 1002(12), 12 U.S.C. 5481(12) (defining “enumerated consumer laws” to include TILA), Dodd-Frank section 1400(b), 15 U.S.C. 1601 note (defining “enumerated consumer laws” to include certain subtitles and provisions of Title XIV).

Historically, TILA section 105(a) has served as a broad source of authority for rules that promote the informed use of credit and avoid unfair credit billing practices through required disclosures and substantive regulation of certain practices. Dodd-Frank Act section 1100A additionally clarifies the Bureau's TILA section 105(a) authority by amending that section to provide express authority to prescribe regulations that contain "additional requirements" that the Bureau finds are necessary or proper to effectuate the purposes of TILA, to prevent circumvention or evasion thereof, or to facilitate compliance. This amendment clarified that the Bureau has the authority to exercise TILA section 105(a) to prescribe requirements beyond those specifically listed in the statute that meet the standards outlined in section 105(a). The Dodd-Frank Act also clarified the Bureau's rulemaking authority over certain high-cost mortgages pursuant to section 105(a). As amended by the Dodd-Frank Act, TILA section 105(a) authority to make adjustments and exceptions to the requirements of TILA applies to all transactions subject to TILA, except with respect to the provisions of TILA section 129<sup>60</sup> that apply to the high-cost mortgages referred to in TILA section 103(bb), 15 U.S.C. 1602(bb).

For the reasons discussed in this notice, the Bureau is proposing regulations to carry out TILA's purposes and is proposing such additional requirements, adjustments, and exceptions as, in the Bureau's judgment, are necessary and proper to carry out the purposes of TILA, prevent circumvention or evasion thereof, or to facilitate compliance. In developing these aspects of the proposal pursuant to its authority under TILA section 105(a), the Bureau has considered the purposes of TILA, including ensuring meaningful disclosures, helping consumers avoid the uninformed use of credit, and protecting consumers against inaccurate and unfair credit billing practices. See TILA section 102(a); 15 U.S.C. 1601(a).

**TILA section 105(f).** Section 105(f) of TILA, 15 U.S.C. 1604(f), authorizes the Bureau to exempt from all or part of TILA any class of transactions if the Bureau determines that TILA coverage does not provide a meaningful benefit to consumers in the form of useful information or protection. In exercising this authority, the Bureau must consider

the factors identified in section 105(f) of TILA and publish its rationale at the time it proposes an exemption for public comment. Specifically, the Bureau must consider:

(a) The amount of the loan and whether the disclosures, right of rescission, and other provisions provide a benefit to the consumers who are parties to such transactions, as determined by the Bureau;

(b) The extent to which the requirements of this subchapter complicate, hinder, or make more expensive the credit process for the class of transactions;

(c) The status of the borrower, including—

(1) Any related financial arrangements of the borrower, as determined by the Bureau;

(2) The financial sophistication of the borrower relative to the type of transaction; and

(3) The importance to the borrower of the credit, related supporting property, and coverage under this subchapter, as determined by the Bureau;

(d) Whether the loan is secured by the principal residence of the consumer; and

(e) Whether the goal of consumer protection would be undermined by such an exemption. For the reasons discussed in this notice, the Bureau is proposing to exempt certain transactions from the requirements of TILA pursuant to its authority under TILA section 105(f). In developing this proposal under TILA section 105(f), the Bureau has considered the relevant factors and determined that the proposed exemptions may be appropriate.

#### *The Dodd-Frank Act*

**Dodd-Frank Act section 1022(b).** Section 1022(b)(1) of the Dodd-Frank Act authorizes the Bureau to prescribe rules "as may be necessary or appropriate to enable the Bureau to administer and carry out the purposes and objectives of the Federal consumer financial laws, and to prevent evasions thereof[.]" 12 U.S.C. 5512(b)(1). Section 1022(b)(2) of the Dodd-Frank Act prescribes certain standards for rulemaking that the Bureau must follow in exercising its authority under section 1022(b)(1). 12 U.S.C. 5512(b)(2). As discussed above, TILA is a Federal consumer financial law. Accordingly, the Bureau proposes to exercise its authority under DFA section 1022(b) to prescribe rules under TILA that carry out the purposes and prevent evasion of those laws.

**Dodd-Frank Act section 1032.** Section 1032(a) of the Dodd-Frank Act governs

disclosures and provides that the Bureau "may prescribe rules to ensure that the features of any consumer financial product or service, both initially and over the term of the product or service, are fully, accurately, and effectively disclosed to consumers in a manner that permits consumers to understand the costs, benefits, and risks associated with the product or service, in light of the facts and circumstances." 12 U.S.C. 5532(a). The authority granted to the Bureau in DFA section 1032(a) is broad, and empowers the Bureau to prescribe rules regarding the disclosure of the "features" of consumer financial products and services generally. Accordingly, the Bureau may prescribe rules containing disclosure requirements even if other Federal consumer financial laws do not specifically require disclosure of such features.

Dodd-Frank Act section 1032(c) provides that, in prescribing rules pursuant to DFA section 1032, the Bureau "shall consider available evidence about consumer awareness, understanding of, and responses to disclosures or communications about the risks, costs, and benefits of consumer financial products or services." 12 U.S.C. 5532(c). Accordingly, in developing proposed rules under Dodd-Frank Act section 1032(a) for this proposal, the Bureau has considered available studies, reports, and other evidence about consumer awareness, understanding of, and responses to disclosures or communications about the risks, costs, and benefits of consumer financial products or services. For the reasons discussed in this notice, the Bureau is proposing portions of this rule pursuant to its authority under Dodd-Frank Act section 1032(a).

In addition, DFA section 1032(b)(1) provides that "any final rule prescribed by the Bureau under this [section 1032] requiring disclosures may include a model form that may be used at the option of the covered person for provision of the required disclosures." 12 U.S.C. 5532(b)(1). Any model form issued pursuant to that authority shall contain a clear and conspicuous disclosure that, at a minimum, uses plain language that is comprehensible to consumers, using a clear format and design, such as readable type font, and succinctly explains the information that must be communicated to the consumer. DFA section 1032(b)(2); 12 U.S.C. 5532(b)(2). As discussed in the section-by-section analysis for proposed §§ 1026.20(d) and 1026.41, the Bureau is proposing model forms for ARM interest rate adjustment notices and periodic

<sup>60</sup> 15 U.S.C. 1639. TILA section 129 contains requirements for certain high-cost mortgages, established by the Home Ownership and Equity Protection Act (HOEPA), which are commonly called HOEPA loans.

statements. As discussed in this notice, the Bureau is proposing these model forms pursuant to its authority under DFA section 1032(b)(1).

*Dodd-Frank Act section 1405(b).*

Section 1405(b) of the Dodd-Frank Act provides that, “[n]otwithstanding any other provision of [title 14 of the Dodd-Frank Act], in order to improve consumer awareness and understanding of transactions involving residential mortgage loans through the use of disclosures, the Bureau may, by rule, exempt from or modify disclosure requirements, in whole or in part, for any class of residential mortgage loans if the Bureau determines that such exemption or modification is in the interest of consumers and in the public interest.” 15 U.S.C. 1601 note. Section 1401 of the Dodd-Frank Act, which amends TILA section 103(cc), 15 U.S.C. 1602(cc), generally defines residential mortgage loan as any consumer credit transaction that is secured by a mortgage on a dwelling or on residential real property that includes a dwelling other than an open-end credit plan or an extension of credit secured by a consumer’s interest in a timeshare plan. Notably, the authority granted by section 1405(b) applies to “disclosure requirements” generally, and is not limited to a specific statute or statutes. Accordingly, DFA section 1405(b) is a broad source of authority to modify the disclosure requirements of TILA.

In developing proposed rules for residential mortgage loans under Dodd-Frank Act section 1405(b) for this proposal, the Bureau has considered the purposes of improving consumer awareness and understanding of transactions involving residential mortgage loans through the use of disclosures, and the interests of consumers and the public. For the reasons discussed in this notice, the Bureau is proposing portions of this rule pursuant to its authority under Dodd-Frank Act section 1405(b).

See the section-by-section analysis for each proposed section for further elaboration on legal authority.

## VI. Section-by-Section Analysis

### A. Regulation Z

#### Section 1026.17 General Disclosure Requirements

##### 17(a) Form of Disclosures

##### 17(a)(1)

Section 1026.17(a)(1) contains form requirements generally applicable to disclosures under subpart C. The Bureau proposes to make certain modifications to these requirements as applicable to the ARM interest rate

adjustment payment change notices under proposed § 1026.20(c) and the initial ARM interest rate adjustment notices under proposed § 1026.20(d).

Section 1026.17(a) requires, among other things, that certain disclosures contain only information directly related to that disclosure. Current § 1026.20(c) is not included in the list of disclosures subject to this requirement. Further, commentary to § 1026.17(a)(1) states that the disclosures required by current § 1026.20(c) are not subject to the general segregation requirements under § 1026.17(a)(1).

The payment change notice proposed by § 1026.20(c) is intended to inform consumers of upcoming changes to their interest rate and mortgage payments and to give them time to explore alternatives. The Bureau does not believe that the form requirements applicable to current § 1026.20(c) notices are sufficient to highlight and emphasize important information consumers need to make decisions about their adjustable-rate mortgages. Presenting information to consumers separate from other information enhances consumers’ awareness of the material. Therefore, the Bureau proposes to amend § 1026.17(a)(1) and comment 17(a)(1)–2.ii to add proposed § 1026.20(c) to the enumerated disclosures required to contain only information directly related to the disclosure and to require that proposed § 1026.20(c) disclosures be grouped together and segregated from everything else.

Other § 1026.17(a)(1) requirements, such as that disclosures be clear and conspicuous, in writing, and provided electronically subject to compliance with Electronic Signatures in Global and National Commerce Act (E-Sign Act) (15 U.S.C. 7001 et seq.), would continue to apply to § 1026.20(c).

TILA section 128A provides that the initial ARM interest rate adjustment notices, which the Bureau proposes to implement in proposed § 1026.20(d), be “separate and distinct from all other correspondence to the consumer.”

Accordingly, the Bureau proposes to revise § 1026.17(a), to make clear that the proposed § 1026.20(d) disclosures are not subject to the general segregation requirement under that section but rather, pursuant to proposed § 1026.20(d), are required to be separate and distinct from all other correspondence. See comment 20(d) for further discussion of the separate and distinct requirement. Other requirements of § 1026.17(a), such as that disclosures be clear and conspicuous, in writing, and provided

electronically subject to compliance with the E-Sign Act, would apply to the proposed § 1026.20(d) disclosures.

The proposed application of § 1026.17(a)(1), as modified, to proposed § 1026.20(c) and (d) is authorized, in part, under TILA section 122, which requires that disclosures under TILA be clear and conspicuous, in accordance with regulations of the Bureau. The requirements are further authorized under TILA section 105(a) because the Bureau believes that the proposed form requirements are necessary and proper to effectuate the purposes of TILA to assure a meaningful disclosure of credit terms, avoid the uninformed use of credit, and protect consumers against inaccurate and unfair credit billing practices by ensuring that consumers understand the content of the proposed ARM notices. Moreover, as discussed below, the disclosures proposed under § 1026.20(c) are authorized, among other provisions, under TILA section 128(f)(2), which authorizes the Bureau to develop and prescribe a standard form for the disclosures required under TILA section 128(f).

As to proposed § 1026.20(d) disclosures, DFA section 1418, TILA section 128A(b) specifically provides that the disclosures shall be in writing, separate and distinct from all other correspondence. In addition, the Bureau believes, consistent with DFA section 1032(a), that the proposed application of § 1026.17(a)(1), as modified, to § 1026.20(d) will ensure that the features of ARM loans are effectively disclosed to consumers in a manner that allows consumers to understand the information disclosed. The Bureau further believes, consistent with DFA section 1405(a), that it is proper to modify DFA section 1418 to apply the form requirements in proposed § 1026.17(a)(1) to improve consumer awareness and understanding of ARM adjustments.

##### 17(b) Time of Disclosures

The Bureau is proposing to revise § 1026.17(b) to add proposed § 1026.20(d) to the list of variable-rate disclosure provisions with special timing requirements. This proposed amendment would alert creditors, assignees, and servicers that, as with proposed § 1026.20(c) payment adjustment notices, there are timing requirements particular to the proposed § 1026.20(d) initial interest rate adjustment notices.

## 17(c) Basis of Disclosures and Use of Estimates

### 17(c)(1)

Section 1026.17(c)(1) requires disclosures to reflect the terms of the legal obligation between the parties. Current comment 17(c)(1)–1 provides that, under this requirement, disclosures generally must reflect the credit terms to which the parties are legally bound as of the outset of the transaction, but that in the case of disclosures required under § 1026.20(c), the disclosures shall reflect the credit terms to which the parties are legally bound when the disclosures are provided. The Bureau proposes revising comment 17(c)(1)–1 to make clear that the disclosures required under proposed § 1026.20(d), like those under proposed § 1026.20(c), shall reflect the credit terms to which the parties are legally bound when the disclosures are provided, rather than at the outset of the transaction.

## Section 1026.18 Content of Disclosures

### 18(f) Variable Rate

#### 18(f)–1

Current comment 18(f)–1 clarifies that creditors electing to substitute § 1026.19(b) disclosures for § 1026.18(f)(1) disclosures, as permitted by § 1026.18(f)(1) and (3), may, but need not, also provide disclosures required by current § 1026.20(c). Under current § 1026.20(c), disclosures are permissive in such cases because the § 1026.19(b) substitution is only permitted for variable-rate transactions not secured by the consumer's principal dwelling or variable-rate transactions secured by the consumers' principal dwelling, but with a term of one year or less. These transactions are not covered by current § 1026.20(c). Thus, current comment 18(f)–1 does not alter the legal requirements applicable to creditors. The clarification was, however, helpful because current § 1026.20(c) cross-references § 1026.19(b) and applies to transactions covered by § 1026.19(b).

The Bureau proposes to delete this reference to § 1026.20(c) from the comment because it is no longer helpful since neither proposed § 1026.20(c) nor (d) cross-references § 1026.19(b) and those proposed provisions define their scope of coverage without reference to § 1026.19(b). Moreover, proposed § 1026.20(c) or (d) apply to some ARMs with terms of one year or less such that applying the current comment would create an unwarranted exception to the requirement to provide ARM notices to consumers with those types of ARMs. For these reasons, the Bureau proposes

to delete the reference to § 1026.20(c) in comment 18(f)–1.

## Section 1026.19 Certain Mortgage and Variable-Rate Transactions

### 19(b) Certain Variable Rate Transactions

#### 19(b)–4 Other Variable-Rate Regulations

The Bureau proposes revising comment 19(b)–4 to delete reference to current § 1026.20(c) and (d). Current comment 19(b)–4 explains that transactions in which the creditor is required to comply with and has complied with the disclosure requirements of the variable-rate regulations of other Federal agencies are exempt from the requirements of § 1026.20(c) by virtue of current § 1026.20(d). Consistent with the proposed deletion of current § 1026.20(d), the Bureau proposes revising comment 19(b)–4 to delete reference to current § 1026.20(c) and (d).

### 19(b)–5.i.C Certain Mortgage and Variable-Rate Transactions

The Bureau proposes revising comment 19(b)–5.i.C to cross-reference other commentary that makes clear that proposed § 1026.20(c) and (d) do not apply to “price-level-adjusted mortgages” that have a fixed-rate of interest but provide for periodic adjustments to payments and the loan balance to reflect changes in an index measuring prices or inflation.

#### 19(b)(2)(xi)–1 Adjustment Notices

Pursuant to current § 1026.19(b)(2)(xi), disclosures regarding the type of information that will be provided in notices of interest rate adjustments and the timing of such notices must be provided to consumers applying for variable-rate transactions secured by the consumer's principal dwelling with a term greater than one year. Current comment 19(b)(2)(xi)–1 clarifies that these disclosures include information regarding the content and timing of disclosures consumers will receive pursuant to current § 1026.20(c). The Bureau proposes adding reference to proposed § 1026.20(d) to the comment, since those disclosures would be provided to consumers under the Bureau's proposed rule. The proposed comment also makes conforming changes to the text suggested for describing the ARM notices to reflect the timing and content of the disclosures proposed by § 1026.20(c) and (d).

## Section 1026.20 Subsequent Disclosure Requirements

### 20(c) Rate Adjustments

Current § 1026.20(c) requires that disclosures be provided to consumers with variable-rate mortgages each time an adjustment results in a corresponding payment change and at least once each year during which an interest rate adjustment is implemented without a corresponding payment change.

The current rule does not differentiate between the content required for the annual notice and the notices required each time the interest rate adjustment results in a corresponding payment change. Current § 1026.20(c) requires that adjustment notices disclose the following: (1) The current and prior interest rates for the loan; (2) the index values upon which the current and prior interest rates are based; (3) the extent to which the creditor has foregone any increase in the interest rate; (4) the contractual effects of the adjustment, including the payment due after the adjustment is made, and a statement of the loan balance; and (5) the payment, if different from the payment due after adjustment, that would be required to fully amortize the loan at the new interest rate over the remainder of the loan term.

The Bureau proposes two major changes to § 1026.20(c). First, the Bureau proposes eliminating the annual notice sent each year during which an interest rate adjustment is implemented without a corresponding payment change. As explained in more detail below, the Bureau believes that Dodd-Frank Act amendments to TILA, and the Bureau's proposed amendments to Regulation Z that would implement those provisions, would provide consumers with much of the information contained in the annual notice thereby greatly minimizing the need for its protections. Second, the proposal updates current § 1026.20(c) by adding disclosures that the Bureau believes will enhance protections for consumers with ARMs. The proposed revisions to § 1026.20(c) also harmonize with the requirements the Bureau is proposing for the initial ARM interest rate adjustment notice under § 1026.20(d), thereby promoting consistency between the Regulation Z ARM provisions.

*Elimination of annual disclosure.* First, proposed § 1026.20(c) eliminates the annual notice requirement under the current rule. The Bureau believes that consumers who receive the current annual notice, such as consumers with ARMs with payment caps, would

receive much of the same information in the periodic statement under proposed § 1026.41, discussed below. The proposed periodic statement would provide consumers with comprehensive information about their mortgages each billing cycle. The periodic statement would include some of the same key information provided to consumers under the current § 1026.20(c) annual notice, such as the current interest rate and the date after which that rate would adjust. It also would provide other information that may be useful to consumers who would receive the § 1026.20(c) annual ARM notice, including the existence and amount of any prepayment penalty; allocation of the consumer's payment by principal, interest, and escrow; the amount of the outstanding principal; contact information for the State housing finance authority; and information to access a list of Federally-certified housing counselors.

In light of the amount, type, and frequency of the information the Bureau proposes to provide in the periodic statement to consumers with ARMs that are subject to the current § 1026.20(c) annual ARM interest rate notice, the Bureau proposes to eliminate the requirement for the annual notice as duplicative and as potentially contributing to information overload that could deflect consumer attention away from the information such consumers would receive in other required disclosures. The Bureau solicits comments on the need, value, or use of retaining the annual notice required under current § 1026.20(c) for consumers whose ARM interest rates adjust during the course of a year without resulting in corresponding payment changes.

The Bureau proposes to delete comments 20(c)(1)–1 and 20(c)(4)–1 which, among other things, address the content of the § 1026.20(c) annual notice the Bureau is proposing to eliminate. Current comment 20(c)(1)–1 also explains, among other things, the meaning of the terms “current” and “prior” rates and that in disclosing all other rates that applied during the period between notices, the creditor may disclose a range of the highest and lowest rates during that year period. Current comment 20(c)(4)–1, among other things, defines the term loan “balance” and explains that a “contractual effect” of a rate adjustment includes disclosure of any change in the term or maturity of the loan if the change resulted from the rate adjustment. The Bureau also proposes deletion of these current comments as they relate to the recurring disclosures

that would be required by proposed § 1026.20(c) for interest rate adjustments resulting in a corresponding payment change. The Bureau proposes to replace these comments with the new commentary discussed below.

*Amendment of payment change disclosure.* Second, proposed § 1026.20(c) would amend existing § 1026.20(c) as it relates to interest rate adjustments that result in a corresponding payment change. The proposal retains much of the content required in the current notice and also would require disclosure of additional information that the Bureau believes would help consumers better understand and manage their adjustable-rate mortgages. The proposed revisions to current § 1026.20(c) harmonize with the initial ARM interest rate adjustment notice proposed by § 1026.20(d). The Bureau believes that promoting consistency between the ARM disclosure provisions of § 1026.20(c) and (d) would reduce compliance burdens on industry and minimize consumer confusion.

*Creditors, assignees, and servicers.* The Bureau also proposes to amend § 1026.20(c) to provide that it applies to creditors, assignees, and servicers. Current § 1026.20(c) applies to creditors and existing comment 20(c)–1 clarifies that the requirements of § 1026.20(c) also apply to subsequent holders, *i.e.*, assignees. The Bureau's proposal provides that § 1026.20(c) would apply to servicers, as well as to creditors and assignees. Proposed comment 20(c)–1 clarifies that a creditor, assignee, or servicer that no longer owns the mortgage loan or the mortgage servicing rights is not subject to the requirements of § 1026.20(c).

As discussed below, proposed § 1026.20(c) is authorized under, among other authorities, TILA section 128(f), which applies to creditors, assignees, and servicers. The proposal is consistent with proposed § 1026.20(d) such that both proposed § 1026.20(c) and (d) would apply to creditors, assignees and servicers.

The Bureau believes that applying § 1026.20(c) to creditors and assignees, but not servicers, would compromise consumers' recourse in the case of a violation of § 1026.20(c). Many creditors and assignees do not service the loans they own and instead sell the mortgage servicing rights to a third party. The servicer is the party with which consumers have contact on an ongoing basis regarding their mortgages. Consumers send their payments to the servicer and communicate with the servicer regarding any questions or problems with their mortgage that may

arise. Where the owner and the servicer are different entities, consumers may not know the identity of the owner and may not even realize that the servicer is not the owner of their mortgage. Moreover, it can be difficult for consumers to ascertain the identity of the creditor or assignee, even though servicers would be required to identify the owner of a mortgage under rules proposed pursuant to DFA section 1463. Thus, in the case of a violation of proposed § 1026.20(c), consumers should be able to seek relief against the servicer as the primary party from whom they receive service and with whom they maintain communication regarding their mortgages. See below, section 20(d), for a discussion of application of proposed § 1026.20(d) initial ARM interest rate adjustment notices to assignees. The same rationale applies to proposed § 1026.20(c) ARM payment adjustment notices.

Proposed comment 20(c)–1 explains that any provision of subpart C that applies to the disclosures required by § 1026.20(c) also applies to creditors, assignees, and servicers. This is the case even where the other provisions of subpart C refer only to creditors. For the reasons discussed above, the Bureau proposes that the requirements of other regulations that apply to the § 1026.20(c) ARM payment adjustment notices apply to servicers as well as to creditors and assignees.

The proposal also would delete current comment 20(c)–1, which, among other things, refers to subsequent holders, in favor of consistent usage of the term assignee in proposed § 1026.20(c) and (d). It would also delete comment 20(c)–3 as duplicative of the § 1026.17(c)(1) requirement that the disclosures reflect the terms of the parties' legal obligations.

*Conversions.* Proposed § 1026.20(c) also applies to ARMs converting to fixed-rate mortgages when the adjustment to the interest rate results in a corresponding payment change. Providing this notice would alert consumers to their new interest rate and payment following conversion from an ARM to a fixed-rate mortgage. Proposed comment 20(c)–2 explains that, in the case of an open-end account converting to a closed-end adjustable-rate mortgage, § 1026.20(c) disclosures are not required until the implementation of the first interest rate adjustment that results in a corresponding payment change post-conversion. Under the proposed rule, this conversion is analogous to consummation. Thus, like other ARMs subject to the requirements of proposed § 1026.20(c), disclosures for these types of converted ARMs would not be

required until the first interest rate adjustment following the conversion which results in a corresponding payment change. The proposed rule is consistent with existing commentary and proposed § 1026.20(d) regarding conversions. *See* current comment 20(c)–1.

**Authority.** The Bureau proposes to amend § 1026.20(c) pursuant to its authority under TILA section 105(a). For the reasons discussed in the section-by-section analysis for each of the proposed amendments to § 1026.20(c), the Bureau believes that the proposed amendments are necessary and proper to effectuate the purposes of TILA to assure a meaningful disclosure of credit terms, avoid the uninformed use of credit, and protect consumers against inaccurate and unfair credit billing practices. Proposed § 1026.20(c) also is authorized under TILA section 128(f), which requires that certain information enumerated in the statute be provided to consumers every billing cycle in a periodic statement and also confers on the Bureau the authority to require periodic disclosure of “[s]uch other information as the Bureau may prescribe in regulations.” Proposed § 1026.20(c) is further authorized under DFA section 1405(b), which permits the Bureau to modify disclosure requirements where such modification is in the interest of consumers and the public.

Although TILA section 128(f) authorizes the Bureau to require that the content for the § 1026.20(c) ARM notices be included in the periodic statement, the Bureau believes, for the reasons set forth above and below, that consumers would be better served if this information was provided as a separate disclosure. Under proposed § 1026.17(a), the proposed § 1026.20(c) ARM payment adjustment notice would have to be provided separate and distinct from the periodic statement. The disclosures required by proposed § 1026.20(c), however, may be provided to consumers together with the periodic statement, depending on the mode of delivery, in the same envelope or as an additional attachment to the email. The Bureau also believes that the interest of consumers and the public interest would be better served by receiving the § 1026.20(c) ARM notice, within the time frame discussed below, each time the ARM interest rate adjusts resulting in a corresponding payment change, rather than with each billing cycle.

## 20(c)(1) Coverage of Rate Adjustment Disclosures

### 20(c)(1)(i) In General

Proposed § 1026.20(c)(1) defines an adjustable-rate mortgage, for purposes of § 1026.20(c), as a closed-end consumer credit transaction secured by the consumer’s principal dwelling in which the annual percentage rate may increase after consummation. Current § 1026.20(c) requires disclosures only for adjustments to the interest rate in variable-rate transactions subject to § 1026.19(b), which is limited to loans secured by the consumer’s principal dwelling with a term of greater than one year. The Bureau proposes deleting the cross-reference to § 1026.19(b), thereby expanding the scope of proposed § 1026.20(c) to include loans with terms of one year or less. Proposed § 1026.20(c)(1)(i) would replace current § 1026.20(c) and comment 20(c)–1 with regard to which loans are subject to the interest rate adjustment disclosures.

There is one type of short-term ARM that the Bureau proposes to except from the requirements of § 1026.20(c): Construction loans with terms of one year or less. *See* section 20(c)(1)(ii) below for a full discussion of this proposed exception for construction ARMs with terms of one year or less. The Bureau solicits comment on whether there are other ARMs with terms of less than one year and whether the proposed 60-day minimum notice period is appropriate for such loans. *See* section 20(c)(2) below for a full discussion of the timing proposed for § 1026.20(c). If the 60-day period is not appropriate, the Bureau solicits comment on what period would be appropriate that would also provide consumers with sufficient notice of a payment change. This proposal regarding coverage is consistent with the statutory requirements of TILA section 128A and proposed § 1026.20(d) in that those provisions generally apply to all ARMs, regardless of term length. Thus, the proposal to expand § 1026.20(c) to ARMs with terms of one year or less would harmonize the coverage of the two types of ARM adjustment notices, thereby ensuring that both § 1026.20(d) notices and § 1026.20(c) notices, when required, are provided to the same consumers.

The Bureau proposes using the terms “adjustable-rate mortgage” or “ARM” to replace the term “variable-rate transaction” in current § 1026.20(c). Proposed comment 20(c)(1)(i)–1 clarifies that the term “variable-rate transaction,” as used in § 1026.19(b) and elsewhere in Regulation Z, is synonymous with the term “adjustable-rate mortgage” or

“ARM”, except where specifically distinguished. The Bureau proposes this revision because “adjustable-rate mortgage” or “ARM” are the terms commonly used for mortgages covered by current and proposed § 1026.20(c).

Proposed comment 20(c)(1)(i)–1 also clarifies that the requirements of § 1026.20(c)(1)(i) are not limited to transactions financing the initial acquisition of the consumer’s principal dwelling, but also would apply to other closed-end ARM transactions secured by the consumer’s principal dwelling, consistent with current comment 19(b)–1 and current § 1026.20(c).

### 20(c)(1)(ii) Exceptions

Proposed § 1026.20(c)(1)(ii) sets forth two exceptions to the disclosure requirements of § 1026.20(c). These exceptions apply to: (1) Construction loans with terms of one year or less; and (2) the first adjustment to an ARM if the first payment at the adjusted level is due within 210 days after consummation and the actual, not estimated, new interest rate was disclosed at consummation, in the initial ARM interest rate adjustment notice that would be required by proposed § 1026.20(d). Proposed comments 20(c)(1)(ii)–1 and –2 provide further explanation. Proposed § 1026.20(d) also would except the same construction loans.

As discussed in more detail below in connection with the notice required for an initial ARM interest rate adjustment under § 1026.20(d), the Bureau also considered, but decided against, permitting or requiring small creditors, assignees, and servicers to include in the periodic statement the information required for the first payment change notice under proposed § 1026.20(c). The Bureau also considered this option with regard to all notices that small entities would be required to provide to consumers under proposed § 1026.20(c). As discussed further below, the Bureau solicits comments from small entities—and from creditors, assignees, and servicers in general—as to whether small entities or all creditors, assignees, and servicers should be permitted or required to provide the information required in the first payment change notices under proposed § 1026.20(c) in the periodic statement instead of as a separate ARM notice and whether this should be done for all § 1026.20(c) notices.

Regarding the first exception the Bureau proposes, construction loans generally have short terms of six months to one year and are subject to frequent interest rate adjustments, usually monthly or quarterly. The construction

period usually involves several disbursements of funds at times and in amounts that are unknown at the beginning of that period. The consumer generally pays only accrued interest until construction is completed. The creditor, assignee, or servicer, in addition to disbursing payments in stages, closely monitors the progress of construction. Generally, at the completion of the construction, the construction loan is converted into permanent financing in which the loan amount is amortized just as in a standard mortgage transaction. See comment 17(c)(6)–2 for additional information on construction loans.

The frequent interest rate adjustments, multiple disbursements of funds, short loan term, and on-going communication between the creditor, assignee, or servicer and consumer, distinguish construction loans from other ARMs. These loans are meant to function as bridge financing until construction is completed and permanent financing can be put in place. Consumers with construction ARM loans are not at risk of payment shock like other ARMs where interest rates change less frequently. Moreover, given the frequency of interest rate adjustments on construction loans, creditors, assignees, or servicers would have difficulty complying with the proposed requirement to provide the notice to consumers 60 to 120 days before payment at a new level is due for each adjustment resulting in a corresponding payment change. For these reasons, providing notices under § 1026.20(c) for these loans would not provide a meaningful benefit to the consumer nor improve consumers' awareness and understanding of their construction loans with terms of one year or less. Proposed comment 20(c)(1)(i)–1 applies the standards in comment 19(b)–1 for determining the term of a construction loan.

The second exception, for the first adjustment to an ARM causing a payment change if the first payment at the adjusted level is due within 210 days after consummation, would apply only if the exact interest rate, not an estimate, is disclosed at consummation. For ARMs adjusting within six months of consummation, *i.e.*, 210 days before the first payment is due at the new level, the disclosures proposed by § 1026.20(d) must be provided at consummation. The recency of consummation obviates the need for the § 1026.20(c) notice in this circumstance because consumers would have been apprised of the upcoming adjustment and payment change just months prior to its occurrence and their mortgages

would be so new as to not require the alerts in the notice regarding pursuing alternatives. Thus, providing § 1026.20(c) disclosures in these circumstances would be duplicative, not contribute to consumer awareness and understanding, and not provide a meaningful benefit to consumers.

Proposed comment 20(c)(1)(ii)–3 discusses other loans to which the proposed rule does not apply. Proposed comment 20(c)(1)(ii)–3 is consistent with proposed comment 20(d)(1)(ii)–2 with regard to the loans which are not subject to the proposed ARM disclosure rules. Certain Regulation Z provisions treat some of these loans as variable-rate transactions, even if they are structured as fixed-rate transactions. The proposed comment clarifies that, for purposes of § 1026.20(c), the following loans, if fixed-rate transactions, are not ARMs and therefore not subject to ARM notices pursuant to § 1026.20(c): Shared-equity or shared-appreciation mortgages; price-level adjusted or other indexed mortgages that have a fixed rate of interest but provide for periodic adjustments to payments and the loan balance to reflect changes in an index measuring prices or inflation; graduated-payment mortgages or step-rate transactions; renewable balloon-payment instruments; and preferred-rate loans. The particular features of these types of loans may trigger interest rate or payment changes over the term of the loan or at the time the consumer pays off the final balance. However, these changes are based on factors other than a change in the value of an index or a formula. Because the enumerated loans are not ARMs they are not covered by proposed § 1026.20(c) and require no disclosures under this section.

Proposed and current § 1026.20(c) are generally consistent with regard to the ARMs to which they do not apply. The principal difference is that current § 1026.20(c) does apply to renewable balloon-payment instruments and preferred-rate loans, even if they are structured as fixed-rate transactions while proposed § 1026.20(c) would not apply to such loans. See § 1026.19(b) and comment 19(b)–5.i.A and B. Also, as discussed above, current § 1026.20(c) does not apply to loans with terms of one year or less. This category includes construction loans, which are excepted from coverage under proposed § 1026.20(c). Logically, the Bureau's proposed exception for initial § 1026.20(c) ARM adjustments if the first payment at the adjusted level is due within 210 days of consummation is inapplicable to the current rule since proposed § 1026.20(d) is not yet implemented to replace the current

§ 1026.20(c) disclosures provided at consummation.

Like proposed comment 20(c)(1)(ii)–3, current comment 20(c)–2 clarifies that § 1026.20(c) does not apply to shared-equity or shared-appreciation mortgages or to price-level adjusted or other such indexed mortgages. The current rule cross-references § 1026.19(b) and applies to all variable-rate transactions covered by that rule. Comment 19(b)–4 explains that graduated-payment mortgages and step-rate transactions without variable-rate features are not subject to § 1026.19(b). Therefore, like the proposed rule, such loans are not subject to current § 1026.20(c).

The current rule does not mention renewable balloon-payment instruments and preferred-rate loans, but current § 1026.20(c) applies to these loan products through the rule's cross-reference to § 1026.19(b) and therefore to comment 19(b)–5.i.A and B. As discussed above, these loans are not adjustable-rate mortgages and the Bureau does not believe that it is appropriate to require the disclosures in proposed § 1026.20(c) for such loans. The particular features of these types of loans may trigger interest rate or payment changes over the term of the loan or at the time the consumer pays off the final balance. However, these changes are based on factors other than a change in the value of an index or a formula. For example, whether or when the interest rate will adjust for a preferred-rate loan with a fixed interest rate is likely not knowable to the creditor, assignee, or servicer 60 to 120 days in advance of the due date for the first payment at a new level after the adjustment. This is because the loss of the preferred rate is based on factors other than a formula or change in the value of an index agreed to at consummation. Like the Bureau's proposed rule, the Board also proposed to remove renewable balloon-payment instruments and preferred-rate loans from coverage under § 1026.20(c) in its 2009 Closed-End Proposal.<sup>61</sup>

#### 20(c)(2) Timing and Content of Rate Adjustment Disclosures

Proposed § 1026.20(c)(2) would require that ARM disclosures be provided to consumers 60 to 120 days before payment at a new level is due. Under current § 1026.20(c), notices must be provided to consumers 25 to 120 days before payment at a new level is due. Thus, the proposed rule would increase the minimum advance notice to consumers from 25 to 60 days before a new payment amount is due. There are

<sup>61</sup> 74 FR 43232, 43264, 43387 (Aug. 26, 2009).

two circumstances under which the rule proposes a different time frame, which are discussed below. Proposed comment 20(c)(2)–1 would replace current comment 20(c)–1 regarding timing.

Current and proposed § 1026.20(c) disclosures provide consumers with their actual new interest rate and payment. The disclosures proposed by § 1026.20(d) likely would provide estimates of these amounts. The longer time frame proposed by the rule is intended to give consumers adequate time to refinance or take other actions based on these exact amounts, if they are not able to make higher payments. The current minimum time of 25 days does not give consumers sufficient time to pursue meaningful alternatives such as refinancing, home sale, loan modification, forbearance, or deed in lieu of foreclosure. In the current market, “it now takes the nation’s biggest mortgage lenders an average of more than 70 days to complete a refinance.”<sup>62</sup> Even if consumers elect not to refinance or pursue other alternatives, the proposed rule would give them more time to adjust their finances to the actual amount of an increase in their mortgage payments.

The Bureau believes that for most adjustable-rate mortgages, the proposed 60-day minimum time frame would provide sufficient time for creditors, assignees, and servicers to comply with the proposed rule. Through outreach to servicers of adjustable-rate mortgages it appears that, for most ARMs, servicers know the index value from which the new interest rate and payment are calculated at least 45 days before the date of the interest rate adjustment. Because interest generally is paid one month in arrears, this means that, for most ARMs, servicers know the index value approximately 75 days before the due date of the first new payment, depending on the number of days in the month during which interest begins accruing at the new rate.

Creditors, assignees, and servicers generally refer to the date the adjusted interest rate goes into effect as the “change date.” The “look-back period” is the number of days prior to the change date on which the index value will be selected which serves as the basis for the new interest rate and payment. In general, interest rate change dates occur on the first of the month to correspond with payment due dates. Thus, the due date for the new payment generally falls on the first of the month following the change date.

Based on outreach conducted by the Bureau, it appears that small servicers

often send out the payment change notices required by § 1026.20(c) on the same day the index value is selected. In that case, for a loan with a 45-day look-back period, the notice is ready 45 days before the change date and, with an approximately 30-day billing cycle between the change date and the date payment at the new level is due, the interest rate adjustment notice can be provided to the consumer approximately 75 days before the new payment is due. Under these circumstances, the servicer could comfortably comply with a rule requiring that notice be provided to consumers 60 days before the payment at a new level is due.

On the other hand, many large creditors, assignees, or servicers conduct what is referred to as a “verification period” before sending out the notices required by § 1026.20(c). This verification period generally takes anywhere from three to ten days and involves confirming the index rate and other quality control measures to insure the notices are correct.<sup>63</sup> In these cases, for a loan with a 45-day look-back period, the payment change notices can be provided between approximately 42 and 35 days prior to the change date, which is either 70 to 73 or 63 to 66 days before the new payment is due, depending on the verification period used and the length of the billing cycle. Under these circumstances, payment change notices could be provided to consumers within the 60-day period, even assuming a verification period of up to thirteen days. For loans with the shortest verification period of three days, the payment change notice could be provided to consumers within 70 days prior to payment due at a new level.

In sum, it appears that for most ARMs, creditors, assignees, or servicers could comply with the 60-day time period proposed by the Bureau. The Bureau solicits comment about this proposed timing of the § 1026.20(c) notice.

Some ARMs have look-back periods shorter than 45 days. For example, ARMs backed by the FHA and VA often have look-back periods of 15 or 30 days. For some ARMs, the calculation date is the first business day of the month that precedes the effective date of the interest rate change. Since the first day of that month may not fall on a business day, the look-back period may be less

than 30 days, excluding any verification period.

In two circumstances, the Bureau is proposing a different time period from the proposed 60 to 120 days. The Bureau proposes that existing ARMs with look-back periods of less than 45 days that were originated before a specified date provide the notices required under this proposed rule within 25 to 120 days before payment at a new level is due. The Bureau proposes that the specified date be July 21, 2013. The Bureau understands that the creditors, assignees, or servicers of such loans would not be able to comply with the 60- to 120-day time frame proposed in § 1026.20(c). Although this time frame would shorten the advance notice provided to some consumers, the Bureau is proposing to grandfather these ARMs in order to prevent altering existing contractual agreements regarding the look-back period. Thus, going forward, ARMs must be structured to permit compliance with the proposed 60- to 120-day time frame. The Bureau solicits comment on whether it should grandfather existing ARMs with look-back periods of less than 45 days. The Bureau also seeks comment on whether July 21, 2013 is an appropriate time frame for grandfathering existing ARMs with look-back periods of less than 45 days or if another time period would be more appropriate and why. If not, the Bureau seeks comment on what would be an appropriate time frame for the expiration of the grandfathering period. The Bureau also solicits comments on whether other adjustable-rate mortgages should be allowed to continue with a 25- to 120-day period.

The Bureau also proposes to alter the timing requirements for ARMs that adjust for the first time within 60 days of consummation where the actual, not estimated, new interest rate was not disclosed at consummation. (If the actual interest rate was disclosed at consummation, such loans would be excepted from the rule pursuant to proposed § 1026.20(c)(1)(ii)). The creditors, assignees, or servicers of such loans would not be able to comply with the proposed 60-day time frame. For such loans, the disclosures proposed by § 1026.20(c) must be provided to consumers as soon as practicable, but not less than 25 days before a payment at a new level is due.

The Bureau solicits comment about the feasibility of applying the proposed 60-day period to ARMs that have look-back period of less than 45 days. The Bureau solicits comments about whether a look-back period of 45 days or longer is feasible going forward for loans that currently use shorter look-

<sup>63</sup> No creditor, assignee, or servicer contacted by the Bureau used a system employing an automatic feed of information from the publisher of an index source. All data was entered and verified manually.

<sup>62</sup> Timiraos & Simon, *supra* note 52.

back periods and, if not, why not. The Bureau solicits comments on the extent, if any, to which the relative length of the look-back period may affect the interest rate risk for the creditor, assignee, or servicer.

For all ARMs, the Bureau solicits comments on the operational changes that would be required to provide § 1026.20(c) notices at least 60 days before payment at a new level is due. Comment is requested on any factors that would hinder compliance with this time frames. In light of technological and other advances since the promulgation of current § 1026.20(c) in 1987, the Bureau also solicits comment on whether, and if so why, lengthy verification periods are necessary and on the feasibility of reducing the length of these verification periods.

#### 20(c)(2)(i) Statement Regarding Changes to Interest Rate and Payment

For interest rate adjustments resulting in corresponding payment changes, proposed § 1026.20(c)(2)(i)(A) would inform consumers that, under the terms of their adjustable-rate mortgage, the specific period in which their interest rate stayed the same will end on a certain date and that their interest rate and mortgage payment will change on that date. This disclosure is similar to the pre-consumption disclosures provided to consumers pursuant to current § 1026.19(b)(2)(i) and § 1026.37(i) as recently proposed by the 2012 TILA-RESPA Proposal.

Under proposed § 1026.20(c)(2)(i)(B), the creditor, assignee, or servicer must include in the disclosure the date of the impending and future interest rate adjustments. Proposed § 1026.20(c)(2)(i)(C) would require disclosure of any other changes to the loan taking place on the same day of the rate adjustment, such as changes in amortization caused by the expiration of interest-only or payment-option features.

The first ARM model form tested did not contain the proposed statement informing consumers of impending and future changes to their interest rate and the basis for these changes. Although participants understood that their interest rate was adjusting and this would affect their payment, they did not understand that these changes would occur periodically subject to the terms of their mortgage contract. Inclusion of this statement in the second round of testing successfully resolved this confusion. All but one consumer tested in round two and three of testing understood that, under the scenario

presented to them, their interest rate would change annually.<sup>64</sup>

#### 20(c)(2)(ii) Table With Current and New Interest Rates and Payments

Proposed § 1026.20(c)(2)(ii) would require disclosure of the following information in the form of a table: (A) The current and new interest rates; (B) the current and new periodic payment amounts and the date the first new payment is due; and (C) for interest-only or negatively-amortizing payments, the amount of the current and new payment allocated to interest, principal, and property taxes and mortgage-related insurance, as applicable. The information in this table would appear within the larger table containing all the required disclosures.

This table would follow the same order as, and have headings and format substantially similar to, those in the table in Forms H-4(D)(1) and (2) in Appendix H of subpart C. The Bureau learned through consumer testing that, when presented with information in a logical order, consumers more easily grasped the complex concepts contained in the proposed § 1026.20(c) notice. For example, the form begins by informing consumers of the basic purpose of the notice: Their interest rate is going to adjust, when it will adjust, and the adjustment will change their mortgage payment. This introduction is immediately followed by a visual illustration of this information in the form of a table comparing consumers' current and new interest rates. Based on consumer testing, the Bureau believes that consumer understanding is enhanced by presenting the information in a simple manner, grouped together by concept, and in a specific order that allows consumers the opportunity to build upon knowledge gained. For these reasons, the Bureau proposes that creditors, assignees, or servicers disclose the information in the table as set forth in Forms H-4(D)(1) and (2) in Appendix H.

Proposed § 1026.20(c)(2)(ii) replaces current § 1026.20(c)(1) and (4), but retains the obligation to disclose the current and new interest rates and the amount of the new payment. Proposed § 1026.20(c)(2)(ii)(A) also would require disclosure of the date when the consumer must start paying the new payment and proposed comment § 1026.20(c)(2)(ii)(A)-1 clarifies that the new interest rate must be the actual rate, not an estimate. Proposed rule § 1026.20(c)(2)(ii) also replaces the language "prior" and "current" in the current rule with the terms "current"

and "new," respectively, and deletes comment 20(c)(2)-1 which, among other things, uses the terms "prior" and "current." This change is designed to make clear that "current" means the interest rate and payment in effect prior to the interest rate adjustment and "new" means the interest rate and payment resulting from the interest rate adjustment.

Proposed comment 20(c)(2)(ii)(A)-1 defines the term "current" interest rate as the one in effect on the date of the disclosure. This more succinct definition replaces the lengthy definition of "prior interest rates" in current comment 20(c)(1) as the interest rate disclosed in the last notice, as well as all other interest rates applied to the transaction in the period since the last notice, or, if there had been no prior adjustment notice, the interest rate applicable at consummation and all other interest rates applied to the transaction in the period since consummation.

In all rounds of testing, consumers were presented with model forms with tables depicting a scenario in which the interest rate and payment would increase as a result of the adjustment. All participants in all rounds of testing understood that their interest rate and payment were going to increase and when these changes would occur.<sup>65</sup>

Current ARM notices are not required to show the allocation of payments among principal, interest, and escrow accounts for any ARM. The Bureau proposes including this information in the table for interest-only and negatively-amortizing ARMs. The Bureau believes this information would help consumers better understand the risk of these products by demonstrating that their payments would not reduce the principal. The Bureau also believes providing the payment allocation would help consumers understand the effect of the interest rate adjustment, especially in the case of a change in the ARM's features coinciding with the interest rate adjustment, such as the expiration of an interest-only or payment-option feature. Since payment allocation may change over time, the proposed rule would require disclosure of the expected payment allocation for the first payment period during which the adjusted interest rate would apply.

The allocation of payment disclosure was tested in the third round of testing. The rate adjustment notice tested showed the following scenario: The first adjustment of a 3/1 hybrid ARM—an ARM with a fixed interest rate for three years followed by annual interest rate

<sup>64</sup> Macro Report, *supra* note 38, at vii.

<sup>65</sup> *Id.*

adjustments—with interest-only payments for the first three years. On the date of the adjustment, the interest-only feature would expire and the ARM would become amortizing. Only about half of participants understood that their payments were changing from interest-only to amortizing. Participants generally understood the concept of allocation of payments but were confused by the table in the notice that broke out principal and interest for the current payment, but combined the two for the new amount. As a result, this table was revised so that separate amounts for principal and interest were shown for all payments.<sup>66</sup>

The Bureau recognizes that certain Dodd-Frank Act amendments to TILA will restrict origination of non-amortizing and negatively-amortizing loans. For example, TILA section 129C and the 2011 ATR (Ability to Repay) Proposal which would implement that provision, generally require creditors to determine that a consumer can repay a mortgage loan and include a requirement that these determinations assume a fully-amortizing loan. Thus, this law and regulation, when finalized, will restrict the origination of risky mortgages such as interest-only and negatively-amortizing ARMs.

Other Dodd-Frank amendments to TILA, such as the proposed periodic statement provisions discussed below, will provide payment allocation information to consumers for each billing cycle. Thus, consumers who currently have interest-only or negatively-amortizing loans or may obtain such loans in the future will receive information about the interest-only or negatively-amortizing features of their loans through the payment allocation information in the periodic statement. Also, as noted above, consumer testing showed that participants were confused by the allocation table. Since the Bureau was not able to test a revised version of the model form to see if it rectified the confusion caused by the allocation table or if the concepts of interest-only and negatively-amortizing ARMs themselves are the source of the confusion, the Bureau is uncertain of the value of disclosing this information to consumers in the ARM interest rate adjustment notice. In view of these changes to the law and the outcome of consumer testing, the Bureau solicits comments on whether to include allocation information for interest-only

and negatively-amortizing ARMs in the table proposed above.

#### 20(c)(2)(iii) Explanation of How the Interest Rate Is Determined

Proposed § 1026.20(c)(2)(iii) would require the ARM disclosures to explain how the interest rate is determined. Consumer testing revealed that consumers generally have difficulty understanding the relationship of the index, margin, and interest rate.<sup>67</sup> Therefore, the Bureau is proposing a relatively brief and simple explanation that the new interest rate is calculated by taking the published index rate and adding a certain number of percentage points, called the “margin.” Proposed § 1026.20(c)(2)(iii) would also require disclosure of the specific amount of the margin.

The proposed explanation of how the consumer's new interest rate is determined, such as adjustment of the index by the addition of a margin, mirrors the pre-consummation disclosure required around the time of application by current § 1026.19(b)(2)(iii) and TILA section 128A requirements for initial interest rate disclosures. It also parallels the pre-consummation disclosure of the index and margin proposed in the 2012 TILA-RESPA Proposal. Proposed § 1026.20(c) also would require disclosure of the name and published source of the index or formula, as required in other disclosures by § 1026.19(b)(2)(ii) and TILA section 128A.

The proposed rule would replace the current § 1026.20(c)(2) required disclosure of the index values upon which the “current” and “prior” interest rates are based. The Bureau believes that providing consumers with index values is less valuable than providing them with their actual interest rates. Current comment 20(c)(2)–1, which addresses the requirement to disclose current and prior interest rate, would also be deleted.

Consumer testing indicated that the explanation helped consumers better understand the relationship between interest rate, index, and margin. It also helped dispel the notion held by many consumers in the initial rounds of testing that lenders subjectively determined their new interest rate at each adjustment.<sup>68</sup> The Bureau believes that its proposed rule and forms strike an appropriate balance between providing consumers with key information necessary to understand the basic interest rate adjustment of their

adjustable-rate mortgages without overloading consumers with complex and confusing technical information.

#### 20(c)(2)(iv) Rate Limits and Unapplied Carryover Interest

Proposed § 1026.20(c)(2)(iv) would require the disclosure of any limits on the interest rate or payment increases at each adjustment and over the life of the loan. It also would require disclosure of the extent to which the creditor has foregone any increase in the interest rate due to a limit, called unapplied carryover interest. Disclosure of rate limits is not required by the current rule. The Bureau believes that knowing the limitations of their ARM rates and payments would help consumers understand the consequences of interest rate adjustments and weigh the relative benefits of pursuing alternatives. For example, if an adjustment causes a significant increase in the consumer's payment, knowing how much more the interest rate or payment could increase could help inform a consumer's decision on whether or not to seek alternative financing.

Both proposed § 1026.20(c)(2)(iv) and current § 1026.20(c)(3) require disclosure of any foregone interest rate increase. Unlike the current rule, the proposed rule would require an explanation in the ARM payment change notice that the additional interest was not applied due to a rate limit and provide the earliest date such foregone interest may be applied.

Proposed comment 20(c)(2)(iv)–1 regarding unapplied interest closely parallels, and would replace, current comment 20(c)(3)–1. The proposed comment explains that disclosure of foregone interest would apply only to transactions permitting interest rate carryover. It further explains that the amount of the interest increase foregone is the amount that, subject to rate caps, can be added to future interest rate adjustments to increase, or offset decreases in, the rate determined according to the index or formula.

Consumers had difficulty understanding the concept of interest rate carryover when it was introduced during the third round of testing. This difficulty may have been due to the simultaneous introduction of other complex notions, such as interest-only or negatively-amortizing features and the allocation of interest, principal, and escrow payments for such loans. In response, the Bureau has simplified the explanation of carryover interest.<sup>69</sup>

The Bureau recognizes that the disclosure of rate limits and unapplied

<sup>66</sup> *Id.* at vii–viii. This revision to the allocation disclosure, which is identical in the proposed § 1026.20(c) and (d) notices, was made after the third round of testing of the § 1026.20(d) notice, and therefore was not tested with consumers.

<sup>67</sup> *Id.* at viii.

<sup>68</sup> *Id.*

<sup>69</sup> *Id.* at viii–ix.

carryover interest provide information that may help consumers better understand their ARMs. However, the Bureau is considering whether the help this information may provide outweighs its distraction from other more key information. Also, as explained above, consumers had difficulty understanding the concept of carryover interest and the Bureau does not want this difficulty to diminish the effectiveness of the proposed § 1026.20(c) disclosures. The Bureau solicits comment on whether to include rate limits and unapplied carryover interest in the proposed § 1026.20(c) disclosures.

#### 20(c)(2)(v) Explanation of How the New Payment Is Determined

Proposed § 1026.20(c)(2)(v) would require ARM disclosures to explain how the new payment is determined, including (A) the index or formula, (B) any adjustment to the index or formula, such as by addition of the margin or application of previously foregone interest, (C) the loan balance, and (D) the length of the remaining loan term. This explanation is consistent with the disclosures provided at the time of application pursuant to § 1026.19(b)(2)(iii). It is also consistent with the TILA section 128A requirement to disclose the assumptions upon which the new payment is based, which the Bureau proposes to implement in proposed § 1026.20(d), and thus promotes consistency among Regulation Z ARM disclosures.

The current rule, as explained in comment 20(c)(4)–1, which the proposed rule would delete, requires disclosure of the contractual effects of the adjustment. This includes the payment due after the adjustment is made and whether the payment has been adjusted. The proposed rule would require disclosure of this information as well as the name of the index and any specific adjustment to the index, such as the addition of a margin or an adjustment due to carryover interest. Proposed comment 20(c)(2)(v)(B)–1 explains that a disclosure regarding the application of previously foregone interest is required only for transactions permitting interest rate carryover. The proposed comment further explains that foregone interest is any percentage added or carried over to the interest rate because a rate cap prevented the increase at an earlier adjustment. As discussed above, the Bureau found that this explanation helped consumers better understand how the index or formula and margin determine their new payment and dispelled the notion held by many consumers in the initial rounds of testing that the lender

subjectively determined their new interest rate, and thus the new payment, at each adjustment.

The proposal would require disclosure of both the loan balance and the remaining loan term expected on the date of the interest rate adjustment. The current rule requires disclosure of the loan balance but not the remaining loan term. The date on which the balance is taken differs slightly in proposed § 1026.20(c) from the current rule. Current comment 20(c)(4)–1 explains that the balance disclosed is the one that serves as the basis for calculating the new adjusted payment while the Bureau proposes disclosure of a more current balance, *i.e.*, the one expected on the date of the adjustment. Both the proposed rule and the current rule, as explained in current comment 20(c)(4)–1, provide for disclosure of any change in the term or maturity of the loan caused by the adjustment.

Disclosure of the four key assumptions upon which the new payment is based provides a succinct overview of how the interest rate adjustment works. It also demonstrates that factors other than the index can increase consumers' interest rates and payments. Disclosures of these factors would provide consumers with a snapshot of the current status of their adjustable-rate mortgages and with basic information to help them make decisions about keeping their current loan or shopping for alternatives.

Current comment 20(c)(4)–1 requires disclosure of certain information related to loans that are not fully amortizing. Disclosure of similar information is proposed in § 1026.20(c)(2)(vi), discussed below.

#### 20(c)(2)(vi) Interest-Only and Negative-Amortization Statement and Payment

Proposed § 1026.20(c)(2)(vi) would require § 1026.20(c) notices to include a statement regarding the allocation of payments to principal and interest for interest-only or negatively-amortizing loans. If negative amortization occurs as a result of the interest rate adjustment, the proposed rule would require disclosure of the payment necessary to fully amortize such loans at the new interest rate over the remainder of the loan term. As explained in proposed comment 20(c)(2)(vi)–1, for interest-only loans, the statement would inform the consumer that the new payment covers all of the interest but none of the principal owed and, therefore, will not reduce the loan balance. For negatively-amortizing ARMs, the statement would inform the consumer that the new payment covers only part of the interest and none of the principal, and therefore

the unpaid interest will add to the balance or increase the term of the loan. The current rule, clarified by current comment 20(c)(5)–1, requires disclosure of the payment necessary to fully amortize loans that become negatively-amortizing as a result of the adjustment but does not require the statement regarding amortization. Proposed § 1026.20(c)(2)(vi) and proposed comments 20(c)(2)(vi)–1 and 20(c)(2)(vi)–2 would replace the current rule and current comment 20(c)(5)–1.

Both current § 1026.20(c) and the Board's 2009 Closed-End Proposal to revise § 1026.20(c) include, for ARMs that become negatively amortizing as a result of the interest rate adjustment, disclosure of the payment necessary to fully amortize those loans at the new interest rate over the remainder of the loan term. However, the Bureau believes there are countervailing considerations regarding whether to include this information in proposed § 1026.20(c).

The Bureau recognizes that certain Dodd-Frank Act amendments to TILA will restrict origination of non-amortizing and negatively-amortizing loans. For example, TILA section 129C and the 2011 ATR Proposal that would implement that provision, generally require creditors to determine that a consumer can repay a mortgage loan and include a requirement that these determinations assume a fully-amortizing loan. Thus, this law and regulation, when finalized, will restrict the origination of risky mortgages such as interest-only and negatively-amortizing ARMs.

Other Dodd-Frank amendments to TILA, such as the periodic statement proposed by § 1026.41, will include information about non-amortizing and negatively-amortizing loans in each billing cycle, such as an allocation of payments. Thus, consumers who currently have interest-only and negatively-amortizing ARMs or may obtain such loans in the future will receive certain information about the interest-only or negatively-amortizing features of their loans in another disclosure, although this will not include the payment required to fully amortize negatively-amortizing loans. Disclosure of the payment necessary to fully amortize negatively-amortizing loans was not consumer tested but testing of the table showing the payment allocation of interest-only and negatively-amortizing ARMs indicated that consumers were confused by the concept of amortization. Thus, the Bureau is weighing the value of disclosing specific information regarding amortization, such as the payment needed to fully amortize

negatively-amortizing ARMs. In view of these changes to the law and the outcome of consumer testing, the Bureau solicits comments on whether to include the payment required to amortize ARMs that became negatively amortizing as a result of an interest rate adjustment.

#### 20(c)(2)(vii) Prepayment Penalty

Proposed § 1026.20(c)(2)(vii) would require disclosure of the circumstances under which any prepayment penalty may be imposed, such as selling or refinancing the principal residence, the time period during which such penalty would apply, and the maximum dollar amount of the penalty. The current rule does not have this requirement. The proposed rule cross-references the definition of prepayment penalty in subpart E, § 1026.41(d)(7)(iv), in the proposed rule for periodic statements.

Interest rate adjustments may cause payment shock or require consumers to pay their mortgage at a rate they may no longer be able to afford, prompting them to consider alternatives such as refinancing. In order to fully understand the implications of such actions, the Bureau believes that consumers should know whether prepayment penalties may apply. Such information should include the maximum penalty in dollars that may apply and the time period during which the penalty may be imposed. The dollar amount of the penalty, as opposed to a percentage, is more meaningful to consumers.

The Bureau also proposes disclosure of any prepayment penalty in § 1026.20(d) ARM rate adjustment notices and in the periodic statements proposed by § 1026.41. Consumer testing of the periodic statement included a scenario in which a prepayment penalty applied. Most participants understood that a prepayment penalty applied if they paid off the balance of their loan early, but some participants were unclear whether it applied to the sale of the home, refinancing, or other alternative actions consumers could pursue in lieu of maintaining their adjustable-rate mortgages.<sup>70</sup> For this reason, the Bureau proposes to clarify the circumstances under which a prepayment penalty would apply. The proposed forms would alert consumers that a prepayment penalty may apply if they pay off their loan, refinance, or sell their home before the stated date.

The Bureau recognizes that Dodd-Frank Act amendments to TILA, such as 129C and the 2011 ATR Proposal that would implement that provision, would

significantly restrict a lender's ability to impose prepayment penalties. Other Dodd-Frank amendments to TILA, such as the proposed periodic statement, would provide consumers with information about their prepayment penalties for each billing cycle. Thus, consumers who currently have ARMs with prepayment penalty provisions or may obtain such loans in the future would generally receive information about them at frequent intervals in another disclosure. In view of these changes to the law, the Bureau solicits comments on whether to include information regarding prepayment penalties in proposed § 1026.20(c).

#### 20(c)(3) Format of Disclosures

As discussed above, the Bureau proposes to make § 1026.20(c) subject to certain of the § 1026.17(a)(1) form requirement to which § 1026.20(c) disclosures are currently not subject. These requirements include grouping the disclosures together, segregating them from everything else, and prohibiting inclusion of any information not directly related to the § 1026.20(c) disclosures.<sup>71</sup> As discussed above in connection with Section 17(a)(1), this revises the current rule but the Bureau believes the revision is necessary to effectively highlight information for consumers about changes to their ARM interest rates and payments.

##### 20(c)(3)(i) All Disclosures in Tabular Form

Proposed § 1026.20(c)(3)(i) would require that the ARM adjustment disclosures be provided in the form of a table and in the same order as, and with headings and format substantially similar to, Forms H-4(D)(1) and (2) in Appendix H to subpart C for interest rate adjustments resulting in a corresponding payment change.

The proposed ARM adjustment notice contains complex concepts challenging for consumers to understand. For example, consumer testing revealed that participants generally had difficulty understanding the relationship among index, margin, and interest rate.<sup>72</sup> They also had difficulty with the concepts of amortization and interest rate carryover.<sup>73</sup> As a starting point, the Bureau looked at the model forms developed by the Board for its 2009 Closed-End Proposal to amend

§ 1026.20(c). The Bureau then conducted its own consumer testing.

The Bureau's testing showed that consumers can more readily understand these concepts when the information is presented to them in a simple manner and in the groupings contained in the model forms. The Bureau also observed that consumers more readily understood the concepts when they were presented in a logical order, with one concept presented as a foundation to understanding other concepts. For example, the form begins by informing consumers of the purpose of the notice: That their interest rate is going to adjust, when it will adjust, and that the adjustment will change their mortgage payment. This introduction is immediately followed by a table visually showing consumers' current and new interest rates. In another example, the proposed notice informs consumers about their index rate and margin before explaining how the new payment is calculated based on those factors, as well as other factors such as the loan balance and remaining loan term.

Based on consumer testing, the Bureau believes that consumer understanding is enhanced by presenting the information in a simple manner, grouped together by concept, and in a specific order that allows consumers the opportunity to build upon knowledge gained. For these reasons, the Bureau proposes that creditors, assignees, or servicers disclose the information required by proposed § 1026.20(c) with headings, content, and format substantially similar to Forms H-4(D)(1) and (2) in Appendix H to this part.

Over the course of consumer testing, participant comprehension improved with each successive iteration of the model form. As a result, the Bureau believes that displaying the information in tabular form focuses consumer attention and lends to greater understanding. Similarly, the Bureau found that the particular content and order of the information, as well as the specific headings and format used, presented the information in a way that consumers both could understand and from which they could benefit.

##### 20(c)(3)(ii) Format of Interest Rate and Payment Table

Proposed § 1026.20(c)(3)(ii) would require tabular format for ARM payment change notices of: The current and new interest rates, the current and new payments, and the date the first new payment is due. For interest-only and negatively-amortizing ARMs, the table would also include the allocation of

<sup>71</sup> Other § 1026.17(a)(1) form requirements that currently apply to § 1026.20(c) would continue to apply, such as the option of providing the disclosures to consumers in electronic form, subject to compliance with consumer consent and other applicable provisions of the E-Sign Act.

<sup>72</sup> Macro Report, *supra* note 38, at viii.

<sup>73</sup> *Id.* at viii-ix.

<sup>70</sup> *Id.* at vi.

payments. This table would be located within the table proposed by § 1026.20(c)(3)(i). This table is substantially similar to the one tested by the Board for its 2009 Closed-End Proposal to revise § 1026.20(c). The proposal would require the table to follow the same order as, and have headings, content, and format substantially similar to, Forms H-4(D)(1) and (2) in Appendix H of subpart C.

Disclosing the current interest rate and payment in the same table allows consumers to readily compare those rates with the adjusted rate and new payment. Consumer testing revealed that nearly all participants were readily able to identify the table and understand the content.<sup>74</sup> The new interest rate and payment and date the first new payment is due is key information the consumer must know in order to commence payment at the new rate. For these reasons, the Bureau proposes locating this information prominently in the disclosure.

#### 20(d) Initial Rate Adjustments

*Elimination of current § 1026.20(d).* Current § 1026.20(d) permits creditors to substitute information provided in accordance with variable-rate subsequent disclosure regulations of other Federal agencies for the disclosures required by § 1026.20(c). In the 2009 Closed-End Proposal, the Board proposed amending the regulation that is now § 1026.20, including deleting the provision that is current § 1026.20(d). The Board stated that, as of August 2009, there were “[n]o comprehensive disclosure requirements for variable-rate mortgage transactions \* \* \* in effect under the regulations of the other Federal financial institution supervisory agencies.”<sup>75</sup> The Board explained that when it originally adopted the provision in 1987, as footnote 45c of § 226.20(c) of Regulation Z,<sup>76</sup> the regulations of other financial institution supervisory agencies—namely the OCC, the Federal Home Loan Bank Board (the FHLBB), and HUD—contained subsequent disclosure requirements for ARMs.<sup>77</sup>

The Bureau proposes deleting the current content of § 1026.20(d) because it is not aware of any other Federal

financial institution supervisory agency rules requiring comprehensive disclosure requirements for ARMs. The Bureau solicits comment on whether there is any reason to retain this provision. The Bureau solicits comments, for example, on whether this proposed regulatory change would have implications for rights under the Alternative Mortgage Transaction Parity Act. For the reasons discussed above with respect to proposed § 1026.20(c), the Bureau proposes this deletion pursuant to its authority under TILA sections 105(a) and 128(f)(1)(H) and DFA section 1405(b).

*New initial ARM interest rate adjustment disclosures.* In the section that would be left vacant by the proposed deletion of § 1026.20(d), the Bureau proposes to implement the initial ARM adjustment notice mandated by TILA section 128A. Proposed § 1026.20(d) would require disclosure to consumers with certain adjustable-rate mortgages, approximately six months prior to the initial interest rate adjustment, of key information about the upcoming adjustment, including the new rate and payment and options for pursuing alternatives to their adjustable-rate mortgage. This initial ARM adjustment notice would harmonize with the ARM payment change notice that would be required under the proposed revisions to § 1026.20(c). The Bureau believes that promoting consistency between the ARM disclosure provisions of proposed § 1026.20(c) and (d) would reduce compliance burdens on industry and minimize consumer confusion.

*Form of delivery.* As required under TILA section 128A(b), proposed § 1026.20(d) would require that the initial ARM interest rate adjustment notices be provided to consumers in writing, separate and distinct from all other correspondence. Proposed comment 20(d)–2 explains that to satisfy this requirement, the notices must be mailed or delivered separately from any other material. For example, in the case of mailing the disclosure, there should be no material in the envelope other than the initial interest rate adjustment notice. In the case of emailing the disclosure, the only attachment should be the initial interest rate adjustment notice. This requirement contrasts with proposed § 1026.20(c), which would be subject to the less stringent segregation requirements of § 1026.17(a)(1), as amended by the Bureau’s proposal. The proposed comment further explains that the notices proposed by § 1026.20(d) may be provided to consumers in electronic form with consumer consent, pursuant to the requirements of

§ 1026.17(a)(1). The Bureau solicits comments on whether consumer protection would be compromised by providing § 1026.20(d) notices on a separate piece of paper but in the same envelope or as email correspondence with other messages from the creditor, assignee, or servicer.

*Creditors, assignees, and servicers.* Proposed § 1026.20(d) applies to creditors, assignees, and servicers. Proposed comment 20(d)–1 clarifies that a creditor, assignee, or servicer that no longer owns the mortgage loan or the mortgage servicing rights is not subject to the requirements of § 1026.20(c). This proposed language tracks, in part, the requirements of TILA section 128A that creditors and servicers must provide the initial ARM interest rate adjustment notices, but adds assignees to the list of covered persons. The Bureau believes that holding creditors, but not assignees, liable under the regulation would result in inconsistent levels of consumer protection and an unlevel playing field for owners of mortgages.

It is a common practice for creditors to sell many or all of the loans they originate rather than hold them in portfolio. If the creditor were to sell the ARM, the consumer would have no recourse against the subsequent holder for violations of § 1026.20(d) if assignees were not made subject to § 1026.20(d). Shielding assignees from liability under the proposed rule would have particularly deleterious effects on consumers seeking relief against a servicer to whom an assignee sold the ARM’s mortgage servicing rights, if that servicer had insufficient resources to satisfy a judgment the consumer may obtain for violations of § 1026.20(d). Consumers who happen to have ARMs sold by the original creditor to a subsequent holder would have less protection under the regulation than consumers with ARMs that are retained in portfolio by the creditor originating the loan. It also would create an unfair advantage for assignees. The Bureau believes that the protections afforded under proposed § 1026.20(d) should not be determined by the happenstance of loan ownership or favor one sector of the mortgage market over another. For these reasons, the Bureau proposes to make assignees, along with creditors and servicers, subject to the requirements of § 1026.20(d).

Proposed comment 20(d)–1 explains that any provision of subpart C that applies to the disclosures required by § 1026.20(d) also applies to creditors, assignees, and servicers. This is the case even where the other provisions of subpart C refer only to creditors. For the reasons discussed above, the Bureau

<sup>74</sup> *Id.* at vii.

<sup>75</sup> 74 FR 43232, 43272 (Aug. 26, 2009).

<sup>76</sup> Regulation Z was previously implemented by the Board at 12 CFR 226. In light of the general transfer of the Board’s rulemaking authority for TILA to the Bureau, the Bureau adopted an interim final rule recodifying the Board’s Regulation Z at 12 CFR 1026.

<sup>77</sup> 74 FR 43232, 43273 (citing 52 FR 48665, 48671 (Dec. 24, 1987)).

proposes that the requirements of other regulations that apply to the § 1026.20(d) initial ARM interest rate adjustment notices apply to assignees as well as to creditors and servicers.

The extension of the requirement to assignees is authorized under TILA section 105(a) because, for the reasons discussed above, it is necessary and proper to effectuate the purposes of TILA, including to assure a meaningful disclosure of credit terms and protect the consumer against unfair credit billing practices, and to prevent circumvention or evasion of TILA. The Bureau also proposes to use its authority under DFA section 1405(b) to extend the applicability of the initial ARM adjustment notices under TILA section 128A to assignees. As discussed above, this extension would serve the interest of consumers and the public interest. Application of proposed § 1026.20(d) to assignees is consistent with current § 1026.20(c) commentary applying that disclosure requirement to subsequent holders. Application of proposed § 1026.20(d) to creditors, assignees, and servicers also promotes consistency with proposed § 1026.20(c) and the periodic statement proposed by § 1026.41, which also apply to creditors, assignees, and servicers.

**Timing.** Proposed § 1026.20(d) generally follows the statutory requirement in TILA section 128A that the initial interest rate adjustment notice must be provided to consumers during the one-month period that ends six months before the date on which the interest rate in effect during the introductory period ends. Thus, the disclosure must be provided six to seven months before the initial interest rate adjustment. The § 1026.20(d) disclosures are designed to avoid payment shock so as to put consumers on notice of upcoming changes to their adjustable-rate mortgages that may result in higher payments. The six to seven month advance notice allows sufficient time for consumers to consider their alternatives if the notice discloses an increase in payment that they cannot afford. One alternative consumers might consider is refinancing their home. In the current market, “it now takes the nation’s biggest mortgage lenders an average of more than 70 days to complete a refinance.” \* \* \* <sup>78</sup>

In the interest of consistency within Regulation Z, proposed § 1026.20(d) ties its timing requirement to the date the first payment at a new level is due rather than the date of the interest rate adjustment. This is consistent with the time frame for both current and

proposed § 1026.20(c). Since interest generally is paid in arrears, for most ARMs, this adds another approximately 30 days to the time frame for delivery of the disclosures. Thus, the notices proposed by § 1026.20(d) must be provided to consumers seven to eight months in advance of payment at the adjusted rate. Measured in days, the initial interest rate adjustment disclosures are due at least 210, but not more than 240, days before the first payment at the adjusted level is due. By tying the timing of the disclosure to the date payment at a new level is due and calculating it in days rather than months, proposed § 1026.20(d) is more precise, since months can vary in length, and maintains consistency with the timing requirements of proposed § 1026.20(c).

Pursuant to TILA section 128A, for ARMs adjusting for the first time within six months after consummation, the proposed § 1026.20(d) initial interest rate adjustment notices must be provided at consummation. The proposed rule states that when this occurs, the disclosure must be provided 210 days before the first date payment at a new level is due. The proposed rule ties the timing of this requirement to days rather than months, thereby ensuring both internal consistency and consistency with § 1026.20(c).

Proposed comment 20(d)–2 explains that the timing requirements exclude any grace period. It also explains that the date the first payment at the adjusted level is due is the same as the due date of the first payment calculated using the adjusted interest rate.

**SBREFA.** The small entity representatives (SERs) that advised the SBREFA panel on the mortgage servicing rules under consideration by the Bureau expressed doubt as to the value of the § 1026.20(d) notices because providing the notices so many months in advance of the interest rate adjustment would require disclosure of an estimated, rather than the actual, interest rate and payment due.<sup>79</sup> Several SERS expressed concern that the estimates would confuse consumers. They also noted that, in addition to the requirement to provide initial interest rate adjustment notices under § 1026.20(d), servicers would remain obliged to also provide a later notice in the case of a payment change, pursuant to § 1026.20(c), for the initial rate adjustments in order to apprise consumers of the actual amount of their interest rate and payment resulting from the adjustment. They expressed

concerns about the one-time development costs and on-going costs associated with providing both the initial ARM adjustment notices and the recurring notices under § 1026.20(c).<sup>80</sup>

Consistent with this recommendation, after conclusion of the SBREFA process, the Bureau conducted further policy analysis of a possible exemption for small creditors, assignees, and servicers. After additional consideration, however, the Bureau decided to propose that notices under both § 1026.20(c) and § 1026.20(d) be provided. The Bureau believes that the two notices serve related but distinct purposes, such that eliminating the § 1026.20(c) notice could harm consumers. In particular, the § 1026.20(d) notice is designed to provide consumers with very early warning that their rates are about to change, so that consumers can begin exploring other options. If the consumer chooses not to do so or has not completed that process, a notice closer to the adjustment date that reflects the actual rather than estimated change in payment is still valuable to the consumer as both a second warning and budgeting tool. While the ARM interest rate adjustment information proposed for the first payment change notice required by proposed § 1026.20(c) could be provided in the periodic statement that would be provided to consumers under proposed § 1026.41, discussed below, rather than as a standalone notice under § 1026.20(c), the Bureau notes that that might require greater programming complexity in connection with the periodic statements. In addition, the Bureau is proposing to exempt certain small servicers from the periodic statement requirement.

The Bureau also believes that the amount of burden reduction for servicers from an exemption from providing a § 1026.20(c) notice in connection with an initial interest rate adjustment would be extremely minimal, given that servicers would have to maintain systems to generate § 1026.20(c) notices for each subsequent interest rate adjustment resulting in a corresponding payment change. Thus, excepting small servicers from providing the first § 1026.20(c) notice would not provide a significant reduction in burden.

The Bureau also considered whether to except small servicers, creditors, and assignees from the initial ARM interest rate notice required by § 1026.20(d). The SERs expressed concern that consumers would be confused by receiving estimates, rather than their actual new interest rate and payment, in the

<sup>78</sup> Timiraos & Simon, *supra* note 52.

<sup>79</sup> See SBREFA Final Report, *supra* note 22, at 20–21, 29–30.

<sup>80</sup> *Id.*

§ 1026.20(d) notice.<sup>81</sup> However, the Bureau believes the best approach to address this concern is to clarify the contents of the notice, rather than eliminate it entirely. Congress has made a specific policy judgment that an early notice has value to consumers. Creating an exemption for small creditors, assignees, and servicers would deprive certain consumers of the benefits that Congress intended, specifically advance notice seven to eight months before payment at a new level is due after the initial interest rate adjustment to allow consumers time to weigh the potential impacts of a rate change and to explore alternative actions. An exception would also deprive certain consumers of the information provided in the § 1026.20(d) notice about alternatives and how to contact their State housing finance authority and access a list of government-certified counseling agencies and programs.

On balance, the Bureau does not believe that the § 1026.20(d) notice imposes a significant burden on small entities because it is a one-time notice. Moreover, the notice is designed to be consistent with the § 1026.20(c) notice in order to, among other things, reduce the burden on industry. For these reasons, the Bureau proposes generally to require all creditors, assignees, and servicers to provide the ARM interest rate adjustment notices required by proposed § 1026.20(c) and (d). However, the Bureau seeks comment on the issues raised by the two sets of disclosures, particularly whether the burden imposed on small entities by the requirements of § 1026.20(d) outweighs the consumer protection benefits afforded by the early notice of the initial ARM interest rate adjustment.

The Bureau also solicits comment on whether small servicers (or creditors, assignees, and servicers in general) that provide a periodic statement to a consumer with an ARM should be permitted or required to provide the information required by § 1026.20(c), for an initial interest rate adjustment for which a notice under § 1026.20(d) is required, in a periodic statement provided to consumers 60 to 120 days before payment at a new level is due. The Bureau further solicits comment on whether to permit or require all § 1026.20(c) notices required by the proposed rule to be incorporated into periodic statements in lieu of providing a separate notice.

*Conversions.* Proposed comment 20(d)–3 explains that in the case of an open-end account converting to a closed-end adjustable-rate mortgage,

§ 1026.20(d) disclosures are not required until the implementation of the initial interest rate adjustment post-conversion. Under the proposed rule, the conversion is analogous to consummation. Thus, like other ARMs subject to the requirements of proposed § 1026.20(d), disclosures for these converted ARMs would not be required until the first interest rate adjustment following the conversion. This proposal is consistent with the § 1026.20(c) proposal for open-end accounts converting to closed-end adjustable-rate mortgages.

#### 20(d)(1) Coverage of the Initial Rate Adjustment Disclosures

##### 20(d)(1)(i) In General

Proposed § 1026.20(d)(1)(i) defines an adjustable-rate mortgage or ARM as a closed-end consumer credit transaction secured by the consumer's principal dwelling in which the annual percentage rate may increase after consummation. The proposed rule uses the wording from the definitions of “adjustable-rate” and “variable-rate” mortgage in subpart C of Regulation Z. It does this to promote consistency within the regulation. Proposed comment 20(d)(1)(i)–1 explains that the definition of ARM means variable-rate mortgage as that term is used elsewhere in subpart C of Regulation Z, except as provided in proposed comment 20(d)(1)(ii)–2.

*Applicability to closed-end transactions.* The Bureau believes that TILA section 128A and the implementing disclosures in proposed 1026.20(d) primarily benefit consumers with closed-end adjustable-rate mortgages. In contrast, open-end credit transactions secured by a consumer's dwelling (home equity plans) with adjustable-rate features are subject to distinct disclosure requirements under TILA and subpart B of Regulation Z that substitute for the proposed § 1026.20(c) and (d) disclosures. Therefore, as discussed below, the Bureau proposes to use its authority under TILA section 105(a) and (f) to exempt adjustable-rate home equity plans from the requirements of proposed § 1026.20(d).

Section 127A of TILA and § 1026.40(b) and (d) of Regulation Z require the disclosure of specific information about home equity plans at the time an application is provided to the consumer. These disclosures include specific information about variable or adjustable-rate plans, including, among other things, the fact that the plan has a variable or adjustable-rate feature, the index used in making adjustments and a source of

information about the index, an explanation of how the index is adjusted such as by the addition of a margin, and information about frequency of and limitations to changes to the applicable rate, payment amount, and index. See § 1026.40(d)(12). The required account opening disclosures for home equity plans also must include information about any variable or adjustable-rate feature, including the circumstances under which rates may increase, limitations on the increase, and the effect of any increase. See § 1026.6(a)(1)(ii) and (3)(vii).

Thus, Regulation Z already contains a comprehensive scheme for disclosing to consumers the variable or adjustable-rate features of home equity plans. The Bureau believes that requiring servicers to provide information about the index and an explanation of how the interest rate and payment would be determined, as required by TILA section 128A and proposed by § 1026.20(d), in connection with home equity plans would be inconsistent with, and largely duplicative of, the current disclosure regime and would be confusing and unhelpful for consumers. Moreover, unlike closed-end adjustable-rate mortgages, consumers with home equity plans generally may draw from the adjustable-rate feature on the account at any time. Thus, providing the good faith estimate of the amount of the monthly payment that would apply after the interest rate adjustment, as required by TILA section 128A and proposed by § 1026.20(d), would not be useful because the estimate would be based on the outstanding loan balance at the time the notice is given, which would change after the notice is given anytime the consumer withdraws funds. Finally, the alerts to consumers required by TILA section 128A and proposed by § 1026.20(d) would not provide a benefit to consumers with home equity plans with adjustable-rate features. Generally, introductory periods for adjustable-rate features on home equity plans tend to last less than six months. The Bureau believes it is unlikely consumers would consider pursuing alternatives so close in time to opening their home equity plans.

Two other factors also support the Bureau's use of the TILA section 105(a) exemption authority to exclude home equity plans from the requirements of proposed § 1026.20(d). First, use of the term “consummation” in TILA section 128A supports the application of proposed § 1026.20(d) only to closed-end transactions. Regulation Z generally requires disclosures for closed-end credit transactions to be provided “before consummation of the

<sup>81</sup> *Id.* at 21.

transaction.” By contrast, Regulation Z generally requires account opening disclosures for open-end credit transactions to be provided “before the first transaction is made under the plan.” See § 1026.17(b) and § 1026.5(b)(1)(i). Because Regulation Z uses the term “consummation” in connection with closed-end credit transactions, use of the word “consummation” in DFA section 1418 supports the Bureau’s proposed exemption for open-end home equity plans from the requirements of § 1026.20(d). Second, DFA section 1418 is codified in TILA section 128A. The adjacent and similarly numbered provision, TILA section 128, is entitled and applies only to “Consumer Credit not under Open End Credit Plans.” Congress’s placement of the new ARM disclosure requirement in a segment of TILA that applies only to closed-end credit transactions further supports the Bureau’s decision to exempt open-end credit transactions, in this case variable or adjustable-rate home equity plans, from the requirements of that section.

For the reasons discussed above, exempting home equity plans from the requirements of § 1026.20(d) is necessary and proper under TILA section 105(a) to further the consumer protection purposes of TILA and facilitate compliance. As discussed above, the Bureau believes that the information contained in the notice proposed by § 1026.20(d) would not be meaningful to consumers with home equity plans that have adjustable-rate features and could lead to information overload and confusion for those consumers. The Bureau further proposes the exemption for open-end transactions pursuant to its authority under TILA section 105(f). As discussed above, because open-end transactions are subject to their own regulatory scheme, are not structured in such a way as to garner benefit from the disclosures proposed by § 1026.20(d), and the placement of 128A in TILA indicates congressional intent to limit its coverage to closed-end transactions, the Bureau believes, in light of the factors in TILA section 105(f)(2), that requiring the proposed § 1026.20(d) notice for open-end accounts that have adjustable-rate features would not provide a meaningful benefit to consumers. Specifically, the Bureau considers that the exemption is proper irrespective of the amount of the loan or the status of the borrower (including related financial arrangements, financial sophistication, and the importance to the borrower of the loan). The Bureau further notes, in light of TILA section

105(f)(2)(D), that the requirements in § 1026.20(d) would only apply to loans secured by the consumer’s principal dwelling.

*Savings Clause.* Regarding other categories of loans to which proposed § 1026.20(d) would apply, the statute’s provisions apply to hybrid ARMs, which it defines as “consumer credit transaction[s] secured by the consumer’s principal residence with a fixed interest rate for an introductory period that adjusts or resets to a variable interest rate after such period.”<sup>82</sup> The statute, however, has a “savings clause,” that allows the Bureau to require the initial interest rate adjustment notice for loans that are not hybrid ARMs. The Bureau proposes to use this authority generally to extend the disclosure requirements of proposed § 1026.20(d) to ARMs that are not hybrid. The Bureau believes this approach is necessary because both hybrid ARMs and those that are not hybrid may subject consumers to the same payment shock that the advance notice of the first interest rate adjustment is designed to address. For example, both 3/1 hybrid ARMs, where the initial interest rate is fixed for three years and then adjusts every year after that, and 3/3 ARMs, where the initial interest rate adjusts after three years and then every three years after that, adjust for the first time after three years and present the same potential payment shock to consumers holding either mortgage. The same is true for 5/1 hybrid ARMs and 5/5 ARMs, 7/1 hybrid ARMs and 7/7 ARMs, 10/1 hybrid ARMs and 10/10 ARMs, etc. In sum, conventional ARMs and hybrid ARMs can have the same initial periods without an interest rate adjustment and thus, the same potential jump in their interest rates at the time of the first interest rate adjustment.

Proposed comment 20(d)(1)(i)–1 clarifies that the initial ARM adjustment notice are not limited to transactions financing the initial acquisition of the consumer’s principal dwelling but also would apply to other closed-end ARM transactions secured by the consumer’s principal dwelling, consistent with current comment 19(b)–1 and proposed § 1026.20(c).

#### 20(d)(1)(ii) Exceptions

Proposed § 1026.20(d)(1)(ii) excepts construction loans with terms of one

<sup>82</sup> TILA section 128A. For example, a 3/1 hybrid ARM has a three-year introductory period with a fixed interest rate, after which the interest rate adjusts annually. ARMs that are not hybrid, on the other hand, have no period with a fixed rate of interest. Such ARMs start out with a rate that adjusts at set intervals, such as 3/4 (adjusts every three years), 5/4 (adjusts every five years), etc.

year or less from the disclosure requirements of § 1026.20(d). Proposed § 1026.20(c) includes the same exception. Proposed comment 20(d)(1)(ii)–1 applies the standards in comment 19(b)–1 for determining the term of a construction loan.

Construction loans generally have short terms of six months to one year and are subject to frequent interest rate adjustments, usually monthly or quarterly. The construction period usually involves several disbursements of funds at times and in amounts that are unknown at the beginning of that period. The consumer generally pays only accrued interest until construction is completed. The creditor, assignee, or servicer, in addition to disbursing payments in stages, closely monitors the progress of construction. Generally, at the completion of the construction, the construction loan is converted into permanent financing in which the loan amount is amortized just as in a standard mortgage transaction. See comment 17(c)(6)–2 for additional information on construction loans.

The frequent interest rate adjustments, multiple disbursements of funds, the short loan term, and on-going communication between the creditor, assignee, or servicer and consumer distinguish construction loans from other ARMs. These loans are meant to function as bridge financing until construction is completed and permanent financing can be put in place. Consumers with construction ARM loans are not at risk of payment shock like other ARM where interest rates change less frequently. Moreover, given the frequency of interest rate adjustments on construction loans, creditors, assignees, or servicers would have difficulty complying with the proposed requirement to provide the notice to consumers 210 to 240 days before the first payment at the adjusted level is due. For these reasons, providing notices under § 1026.20(d) for these loans would not provide a meaningful benefit to the consumer nor improve consumers’ awareness and understanding of their construction loans with terms of less than one year.

*Authority.* Accordingly, the Bureau proposes to use its authority under TILA section 105(a) to except construction loans with terms of one year or less from the requirements of proposed § 1026.20(d). As explained above, the disclosure requirements of § 1026.20(d) would be confusing and difficult to comply with in the context of a short-term construction loan. Thus, exempting such loans is necessary and proper under TILA section 105(a) to further the consumer protection

purposes of TILA and facilitate compliance. The Bureau further proposes the exemption for construction loans pursuant to its authority under TILA section 105(f). For the reasons discussed above, the Bureau believes, in light of the factors in TILA section 105(f)(2), that requiring the § 1026.20(d) notice for construction loans with terms of one year or less would not provide a meaningful benefit to consumers. Specifically, the Bureau considers that the exemption is proper irrespective of the amount of the loan or the status of the borrower (including related financial arrangements, financial sophistication, and the importance to the borrower of the loan). The Bureau further notes, in light of TILA section 105(f)(2)(D), that the requirements in § 1026.20(d) would only apply to loans secured by the consumer's principal dwelling.

The Bureau solicits comment on whether there are other ARMs with terms of less than one year, and whether such ARMs should be excepted from the requirements of § 1026.20(d). If the time period of the advance notice for consumers required by § 1026.20(d) is not appropriate for these short-term ARMs, the Bureau solicits comment on what period would be appropriate that would also provide consumers with sufficient notice of the estimated initial adjusted interest rate and any new payment.

Proposed comment 20(d)(1)(ii)–2 discusses other loans to which the proposed rule does not apply. Proposed comment 20(d)(1)(ii)–2 is consistent with proposed comment 20(c)(1)(ii)–3 with regard to the loans which are not subject to the proposed ARM disclosure rules. Certain Regulation Z provisions treat some of these loans as variable-rate transactions, even if they are structured as fixed-rate transactions. The proposed comment clarifies that, for purposes of proposed § 1026.20(d), the following loans, if fixed-rate transactions, are not ARMs and therefore are not subject to ARM notices pursuant to § 1026.20(d): Shared-equity or shared-appreciation mortgages; price-level adjusted or other indexed mortgages that have a fixed rate of interest but provide for periodic adjustments to payments and the loan balance to reflect changes in an index measuring prices or inflation; graduated-payment mortgages or step-rate transactions; renewable balloon-payment instruments; and preferred-rate loans. The particular features of these types of loans may trigger interest rate or payment changes over the term of the loan or at the time the consumer pays off the final balance. However, these changes are based on factors other than

a change in the value of an index or a formula. For example, whether or when the interest rate will adjust for the first time for a preferred-rate loan with a fixed interest rate is likely not knowable six to seven months in advance of the adjustment. This is because the loss of the preferred rate is based on factors other than a formula or change in the value of an index agreed to at consummation. Because the enumerated loans are not ARMs they are not covered by TILA section 128A or proposed § 1026.20(d) and require no disclosures under this rule.

#### 20(d)(2) Content of Initial Rate Adjustment Disclosures

*Statutorily-required content.* TILA section 128A requires that the following content be included in the § 1026.20(d) initial rate adjustment notice: (1) Any index or formula used in adjusting or resetting the interest rate and a source of information about the index or formula; (2) an explanation of how the new rate and payment would be determined, including how the index may be adjusted, such as by the addition of a margin; (3) a good faith estimate, based on accepted industry standards, of the amount of the resulting monthly payment after the adjustment or reset and the assumptions on which the estimate is based; (4) a list of alternatives that the consumers may pursue, including refinancing, renegotiation of loan terms, payment forbearance, and pre-foreclosure sales, and descriptions of actions the consumer must take to pursue these alternatives; (5) contact information for HUD- or State housing agency-approved housing counselors or programs reasonably available; and (6) contact information for the State housing finance authority for the State where the consumer resides.

The Bureau interprets the explanation of how the interest rate and payments will be determined set forth in (2) above to require disclosure of any adjustment to the index, for example, the amount of any margin is; an explanation of what a margin is; the loan balance; the length of the remaining term of the loan; and any change in the term or maturity of the loan caused by the interest rate adjustment.

The Bureau interprets the good faith estimate, required under (3) above, to require disclosure, when available, of the exact amount of the new monthly payment after the interest rate adjustment. As discussed below, the Bureau believes that in most cases the lengthy advance notice required by proposed § 1026.20(d) will necessitate disclosure in the initial ARM interest

rate adjustment notices of estimates of the new interest rate and payment, rather than exact amounts. The Bureau believes, however, that a good faith estimate would require disclosure of the exact amount of the new monthly payment, if known, rather than an estimate. The Bureau interprets the assumptions on which the good faith estimate is based to require disclosure, among other things, of the current interest rate and payment, as well as the amount of the new interest rate after the adjustment, if known, or an estimate if the exact amount of the new interest rate is not known. As with the new payment amount, the Bureau believes that generally only an estimate of the new interest rate will be available at the time the notice is provided, but interprets the statute to require disclosure of the exact amount of the new interest rate, if this amount is available. Even if this content were not contemplated under the statute, the Bureau believes it would be appropriate to use its adjustment authority to require disclosure of such information for the reasons discussed below.

*Additional content.* In addition to the content explicitly required under the statute, the Bureau proposes, as discussed in more detail below, to require the ARM initial interest rate notices to include the date of the disclosures; the telephone number of the creditor, assignee, or servicer; statements specifying that the consumer's interest rate is scheduled to adjust pursuant to the terms of the loan, that the adjustment may effect a change in the mortgage payment, the specific time period the current interest rate has been in effect, the dates of the upcoming and future interest rate adjustments, and any other changes to loan terms, features, or options taking effect on the same date as the interest rate adjustment; the due date of the first payment after the adjustment; for interest-only or negatively-amortizing payments, the amount of the current and new payment allocated to principal, interest, and taxes and insurance in escrow, as applicable; a statement regarding payment allocation for interest-only and negatively-amortizing loans, including the payment required to fully amortize an ARM that becomes negatively-amortizing as a result of the interest rate adjustment; any interest rate or payment limits and any foregone interest; if the new interest rate or new payment provided is an estimate, a statement that another disclosure containing the actual new interest rate and payment will be provided within a specified time period—if the actual

interest rate adjustment results in a corresponding payment change; and the amount and expiration date of any prepayment penalty and the circumstances under which such penalty might apply.

The proposed additional content, including the content that the Bureau interprets to be required under the statute, is authorized under TILA section 105(a). As further discussed below, the proposed additional content is necessary and proper to assure that consumers understand the consequences of the upcoming ARM rate adjustments and have sufficient time to adjust their behavior accordingly, thereby avoiding the uninformed use of credit and protecting consumers against inaccurate and unfair credit billing practices. The proposed additional content is further authorized under DFA section 1032 by assuring that the key features of consumers' adjustable-rate mortgage, over the term of the ARM, are "fully, accurately, and effectively disclosed to consumers in a manner that permits consumers to understand [its] costs, benefits, and risks." The proposed additional information better informs consumers of the implications of interest-rate adjustments before they happen and thus enables them to weigh their options going forward. For the same reasons, the Bureau believes, consistent with DFA section 1405(b), that the proposed additional content would improve consumer awareness and understanding of their residential ARM loans and is thus in the interest of consumers and the public interest. The proposed additional content is also consistent with TILA section 128A(b) itself, which provides a non-exclusive list of required content, thereby statutorily contemplating additional content.

*Good faith estimate.* As noted above, TILA section 128A provides that the § 1026.20(d) interest rate adjustment disclosures should include "[a] good faith estimate, based on accepted industry standards \* \* \* of the amount of the monthly payment that will apply after the date of the adjustment or reset, and the assumptions on which the estimate is based." ARM contracts generally provide that the calculation of the new interest rate and payment be based on an index value published closer to the date of the interest rate adjustment than those available during the time frame within which creditors, assignees, and servicers must provide the initial ARM interest rate adjustments pursuant to § 1026.20(d). See 20(c)(2) above for a full discussion of the time frame generally required for

ascertaining the index rate used to calculate the adjusted interest rate and new payment. Thus, it is unlikely creditors, assignees, and servicers will be able to disclose the actual new interest rate and payment in the initial ARM interest rate notices. For this reason, consistent with the language of the statute regarding estimates, proposed § 1026.20(d)(2) provides that if the new interest rate or any other calculation using the new interest rate is not known as of the date of the disclosure, use of an estimate, labeled as such, is permissible. The Bureau interprets the statutory good faith standard to require disclosure of the actual amounts if they are available at the time the creditor, assignee, or servicer provides the initial ARM interest rate adjustment notices to consumers pursuant to the time frame required by proposed § 1026.20(d). Since the notice is designed to alert consumers to upcoming changes to their mortgage and to provide consumers with the time needed to take ameliorative actions should the new interest rate and payment be too high, providing the actual new payment would benefit consumers. Across all rounds of consumer testing, most participants shown notices containing estimates of the new rate and payment understood that these amounts were estimates that could change before payment at a new level was due.<sup>83</sup>

To implement the requirements of TILA section 128A that the good faith estimate of the new payment be based on accepted industry standards, proposed § 1026.20(d) would require that any estimate be calculated using the index figure disclosed in the source of information described in proposed § 1026.20(d)(2)(iii)(A) within fifteen business days prior to the date of the disclosure. Linking the date of the notice to the date of the index value used to estimate the new interest rate and payment would prevent consumer confusion as to the recency of the index value. As discussed above under Section 20(c)(2), the fifteen-day period allows creditors, assignees, and servicers sufficient time to calculate the estimates and perform any necessary quality control measures before providing the § 1026.20(d) notices to consumers.

#### 20(d)(2)(i) Date of the Disclosure

Proposed § 1026.20(d)(2)(i) would require that the initial ARM adjustment notice include the date of the disclosure. In order to group together all data regarding the ARM, proposed

§ 1026.20(d)(3)(ii) would require that the date appear outside of and above the table described in proposed § 1026.20(d)(3)(i).

Proposed comment 20(d)(2)(i)-1 explains that the date would be the date the creditor, assignee, or servicer generates the notice. It also must be within fifteen business days after publication of the index level used to calculate the adjusted interest rate and new payment, if it is an estimate and not the actual adjusted interest rate and new payment.<sup>84</sup> Because the disclosures must be provided to consumers so far in advance, the Bureau expects estimates will be used in most cases. Tying the date of the disclosure to the date of the index value should prevent consumer confusion as to the recency of the index value upon which the estimated interest rate and new payment are based.

#### 20(d)(2)(ii) Statement Regarding Change to Interest Rate and Payment

Proposed § 1026.20(d)(2)(ii)(A) would require the initial ARM interest rate adjustment notices to include a statement alerting consumers that, under the terms of their adjustable-rate mortgage, the specific period in which their interest rate stayed the same will end on a certain date, that their interest rate may change on that date, and that any change in their interest rate may result in a change to their mortgage payment. This information is similar to the information required to be disclosed in the pre-consummation disclosures provided to consumers pursuant to current § 1026.19(b)(2)(i) and § 1026.37(i), recently proposed in the 2012 TILA-RESPA Proposal. Proposed comment 20(d)(2)(ii)(A)-1 clarifies that the current interest rate is the one in effect on the date of the disclosure.

Proposed § 1026.20(d)(2)(ii)(B) would require the proposed initial ARM interest rate adjustment notices to include the dates of the impending and future interest rate adjustments and inform consumers that these changes are dictated by the terms of their adjustable-rate mortgages. Proposed § 1026.20(d)(2)(ii)(C) also would require the § 1026.20(d) disclosures to inform consumers of any other loan changes taking place on the same day as the adjustment, such as changes in amortization caused by the expiration of interest-only or payment-option features.

The first ARM model form tested did not contain the statement required by proposed § 1026.20(d)(2)(ii) informing consumers of impending and future changes to their interest rate and the

<sup>83</sup> Macro Report, *supra* note 38, at viii.

<sup>84</sup> See proposed § 1026.20(d)(2).

basis for these changes. Although participants understood that their interest rate was adjusting and their payment might change as a result, they did not understand that these changes would occur periodically subject to the terms of their mortgage contract. Inclusion of this statement in the second round of testing successfully resolved this confusion. All but one consumer tested in rounds two and three of testing understood that, under the scenario presented to them, their interest rate would change on an annual basis.<sup>85</sup>

#### 20(d)(2)(iii) Table With Current and New Interest Rates and Payments

Proposed § 1026.20(d)(2)(iii) would require disclosure of the following information in the form of a table: (A) The current and new interest rates; (B) the current and new periodic payment amounts and the date the first new payment is due; and (C) for interest-only or negatively-amortizing payments, the amount of the current and estimated new payment allocated to interest, principal, and property taxes and mortgage-related insurance, as applicable. The information in this table would appear within the larger table containing the other required disclosures, except for the date of the disclosure.

This table would follow the same order as, and have headings and format substantially similar to, those in the table in Forms H-4(D)(3) and (4) in Appendix H of subpart C. The Bureau learned through consumer testing that, when presented with information in a logical order, consumers more easily grasped the complex concepts contained in the proposed § 1026.20(d) notice. For example, the form begins by informing consumers of the basic purpose of the notice: Their interest rate is going to adjust, when it will adjust, and the adjustment will change their mortgage payment. This introduction is immediately followed by a visual illustration of this information in the form of a table comparing the consumers' current and new interest rates. Based on consumer testing, the Bureau believes that consumer understanding is enhanced by presenting the information in a simple manner, grouped together by concept, and in a specific order that allows consumers the opportunity to build upon knowledge gained. For these reasons, the Bureau proposes that creditors, assignees, or servicers disclose the information in the table as set forth in Forms H-4(D)(3) and (4) in Appendix H.

In all rounds of testing, consumers were presented with model forms with tables depicting a scenario in which the interest rate and payment would increase as a result of the adjustment. All participants in all rounds of testing understood that their interest rate and payment were going to increase and when these changes would occur.<sup>86</sup>

The Bureau proposes including allocation information in the table for interest-only and negatively-amortizing ARMs. The Bureau believes this information would help consumers better understand the risk of these products by demonstrating that their payments would not reduce the loan principal. The Bureau also believes providing the payment allocation would help consumers understand the effect of the interest rate adjustment, especially in the case of a change in the ARM's features coinciding with the interest rate adjustment, such as the expiration of an interest-only or payment-option feature. Since payment allocation may change over time, the proposed rule would require disclosure of the expected payment allocation for the first payment period during which the adjusted interest rate will apply.

The allocation of payment disclosure was tested in the third round of testing. The notice tested showed the scenario of a  $\frac{3}{4}$  hybrid ARM with interest-only payments for the first three years of the loan adjusting for the first time. On the date of the adjustment, the interest-only feature would expire and the ARM would become amortizing. Only about half of participants understood that their payments would be changing from interest-only to amortizing. Participants generally understood the concept of allocation of payments but were confused by the table in the notice that broke out principal and interest for the current payment, but combined the two for the new amount. As a result, this table was revised so that separate amounts for principal and interest were shown for all payments.<sup>87</sup>

The Bureau recognizes that certain Dodd-Frank Act amendments to TILA will restrict origination of non-amortizing and negatively-amortizing loans. For example, TILA section 129C and the 2011 ATR Proposal that would implement that provision, generally require creditors to determine that a consumer can repay a mortgage loan and include a requirement that these determinations assume a fully-amortizing loan. Thus, this law and

regulation, when finalized, will restrict the origination of risky mortgages such as interest-only and negatively-amortizing ARMs.

Other Dodd-Frank amendments to TILA, such as the proposed periodic statement provisions discussed below, will provide payment allocation information to consumers for each billing cycle. Thus, consumers who currently have interest-only or negatively-amortizing loans or may obtain such loans in the future will receive information about the interest-only or negatively-amortizing features of their loans through the payment allocation information in the periodic statement. Also, as noted above, consumer testing showed that participants were confused by the allocation table. Since the Bureau was not able to test a revised version of the form to see if it rectified the confusion caused by the allocation table or if the concepts of non-amortizing and negatively-amortizing ARMs themselves are the source of the confusion, the Bureau questions the value of disclosing this information to consumers in the ARM interest rate adjustment notice. In view of these changes to the law and the outcome of consumer testing, the Bureau solicits comments on whether to include allocation information for interest-only and negatively-amortizing ARMs in the table proposed above.

#### 20(d)(2)(iv) Explanation of How the Interest Rate Is Determined

TILA section 128A mandates that the initial interest rate adjustment notices include any index or formula used in making adjustments to or resetting the interest rate, and a source of information about the index or formula. Accordingly, proposed § 1026.20(d)(2)(iv)(A) would require disclosure of the name and published source of the index or formula. This disclosure requirement is consistent with the pre-consummation disclosure requirements of current rule § 1026.19(b)(2)(iii). Proposed § 1026.37(i), part of the 2012 TILA-RESPA Proposal, likewise would require disclosure of the index name prior to consummation.

TILA section 128A also mandates that the initial interest rate disclosures include an explanation of how the new interest rate and payment would be determined, including an explanation of how the index was adjusted, such as by the addition of a margin. Proposed § 1026.20(d)(2)(iv) would require § 1026.20(d) notices to include an explanation of how the new interest rate is determined. This disclosure requirement is consistent with the pre-

<sup>86</sup> *Id.*

<sup>87</sup> *Id.* at vii-viii. This revision was made after the third round of testing, and therefore was not tested with consumers.

<sup>85</sup> Macro Report, *supra* note 38, at vii.

consummation disclosure requirements of current rule § 1026.19(b)(2)(iii). The 2012 TILA-RESPA Proposal's proposed 1026.37(i) likewise would require disclosure prior to consummation of the amount of the margin expressed as a percentage.

Consumer testing revealed that consumers generally have difficulty understanding the relationship of the index, margin, and interest rate.<sup>88</sup> Therefore, the Bureau is proposing a relatively brief and simple explanation that the new interest rate is calculated by taking the published index rate and adding a certain number of percentage points, called the "margin." Proposed § 1026.20(d)(2)(iii) also includes the specific amount of the margin.

Consumer testing indicated that the explanation helped consumers better understand the relationship between the interest rate, index, and margin. It also helped dispel the notion held by many of the consumers in the initial rounds of testing that the lender subjectively determined their new interest rate at each adjustment.<sup>89</sup> The Bureau believes that its proposed rule and forms strike an appropriate balance between providing consumers with key information necessary to understand the basic interest rate adjustment of their adjustable-rate mortgages without overloading consumers with complex and confusing technical information.

#### 20(d)(2)(v) Rate Limits

Proposed rule § 1026.20(d)(2)(v) would require the disclosure of any limits on the interest rate or payment increases at each adjustment and over the life of the loan. The Bureau believes that knowing the limitations of their ARM rates and payments would help consumers understand the consequences of each interest rate adjustment and weigh the relative benefits of the alternatives that would be required to be disclosed under proposed § 1026.20(d)(2)(viii). For example, if an adjustment might cause a significant increase in the consumer's payment, knowing how much more the interest rate or payment could increase could help inform a consumer's decision on whether or not to seek alternative financing.

Proposed § 1026.20(d)(2)(v) also requires disclosure of the extent to which the creditor, assignee, or servicer has foregone any increase in the interest rate. If there is foregone interest, it would require disclosure that the additional interest was not applied due to a rate limit and include the earliest

date such foregone interest may be applied. Proposed comment 20(d)(2)(iv)-1 explains that disclosure of foregone interest would apply only to transactions permitting interest rate carryover. It further explains that the amount of increase foregone at the initial adjustment is the amount that, subject to rate caps, can be added to future interest rate adjustments to increase, or offset decreases in, the rate determined according to the index or formula.

Consumers had difficulty understanding the concept of interest rate carryover when it was introduced during the third round of testing. This difficulty may have been due to the simultaneous introduction of other complex notions, such as interest-only or negatively-amortizing features and the allocation of interest, principal, and escrow payments for such loans. In response, the Bureau has simplified the explanation of carryover interest.<sup>90</sup>

The Bureau recognizes that the disclosure of rate limits and unapplied carryover interest provide information that may help consumers better understand their ARMs. However, the Bureau is considering whether the help this information would provide outweighs its distraction from other more key information. Also, as explained above, consumers had difficulty understanding the concept of carryover interest and the Bureau is concerned this difficulty might diminish the effectiveness of the proposed § 1026.20(d) disclosures. The Bureau solicits comment on whether to include rate limits and unapplied carryover interest in the proposed § 1026.20(d) disclosures.

#### 20(d)(2)(vi) Explanation of How the New Payment Is Determined

TILA section 128A mandates that the initial interest rate notices include an explanation of how the new interest rate and payment would be determined, including an explanation of how the index was adjusted, such as by the addition of a margin. Proposed § 1026.20(d)(2)(vi) would implement this statutory provision by requiring the content discussed below. This proposed disclosure is consistent with the disclosures required at the time of application pursuant to current § 1026.19(b)(2)(iii). It is also consistent with content required under proposed § 1026.20(c) and thus promotes consistency in Regulation Z ARM disclosures.

The disclosure required under proposed § 1026.20(d)(2)(vi) explains

that the new payment is based on (A) the index or formula, (B) any adjustment to the index or formula, such as by addition of the margin, (C) the loan balance, (D) the length of the remaining loan term, and, (E) if the new interest rate or new payment provided is an estimate, a statement that another disclosure containing the actual new interest rate and new payment will be provided to the consumer 2 to 4 months prior to the date the first new payment is due, if the interest rate adjustment causes a corresponding change in payment, pursuant to § 1026.20(c).

The proposal would require disclosure of both the loan balance and the remaining loan term expected on the date of the interest rate adjustment. The proposed rule also would require disclosure of any change in the term or maturity of the loan caused by the adjustment.

As discussed in proposed § 1026.20(d)(2)(iv) above, the Bureau found that this explanation helped consumers better understand how the index or formula and margin determine their new payment and dispelled the notion held by many consumers in the initial rounds of testing that, at each adjustment, the lender subjectively determined their new interest rate, and thus the new payment. Disclosure of the four key assumptions upon which the new payment is based provides a succinct overview of how the interest rate adjustment works. It also demonstrates that factors other than the index can increase consumers' interest rates and payments. Disclosures of these factors would provide consumers with a snapshot of the current status of their adjustable-rate mortgages and with basic information to help them make decisions about keeping their current loan or shopping for alternatives. If an estimated new interest rate and new payment is used, the statement that the consumer will receive another disclosure with the actual new interest rate and new payment, if the interest rate adjustment results in a corresponding payment change, notifies consumers that the creditor, assignee, or servicer will inform them of the actual rate and payment two to four months in advance of the date their first new payment is due.

#### 20(d)(2)(vii) Interest-Only and Negative-Amortization Statement and Payment

Proposed § 1026.20(d)(2)(vii) would require § 1026.20(d) notices to include a statement regarding the allocation of payments to principal and interest for interest-only or negatively-amortizing loans. If negative amortization occurs as a result of the interest rate adjustment,

<sup>88</sup> *Id.* at viii.

<sup>89</sup> *Id.*

<sup>90</sup> *Id.* at viii-ix.

the proposed rule would require disclosure of the payment necessary to fully amortize such loans at the new interest rate over the remainder of the loan term. As explained in proposed comment 20(d)(2)(vii)–1, for interest-only loans, the statement would inform the consumer that the new payment covers all of the interest but none of the principal owed and, therefore, will not reduce the loan balance. For negatively-amortizing ARMs, the statement would inform the consumer that the new payment covers only part of the interest and none of the principal, and therefore the unpaid interest will add to the balance or increase the term of the loan.

Both current § 1026.20(c) and the Board's 2009 Closed-End Proposal to revise § 1026.20(c) include, for ARMs that become negatively amortizing as a result of the interest rate adjustment, disclosure of the payment necessary to fully amortize loans at the new interest rate over the remainder of the loan term. However, the Bureau believes there are countervailing considerations regarding whether to include this information in proposed § 1026.20(d).

The Bureau recognizes that certain Dodd-Frank Act amendments to TILA will restrict origination of non-amortizing and negatively-amortizing loans. For example, TILA section 129C and the 2011 ATR Proposal that would implement that provision, generally require creditors to determine that a consumer can repay a mortgage loan and include a requirement that these determinations assume a fully-amortizing loan. Thus, this law and regulation, when finalized, will restrict the origination of risky mortgages such as interest-only and negatively-amortizing ARMs.

Other Dodd-Frank Act amendments to TILA, such as the periodic statement proposed by § 1026.41, will include information about non-amortizing and negatively-amortizing loans in each billing cycle, such as an allocation of payments. Thus, consumers who currently have interest-only and negatively-amortizing ARMs or may obtain such loans in the future will receive certain information about the interest-only or negatively-amortizing features of their loans in another disclosure, although this will not include the payment required to fully amortize negatively-amortizing loans. The payment necessary to fully amortize these loans was not consumer tested but testing of the table showing the payment allocation of interest-only and negatively-amortizing ARMs indicated that consumers were confused by this concept. Thus, the Bureau is weighing the value of disclosing specific

information regarding amortization, such as the payment needed to fully amortize negatively-amortizing ARMs. In view of these changes to the law and the outcome of consumer testing, the Bureau solicits comments on whether to include the payment required to amortize ARMs that became negatively amortizing as a result of an interest rate adjustment.

#### 20(d)(2)(viii) List of Alternatives

TILA section 128A mandates that the initial interest rate adjustment notices include a list of alternatives consumers may pursue before adjustment or reset and descriptions of the actions consumers must take to pursue these alternatives. These alternatives include refinancing, renegotiation of loan terms, payment forbearance, and pre-foreclosure sales. Proposed § 1026.20(d)(2)(viii) would require disclosure in § 1026.20(d) initial ARM interest rate notices of the four alternatives set forth in the statute. The Bureau proposes to use simpler, commonly used terms in the model forms to describe the alternatives when possible.

The proposed model forms present the list as possibilities for consumers seeking alternatives to the upcoming changes to their interest rate and payment. The proposed forms also explain that most of the alternatives are subject to approval by the lender. All participants tested in the first and second round of testing were able to identify the list of alternatives.<sup>91</sup>

The list of alternatives generally and concisely describes the actions consumers must take to pursue these alternatives, such as contacting their lender or another lender. Another action consumers may take to pursue these alternatives is contacting government organizations. Proposed § 1026.20(d)(2)(xi) would require disclosure in the initial ARM interest rate adjustment notice of information on how to contact such agencies, including the contact information for the State housing finance authority for the State in which the consumer resides and the Web site and telephone number to access the most current list of homeownership counselors or counseling organizations either made available by the Bureau or maintained by HUD. The Bureau proposes to require disclosure of this concise list of alternatives in lieu of a more detailed account of actions consumers may take in order to maximize the effectiveness of the disclosure without weighing it down

with information that may not add significant value.

#### 20(d)(ix) Prepayment Penalty

Proposed § 1026.20(c)(d)(ix) would require disclosure of the circumstances under which any prepayment penalty may be imposed, such as selling or refinancing the principal dwelling, the time period during which such penalty would apply, and the maximum dollar amount of the penalty. The proposed rule cross-references the definition of prepayment penalty in subpart E under § 1026.41(d)(7)(iv) in the proposed rule for periodic statements.

Interest rate adjustments may cause payment shock or require consumers to pay their mortgage at a rate they may no longer be able to afford, prompting them to consider alternatives such as refinancing. In order to fully understand the implications of such actions, the Bureau believes that consumers should know whether prepayment penalties may apply. Such information should include the maximum penalty (in dollars) that may apply and the time period during which the penalty may be imposed. The dollar amount of the penalty, as opposed to a percentage, is more meaningful to consumers.

The Bureau also proposes disclosure of any prepayment penalty in § 1026.20(c) ARM payment change notices and the periodic statements proposed by § 1026.41. Consumer testing of the periodic statement included a scenario in which a prepayment penalty applied. Most participants understood that a prepayment penalty applied if they paid off the balance of their loan early, but some participants were unclear whether it applied to the sale of the home, refinancing, or other alternative actions consumers could pursue in lieu of maintaining their adjustable-rate mortgages.<sup>92</sup> For this reason, the Bureau proposes to clarify the circumstances under which a prepayment penalty would apply. The proposed forms alert consumers that a prepayment penalty may apply if they pay off their loan, refinance, or sell their home before the stated date.

The Bureau recognizes that Dodd-Frank Act amendments to TILA, such as 129C and the 2011 ATR Proposal proposing to implement that provision, would significantly restrict a lender's ability to impose prepayment penalties. Other Dodd-Frank amendments to TILA, such as the proposed periodic statement, would provide consumers with information about their prepayment penalty for each billing

<sup>91</sup> *Id.* at viii.

<sup>92</sup> *Id.* at vi.

cycle. Thus, consumers who currently have ARMs with prepayment penalty provisions or may obtain such loans in the future would generally receive information about them at frequent intervals in another disclosure. In view of these changes to the law, the Bureau solicits comments on whether to include information regarding prepayment penalties in proposed § 1026.20(d).

**20(d)(2)(x) Telephone Number of Creditor, Assignee, or Servicer**

Proposed § 1026.20(d)(2)(x) would require disclosure of the telephone number of the creditor, assignee, or servicer for consumers to call if they anticipate having problems paying the new payment.

**20(d)(2)(xi) Contact Information for Government Agencies and Counseling Agencies or Programs**

TILA section 128A mandates that the initial interest rate adjustment notices include the name, mailing and Internet address, and telephone number of the State housing finance authority (as defined in section 1301 of FIRREA) for the State in which the consumer resides. Proposed § 1026.20(d)(2)(xi) would implement this statutory mandate by requiring inclusion of this information in the § 1026.20(d) initial interest rate adjustment notice. Two other mortgage servicing rulemakings proposed by the Bureau, the periodic statement, *see* below, and the early intervention for delinquent borrowers in the 2012 RESPA Servicing Proposal, also would require contact information for the State housing finance authority. However, those proposals would require the contact information for the State in which the property is located rather than in which the consumer resides, since the scope of those proposed rules is not limited to a consumer's principal dwelling. This is consistent with the proposed ARM rule since the consumer's principal dwelling should be located in the State in which the property is located. The Bureau seeks comment on how to address any compliance difficulties posed by this inconsistency.

TILA section 128A also mandates that the initial interest rate adjustment notices include the names, mailing and Internet addresses, and telephone numbers of counseling agencies or programs reasonably available to the consumer that have been certified or approved and made publicly available by HUD or a State housing finance authority.

On July 9, 2012, the Bureau released proposed rules to implement other

Dodd-Frank Act requirements expanding protections for "high-cost" mortgage loans under HOEPA, including a requirement that borrowers receive housing counseling (2012 HOEPA Proposal).<sup>93</sup> The 2012 HOEPA proposal also proposed to implement other homeownership-counseling-related requirements that are not amendments to HOEPA, including a proposed amendment to Regulation X that lenders provide a list of five homeownership counselors or counseling organizations to applicants for a federally related mortgage loan.<sup>94</sup>

The Bureau has taken an alternative approach with regard to the initial ARM interest rate adjustment notice and proposes to use its exception authority to require creditors, assignees, and servicers simply to provide the Web site address to access either the Bureau list or the HUD list of homeownership counseling agencies and programs,<sup>95</sup> instead of requiring contact information for a list of specific counseling agencies or programs. The Bureau believes that this approach appropriately balances consumer and industry interests based on the following considerations:

The ARM notice required by proposed § 1026.20(d) has limited space and contains a significant amount of important technical information about the consumer's loan. Including too much information could overwhelm consumers and minimize the value of the other information contained in the notice. Also, not all consumers would benefit from the counselor information, although it would provide an important benefit for those consumers who face

financial difficulties if their initial interest rate adjustment may cause their mortgage payments to significantly increase. Finally, importing updated information from the Bureau or HUD Web site would involve more programming burden than simply listing one of the agencies' Web sites.

Providing consumers with the Web site address for either the Bureau or HUD list of homeownership counseling agencies and programs would streamline the disclosure and present clear and concise information for the consumer to use. However, directing consumers to the actual list would allow them to choose a conveniently located program or agency and to locate other programs or agencies if those contacted initially could not help the consumer at that time. The Bureau seeks comment on whether this proposal strikes an appropriate balance, and on the benefits and burdens to both consumers and industry of requiring that a list of several individual housing counselors be included in the initial ARM interest rate adjustment notice.

*Authority.* The Bureau proposes to use its authority under TILA sections 105(a) and (f) and DFA section 1405(b) to exempt creditors, assignees, and servicers from the requirement in TILA section 128A to include in the initial ARM interest rate adjustment notice contact information for specific government-certified counseling agencies or programs reasonably available to the consumer, and its authority under TILA section 105(a) and DFA section 1405(b) to instead require that the initial ARM interest rate adjustment notice contain information that directs consumers to the Bureau list or HUD list of homeownership counselors or counseling agencies. For the reasons discussed above, the Bureau believes that the proposed exception and addition is necessary and proper under TILA section 105(a) both to effectuate the purposes of TILA—to promote the informed use of credit and protect consumers against inaccurate and unfair credit billing practices—and to facilitate compliance. Moreover, the Bureau believes, in light of the factors in TILA section 105(f), that disclosure of the government-certified counseling agencies or programs reasonably available to the consumer specified in TILA section 128A would not provide a meaningful benefit to consumers. Specifically, the Bureau considers that the exemption is proper irrespective of the amount of the loan and the status of the borrower (including related financial arrangements, financial sophistication, and the importance to the borrower of the loan). The Bureau

<sup>93</sup> See 2012 HOEPA Proposal, available at [http://files.consumerfinance.gov/f/201207\\_cfpb\\_proposed-rule\\_high-cost-mortgage-protections.pdf](http://files.consumerfinance.gov/f/201207_cfpb_proposed-rule_high-cost-mortgage-protections.pdf), at 29–35.

<sup>94</sup> The list provided by the lender pursuant to the 2012 HOEPA Proposal would include only homeownership counselors or counseling organizations from either the most current list of homeownership counselors or counseling organizations made available by the Bureau for use by lenders, or the most current list maintained by HUD of homeownership counselors or counseling organizations certified by HUD, or otherwise approved by HUD. The 2012 HOEPA Proposal proposed that the list include five homeownership counselors or counseling organizations located in the zip code of the loan applicant's current address, or, if there are not the requisite five counselors or counseling organizations in that zip code, then counselors or organizations within the zip code or zip codes closest to the loan applicant's current address. To facilitate compliance with the proposed list requirement, the Bureau is expecting to develop a Web site portal that would allow lenders to type in the loan applicant's zip code to generate the requisite list, which could then be printed for distribution to the loan applicant. See 2012 HOEPA Proposal at 31–32 (discussing proposed Regulation X § 1024.20(a)).

<sup>95</sup> At the time of publishing, the Bureau list was not yet available; the HUD list is available at <http://www.hud.gov/offices/hsg/sfh/hcc/hcs.cfm>.

further notes, in light of TILA section 105(f)(2)(D), that the requirements in § 1026.20(d) would only apply to loans secured by the consumer's principal dwelling. Moreover, in the estimation of the Bureau, the proposed exemption would simplify the initial ARM adjustment notice and improve the housing counselor information provided to the consumer, thus furthering the consumer protection purposes of TILA. In addition, consistent with section 1405(b) of the Dodd-Frank Act, the Bureau believes that the proposed modification of the requirements in TILA section 128A would improve consumer awareness and understanding and is in the interest of consumers and in the public interest.

#### 20(d)(3) Format of Initial Rate Adjustment Disclosures

As discussed above, the Bureau proposes to make proposed § 1026.20(d) subject to certain of the general form requirements of § 1026.17(a)(1), including requiring that the disclosure be clear and conspicuous, in writing, and in a form consumers can keep, and giving creditors, assignees, and servicers the option of providing the disclosures to consumers in electronic form, subject to compliance with consumer consent and other applicable provisions of the E-Sign Act. However, as discussed above, because § 1026.20(d) disclosures are subject to the statutory requirement that they must be provided separate and distinct from all other correspondence, the Bureau proposes to amend § 1026.17(a) to provide that the general segregation and grouping requirements in that provision would not apply to § 1026.20(d).

*Authority.* In addition, as described below, § 1026.20(d)(3) proposes additional form requirements for initial ARM adjustment notices. For the reasons described below, these requirements are authorized under TILA section 105(a) and DFA sections 1032(a) and 1405(b). As discussed in the section-by-section analysis for each of the proposed sections of § 1026.20(d)(3), the Bureau believes, consistent with TILA section 105(a), that the proposed formatting requirements are necessary and proper to effectuate the purposes of TILA to assure a meaningful disclosure of credit terms, to avoid the uninformed use of credit, and to protect consumers against inaccurate and unfair credit billing practices. Further the Bureau believes, consistent with DFA section 1032(a), that the proposed formatting requirements ensure that the features of the ARM loans covered by proposed § 1026.20(d) are fully, accurately, and effectively disclosed to consumers in a

manner that permits them to understand the costs, benefits, and risks associated with such loans, in light of their individual facts and circumstances. Moreover, consistent with DFA section 1405(b), the Bureau believes that modification of the provision in TILA section 128A to require the proposed format discussed below would improve consumer awareness and understanding of residential mortgage loans transactions involving ARMs, and is thus in the interest of consumers and in the public interest.

#### 20(d)(3)(i) All Disclosures in Tabular Form, Except the Date

Proposed § 1026.20(d)(3)(i) would require that, except for the date of the notice, the initial ARM adjustment disclosures be provided in the form of a table and in the same order as, and with headings and format substantially similar to, Forms H-4(D)(3) and (4) in Appendix H to subpart C for initial interest rate adjustments.

The proposed ARM adjustment notice contains complex concepts challenging for consumers to understand. For example, consumer testing revealed that participants generally had difficulty understanding the relationship among index, margin, and interest rate.<sup>96</sup> They also had difficulty with the concepts of amortization and interest rate carryover.<sup>97</sup> As a starting point, the Bureau looked at the model forms developed by the Board for its 2009 Closed-End Proposal to amend § 1026.20(c). The Bureau then conducted its own consumer testing.

The Bureau's testing showed that consumers can more readily understand these concepts when the information is presented to them in a simple manner and in the groupings contained in the model forms. The Bureau also observed that consumers more readily understood the concepts when they were presented in a logical order, with one concept presented as a foundation to understanding other concepts. For example, the form begins by informing consumers of the purpose of the form: That their interest rate is going to adjust, when it will adjust, and that the adjustment may change their mortgage payment. This introduction is immediately followed by a table visually showing the consumers' current and estimated new interest rates. In another example, the proposed notice informs consumers about their index rate and margin before explaining how the new payment is calculated based on those factors as well as other factors

such as the loan balance and remaining loan term.

Based on consumer testing, the Bureau believes that consumer understanding is enhanced by presenting the information in a simple manner, grouped together by concept, and in a specific order that allows consumers the opportunity to build upon knowledge gained. For these reasons, the Bureau proposes that creditors, assignees, or servicers disclose the information required by proposed § 1026.20(d) with headings, content, and format substantially similar to Forms H-4(D)(3) and (4) in Appendix H to this part.

Over the course of consumer testing, participant comprehension improved with each successive iteration of the model form. As a result, the Bureau believes that displaying the information in tabular form focuses consumer attention and lends to greater understanding. Similarly, the Bureau found that the particular content and order of the information, as well as the specific headings and format used, presented the information in a way that consumers both could understand and from which they could benefit.

#### 20(d)(3)(ii) Format of Date of Disclosure

Proposed § 1026.20(d)(3)(ii) would require that the date of the disclosure appear outside of and above the table required by proposed § 1026.20(d)(3)(i). As discussed above with respect to paragraph 20(d)(2)(i), the date would be segregated since it is not information specific to the consumer's adjustable-rate mortgage.

#### 20(d)(3)(iii) Format of Interest Rate and Payment Table

Proposed § 1026.20(d)(3)(iii) would require tabular format for initial ARM interest rate adjustment notices for interest rates, payments, and the allocation of payments for loans that are interest-only or are negatively amortizing. This table would be located within the table proposed by § 1026.20(d)(3)(i). This table is substantially similar to the one tested by the Board for its 2009 Closed-End Proposal to revise § 1026.20(c). The proposal would require the table to follow the same order as, and have headings and format substantially similar to, Forms H-4(D)(3) and (4) in Appendix H of subpart C.

Disclosing the current interest rate and payment in the same table allows consumers to readily compare them with the estimated or actual adjusted rate and new payment. Consumer testing revealed that nearly all participants were readily able to

<sup>96</sup> Macro Report, *supra* note 38, at viii.

<sup>97</sup> *Id.* at viii-ix.

identify and understood the table and its contents.<sup>98</sup> The estimated or actual new interest rate and payment and date the first new payment is due is key information the consumer must know in order to commence payment at the new rate. For these reasons, the Bureau proposes locating this information prominently in the disclosure.

#### Section 1026.36 Prohibited Acts or Practices in Connection With Credit Secured by a Dwelling

##### 36(c) Servicing Practices

Existing § 1026.36(c) provides requirements for servicers in connection with a consumer credit transaction secured by a consumer's principal dwelling. Essentially, such servicers must promptly credit payments, must not "pyramid" late fees, and must provide payoff statements at the consumer's request. The Dodd-Frank Act essentially codifies the § 1026.36(c) provisions on prompt crediting and payoff statements with minor changes, as discussed below. The Bureau is amending Regulation Z both to implement the new statutory requirements, and to address the related issue of the handling of partial payments. Currently, Regulation Z addresses prompt crediting in § 1026.36(c)(1)(i). The Bureau is proposing limiting the scope of existing § 1026.36(c)(1)(i) to full contractual payments, and addressing partial payments (anything less than a full contractual payment) in proposed § 1026.36(c)(1)(ii), as discussed below. The Bureau proposes to retain the substantive requirements on non-conforming payments currently in § 1026.36(c)(2), but to move them to paragraph (c)(1)(iii). Likewise, the Bureau does not propose to change the Regulation Z provision addressing "pyramiding" of late fees currently in § 1026.36(c)(1)(ii), but only to move the provision to new paragraph (c)(3). Finally, the Bureau is proposing four substantive changes to the provisions on payoff statements, currently located in § 1026.36(c)(1)(iii), as well as to move these provisions to proposed paragraph 36(c)(3).

The Bureau believes these changes to Regulation Z are best implemented by restructuring paragraph (c) and simplifying some of the language. This restructuring generally is not intended to make any substantive changes. All substantive changes to the paragraph (c) are discussed below.

##### 36(c)(1)(i) Full Contractual Payments

DFA section 1464(a) established TILA section 129F, which codifies existing Regulation Z § 1026.36(c)(1)(i) with regard to prompt crediting of mortgage loan payments. The statute and the existing regulation both provide generally that "no servicer shall fail to credit a payment to the consumer's loan account as of the date of receipt, except when a delay in crediting does not result in any charge to the consumer or in the reporting of negative information to a consumer reporting agency." Proposed new paragraph (c)(1)(i) generally restates existing (c)(1)(i) with the only change that the existing regulation applies to all payments, while proposed (c)(1)(i) would be limited to full contractual payments. The Bureau is proposing to establish new § 1026.36(c)(1)(ii) to clarify servicers' obligations when they receive a partial payment (anything less than a full contractual payment), as discussed below.

As discussed above, proposed § 1026.36(c)(i) generally tracks the Dodd-Frank Act and current regulation, but changes the reference to "a payment" to "a full contractual payment" and makes minor modifications to reflect the proposed restructuring of the regulation. The proposed regulation text provides that a full contractual payment covers principal, interest, and escrow (if applicable), but not late fees. The Bureau engaged in outreach and found that many servicers already apply payments that cover principal, interest, and escrow (if applicable) without deducting late fees. This ensures that consumers get the full benefit of having made a payment. The Bureau seeks comment as to whether late fees should also be included in the definition of a full contractual payment.

##### 36(c)(1)(ii) Partial Payments

Current Regulation Z does not define what constitutes a "payment" for purposes of the crediting requirement, but leaves that question to be determined by the contractual documents and other applicable law. Specifically, current comment 36(c)(1)(i)-2 refers to "the legal obligation between the consumer and the creditor" as determined by "applicable state or other law" to determine whether a partial payment is a "payment" under the payment crediting provisions. Outreach to consumer and industry stakeholders revealed that partial payments are currently handled in a variety of ways. Some lenders do not accept partial

payments, some lenders apply partial payments, and some lenders send partial payments to a suspense or unapplied funds account. Currently there is no Federal regulation that governs such accounts. The Bureau is proposing to address partial payments in new § 1026.36(c)(1)(ii).

Proposed § 1026.36(c)(1)(ii) provides specific rules regarding the handling of partial payments and suspense accounts. New paragraph (c)(1)(ii) would require, consistent with the proposed periodic statement requirements in § 1026.41 discussed below, that if a servicer holds a partial payment, meaning any payment less than a full contractual payment, in a suspense or unapplied funds account, the servicer must disclose on the periodic statement the amount of funds held in such account. The servicer must also disclose when such funds will be applied to the outstanding payments due on the account. This proposed requirement is authorized under TILA section 129(f), which requires creditors, assignees, and servicers to send statements for each billing cycle including "[s]uch other information as the Bureau may prescribe in regulations."

Additionally, proposed § 1026.36(c)(1)(ii) provides that if a servicer holds a partial payment in a suspense or unapplied funds account, once there are sufficient funds in the account to cover a full contractual payment, the servicer must apply those funds to the oldest outstanding payment due. The proposed requirement that the funds be applied to the oldest outstanding payment would advance the date of delinquency by one billing cycle, and thus benefit the consumer. For example, suppose a previously current consumer must make a \$1,000 monthly payment, and the consumer paid \$500 on January 1st and \$500 on February 1st. When the second \$500 payment is made, a full contractual payment of \$1,000 (assuming late fees are not included in the definition of full contractual payment) is in the suspense account and must be applied to the January payment. Thus, this consumer would only be one month delinquent at the end of February. The Bureau interprets the language in TILA section 129F(a), that servicers must "credit" payments as of the date of receipt, except when a delay in crediting does not result in "any charge" to the consumer to authorize the proposed requirement that partial payments held in suspense accounts be credited to the oldest outstanding payment when a full contractual payment accumulates. Crediting the funds to a payment that

<sup>98</sup> *Id.* at vii.

was not the most delinquent would result in a charge to the consumer by extending the duration of the delinquency. To the extent not required under TILA section 129F(a), the Bureau believes this proposed requirement regarding crediting of funds is authorized under TILA section 105(a). As explained above, the Bureau believes the requirement is necessary and proper to effectuate the purpose of TILA to protect consumers against inaccurate and unfair credit billing practices by ensuring that funds held in a suspense account are promptly applied to the oldest outstanding payment when sufficient funds accumulate in such an account to cover a full contractual payment.

Proposed comment 36(c)(1)(ii)–1 describes the servicer's options upon receipt of a partial payment, including: Crediting the payment on receipt, returning the payment, or holding the payment in a suspense or unapplied funds account.

The proposed regulation would leave servicers significant flexibility in the handling of partial payments in accordance with contractual terms and other applicable law, for instance by rejecting the payment, crediting it immediately, or holding it in a suspense account. However, the proposed rule would also ensure greater consistency in the handling of suspense accounts by requiring, consistent with proposed § 1026.41, that servicers disclose on the periodic statement that the funds are being held in such accounts and, once sufficient funds accumulate to cover a full contractual payment, that the servicer apply the funds to the oldest outstanding payment owed by the consumer. If sufficient funds accumulate to cover more than one full contractual payment, these funds would be applied to the next oldest outstanding payment. Partial payment amounts would be treated as described above.

The Bureau believes this proposed approach would clarify servicers' obligations in processing both full contractual payment and partial payments, as well as ensure all payments are properly applied. The proposed disclosures would help consumers understand that their payments are being held in a suspense account rather than having been applied, and when those partial payments would be applied. Additionally, requiring application to the oldest outstanding payment when a full payment accumulates will provide protection to consumers, as well as reduce the outstanding principal balance on certain consumer loans.

Finally, the Bureau seeks comment on if this approach is the proper way to address suspense accounts, and specifically, whether there should be time requirements on returning partial payments. If a servicer chooses not to accept a partial payment, must that payment be returned within a specific amount of time, and if so, how long should that time be? Additionally, the SBREFA Panel recommended the Bureau consider if additional flexibility can be provided in the proposed rule for small servicers, to the extent their current practices differ from the proposal and provide appropriate consumer protections.<sup>99</sup> The Bureau seeks comment on whether the proposed rule differs from existing small servicer practices, and if so, how additional flexibility can be provided while still providing appropriate consumer protection.

#### 36(c)(1)(iii) Non-Conforming Payments

TILA section 129F(b) further provides that “[i]f a servicer specifies in writing requirements for the consumer to follow in making payments, but accepts a payment that does not conform to the requirements, the servicer shall credit the payment as of 5 days after receipt.” This provision codifies the treatment of non-conforming payments in current § 1026.36(c)(2). The Bureau is not making any substantive changes to this provision, as the current rule is clear and provides protection for consumers, but the Bureau proposes to redesignate the section as new § 1026.36(c)(1)(iii).

The Bureau notes that payments held in a suspense or unapplied funds account, as addressed in proposed § 1026.36(c)(1)(ii) discussed above, would not be considered to have been “accepted” by the servicer. Thus, under the Bureau's proposal, partial payments retained in suspense or unapplied funds accounts are treated as payments that have not been accepted subject to § 1026.36(c)(1)(ii), as opposed to non-conforming payments that have been accepted subject to proposed § 1026.36(c)(1)(iii), which must be credited within five days of receipt.

#### 36(c)(2) Prohibition on Pyramiding of Late Fees

The Bureau is not proposing any substantive changes to existing 36(c)(1)(ii), prohibiting the pyramiding of late fees. However the Bureau proposes redesignating this as new paragraph 36(c)(2).

#### 36(c)(3) Payoff Statements

DFA section 1464(b) established TILA section 129G, which requires that a creditor or servicer send an accurate payoff balance amount to the consumer within a reasonable time, but in no case more than seven business days, after the receipt of a written request for such balance from or on behalf of the consumer. This provision generally codifies existing § 1026.36(c)(1)(iii) of Regulation Z regarding provision of payoff statements with four substantive changes. First, while existing Regulation Z only applied the requirements to servicers, the statute applies the requirements to both servicers and creditors. Second, the statute applies the prompt response requirement to “home loans,” rather than consumer credit transactions secured by the consumer's principal dwelling. Third, the statute limits the reasonable time for responding to not more than seven business days; by contrast, existing comment 36(c)(1)(iii)–1 generally creates a five business day safe harbor for responding, but notes that it might be reasonable to take longer to respond in certain circumstances. Fourth, the statute requires a prompt response only to written requests for payoff amounts, while the existing regulation requires a prompt response to all such requests. Due to the reorganization of paragraph (c), the proposed provisions on payoff statements will be located in paragraph (c)(3).

*Covered persons.* Existing § 1026.36(c)(1)(iii) applies to servicers. TILA section 129G, as established by DFA section 1464(b), applies the payoff statement requirement to creditors and servicers. For the reasons discussed in the section-by-section analysis of § 1026.20(d) above, the Bureau interprets this to mean the payoff statement provision applies to creditors, assignees, and servicers as applicable. Proposed comment 36(c)(3)–1 clarifies that a creditor who no longer owns the mortgage loan or the mortgage servicing rights is not “applicable” and therefore not subject to the payoff statement requirements. The Bureau notes that the other subparts of paragraph (c) continue to be limited to servicers.

*Scope.* Existing § 1026.36(c)(1)(iii) is limited to consumer credit transactions secured by principal dwellings. The Bureau is proposing to expand the scope of the provision to consumer credit transactions secured by all dwellings. TILA section 129G, as established by DFA section 1464(b), applies the payoff statement requirement to “home loans,” a term not used elsewhere in TILA. The Bureau interprets this term to expand

<sup>99</sup> SBREFA Final Report, *supra* note 22, at 32.

the scope of the requirement from consumer credit transaction secured by principal dwellings to consumer credit transactions secured by any dwelling. Thus, the proposed regulation applies to consumer credit transactions (both open- and closed-end), secured by a dwelling, not just a principal dwelling. The Bureau notes that the other subparts of paragraph (c) continue to be limited to consumer credit transactions secured by a consumer's principal dwelling.

*Seven business days.* Existing § 1026.36(c)(1)(iii) requires the payoff statement to be sent within a reasonable amount of time, and comment 36(c)(1)(iii)-1 clarifies that a reasonable time is "within 5 business days under most circumstances." New TILA section 129G provides that a reasonable time may not be more than seven business days after the receipt of the request. Proposed § 1026.36(c)(3) reflects this change. Because of this change, the Bureau proposes removing existing comment 36(c)(1)(iii)-1.

*Written requests.* Existing § 1026.36(c)(1)(iii) requires the payoff statement to be sent after a request is received from the consumer. New TILA section 129G limits the requirement to provide a prompt response to "written requests" for payoff statements. Thus proposed new paragraph (c)(3) would require payoff statements to be provided after receipt of a written request. Related comment (c)(3)-3 (renumbered from (c)(1)(iii)-3)), which provides examples of reasonable requirements the servicer may establish for payoff requests, is also updated to reflect this change.

The SBREFA Panel recommended the Bureau consider if additional flexibility can be provided in the proposed rule for small servicers, to the extent their current practices differ from the proposal and provide appropriate consumer protections.<sup>100</sup> The Bureau seeks comment on whether the proposed rule differs from existing small servicer practices, and if so, how additional flexibility can be provided while still providing appropriate consumer protection.

#### Section 1026.41 Periodic Statements for Residential Mortgage Loans

Proposed § 1026.41 would establish the periodic statement requirement for residential mortgage loans. This section implements TILA section 128(f) as established by DFA section 1420. The statute requires the periodic statement to disclose seven items of information (the amount of the principal obligation, current interest rate and reset date if applicable, information on prepayment

penalties and late fees, contact information for the servicer, and housing counselor information), as well as such other information as the Bureau may prescribe in regulations.<sup>101</sup> The Bureau believes the periodic statement would provide the greatest value to consumers by also providing information regarding upcoming payment obligations and the application of past payments; a list of recent transaction activity; additional account information; and delinquency information. Thus, the Bureau proposes pursuant to TILA section 129(f)(1)(H) that each periodic statement also include this additional information.

TILA section 128(f) applies the requirement to provide a periodic statement to creditors, assignees, and servicers of residential mortgage loans. To increase readability, proposed § 1026.41 uses the term "servicer" to describe the entities covered by the proposed requirement, and defines servicer to mean creditors, assignees, or servicers for the purposes of § 1026.41. This terminology is also used in the section-by-section analysis for proposed § 1026.41. The statute applies the periodic statement to "the creditor, assignee, or servicer." Comment 41(a)-3 clarifies that only one periodic statement must be sent to the consumer each billing cycle, while the creditor, assignee and servicer are subject to the periodic statement requirement, they may decide among themselves who will send the statement. Comment 41(a)-4 clarifies that a creditor who no longer owns the mortgage loan or the mortgage servicing rights is not "applicable" and therefore not subject to the requirements. The Bureau interpretation of the statute would not apply the ongoing periodic statement requirements to an entity that originated the loan, but has sold both the loan and the servicing rights and no longer has any connection to the loan.

As proposed, the periodic statement carefully balances the need to provide consumers with sufficient information against the risk of overwhelming consumers with too much information. The proposed requirements are designed to make the statement easy to read, whether provided in a paper form or electronically. The Bureau believes that imposing a requirement that information be grouped would present the information in a logical format, while allowing servicers flexibility in customizing the statement. Thus, the proposed regulations discussed below would require the following groupings of information:

- *The Amount Due:* The most prominent disclosure on the statement would be the amount due. The due date of the payment due and information on the late fee is also included in this grouping.

- *Explanation of Amount Due:* This grouping would include a breakdown of the amount due, showing allocation to principal, interest, and escrow. This grouping would also provide the total sum of any fees or charges imposed, and any amount of past due payment.

- *Past Payment Breakdown:* This grouping would include a breakdown of how previous payments were applied.

- *Transaction Activity:* This grouping would be a list of any activity that credits or debits the outstanding account balance, for example, charges imposed or payments received.

The periodic statement would also include the following information:

- Certain messages as required at certain times (for example, information on funds held in a suspense or unapplied funds account).

- Contact information for the servicer.

- Account information as required by the statute, including the amount of the principal obligation, current interest rate, and when it might change (if applicable), information on prepayment penalties (if applicable) and late fees, contact information for the servicer, and housing counselor information.

- Finally, additional delinquency information would be required when a consumer is more than 45 days delinquent on his or her loan. Each of these disclosures is discussed below. Additionally, the proposed regulation sets forth requirements regarding the timing and form of the periodic statement and establishes exemptions to the requirement to provide a periodic statement.

#### 41(a) In General

Proposed § 1026.41(a) states the general requirement that, for a closed-end consumer credit transaction secured by a dwelling, a creditor, assignee, or servicer must transmit to the consumer for each billing cycle a periodic statement meeting the timing, form, and content requirements of § 1026.41, unless an exemption applies. As discussed below, the proposed requirements and exemptions are authorized under TILA sections 128(f), and 105(a) and (f), and DFA sections 1032(a) and 1405(b).

As discussed above, the periodic statement is intended to serve a variety of purposes, including informing consumers of their payment obligations, providing information about the

<sup>100</sup> *Id.*

<sup>101</sup> TILA section 129(f)(1).

mortgage loan, creating a record of transactions that increase or decrease the outstanding balance, providing the information needed to identify and assert errors, and providing information when borrowers are delinquent. To meet these goals, paragraphs (b), (c), and (d) respectively, propose the requirements for the timing, form, content, and layout of the periodic statement. Paragraph (e) proposes exemptions from the proposed periodic statement requirement.

**Entities covered.** TILA section 128(f) imposes the periodic statement requirement on creditors, assignees, and servicers. Proposed § 1026.41(a) would implement this provision by specifying that the duty to transmit periodic statements applies to the servicer, defined to mean creditor, assignee, or servicer. The consumer is only required to receive one periodic statement each billing cycle, but creditors, assignees, and servicers would all be responsible for ensuring that the consumer receives a periodic statement that meets the requirements of § 1026.41.

**Scope.** Under TILA section 128(f), the periodic statement requirement applies to residential mortgage loans. The term “residential mortgage loan” is generally defined in TILA section 103(cc)(5) to mean any consumer credit transaction that is secured by a mortgage, deed of trust, or other equivalent consensual security interest on a dwelling or on residential real property that includes a dwelling, other than a consumer credit transaction under an open-end credit plan. Consistent with this definition, proposed paragraph (a) would apply the periodic statement requirement to “any closed-end consumer credit transaction secured by a dwelling.” This language implements the substantive scope of the statute; no substantive change is intended.

**Transmit to the consumer.** Proposed § 1026.41(a) would require the servicer to transmit the periodic statement to the consumer. The term “transmit” is used in the statute. Use of this term would indicate that the servicer must do more than simply make the statement available; the statement would be required to be sent to the consumer. Paper statements mailed to the consumer would meet this requirement. As discussed below with respect to proposed § 1026.41(c), if the servicer is using an electronic method of distribution, a servicer may send the consumer an email indicating that the statement is available, rather than attaching the statement itself, to account for information security concerns.

Proposed comment 41(a)–1 clarifies that joint obligors need not receive separate statements; a single statement

addressed to both of them would satisfy the periodic statement requirement.

**Billing cycles.** Proposed § 1026.41(a) would require a periodic statement to be sent each “billing cycle.” The billing cycle corresponds to the frequency of payments, as established by the legal obligation of the consumer as determined by the mortgage note and any subsequent modifications to that obligation. Thus, if a loan requires the consumer to make monthly payments, that consumer will have a monthly billing cycle. Likewise, if a consumer makes quarterly payments, that consumer will have a quarterly billing cycle.

Based on industry outreach, the Bureau has learned of other alternatives to monthly billing cycles. Some loans may be timed to accommodate consumers employed in seasonal industries (for example, a loan may have 10 payments over the course of a year). For such loans the billing cycle may not align with the calendar months. Another non-monthly payment arrangement may occur when payments are made every other week, or other similar less-than-monthly periods. For example, servicers and consumers may arrange a bi-weekly payment program to align mortgage payments with the consumer’s paychecks. Such billing cycles may be arrangements with the servicer that do not modify the legal obligation of the consumer. In such cases, a periodic statement may, but is not required to, reflect this modified payment cycle.

The Bureau realizes that a requirement to provide statements every other week may be costly for servicers and unhelpful to consumers. In addition, such a short cycle may cause problems with information on the statement being outdated. Thus, paragraph (a) allows that if a loan has a billing cycle shorter than a period of 31 days (for example, a bi-weekly billing cycle), a periodic statement covering an entire month may be used. Related proposed comment 41(a)–2 clarifies how such a single statement would aggregate information from multiple billing cycles.

**Authority.** Proposed paragraph (a) implements new TILA section 128(f)(1) requiring that a creditor, assignee, or servicer, with respect to any closed-end consumer credit transaction secured by a dwelling must transmit a periodic statement to the consumer. In addition, the Bureau proposes in paragraph (a) to use its authority under TILA section 105(a) and (f) and DFA section 1405(b) to exempt creditors, assignees, and servicers of residential mortgage loans from the requirement in TILA section 128(f)(1)(G) to transmit periodic

statement each billing cycle when the billing cycle is less than a month, and to instead permit servicers to provide an aggregated periodic statement covering an entire month. For the reasons discussed above, the Bureau believes that the proposed exception is necessary and proper under TILA section 105(a) both to effectuate the purposes of TILA—to promote the informed use of credit and protect consumers against inaccurate and unfair credit billing practices—and to facilitate compliance. Moreover, the Bureau believes, in light of the factors in TILA section 105(f), that sending periodic statements more than once a month would not provide a meaningful benefit to consumers. Specifically, the Bureau considers that the exemption is proper irrespective of the amount of the loan, the status of the borrower (including related financial arrangements, financial sophistication, and the importance to the borrower of the loan), or whether the loan is secured by the principal residence of the consumer. Further, in the estimation of the Bureau, consistent with DFA section 1405(b), the proposed exemption will prevent the consumer confusion that might result from receiving multiple periodic statements in close sequence, thus furthering the consumer protection purposes of the statute.

Paragraph (b) interprets the statutory requirement that a periodic statement must be provided for each billing cycle by requiring the periodic statement be delivered or placed in the mail within a reasonably prompt time after the close of the grace period of the previous billing cycle.

Paragraph (c) invokes authority under TILA sections 105(a), 122, and 128(f)(2) to require that the disclosures must be made clearly and conspicuously in writing, or electronically if the consumer agrees, and in a form the consumer may keep. The Bureau also interprets the statute to mandate certain of these form requirements.

As discussed in more detail below, the Bureau generally proposes to impose the periodic statement requirement pursuant to its authority under TILA sections 128(f) and 105(a), and DFA sections 1032(a) and 1405(b).

#### 41(b) Timing of the Periodic Statement

Proposed § 1026.41(b) provides that the periodic statement must be sent within a reasonably prompt time after the close of the grace period of the previous billing cycle. Proposed comment 41(b)–1 provides that four days after the close of any grace period would be considered reasonably prompt.

For the first payment on the mortgage loan, proposed paragraph (b) would require that the first periodic statement be sent no later than 10 days before this first payment is due. This adjustment is necessary because there is no previous billing cycle from which to time the sending of the first statement.

The periodic statement serves the dual purposes of giving an accounting of payments received since the previous periodic statement, and reminding the consumer about the upcoming payment. To achieve these dual purposes, the periodic statement must arrive after the last payment was received and before the next payment is due, which can be a relatively narrow window. If a payment is due on the first of the month, grace periods may give the consumer as late as the 15th of the month to make that payment. Thus, if a statement is sent before the 15th of the month, that statement may not reflect the consumer's most recent payment, or any late charge imposed due to a late payment. However, if a statement is sent at the close of the month, that statement may not arrive before the next payment is due on the first day of the next month. Allowing a few days for processing and mailing of statements creates a tight timeframe. The Bureau seeks comment on whether the proposed regulation appropriately addresses this timeframe. Additionally, the Bureau seeks comment on whether it is operationally difficult to have the first statement delivered or placed in the mail 10 days before the first payment is due.

The Bureau interprets the requirement in TILA section 128(f) that periodic statements be sent for "each billing cycle" to authorize the timing requirements proposed in § 1026.41(b). In addition, the proposed timing requirements are authorized under TILA section 105(a), and DFA sections 1032(a) and 1405(b). For the reasons noted above, the Bureau believes, consistent with TILA section 105(a), that the proposed requirements are necessary and proper to effectuate the purposes of TILA to assure a meaningful disclosure of credit terms and protect consumers against inaccurate and unfair credit billing practices by assuring that consumers receive the periodic statement at a time that is useful to them. In addition, consistent with DFA section 1032(a), the Bureau believes that the proposed timing requirements help ensure that the features of consumers' residential mortgage loans, both initially and over the term of the loan, are effectively disclosed to consumers in a manner that permits them to understand the costs, benefits, and risks associated

with the loan. Moreover, consistent with DFA section 1405(b), the Bureau believes that the proposed timing requirements would improve consumer awareness and understanding of their residential mortgage loans by assuring that consumers receive the periodic statements at a meaningful time, after their last payment is made and before their next payment is due, and that proposed requirements are thus in the interest of consumers.

#### 41(c) Form of the Periodic Statement

Proposed § 1026.41(c) provides that the periodic statement disclosures required by section § 1026.41 must be made clearly and conspicuously in writing, or electronically, if the consumer agrees, and in a form the consumer may keep. TILA section 128(f)(1) specifies that periodic statements must be "conspicuous and prominent," and TILA section 128(f)(2) requires the Bureau to develop and prescribe a standard form to be transmitted in writing or electronically. The Bureau proposes to implement these provisions, in part through the form requirements set forth in proposed § 1026.41(c) and the related forms provided in Appendix H-28. In addition, the proposed form requirements are authorized under TILA section 122, which requires the disclosures under TILA be clear and conspicuous, TILA section 105(a) and DFA sections 1032(a) and 1405(b). As discussed below, the Bureau believes, consistent with TILA section 105(a), that the proposed form requirements are necessary and proper to effectuate the purposes of TILA to assure a meaningful disclosure of credit terms and protect the consumer against inaccurate and unfair credit billing practices by assuring that the periodic statement sent to consumers is in a form that they can understand. In addition, consistent with DFA section 1032(a), the Bureau believes that the proposed form requirements help ensure that the features of consumers' residential mortgage loans, both initially and over the term of the loan, are effectively disclosed to consumers in a manner that permits them to understand the costs, benefits, and risks associated with the loan. Moreover, consistent with DFA section 1405(b), the Bureau believes that the proposed form requirements would improve consumer awareness and understanding of their residential mortgage loans by assuring that the periodic statements sent to consumers are in a useable form that is easy to understand and that the form requirements are thus in the interest of consumers and the public interest.

*Clear and conspicuous.* TILA section 122 requires that disclosures under TILA be clear and conspicuous. Existing § 1026.31(b) generally implements this requirement with respect to disclosures required by subpart E, where new § 1026.41 will be located. Section 1026.31(b) applies only to creditors, however. Thus, to make this requirement applicable to servicers (defined to include creditors and assignees), proposed paragraph 41(c) would require, consistent with TILA section 122 and existing § 1026.31(b), that the periodic statement be clear and conspicuous. Proposed comment 41(c)-1 clarifies the clear and conspicuous standard, stating that it generally requires that disclosures be in a reasonably understandable form, and explains that other information may be included on the statement, so long as that other information does not overwhelm or obscure the required disclosures. Thus, information that is traditionally found on their periodic statements, but not proposed as required by this regulation, such as the servicer's logo, information on payment methods, or additional information on escrow accounts, may continue to be included on periodic statements.

*Additional information.* Proposed comment 41(c)-2 states that nothing in this subpart prohibits a servicer from including additional information or combining disclosures required by other laws with the disclosures required by § 1026.41, unless such prohibition is expressly set forth in § 1026.41 or the applicable law. For example, the grouping requirements discussed below may not be overridden by additional information in the statement.

Based on industry outreach, the Bureau understands that some institutions provide a combined statement for mortgage loans and other financial products. For example if a consumer has both a checking account and a mortgage with a credit union, the consumer may receive a single combined statement. The Bureau seeks comment on how servicers would actually combine statements. In particular, the Bureau notes that difficulties may arise when different disclosures have different timing requirements, and when multiple disclosures have requirements that information be presented on the first page of the statement. For example, if both mortgage loan disclosures and credit card disclosures are required to be on the first page of a statement, how would these statements be combined?

*Electronic distribution.* TILA section 128(f)(2) provides that periodic statements "may be transmitted in

writing or electronically.” Consistent with this provision, proposed § 1026.41(c) would allow statements to be provided electronically, if the consumer agrees. As discussed above, the requirement to transmit a periodic statement to the consumer may be met by sending the consumer an e-mail notification that the statement is available, rather than e-mailing the statement itself in light of information security concerns. This paragraph would require only affirmative consent by the consumer to receive statements, not compliance with E-Sign verification procedures. The Bureau does not believe E-Sign consent is required by the statute. E-Sign is designed to provide an electronic alternative to required writings. The statute, however, requires only periodic “statements” as opposed to “writings” to be transmitted to consumers. Additionally, the statute contemplates electronic statements, as TILA section 129(f)(2) provides that the Bureau shall prescribe a standard form, taking into account that the statements required may be transmitted in writing or electronically. Thus, the Bureau believes that Congress did not intend to require E-Sign verification procedures. The Bureau seeks comment as to whether additional requirements should be placed on when a consumer consents to receiving electronic statements. For example, must consent be obtained or confirmed electronically in a manner that demonstrates that the consumer is able to access information electronically? The Bureau also seeks comment on whether consumers who already receive electronic statements should be deemed as having consented to receive statements electronically. Additionally, the Bureau seeks comment on whether consumers who have auto-debit set up to deduct payments from their bank account should be deemed as having consented to receive statements electronically.

**Retainability.** Proposed § 1026.41(c) would require the disclosure be provided in a form the consumer may keep. Paper statements sent by mail or provided in person, would satisfy this requirement. If electronic statements are used, they must be in a form which the consumer can print or download.

**Sample forms.** Proposed § 1026.41(c) also states that sample forms are provided in Appendix H–28, and that appropriate use of these forms will be deemed to comply with the section. The sample forms were developed through consumer testing as discussed in part III.B above, and are intended to give guidance regarding compliance with proposed § 1026.41. However, they are not required forms, and any

arrangements of the information that meet the requirements of proposed § 1026.41 would be considered in compliance with the section. The sample forms also contain additional information (for example, a tear-off coupon on the bottom) that is not required to be on the form, but is included to give context to the sample. These proposed regulations and sample forms were crafted to give servicers flexibility in designing their periodic statements. The Bureau proposes these sample forms pursuant to its authority, inter alia, under TILA section 128(f)(2).

#### 41(d) Content and Layout of the Periodic Statement

Proposed § 1026.41(d) contains content and layout requirements that implement, in part, TILA section 128(f), and is additionally authorized under TILA section 105(a) and DFA sections 1302(a) and 1405(b).

The content required by paragraph (d) is authorized under TILA section 128(f)(1). Such content is authorized as follows:

- **Statutorily-required content:** TILA sections 128(f)(1)(a) through (g) requires the inclusion of certain items of information in the periodic statement. The proposed regulation generally implement these provisions by requiring the content set forth in § 1026.41(d)(1)(ii), (6) and (7), and the description of late fees in § 1026.41(d)(4).

- **Additional content:** TILA section 128(f)(1)(H) requires inclusion in periodic statements of such other information as the Bureau may prescribe by regulation. The remainder of the content of the periodic statement is proposed under this authority.

The grouping and other form requirements of the layout in paragraph (d) implement, in part, the requirement under TILA section 128(f)(1) that the content of the periodic statement be presented in a conspicuous and prominent manner, and under TILA section 128(f)(2) for the Bureau to develop and prescribe a standard form for the periodic statement disclosure. In addition, as discussed above with respect to the form requirements under § 1026.41(c) and for the reasons explained below, the proposed grouping and form requirements under § 1026.41(d) are authorized under TILA section 105(a) and DFA sections 1032(a) and 1405(b).

The periodic statement is designed to provide the consumer with information in an easy-to-read format. The goal of the proposed grouping and form requirements is to highlight key information—the amount due—and

organize information so the statement would not be overwhelming to the consumer. The commentary to paragraph (d), discussed below, reflects these goals.

**Exemptions and adjustments:** TILA section 128(f)(1)(G) requires the periodic statement to include the names, addresses and other contact information for government-certified counseling agencies or programs reasonably available to the consumer. For the reasons discussed below, the Bureau proposes to use its authority under TILA section 105(a) and (f) to exempt servicers from having to include this information in periodic statements to and to instead require the periodic statement to include contact information for the State housing finance authority for the State in which the property is located and information to access the HUD list or Bureau list of homeownership counselors or counseling organizations. This adjustment is additionally authorized under DFA section 1405(b).

**Close proximity.** Proposed § 1026.41(d) would require specific disclosures be grouped together and presented in close proximity. Information is grouped together to aid the consumer in understanding relatively complex information about their mortgage. The General Design Principles discussed in the Macro final report (Macro Report) include grouping together related concepts and figures because consumers are likely to find it easier to absorb and make sense of financial forms if the information is grouped in a logical way.<sup>102</sup>

Proposed comment 41(d)–1 clarifies that close proximity requires items to be grouped together and set off from the other groupings of items. This can be accomplished, for example, by including lines or boxes on the statement, or by including white space between the groupings. Items required to be in close proximity should not have any intervening text between them. The close proximity standard is found in other parts of Regulation Z, including §§ 1026.24(b) and 1026.48. In both provisions, the commentary interprets close proximity to require the information to be located immediately next to or directly above or below, without any intervening text or graphical displays.<sup>103</sup>

**Information not applicable.** Proposed comment 41(d)–2 provides that information that is not applicable to the loan may be omitted from a periodic statement. For example, if a loan does

<sup>102</sup> Macro Report, *supra* note 38, at 4.

<sup>103</sup> See comments 24(b)–2 and 48–3 respectively.

not have a prepayment penalty, the periodic statement may omit the prepayment penalty disclosure.

**Terminology.** Proposed comment 41(d)–3 provides that the periodic statement may use terminology other than that found on the sample forms so long as the new terminology is commonly understood. This gives servicers the flexibility to use regional terminology or commonly used terms with which consumers are familiar. For example, during consumer testing in California, participants were confused by the use of the term “escrow.” One participant explained that in California, the term “escrow” refers to an account set up to hold funds until a homebuyer closes on the house. This participant said he was more familiar with the term “impound account” to refer to the account holding funds for taxes and insurance.<sup>104</sup> In this example, use of the term “impound account” to refer to the escrow account for taxes and insurance would be permitted for periodic statements provided to consumers in California.

#### 41(d)(1) Amount Due

Proposed § 1026.41(d)(1) would require the periodic statement to provide information on the amount due, the payment due date, and the amount of any fee that would be assessed for a late payment, as well as the date on which that fee would be imposed if payment is not received. This information would have to be grouped together and located at the top of the first page of the statement. The amount due would have to be more prominent than any information on the page. This is consistent with the general principle of designing disclosures to highlight the most important information for consumers to make it easy for them to find.<sup>105</sup> A primary purpose of the periodic statement is to alert the consumer to upcoming payment obligations. The Bureau interprets TILA section 129(f)(E), which requires the periodic statement to include a description of any late payment fees, to require disclosure of the amount of any fees that would be assessed for late payments as well as the date the fee would be imposed if the payment has not been received, as well as other information regarding late fees discussed below. Although information concerning the amount due and the payment due date is not enumerated in the statute, the Bureau believes that this is the information the consumer is most likely to need. Because of the

importance of this information, it is placed in the prominent position of the top of the first page, and the total amount must be the most prominent item on the page. In consumer testing, all participants were able to identify the amount due on the sample periodic statement presented to them.<sup>106</sup>

If the consumer has a payment-option loan, each of the payment options must be displayed with the amount due information. An example of such a statement is included in proposed Appendix H–28(C).

#### 41(d)(2) Explanation of Amount Due

Proposed § 1026.41(d)(2) would require periodic statements to include an explanation of the amount due, providing the monthly payment amount, including the allocation of that payment to principal, interest and escrow (if applicable). Additionally, the statement would have to provide the total fees or charges incurred since the last statement, and any amount past-due (which would include both over-due payments and over-due fees). This information would have to be grouped together in close proximity and located on the first page of the statement.

The Explanation of Amount Due is intended to give consumers a snapshot of why they are being asked to pay the amount due. At a glance, consumers would be able to see their payment amount; how much is allocated to principal, interest and escrow (if applicable); and the total fees or other charges incurred since the last statement; and any post-due amounts. In this section, the fees incurred since the last statement would be shown in aggregate; a breakdown of the individual fees would be provided in the Transaction Activity section, discussed below. Additionally, this section would show the total of past due payments and fees from previous billing cycles. In the first round of consumer testing, Macro tested the form to see if participants were able to understand what charges constituted the total amount due. The sample form used in testing showed a late payment fee. After looking at the Explanation of Amount Due, all participants understood the amount due included a regular monthly payment and a late fee.<sup>107</sup> This indicates that the Explanation of Amount Due helps consumers understand the amount they need to pay.

If the consumer has a payment-option loan, a breakdown of each of the payment options would be required in the Explanation of Amount Due.

Additionally, the Explanation of Amount Due would require inclusion of information about how each of the payment options will affect the outstanding loan balance. A form with such a box was tested during consumer testing. All but one of the participants were able to understand the effects the different payment options would have on their loan balance—that the loan balance would decrease, stay the same (for interest-only payments) or increase.<sup>108</sup> A sample form is provided in Appendix H–28(C).

#### 41(d)(3) Past Payment Breakdown

Proposed paragraph (d)(3) would require periodic statements to include a snapshot of how past payments have been applied. Proposed § 1026.41(d)(3)(i) would require the periodic statement to include both the total of all payments received since the last statement and a breakdown of how those payments were applied to principal, interest, escrow, fees, and charges, and any partial payment or suspense account (if applicable). Proposed § 1026.41(d)(3)(ii) would require the total of all payments received since the beginning of the calendar year and a breakdown of how those payments were applied to principal, interest, escrow, fees, and charges, as well as the amount currently held in any partial payment or suspense account (if applicable). This information would have to be grouped together in close proximity, and located on the first page of the statement.

The past payment breakdown disclosure serves several purposes on the periodic statement, including creating a record of payment application, providing the consumer information needed to assert any errors, and providing information about the mortgage expenses.

The breakdown in paragraph (d)(3)(i), showing all payments made since the last statement, would allow the consumer to confirm that his or her payments was properly applied. If the payments were not properly applied, the breakdown would provide the consumers the information needed to assert an error. Although testing participants had some confusion about partial payments as discussed below, they were able to identify how their payments had been applied based on the past payment breakdown information included on the sample statement.<sup>109</sup>

Both the breakdown since the last billing cycle and the breakdown of the

<sup>104</sup> Macro Report, *supra* note 38, at 12.

<sup>105</sup> *Id.* at 4.

<sup>106</sup> *See id.* at 6.

<sup>107</sup> *Id.*

<sup>108</sup> *Id.* at 14.

<sup>109</sup> *Id.* at 9.

year-to-date play an important role in educating the consumer. The payments since the last statement inform consumers of how much their outstanding principal has decreased, while the year-to-date information educates consumers on the costs of their mortgage loan. Consumer testing revealed that consumers may be surprised by how much of their payment is going to interest or fees as opposed to principal. Aggregated over the year-to-date can bring this expense to a consumers' attention, and motivate them to possibly change behaviors that are generating significant expenses. For example, consumers who habitually submit their payment a few days late may correct this behavior if they realize it is costing them hundreds of dollars a year. The breakdown of all payments made in the current calendar year to date is of particular importance in educating consumers about their loans, especially since there is no other mandated year-end summary of all payments received and their application. The past payment breakdown, of both the payments since the last statement, and payments for the year to date, provides the consumer with important information that is not currently required to be disclosed.

**Partial Payments.** Proposed comment 41(d)(3)-1 provides guidance on how partial payments that have been sent to a suspense account should be reflected in the past payments breakdown section of the periodic statement. The proposed comment provides illustrative examples of how partial payments sent to a suspense account should be listed as unapplied funds since the last statement and year to date. Consumer testing revealed that consumers have very little understanding about how partial payments are handled.<sup>110</sup> As discussed in part IV.C above, the periodic statement is designed to help consumers understand how partial payments are processed. The past payment breakdown is useful in communicating information about partial payments and suspense accounts to consumers.

#### 41(d)(4) Transaction Activity

Proposed § 1026.41(d)(4) would require the periodic statement to include a Transaction Activity section that lists any activity since the last statement that credits or debits the outstanding account balance. For each transaction, the statement would include the date of the transaction, a description of the transaction, and the amount of the transaction. This information must be grouped together,

but may be provided anywhere on the statement.

Proposed comment 41(d)(4)-1 clarifies that transaction activity includes any activity that credits or debits the outstanding loan balance. For example, proposed comment 41(d)(4)-1 states that transaction activity would include, without limitation, payments received and applied, payments received and sent to a suspense account, and the imposition of any fee or charge. Thus, the Transaction Activity section would provide a list of all charges and payments, covering the time from the last statement until the current statement is printed. This disclosure would allow the consumer to understand what charges are being imposed and provide further detail regarding the aggregated numbers found in the "Explanation of Amount Due" section. The Transaction Activity section would provide a record of the account since the last statement, allowing the consumer to review for errors, ensure payments were received, and understand any and all costs. If a servicer receives a partial payment and decides to return the payment to the consumer, such a payment would not need to be included as a line item in the Transaction Activity section, because this activity would neither credit nor debit the outstanding account balance. The Bureau seeks comment on whether the periodic statement should be required to include a message under paragraph (d)(5) when a partial payment is returned to the consumer.

**Late fee description.** Proposed comment 41(d)(4)-2 clarifies that the description of any late fee charge in the transaction activity section includes the date of the late fee, the amount of the late fee, and the fact that a late fee was imposed. The Bureau interprets TILA section 129(f)(E), which requires that the periodic statement include "a description" of any late payment fees, to require disclosure of this information, as well as information regarding late fees discussed above.

**Suspense accounts.** Proposed comment 41(d)(4)-3 clarifies that if a partial payment is sent to a suspense account, the fact of the transfer should be reflected in the transaction description (for example, a partial payment entry in the transaction activity might read: "Partial payment sent to suspense account"), the funds sent to the suspense account should be reflected in the unapplied funds section of the past payment breakdown, and an explanation of what must be done to release the funds should be provided in the messages section. The messages section, discussed below, should

include an explanation of what the consumer must do to release the funds from the suspense account.

#### 41(d)(5) Messages

Proposed § 1026.41(d)(5) would require a message on the front of the statement if a partial payment of funds is being held in a suspense account regarding what must be done for the funds to be applied.

The Bureau seeks comment on what, if any, additional messages should be required. In particular, the Bureau seeks comment on whether there should be a required disclosure where the consumer has a negatively-amortizing or interest-only loan. Additionally, the Bureau seeks comment on whether there should be a required disclosure on private mortgage insurance and when it may be eliminated. Finally, the Bureau seeks comment as to if more than one message is required, and if so, should these be grouped together and should these messages be required to be on the first page of the statement?

#### 41(d)(6) Contact Information

Proposed § 1026.41(d)(6) would require that the periodic statement contain contact information specifying where a consumer may obtain information regarding the mortgage. Proposed comment 41(d)(6)-2 clarifies that this contact information must be the same as the contact information for asserting errors or requesting information. The Bureau seeks comment on whether consumers are likely to contact the servicer for information other than errors or inquiries, which would necessitate a different number being included on the periodic statement. Proposed § 1026.41(d)(6) provides that the contact information provided must include a toll-free telephone number. Proposed comment 41(d)(6)-1 clarifies that the servicer may provide additional information, such as a web address, at its option. Proposed § 1026.41(d)(6) does not require that the contact information be set off in a separate section, but simply that it be included on the front page of the statement. This proposed requirement would allow servicers to include this information with their company name and logo at the top of the page or elsewhere on the statement.

#### 41(d)(7) Account Information

Proposed § 1026.41(d)(7) would require that the following information about the mortgage, as required by the statute, be included on the statement: The amount of principal obligation, the current interest rate in effect for the loan, the date on which the interest rate

<sup>110</sup> *Id.* at 11.

may next reset or adjust, the amount of any prepayment penalty, and information on housing counselors. This information may be included anywhere on the statement. This information may, but need not be, grouped together. While the sample form has this information on the first page, the servicer is not required to include this information on the first page.

**Prepayment penalty.** Proposed § 1026.41(d)(7)(iv) defines a prepayment penalty as “a charge imposed for paying all or part of a transaction’s principal before the date on which the principal is due.” This definition is further clarified in the proposed commentary. Proposed comment 41(d)(7)(iv)–1 gives the following examples of prepayment penalties: (1) A charge determined by treating the loan balance as outstanding for a period of time after prepayment in full and applying the interest rate to such “balance,” even if the charge results from interest accrual amortization used for other payments in the transaction under the terms of the loan contract; (2) a fee, such as an origination or other loan closing cost, that is waived by the creditor on the condition that the consumer does not prepay the loan; (3) a minimum finance charge in a simple interest transaction; and (4) computing a refund of unearned interest by a method that is less favorable to the consumer than the actuarial method, as defined by section 933(d) of the Housing and Community Development Act of 1992, 15 U.S.C. 1615(d). Proposed comment 41(d)(7)(iv)–1.i further clarifies that “interest accrual amortization” refers to the method by which the amount of interest due for each period (e.g., month) in a transaction’s term is determined and states, for example, that “monthly interest accrual amortization” treats each payment as made on the scheduled, monthly due date even if it is actually paid early or late (until the expiration of any grace period). The proposed comment also provides an example where a prepayment penalty of \$1,000 is imposed because a full month’s interest of \$3,000 is charged even though only \$2,000 in interest was accrued in the month during which the consumer prepaid.

Proposed comment 41(d)(7)(iv)–2 clarifies that a prepayment penalty does not include: (1) Fees imposed for preparing and providing documents when a loan is paid in full, if the fees are imposed whether or not the loan is prepaid, such as a loan payoff statement, a reconveyance document, or another document releasing the creditor’s security interest in the

dwelling that secures the loan; or (2) loan guarantee fees.

The definition of prepayment penalty in proposed § 1026.41(d)(7)(iv) and comments 41(d)(7)(iv)–1 and –2 substantially incorporate the definitions of and guidance on prepayment penalties from other rulemakings addressing mortgages and, as necessary, reconciles their differences. For example, the Bureau is proposing to incorporate the language from the Board’s 2009 Closed-End Proposal but omitted in the Board’s 2011 ATR Proposal listing a minimum finance charge as an example of a prepayment penalty and stating that loan guarantee fees are not prepayment penalties, because similar language is found in longstanding Regulation Z commentary. Based on the differing approaches taken by the Board in its recent mortgage proposals, however, the Bureau seeks comment on whether a minimum finance charge should be listed as an example of a prepayment penalty and whether loan guarantee fees should be excluded from the definition of the term prepayment penalty.

The Bureau expects to coordinate the definition of the term prepayment penalty in proposed § 1026.41(d)(7)(iv) with the definitions in other pending rulemakings relating to mortgages.

The Bureau seeks comment on the feasibility of disclosing the amount of any prepayment penalty, as the amount of the penalty could depend on the timing or amount of prepayment, and if a preferable alternative would be to disclose the maximum amount of a prepayment penalty. Alternatively, the Bureau seeks comment on whether a better alternative would be for the periodic statement to disclose the existence of a prepayment penalty in place of the amount.

**Housing counselors.** Proposed § 1026.41(d)(7)(v) would require the periodic statement to include contact information for the State housing finance authority for the State in which the property is located, and information to access either the Bureau list or the HUD list of homeownership counselors or counseling organizations.

TILA section 128(f)(1)(G) requires the periodic statement to include the names, addresses, telephone numbers and Internet addresses of counseling agencies or programs reasonably available to the consumer that have been certified or approved and made publically available by the Secretary of Housing and Urban Development or a State housing finance authority.

On July 9, 2012, the Bureau released the 2012 HOEPA Proposal to implement other Dodd-Frank Act provisions,

including the requirement to provide a list of housing counselors in connection with the application process for mortgage loans.<sup>111</sup> In connection with those requirements, the Bureau proposed to require creditors to provide a list of five homeownership counselors or counseling organizations to applicants for various categories of mortgage loans. The Bureau also indicated that it is expecting to develop a website portal that would allow lenders to type in the loan applicant’s zip code to generate the requisite list, which could then be printed for distribution to the loan applicant. This will allow creditors to access lists of the housing counselors with a minimum amount of effort.<sup>112</sup>

In connection with the periodic statement requirement, however, the Bureau is proposing to use its exception authority to require servicers simply to list where consumers can find a list of counselors, rather than to reproduce a list of counselors in each billing cycle. The Bureau believes that this approach appropriately balances consumer and servicer interests based on several considerations.

First, the Bureau is concerned about information overload for consumers. The periodic statement contains a significant amount of information already. While consumers who are deciding whether to take out a mortgage loan in the first instance may greatly benefit from consultation with a housing counselor, that likelihood is greatly reduced with regard to consumers receiving regular periodic statements on existing loans.

Second, the burden on servicers to import the list of counselors into a periodic statement document or to attach a list with each billing cycle is significantly higher than with regard to a single provision of the list. Space on the periodic statements is limited, and importing updated information from the CFPB website each cycle would involve more programming burden than simply listing the two agencies’ websites in the first instance.

To address these concerns, the proposal would require that the periodic

<sup>111</sup> See 2012 HOEPA Proposal, available at [http://files.consumerfinance.gov/f/201207\\_cfpb\\_proposed-rule\\_high-cost-mortgage-protections.pdf](http://files.consumerfinance.gov/f/201207_cfpb_proposed-rule_high-cost-mortgage-protections.pdf), at 29–35.

<sup>112</sup> The list provided by the lender pursuant to the 2012 HOEPA Proposal would include only homeownership counselors or counseling organizations from either the most current list of homeownership counselors or counseling organizations made available by the Bureau for use by lenders, or the most current list maintained by HUD of homeownership counselors or counseling organizations certified by HUD, or otherwise approved by HUD. See *id.* at 32–33.

statements include the contact information to access the State housing finance authority for the State in which the property is located, and the website and telephone number to access either the Bureau list or the HUD list of homeownership counselors or counseling organizations.<sup>113</sup> Directing consumers to this information would allow them to choose a program or agency conveniently located for them, and would allow the consumer to locate other programs or agencies if those contacted initially could not help the consumer at that time. The Bureau seeks comment on whether this proposal strikes an appropriate balance, and on the benefits and burdens to both borrowers and servicers of requiring that a list of several individual housing counselors be included in or with the periodic statement.

Because housing counselor information may not be relevant to consumers who are current and not facing any problems, the proposal does not require this information to be on the front of the statement. The Bureau seeks comment if this information should be required to be located on the front of this statement. In a related requirement, when the delinquency information is provided, the proposed regulations would require that the delinquency information contain a reference to this housing counselor information. This would ensure that the housing counselor information would be brought to the attention of delinquent consumers. These provisions are discussed further below.

The Bureau expects to coordinate the housing counselor information requirement in proposed § 1026.41(d)(7)(v) with the definitions in other pending rulemakings concerning mortgage loans that address housing counselors. The Bureau believes that, to the extent consistent with consumer protection objectives, adopting a consistent approach to providing housing counselor information across its various pending rulemakings will facilitate compliance. The Bureau notes that other housing counselor requirements (for example, the ARMs initial interest rate adjustment notification) require the contact information for the State housing finance authority for the State in which the consumer resides (as opposed to the State in which the property is located). While the Bureau expects the State in which the property is located will most often be the State where the consumer

resides, under certain circumstances (a vacation home), these may be different States. Additionally, the Bureau notes that a difference in regulation requirements for different disclosures may increase compliance costs for servicers. The Bureau seeks comment on which State housing finance authority's contact information should be required on the periodic statement.

The Bureau proposes to use its authority under TILA section 105(a) and (f) and DFA section 1405(b) to exempt creditors, assignees, and servicers of residential mortgage loans from the requirement in TILA section 128(f)(1)(G) to include in periodic statements contact information for government-certified counseling agencies or programs reasonably available to the consumer, and to instead require that periodic statements disclose the State housing finance authority for the State in which the property is located and information to access either the Bureau list or HUD list of homeownership counselors or organizations. For the reasons discussed above, the Bureau believes that the proposed exception and addition is necessary and proper under TILA section 105(a) both to effectuate the purposes of TILA—to promote the informed use of credit and protect consumers against inaccurate and unfair credit billing practices—and to facilitate compliance. Moreover, the Bureau believes, in light of the factors in TILA section 105(f), that disclosure of the information specified in TILA section 128(f)(1)(G) would not provide a meaningful benefit to consumers. Specifically, the Bureau considers that the exemption is proper irrespective of the amount of the loan, the status of the borrower (including related financial arrangements, financial sophistication, and the importance to the borrower of the loan), or whether the loan is secured by the principal residence of the consumer. Further, in the estimation of the Bureau, the proposed exemption will simplify the periodic statement, and improve the housing counselor information provided to the consumer, thus furthering the consumer protection purposes of the statute. In addition, consistent with DFA section 1405(b), the Bureau believes that the proposed modification of the requirements in TILA section 128(f)(1)(G) will improve consumer awareness and understanding and is in the interest of consumers and in the public interest.

#### 41(d)(8) Delinquency Notice

Proposed § 1026.41(d)(8) would require that if the consumer is more than 45 days delinquent, the servicer must include on the periodic statement

certain delinquency information grouped together. The accounting of mortgage payments is confusing at best, and becomes significantly more complicated in a delinquency scenario. The combination of fees, partial payments being sent to suspense accounts, and application of payments to oldest outstanding payments due can quickly lead to confusion. Additionally, consumers in delinquency are often facing stress due to the situation that left them unable to make their mortgage payments. The proposed early intervention rules would require servicers to disclose information about loss mitigation or loan modification, but this information would not be customized to individual consumers. The delinquency notice, discussed below, would provide information that is tailored to the specific consumer. This information would benefit the consumer in several ways. First, this notice would ensure that the consumer is aware of the delinquency as well as potential consequences. Second, this information would ensure that the consumer has the information about his or her loan. For example, certain loan modification programs are tied to specific timelines in delinquency. This information would ensure that consumers understand the timeline for their delinquency so they can benefit from early intervention information. Finally, the delinquency information would create a record of how payments were applied, which would both help consumers understand the amount due and give consumers the information needed to become aware of any errors so they could use the appropriate error resolution procedures.

*Delinquency date and risks.* Proposed paragraph (d)(8)(i) would require the periodic statement to include the date on which the consumer became delinquent. Many timelines relevant to the loss mitigation and foreclosure processes are based on the number of days of delinquency. For example, under certain programs consumers may not be eligible for a loan modification unless they are at least 60 days delinquent. However consumers may not know the date on which he or she was first considered delinquent. This can be especially confusing in a scenario where the consumer is making partial payments. Proposed paragraph (d)(8)(ii) would require the periodic statement to include a statement reminding the consumer of potential risks of delinquency, for example, late fees may be assessed or, after a number of months, the consumer can be subject to foreclosure.

<sup>113</sup> At the time of publishing, the Bureau list was not yet available and the HUD list is available at <http://www.hud.gov/offices/hsg/sfh/hcc/hcs.cfm>.

*A recent account history.* Proposed paragraph (d)(8)(iii) would require the periodic statement to include a recent account history as part of the delinquency information. The accounting associated with mortgage loan payments is complicated, and can be even more so in delinquency situations. The accrual of fees and the application of payments to past months can make it very difficult for consumers to understand the exact amount he or she owes on the loan, and how that total was calculated. Additionally, this complex accounting makes it very difficult for a consumer to identify errors in of payment allocations. Although some of this information would be available from previous periodic statements, the Bureau believes that providing a separate recent account history is warranted under the circumstances.

The Bureau believes that the recent account history would enable the consumer to understand how past payments were applied, provide the information needed to identify any errors, and provide the information necessary to make financial decisions. Proposed paragraph (d)(8)(iii) would require the account history to show the amount due for each billing cycle, or the date on which a payment for a billing cycle was considered fully paid. The date on which the payment was considered fully paid is included to help a consumer understand that a past payment that was previously delinquent has been considered paid. For example, suppose a delinquent consumer does not make a payment in January, but makes a regular payment in February. Without the account history, the consumer would not be able to verify that payments were properly applied. The account history is limited to the lesser of the past 6 months or the last time the account was current to avoid creating a long list that could overwhelm the rest of the periodic statement.

*Notice of any loan modification programs.* Proposed paragraph (d)(8)(iv) would require the periodic statement to include as part of the delinquency information in the periodic statement notice of any acceptance into a modification program, either trial or permanent, create a record of acceptance into the modification program.

*Notice if the loan has been referred to foreclosure.* Proposed paragraph (d)(8)(v) would require the periodic statement to include, as part of the delinquency information notice, that the loan has been referred to foreclosure, if

applicable, to ensure that the consumer is aware of any pending foreclosure.

*Total amount to bring the loan current.* Proposed paragraph (d)(8)(vi) would require that the total amount needed to bring the loan current be included in the delinquency information to ensure that consumers knows how much money they must pay to bring the loan back to current status.

*Housing counselor information reference.* Proposed paragraph (d)(8)(vii) would require that the delinquency notice also contain a statement directing the consumer to the housing counselor information located on the statement, as proposed by paragraph (d)(7)(v). For example, if the housing counselor information is on the back of the statement, the delinquency information, on the front of the statement, would direct consumers to the back of the statement.

*45 Days.* The delinquency information is intended to assist consumers who have fallen behind on their mortgage payments. The proposal would not require provision of this information until the consumer is 45 days delinquent. The Bureau recognizes that not all delinquencies indicate troubled consumers; a single missed payment may be the result of other factors such as misdirected mail. Such consumers would likely be notified of a single missed payment by their servicer, and the lack of payment received would be reflected on the next periodic statement. These consumers would receive minimal additional benefit from the delinquency information, and, if this is a frequent occurrence, such consumers might become accustomed to ignoring the delinquency information. By contrast, two missed payments likely indicate a potentially more serious issue, unlike simply failing to remember to send in a payment on time. Thus, the delinquency information would be required at 45 days to ensure receipt of this information by a borrower who missed two consecutive payments.

#### 41(e) Exemptions

##### 41(e)(1) Reverse Mortgages

Proposed § 1026.41(e)(1) exempts reverse mortgages, as defined by § 1026.33(a), from the periodic statement requirement. The Bureau is proposing this exemption for reverse mortgages because the periodic statement requirement was designed for a traditional mortgage product. Information that would be relevant and useful on a reverse mortgage statement differs substantially from the information required on the periodic statement. Incorporating the unique

aspects of a reverse mortgage into the periodic statement regulations would require massive alterations to the form and regulation. The Bureau believes that it is more appropriate to address consumer protections relating to reverse mortgages in a separate comprehensive rulemaking.

The Bureau proposes to use its authority under TILA sections 105(a) and (f) and DFA section 1405(b) to exempt reverse mortgages from the requirement in TILA section 128(f) to provide periodic statements. For the reasons discussed above, the Bureau believes the proposed exemption is necessary and proper under TILA section 105(a) both to effectuate the purposes of TILA, and to facilitate compliance.

Moreover, the Bureau believes, in light of the factors in TILA section 105(f), that disclosure of the information specified in TILA section 128(f)(1) would not provide a meaningful benefit to consumers of reverse mortgages. Specifically, the Bureau considers that the exemption is proper irrespective of the amount of the loan, the status of the borrower (including related financial arrangements, financial sophistication, and the importance to the borrower of the loan), or whether the loan is secured by the principal residence of the consumer. Further, in the estimation of the Bureau, the proposed exemption would further the consumer protection purposes of the statute by avoiding the consumer confusion that would result by applying the same disclosure requirements to reverse mortgages as other mortgages and leaving reverse mortgages to be addressed in a comprehensive reverse mortgage rulemaking.

In addition, consistent with DFA section 1405(b), the Bureau believes that the proposed modification of the requirements in TILA section 128(f) to exempt reverse mortgages would improve consumer awareness and understanding and is in the interest of consumers and in the public interest.

##### 41(e)(2) Time Shares

Proposed § 1026.41(e)(2) would clarify that timeshares as defined by 11 U.S.C. 101 (53(D)) are exempt from the periodic statement requirement. TILA section 128(f) provides that the periodic statement requirement applies to residential mortgage loans. The definition of residential mortgage loans set forth in TILA section 103(cc)(5) specifies that timeshares do not fall under this definition.

#### 41(e)(3) Coupon Book Exemption

Proposed § 1026.41(e)(3) would implement the statutory exemption for fixed-rate loans for which the servicer provides a coupon book containing substantially similar information as found in the periodic statement. The Bureau recognizes the value of the coupon book as striking a balance between ensuring consumers receive important information, and providing a low burden method for servicers to comply with the periodic statement requirements. As such, the Bureau seeks to effectuate the coupon book exemption. The nature of a coupon book (both its smaller size and static nature) creates difficulties in including substantially similar information as would be on a periodic statement. The main problem is the static nature of a coupon book. Because a coupon book may cover an entire year or more, it cannot include information that changes on a monthly basis. By contrast, a periodic statement can provide dynamic information that changes on a monthly basis. To address this problem, the Bureau is proposing to modify the coupon book exception permitted by TILA section 128(f)(3) to apply the exception where the coupon book contains certain static information and other dynamic information is made accessible to the consumer.

Proposed comment 41(e)(3)–1 defines “fixed-rate” by reference to § 1026.18(s)(7)(iii), which defines “fixed-rate mortgage” as a transaction secured by a dwelling that is not an adjustable-rate or a step-rate mortgage. Proposed comment 41(e)(3)–2 explains what a coupon book is.

The Bureau proposes to use its authority under TILA section 105(a) to give effect to the coupon book exemption in TILA section 128(f)(3). TILA section 128(f)(3) provides an exemption to the periodic statement for fixed-rate loans when a coupon book that contains substantially similar information to the periodic statement is provided. Using its authority under TILA section 128(f)(1)(H), the Bureau has added certain dynamic items to the periodic statement that would be infeasible to include in a coupon book. The Bureau is proposing to use its TILA 105(a) authority to permit use of a coupon book even where certain dynamic information is not included in the book so long as such information is made available via the inquiry process. The Bureau believes this proposed exemption is necessary and proper to facilitate compliance.

*Information in the coupon book.* Proposed paragraph (e)(3)(i) would

require the following information to be included on each coupon within the book: The payment due date, the amount due, and the amount and date that any late fee will be incurred. In specifying the amount due on each coupon, servicers would assume that all prior payments have been paid in full.

Proposed paragraph (e)(3)(ii) would require the following information to be included in the coupon book itself, though it need not be on each coupon: The amount of the principal loan balance, the interest rate in effect for the loan, the date on which the interest rate may next change; the amount of any prepayment fee that may be charged, the contact information for the servicer, and housing counselor information. Each of these items is discussed above in the section-by-section analysis of proposed paragraph (d). The coupon book would also be required to disclose information on how the consumer may obtain the dynamic information discussed below. The information described above may, but is not required to be, included on each coupon. Instead, it may be included anywhere in the coupon book, including on the covers, or on filler pages, as explained by proposed comment 41(e)(3)–3.

Because the outstanding principal balance will typically change during the time period covered by the coupon book, proposed comment 41(e)(3)–4 clarifies that a coupon book need only include the outstanding principal balance at the beginning of that time period.

*Information made available.* As discussed above, due to the static nature of the coupon book, certain dynamic information that is required to be included on periodic statements cannot be included. To use the coupon book provision, the proposed rule would require that the dynamic information be made available upon the consumer's request. The servicer could provide the information orally, or in writing, or electronically, if the consumer consents. Thus, proposed paragraph (e)(3)(iii) would require the following dynamic information be made available to the consumer upon request: The monthly payment amount, including a breakdown showing how much, if any, will be allocated to principal, interest, and any escrow account; the total of fees or charges imposed since the last payment period; any payment amount past due; the total of all payments received since the beginning of the payment period, including a breakdown of how much, if any, of those payments was applied to principal, interest, escrow, fees and charges, and any partial payment suspense accounts; the

total of all payments received since the beginning of the calendar year, including a breakdown of how much, if any, of those payments was applied to principal, interest, escrow, fees and charges, and how much is currently in any partial payment or suspense account; and a list of all the transaction activity (as defined in proposed comment 41(d)(4)–1) that occurred since the payment period.

The Bureau seeks comment on whether requiring servicers to make this information available would impose significant burden or costs that exceed consumer benefits. In particular, the Bureau seeks comment on whether providing the past payment breakdown information would impose greater burden than benefits.

*Delinquency information.* Because of the importance of the delinquency information, proposed paragraph (e)(3)(iv) would require that to qualify for the coupon book exception, the delinquency information required by proposed § 1026.41(d)(8), discussed above, to be sent to the consumer in writing for each billing cycle for which the consumer is more than 45 days delinquent at the beginning of the billing cycle.

#### 41(e)(4) Small Servicer Exemption

Proposed paragraph (e)(4) would exempt certain smaller servicers from the duty to provide periodic statements for certain loans. A small servicer would be defined as a servicer (i) who services 1,000 or fewer mortgage loans; and (ii) only services mortgage loans for which the servicer or an affiliate is the owner or assignee, or for which the servicer or an affiliate is the entity to whom the mortgage loan obligation was initially payable.

The Bureau has decided to propose this exemption after careful consideration of the benefits and burdens of the periodic statement requirement. As proposed, the Bureau believes that the periodic statement will be helpful to consumers because it will provide a well-integrated communication that not only contains information about upcoming payments due, but also information about loan status, fees charged, past payment crediting, and potential resources and other useful information for consumers who have fallen behind in their payments. The Bureau believes that providing a single-integrated document, in place of a number of other communications that contain fragments of this information can be more efficient for consumers and servicers alike. And in light of the historic problems that have been reported in parts of the

servicing industry, the periodic statement could be a useful tool for consumers to monitor their servicers' performance and identify any issues or errors as soon as they occur.

At the same time, the Bureau recognizes that the servicing industry is not monolithic. Producing a periodic statement with the elements proposed in § 1026.41 requires sophisticated programming to place individualized information on each borrower's statement for each billing cycle. The Bureau recognizes that very small servicers would likely have to rely on outside vendors to develop or modify existing systems to produce statements in compliance with the rule. As discussed further below, the Bureau received detailed information from the SBREFA panel process confirming the technological and operational challenges faced by small servicers, as well as postage and other expenses that would be associated with providing periodic statements on an ongoing basis. Because small servicers maintain small portfolios, the SBREFA participants emphasized that they cannot spread fixed costs across a large number of loans the way that larger servicers can.

Where small servicers already have incentives to provide high levels of customer contact and information, the Bureau believes that the circumstances may warrant exempting those servicers from complying with the periodic statement requirement. In particular, small servicers that make loans in their local communities and then either hold their loans in portfolio or retain the servicing rights have incentives to maintain "high-touch" customer service models. Affirmative communications with consumers help such servicers (and their affiliates) to ensure loan performance, protect their reputations in their communities, and market other consumer financial products and services.<sup>114</sup> Because those servicers have a long-term relationship with the borrowers, their incentives with regard to charging fees and other servicing practices may be more aligned with borrower interests. These motivations to ensure a good relationship incentivize good customer service, including making information about upcoming payments, fees charged and payment history, and information for distressed borrowers easily available to consumers by other means.

The Bureau believes, however, that both conditions are necessary to warrant

a possible exemption from the periodic statement rule—that is, that an exemption may be appropriate only for servicers that service a relatively small number of loans and that originated the loans and either retained ownership or servicing rights. Larger servicers are likely to be much more reliant on and sophisticated users of computer technology in order to manage their operations efficiently. In such situations, implementation of the periodic statement requirement is likely to be somewhat easier to accomplish and perhaps even provide technological benefits for the servicers. Larger servicers also generally operate in a larger number of communities under circumstances in which the "high touch" model of customer service is not practicable. In light of this fact and the consumer benefits from integrated communications, the Bureau does not believe it would be appropriate to exempt all servicers who originate loans that they then hold in portfolio or with respect to which they retain servicing rights, without regard to size.

**SBREFA Panel.** The proposed exemption is consistent with feedback that the Bureau received from small entity representatives during the SBREFA panel process regarding the potentially significant burdens that would be imposed by a periodic statement requirement. Participants explained that they already provided much of the information in the proposed periodic statement through alternative means, including correspondence, more limited periodic statements, coupon books, passbooks, and telephone conversations.<sup>115</sup> Even where SERs did not affirmatively provide particular items of information to borrowers, they stated that their companies would generally provide it on request. However, the participants emphasized repeatedly that consolidating all of the information into a single monthly dynamic statement would be difficult for small servicers.<sup>116</sup>

The SERs explained that due to their small size, they generally do not maintain in-house technological expertise and would generally use third-party vendors to develop periodic statements. Due to their small size, they believed they would have no control over these vendor costs.<sup>117</sup> Additionally, the small servicers have smaller portfolios over which to spread the fixed costs of producing periodic statements. Such servicers stated they

are unable to gain cost efficiencies and cannot effectively spread the implementation costs of periodic statements across their loan portfolios. Finally, several SERs stated that simply mailing periodic statements could cost thousands of dollars per month beyond some of their current alternative communication channels, such as coupon books or passbooks.

**Small Servicer Defined.** The Bureau lacks the data necessary to precisely calibrate the amount of burden that would be imposed by the periodic statement requirement on servicers of different sizes. However, the Bureau believes that a threshold of 1,000 loans serviced may be an appropriate approximation to limit the proposed exemption to smaller servicers in the market. Assuming that, on average, most loans are refinanced about every five years, this threshold works out to an average of 200 originations per year. The Bureau estimates that a small servicer of this size would earn about \$600,000 annually in servicing fee revenues.<sup>118</sup> The SERs estimated that the periodic statement burden could cost thousands of dollars each month.<sup>119</sup> For comparison, the Bureau notes that the top 100 mortgage servicers, as measured by size of unpaid principal balance serviced, (which together have approximately 82% of the mortgage servicing market share<sup>120</sup>) each service in excess of \$3 billion of unpaid principal balance.

In addition to the 1,000 loan threshold, the exemption from the

<sup>118</sup> This estimate assumes that a servicer generates a net mortgage servicing fee rate of 35 basis points and that the average unpaid principal balance on the 1,000 loans is \$175,000. The 35 basis points represents a blend of different mortgage servicing asset quality. Mortgage servicing fees for conventional servicing are generally 25 basis points; mortgage servicing fees for subprime mortgage loans or loans sold to trusts guaranteed by Ginnie Mae may vary between 40–50 basis points. Servicers are also able to generate ancillary income from sources other than the mortgage servicing fee, including additional fee revenue, such as late fees, and float on principal, interest and escrow payments, the composition of which may vary significantly among servicers. The Bureau believes that 35 basis points is a reasonable assumption in current market conditions. See, e.g., Newcastle Investment Corp., Form 10-Q, filed May 10, 2012, at 15–16, available at [http://www.sec.gov/Archives/edgar/data/1175483/000138713112001455/nci-10q\\_033112.htm](http://www.sec.gov/Archives/edgar/data/1175483/000138713112001455/nci-10q_033112.htm) (last accessed June 13, 2012) (describing REIT investment in excess mortgage servicing rights (MSRs) from a portfolio of MSRs generating an initial weighted average total mortgage servicing fee amount of 35 basis points).

<sup>119</sup> SBREFA Final Report, *supra* note 22, at 19. (One SER estimated it could cost an additional \$11,000 per month in on-going support, another SER estimated that a vendor might charge \$1,000–\$2,000 per month in fees, a third SER estimated monthly costs of \$2,200 based on a cost of \$1 per statement).

<sup>120</sup> Inside Mortgage Finance, Issue 2012:13 (March 30, 2012) at 12.

<sup>114</sup> See *Re-Thinking Loan Servicing*, Prime Alliance Loan Servicing, p. 8 (April 2010) available at: [http://cuinsight.com/media/doc/WhitePaper\\_CaseStudy/wpcs\\_ReThinking\\_LoanServicing\\_May2010.pdf](http://cuinsight.com/media/doc/WhitePaper_CaseStudy/wpcs_ReThinking_LoanServicing_May2010.pdf).

<sup>115</sup> SBREFA Final Report, *supra* note 22, at 16–19.

<sup>116</sup> *Id.*

<sup>117</sup> *Id.* at 17.

periodic statement would be limited to entities that exclusively service loans that they or an affiliate originated or was the entity to which the obligation was initially payable. A servicer must both exclusively service such loans and satisfy the 1,000-loan threshold to qualify for the small servicer exemption. The exemption is limited to these servicers because of the incentive discussed above.

The proposed commentary clarifies the application of the small servicer definition. Proposed comment 41(e)(4)–1 states that loans obtained by a servicer or an affiliate in connection with a merger or acquisition are considered loans for which the servicer or an affiliate is the creditor to whom the mortgage loan is initially payable.

The proposed rule also states that in determining whether a small servicer services 1,000 mortgage loans or less, a servicer is evaluated based on its size as of January 1 for the remainder of the calendar year. A servicer that, together with its affiliates, crosses the threshold will have six months or until the beginning of the next calendar year, whichever is later, to begin providing periodic statements. Proposed comment 41(e)(4)–2 gives examples for calculating when a servicer who crosses the 1,000 loan threshold would need to begin sending periodic statements. The purpose of this provision is to permit a servicer that crosses the 1,000 loan threshold a period of time (the greater of either six months, or until the beginning of the next calendar year) to bring the servicer's operations into compliance with the periodic statement provisions for which the servicer was previously exempt.

Proposed comments 41(e)(4)–3 clarifies when subservicers or servicers who do not own the loans they are servicing, do not qualify for the small servicer exemption, even if such servicers are below the 1,000 loan threshold.

Proposed comment 41(e)(4)–4 clarifies if a servicer subservices mortgage loans for a master servicer that does not meet the small servicer exemption, the subservicer cannot claim the benefit of the exemption, even if it services 1,000 or fewer loans. The Bureau believes that permitting an exemption in such circumstance could potentially exempt a larger master servicer from the obligation to provide periodic statements, even if it has master servicing responsibility for several thousand loans.

The Bureau seeks comment on all aspects of the proposed exemption, particularly whether the regulation

should exempt small servicers,<sup>121</sup> and, if so, whether the proposed scope and definition of a small servicer is appropriate. Specifically, should the test be the one proposed regarding origination, and is 1,000 or less the appropriate size threshold? The Bureau particularly requests data on implementation costs and the level of general activity by small servicers. The Bureau also seeks comment on whether it would be appropriate to exempt small servicers from other elements of the proposed servicing rules under TILA and RESPA.

**Authority.** The Bureau proposes to exercise its authority under TILA section 105(a) and (f), and DFA section 1405(b) to exempt small servicers from the periodic statement requirement under TILA section 128(f). For the reasons discussed above, the Bureau believes the proposed exemption is necessary and proper under TILA section 105(a) to facilitate compliance. As discussed above, it would be very expensive for small servicers to incur the initial costs of setting up a system to send periodic statements, as a result, such servicers may choose to exit the market. In addition, consistent with TILA section 105(f) and in light of the factors in that provision, the Bureau believes that requiring small servicers to comply with the periodic statement requirement specified in TILA section 128(f) would not provide a meaningful benefit to consumers in the form of useful information or protection. The Bureau believes that the business model of small servicers ensures their consumers already receive the necessary information, and that requiring them to provide periodic statements would impose significant costs and burden. Specifically, the Bureau believes that the exemption is proper without regard to the amount of the loan, the status of the borrower (including related financial arrangements, financial sophistication, and the importance to the borrower of the loan), or whether the loan is secured by the principal residence of the consumer. In addition, consistent with DFA section 1405(b), for the reasons discussed above, the Bureau believes that the proposed modification of the requirements in TILA section 128(f) to exempt small servicers would further the consumer protection purposes of TILA.

#### Appendix H to Part 1026

The Bureau proposes to exercise its authority under TILA section 105(c) to

propose model and sample forms for § 1026.20(c) and (d).

#### Appendix H–4(D) to Part 1026

The Bureau proposes to exercise its authority under TILA section 105(c) to propose model and sample forms for § 1026.20(c) and (d).

#### Appendices G and H—Open-End and Closed-End Model Forms and Clauses

Proposed revisions to Appendices G and H–1 would add the appendix sections that would illustrate examples of the model forms and sample forms for the ARM disclosures proposed by § 1026.20(c) and (d) to the list of appendix sections illustrating examples of other model disclosures required by Regulation Z whose format or content may not be changed by creditors.

#### Appendix H—Closed Model Forms and Clauses–7(i)

Proposed revisions to Appendix H–7(i) would include § 1026.20(d), as well as § 1026.20(c), as the types of models illustrated in this appendix. The proposed revision also would add text so that the provision stated that the Appendix H–4(D) includes examples of the two types of model forms for adjustable-rate mortgages: § 1026.20(d) initial adjustment notices and § 1026.20(c) payment change notices for adjustments resulting in corresponding payment changes.

#### VII. Section 1022(b)(2) Analysis

In developing the proposed rule, the Bureau has considered potential benefits, costs, and impacts, and has consulted or offered to consult with the prudential regulators, HUD, the FHFA, and the Federal Trade Commission, including regarding consistency with any prudential, market, or systemic objectives administered by such agencies.<sup>122</sup> The Bureau also held discussions with or solicited feedback from the U.S. Department of Agriculture Rural Housing Service, the Farm Credit Administration, the FHA, and the VA regarding the potential impacts of the proposed rule on those entities' loan programs.

In this rulemaking, the Bureau proposes to amend Regulation Z, which implements TILA, and the official commentary to the regulation, as part of

<sup>121</sup> As discussed above, for the purposes of § 1026.41, the term “servicer” includes creditors, assignees and servicers.

<sup>122</sup> Specifically, section 1022(b)(2)(A) of the Dodd-Frank Act calls for the Bureau to consider the potential benefits and costs of a regulation to consumers and covered persons, including the potential reduction of access by consumers to consumer financial products or services; the impact on depository institutions and credit unions with \$10 billion or less in total assets as described in section 1026 of the Dodd-Frank Act; and the impact on consumers in rural areas.

its implementation of the Dodd-Frank Act amendments to TILA's mortgage servicing rules. The proposed amendments to Regulation Z implement Dodd-Frank Act Sections 1418 (initial interest rate adjustment notice for ARMs), 1420 (periodic statement), and 1464 (prompt crediting of mortgage payments and response to requests for payoff amounts). The proposed rule would also revise certain existing regulatory requirements for disclosing rate and payment changes to adjustable-rate mortgages in current § 1026.20(c).

Elsewhere in today's **Federal Register**, the Bureau is also publishing the 2012 RESPA Servicing Proposal that would implement section 1463 of the Dodd-Frank Act. The RESPA proposal addresses procedures for obtaining force-placed insurance; procedures for investigating and resolving alleged errors and responding to requests for information; reasonable information management policies and procedures; early intervention for delinquent borrowers; continuity of contact for delinquent borrowers; and loss-mitigation procedures.

As discussed in part II above, mortgage servicing has been marked by pervasive and profound consumer protection problems. As a result of these problems, Congress included in the Dodd-Frank Act the provisions described above, which specifically address mortgage servicing. The new protections in the rules proposed under TILA and RESPA would significantly improve the transparency of mortgage loans after origination, provide substantive protections to consumers, enhance consumers' ability to obtain information from and dispute errors with servicers, and provide consumers, particularly distressed and delinquent consumers, with better customer service when dealing with servicers.

#### A. Provisions To Be Analyzed

The analysis below considers the benefits, costs, and impacts of the following major proposed provisions:

1. New initial interest rate adjustment notices for most closed-end adjustable-rate mortgages.
2. Changes in the format, content, and timing of the Regulation Z § 1026.20(c) disclosure for most closed-end adjustable-rate mortgages.
3. New periodic statement disclosure for most closed-end mortgages.
4. Prompt crediting of payments for consumer credit transactions (both open- and closed-end) secured by the consumer's principal dwelling and response to requests for payoff amounts from consumers with consumer credit

transactions (both open- and closed-end) secured by a dwelling.

With respect to each major proposed provision, the analysis considers the benefits and costs to consumers and covered persons. The analysis also addresses certain alternative provisions that were considered by the Bureau in the development of the rule. The Bureau requests comments on the analysis of the potential benefits, costs and impacts of the proposal.

#### B. Baseline for Analysis

The amendments to TILA are self-effectuating, and the Dodd-Frank Act does not require the Bureau to adopt regulations to implement these amendments. Specifically, the proposed provisions regarding the new initial interest rate adjustment notice and the new periodic statement disclosure implement self-effectuating amendments to TILA. Thus, many costs and benefits of these proposed provisions would arise largely or entirely from the statute, not from the proposed rule. The proposed provisions would provide substantial benefits compared to allowing these TILA amendments to take effect alone, even without the proposed additional content and other features of the disclosures, by clarifying parts of the statute that are ambiguous. Greater clarity on these issues should reduce the compliance burdens on covered persons by reducing costs for attorneys and compliance officers as well as potential costs of over-compliance and unnecessary litigation. Moreover, the costs that these provisions would impose beyond those imposed by the statute itself are likely to be minimal.

DFA section 1022 permits the Bureau to consider the benefits, costs, and impacts of the proposed rule solely compared to the state of the world in which the statute takes effect without an implementing regulation. To provide the public better information about the benefits and costs of the statute, however, the Bureau has chosen to consider the benefits, costs, and impacts of the major provisions of the proposed rule against a pre-statutory baseline (*i.e.*, to consider the benefits, costs, and impacts of the relevant provisions of the Dodd-Frank Act and the regulation combined).

The proposed provisions regarding prompt crediting of payments and response to requests for payoff amounts also implement self-effectuating amendments to TILA. These amendments to TILA, however, largely codify existing Regulation Z provisions in § 1026.36(c). Thus, the pre-statute and post-statute baselines are

substantially the same. The proposed provisions would clarify servicer<sup>123</sup> duties that are ambiguous under the statute and existing regulations.

Finally, the proposed provisions regarding the § 1026.20(c) disclosure for adjustable-rate mortgages impose obligations on servicers<sup>124</sup> that are authorized, but not required, under TILA sections 105(a) and 128(f) and DFA section 1405(b). With respect to proposed § 1026.20(c), the Bureau has chosen to consider the benefits, costs, and impacts of the proposed provisions against the baseline provided by the current provisions of § 1026.20(c).

The Bureau has discretion in future rulemakings to choose the most appropriate baseline for that particular rulemaking.

#### C. Coverage of the Proposal

Each proposed provision covers certain consumer credit transactions secured by a dwelling, as described further in each section below.

#### D. Potential Benefits and Costs to Consumers and Covered Persons

##### 1. New Initial Interest Rate Adjustment Notice for Adjustable-Rate Mortgages

Section 1418 of the Dodd-Frank Act requires servicers to provide a new disclosure to consumers who have hybrid ARMs. The disclosure concerns the initial interest rate adjustment and must be given either (a) between 6 and 7 months prior to such initial interest rate adjustment or (b) at consummation of the mortgage if the initial interest rate adjustment occurs during the first six months after consummation.

The Bureau proposes to implement this provision by requiring that the disclosure be given at least 210, but not more than 240, days before the first payment at the adjusted level is due. The Bureau, relying upon the savings clause in TILA section 128A(b), proposes to broaden the scope of the proposed rule to include ARMs that are not hybrid. The proposed disclosure would include the content required by the statute, except for providing contact information for housing counseling agencies and programs (where the proposed rule provides an alternative disclosure), and certain additional information. Finally, as explained above, the Bureau conducted three rounds of consumer testing. The

<sup>123</sup> Reference in parts VII, VIII, and IX to "servicers" with regard to the proposed rule for requests for payoff amounts means creditors and servicers.

<sup>124</sup> Reference in parts VII, VIII, and IX to "servicers" with regard to the proposed rules for adjustable-rate mortgages means creditors, assignees, and servicers.

disclosures were revised after each round of testing to improve their effectiveness with consumers.

*Benefits to consumers.* The information in the proposed interest rate adjustment notice would provide a number of benefits to consumers with closed-end adjustable-rate mortgages at the initial interest rate adjustment. These benefits may be broadly categorized as facilitating (a) the choice of an alternative to making the new payment, including refinancing; (b) the correction of any errors in the adjusted payment; (c) the budgeting of household resources; and (d) the accumulation of equity by certain consumers (*i.e.*, those with interest-only or negatively-amortizing payments). Individual items in the disclosure may provide more than one of these benefits.

The proposed rule would require disclosure of the new interest rate and payment—the exact amount, where available, or an estimate, where exact amounts are unavailable. Disclosing an estimate of the interest rate and any new payment at least 210, but not more than 240, days before the first payment at the adjusted level is due would give consumers a significant amount of time in which to pursue alternatives to repaying the loan at the adjusted level. When interest rates are stable, the estimate is informative about the future mortgage payment, and consumers benefit from being able to plan future budgets or to address a problem with affordability, perhaps by refinancing. The estimate is less informative about the future mortgage payment when interest rates are volatile, but under any circumstances, an estimated payment that is well above the highest amount that the consumer can afford alerts the consumer to a potential problem and the need to gather additional information.

While some consumers with adjustable-rate mortgages may benefit from disclosure of any potential new interest rate and payment (or estimates of these amounts) well before payment is due, the benefits from this information are likely greatest when provided prior to the initial interest rate adjustment. Subsequent interest rate adjustments reflect the difference between two fully indexed interest rates (*i.e.*, interest rates that are the sum of a benchmark rate and a margin). In contrast, the initial interest rate adjustment may reflect the difference between an interest rate that is below the fully indexed rate at the time of origination (a so-called “teaser” or “introductory” rate) and a rate that is fully indexed at the time of adjustment. For example, in 2005, the teaser rate on subprime ARMs with an initial fixed-

rate period of two or three years was 3.5 percentage points below the fully indexed rate.<sup>125</sup> As a result, mortgages originated in that year faced a potentially large change in the interest rate and payment, or “payment shock,” at the first adjustment. Furthermore, consumers facing the initial interest rate adjustment may fail to anticipate even the possibility of a change in payment, since this is necessarily the first time since origination that the payment could change. Consumers facing payment shock or an unanticipated change in payment also benefit from having additional time to plan future budgets or to address a problem with affordability. Thus, consumers facing the initial interest rate adjustment may benefit from the proposed notice through both the information it provides regarding the potentially new interest rate and payment and the additional time it provides consumers to adapt.

A number of items on the proposed disclosure would help the consumer respond to problems with making the new payment. In addition to information on the amount of the new payment, the proposed disclosure lists alternatives to making the new payment and gives a brief explanation of each alternative. It explains the circumstances under which any prepayment penalty may be imposed and the maximum amount of the penalty. It provides information on rate limits that may affect future payment changes. It provides the telephone number of the creditor, assignee, or servicer to call if the consumer anticipates having problems making the new payment. Finally, it gives contact information for the State housing authority and information to access certain lists of homeownership counselors made available by Federal agencies. All of this information benefits a consumer who needs to find an alternative to making the new payment.

Certain items on the proposed disclosure may assist the consumer in detecting any errors in the computation of the new payment estimate. The proposed disclosure provides an explanation of how the new interest rate and payment are determined, including the index or formula used and any additional adjustment, such as a margin added to the index. It also states any limits on the increase in the interest rate or payment at each adjustment and over the life of the loan. This information may also facilitate consumers’ ability to compare their current mortgage against

competing products and provide other benefits, but at the very least it assists consumers in verifying the accuracy of the new estimated payment.

Finally, certain items on the proposed disclosure may facilitate the accumulation of equity by consumers with interest-only or negatively-amortizing payments. For these consumers, the disclosure states the amount of both the current and the expected new payment allocated to principal, interest, and escrow, as applicable.<sup>126</sup> The disclosure also states that the new payment will not be allocated to pay loan principal. If negative amortization occurs as a result of the adjustment, the disclosure must state the payment required to fully amortize the loan at the new interest rate. The proposed disclosure alerts consumers with these types of loans to features that bear on equity accumulation, and it provides this information at a time when these consumers may be evaluating their mortgage terms and considering refinancing.

As discussed above, the Bureau is proposing formatting requirements for the initial interest rate adjustment notice. These requirements benefit consumers by facilitating consumer understanding of the information in the disclosures. Except for the date of the notice, the proposed rule requires that the disclosures must be provided in the form of a table and in the same order as, and with headings and format substantially similar to, certain forms provided with the proposed rule. The Bureau’s testing showed that consumers readily understood the information in the notice when the terms and calculations were presented in the groupings and logical order contained in the model forms. While there is no formula for producing the ideal disclosure, the proposed formatting requirements are generally informed by decades of consumer testing. The Bureau believes that disclosures that satisfy the proposed formatting requirements likely provide greater benefits to consumers than both the

<sup>126</sup> The current payment allocation would also appear on the proposed periodic statement disclosure. However, listing the current and expected new payment allocation in one disclosure benefits consumers by making clear any differences between the two allocations. The Bureau recognizes that the benefit of information in a particular disclosure may be mitigated to the extent that the same information is available in other disclosures that are provided at the same (or nearly the same) time.

<sup>125</sup> See Christopher Mayer, Karen Pence, & Shane Sherlund, *The Rise in Mortgage Defaults*, 23 J. Econ. Persps. 27, 37 (2009).

alternatives tested and disclosures that do not satisfy these requirements.<sup>127</sup>

*Magnitude of the benefits to consumers.* Research shows that consumers make important decisions about housing finance at the initial interest rate adjustment. Consumers often choose to prepay at the initial interest rate adjustment, and the greater the payment shock, the greater the likelihood of prepayment. These results hold for conventional ARMs originated in the 1990s as well as for subprime hybrid ARMs (2/28 and 3/27) originated in the 2000s.<sup>128</sup>

More controversial is the question of whether payment shock at the initial interest rate adjustment causes default. In general, data from the 2000s does not find a causal relationship between payment shock at the initial interest rate adjustment and default.<sup>129</sup> However, for consumers with certain hybrid ARMs originated in the 2000s, a substantial number experienced a payment shock of at least 5% at the initial interest rate adjustment, and some research finds that the default rate for these loans was three times higher than it would have been if the payment had not changed.<sup>130</sup>

Whether or not the proposed initial interest rate adjustment notice would reduce default under certain conditions, the disclosure may generally facilitate the important decisions about housing finance that consumers make at the initial interest rate adjustment. Extrapolating from FHFA data, the Bureau estimates that approximately 285,000 adjustable-rate mortgages will have an initial interest rate adjustment in each of the next three years. Few adjustable-rate mortgages in recent years have had teaser rates; however,

consumers with these mortgages may benefit from shifting to a fixed-rate mortgage. If the new initial interest rate adjustment notice prompts just 1% of consumers who receive the notice to refinance and these consumers save \$50 per month, the annual savings to consumers would be over \$1.7 million.

The Bureau does not have the data necessary to fully quantify the benefits of the proposed initial interest rate adjustment notice to consumers. Certain consumers with adjustable-rate mortgages will be aware of the upcoming initial interest rate adjustment and the possibility of refinancing or (if there is a payment adjustment) considering alternatives to making a new payment, of needing to reallocate household resources in light of a new payment, of addressing an error in computing a new payment, and of reviewing the household balance sheet in light of an interest-only or negatively-amortizing loan. The Bureau is not aware of data with which it could fully quantify the value of the information in the disclosure to these consumers or determine the savings to them in time and other resources from not having to obtain this information from other sources. Furthermore, there are other consumers with adjustable-rate mortgages who may be uninformed or misinformed (or perhaps forgetful) about the upcoming initial interest rate adjustment, the possibility of an error in computing a potential new payment, or the financial implications of interest-only and negatively-amortizing loans on equity accumulation. The Bureau is not aware of data with which it could quantify the benefits to these consumers of becoming better informed about these features of their mortgages. However, the Bureau believes that the proposed initial interest rate adjustment notice may provide substantial benefits to these consumers.

*Costs to consumers.* As explained below in the discussion of costs to covered persons, the cost per disclosure would be about \$2.60. This estimate takes into account both one-time costs (amortized over five years) and annual production and distribution costs.<sup>131</sup> Under conservative assumptions, in the illustration above, the benefits to consumers who receive the disclosure would be \$6.

Given the small cost per disclosure, the Bureau believes that consumers would see at most a minimal increase in fees or charges. Servicers may in general

attempt to shift a cost increase onto others and consumers may ultimately bear part of an increase that falls nominally on servicers. For the proposed initial interest rate adjustment notice, however, the costs to be shifted are small. Furthermore, even if servicers did attempt to shift the costs, it is not clear that consumers would bear them. Consider, for example, servicers who bid for servicing rights on mortgages originated by others. The additional costs associated with providing the initial rate adjustment notice may cause servicers to bid less aggressively for certain servicing rights. In this case, lenders or investors may bear some of the cost. Servicers may also attempt to obtain higher compensation for servicing from originators. Originators may respond by attempting to increase fees or charges at origination or by increasing the cost of credit. In this case consumers may bear some of the costs, but not necessarily all of them. The relative sensitivity of supply and demand in these inter-related markets would determine the proportion of the cost increase borne by different persons, including consumers.

The proposed rule limits how servicers may present the required information in the disclosure. Servicers would have to present the required information in a format substantially similar to the format of the proposed model forms. The Bureau recognizes the possibility that constraints on the way servicers present information to consumers may prohibit the use of more effective forms that servicers are using or may develop. The constraints would then impose a cost on consumers. The Bureau does not believe there are any such costs in this case. The Bureau is unaware of any efforts by servicers to develop an initial interest rate adjustment notice that meets the requirements of the Dodd-Frank Act and provides the benefits to consumers of the proposed model forms. The Bureau worked closely with Macro to develop the model disclosures, conducted three rounds of consumer testing, and revised the disclosure after testing.

During the SBREFA process, the Bureau received comments from some SERs that disclosing an estimate of the new monthly payment may confuse certain consumers. The Bureau believes that clearly stating on the form that the new monthly payment is an estimate and that consumers will receive a notice with the exact amounts two to four months prior to the date the first payment at the adjusted level is due (in cases where the interest rate adjustment results in a corresponding payment change) will mitigate consumer

<sup>127</sup> For a general discussion of disclosure formatting, disclosure testing and consumer benefits, see Jeanne Hogarth & Ellen Merry, *Designing Disclosures to Inform Consumer Financial Decisionmaking: Lessons Learned from Consumer Testing*, 97 Fed. Reserve Bull. 1 (Aug. 2011).

<sup>128</sup> Brent W. Ambrose & Michael LaCour-Little, *Prepayment Risk in Adjustable Rate Mortgages Subject to Initial Year Discounts: Some New Evidence*, 29 Real Est. Econs. 305 (2001) (showing that the expiration of teaser rates causes more ARM prepayments, using data from the 1990s). The same result, using data from the 2000s and focusing on subprime mortgages, is reported in Shane Sherland, *The Past, Present and Future of Subprime Mortgages*, (Div. of Research & Statistics and Div. of Monetary Affairs, Fed. Reserve Bd., Washington, D.C. 2008); The result that larger payment increases generally cause more ARM prepayments, using data from the 1980s, appears in James Vanderhoff, *Adjustable and Fixed Rate Mortgage Termination, Option Values and Local Market Conditions*, 24 Real Est. Econs. 379 (1996).

<sup>129</sup> Mayer, Pence, & Sherlund, *supra* note 125, at 37.

<sup>130</sup> Anthony Pennington-Cross & Giang Ho, *The Termination of Subprime Hybrid and Fixed-Rate Mortgages*, 38 Real Est. Econs. 399, 420 (2010).

<sup>131</sup> In this and subsequent numerical discussions, "amortizing" an amount \$x over a certain number of years means making equal payments in each year that sum up to \$x.

confusion on this point. The Bureau notes that section 1418 of the Dodd-Frank Act requires disclosure of a good faith estimate of the new monthly payment. In addition, servicers must provide an accurate statement of the new monthly payment in the notice if it is available; and if it is not available, then consumers will receive an accurate statement of the new monthly payment between 60 and 120 days before the first payment is due, if the interest rate adjustment causes a corresponding change in payment pursuant to the proposed § 1026.20(c) disclosure.

*Benefits to covered persons.* The timing and the content of the proposed initial interest rate adjustment notice may provide certain benefits to servicers. Servicers benefit when distressed consumers contact them well in advance of a possible increase in interest rate and payment, since early communication gives servicers and consumers more time to work together constructively. The proposed disclosure provides consumers with substantial advance notice about their potential future payment and alternatives. Distressed consumers with such notice may be more likely to contact their servicer well in advance of an increase in payment, work constructively with their servicer, and, if necessary, explore alternatives.

*Costs to covered persons.* The proposed initial interest rate adjustment notice will result in certain compliance costs to covered persons. Servicers (or their vendors) may need to adapt their software and compliance systems to produce the new form. The new proposed form would also provide to borrowers information that is not currently disclosed to them, including information that is specific to each loan. Servicers (or their vendors) may not have ready access to all of this additional loan-level information; for example, if some of this additional information is stored in a database that is not regularly accessed by systems that produce the current disclosures. The Bureau seeks information from servicers and vendors that provide services to servicers with respect to operations regarding the storage of loan-level information and the costs of providing the proposed new loan-level information to consumers.

Some of the information provided in the proposed initial interest rate adjustment notice is also provided in the proposed revisions to the § 1026.20(c) disclosure. The Bureau believes that harmonizing the two disclosures would mitigate the compliance burden for servicers and

reduce the aggregate production costs to servicers.

Based on discussions with servicers and software vendors to date, the Bureau believes that servicers will for the most part use vendors for one-time software and IT upgrades and for ongoing production and distribution (*i.e.*, mailing) of the disclosure. Servicers will also incur one-time costs to learn about the proposed rule, but those costs will be minimal. Furthermore, the Bureau believes that under existing mortgage servicing contracts, vendors would absorb the one-time software and IT costs and ongoing production costs of disclosures for large- and medium-sized servicers but pass along these costs to small servicers. All servicers would pay distribution costs.

Based on discussions with industry and extrapolating from FHFA data, the Bureau estimates the one-time cost of the proposed disclosure to be just over \$3 million for 12,800 servicers. Amortizing this cost over five years and combining it with annual costs of \$139,000 gives a total annual cost of \$58 per servicer, or \$2.60 per notice. The use of vendors substantially mitigates the costs of revising software and IT, as the efforts of a single vendor addresses the needs of a large number of servicers. The ongoing costs reflect the fact that there will be relatively few initial interest rate adjustments on adjustable-rate mortgages over the next few years.

For small servicers, the one-time cost of the proposed disclosure is \$2.3 million. This also gives a total annual cost of about \$58 per servicer. However, it is not possible to estimate the number of initial interest rate adjustment notices that small servicers will produce each year, since the Bureau is not aware of any reasonably obtainable data on the loan portfolios of small servicers. The Bureau believes that the number is small since the total number of mortgages serviced by small servicers is small and the notice is given only once to each ARM borrower. The Bureau seeks comment on these estimates and asks interested parties to provide data, research, and other information that may inform the further consideration of these costs.

The Bureau recognizes that certain financial benefits to consumers from the initial interest rate adjustment notice may have an associated financial cost to covered persons. Servicer compensation is not directly tied to the interest rate on a consumer's mortgage, but rather to the unpaid principal balance. Thus, when a consumer refinances a mortgage at a lower interest rate, one servicer incurs a cost but another has a benefit. On the

other hand, if a consumer refinances from an adjustable-rate mortgage to a fifteen year fixed-rate mortgage, then the consumer would pay off the unpaid principal balance more quickly and servicer income would fall. Servicers may also receive reduced fee income from delinquent borrowers (or investors) if the notice helps borrowers avoid delinquency. The Bureau believes that the proposed initial interest rate adjustment notice is likely to have a small effect on the costs to servicers through the channels just described, but the Bureau seeks data with which it may further consider these costs.

Finally, as discussed in part VI, the Bureau considered but decided not to except small servicers from the proposed initial interest rate adjustment notice. The Bureau is not proposing an exception for small servicers because an exception would deprive certain consumers of the seven to eight months advance notice before payment at a new level is due that is provided by the disclosure and the information about alternatives and how to contact various sources of assistance. Conversely, the Bureau believes that the benefit to small entities from an exception would be small. Vendors will spread the one-time software and IT costs of the notice over many small servicers and the annual costs will be small since the proposed notice is given just once to each consumer with an adjustable-rate mortgage. As discussed above, the Bureau believes that five annual payments of \$58 by each small servicer will fully amortize the one-time cost of the proposed interest rate adjustment notice.

## 2. Changes in the Format, Content, and Timing of the Regulation Z § 1026.20(c) Disclosure for Adjustable-Rate Mortgages

Under current § 1026.20(c), creditors must mail or deliver to consumers whose payments will change as a result of an interest rate adjustment a notice of interest rate adjustment for variable-rate transactions subject to § 1026.19(b) at least 25, but no more than 120, calendar days before a payment at a new level is due. Creditors must also provide an annual disclosure to consumers whose interest rate, but not mortgage payment, changes during the year covered by the disclosure. The Bureau is proposing to eliminate the annual disclosure. Thus, the discussion below relates exclusively to the payment change disclosure required under § 1026.20(c).<sup>132</sup> The

<sup>132</sup> As discussed in part VI, the Bureau believes that annual notice is duplicative given the proposed

Bureau is proposing to change the minimum time for providing advance notice to consumers from 25 days to 60 days before payment at a new level is due, with an accommodation for existing ARMs with look-back periods of less than 45 days.<sup>133</sup> The maximum time for advance notice would remain the same: 120 days prior to the due date of the first payment at a new level. The coverage, content, and format of the revised § 1026.20(c) disclosure closely tracks the coverage, content, and format of the proposed initial interest rate adjustment disclosure.

*Benefits to consumers.* Regarding the change in timing, the Bureau does not believe that the current minimum of 25 days provides sufficient time for consumers to pursue meaningful alternatives such as refinancing, home sale, loan modification, forbearance, or deed in lieu of foreclosure. Nor does this minimum provide sufficient time for consumers to adjust household finances to cover new payments. The Board's 2009 Closed-End Proposal stated that HMDA data for the years 2004 through 2007 suggested that a requirement to provide ARM adjustment disclosures 60, rather than 25, days before payment at a new level is due more closely reflects the time needed for consumers to refinance a loan.

Regarding the proposed changes in the content of the § 1026.20(c) disclosure, the Bureau believes that it is helpful to consumers to receive similar notices for similar purposes. Thus, the Bureau believes there is some consumer benefit in harmonizing the § 1026.20(c) disclosure with the proposed initial interest rate adjustment disclosure. However, the two disclosures are triggered by different (although related) events and the benefit of the information to consumers is somewhat different.

Both the current and proposed § 1026.20(c) disclosure provide the current and upcoming interest rate and payment (not an estimate) and the date

the first new payment is due. This information facilitates household budgeting and may alert the consumer to a potential problem with affordability.

Proposed § 1026.20(c) requires the disclosure to include an explanation of how the new interest rate and payment are determined, including the index or formula used, any margin added, and any previously foregone interest increase applied. The proposed disclosure also states any limits on the interest rate or payment increase at each adjustment and over the life of the loan. This information assists the consumer in detecting any errors in the computation of the new payment. In contrast, the current § 1026.20(c) disclosure provides the index value without any explanation and does not provide information about limits on interest rate or payment increases.

Information provided in the proposed § 1026.20(c) disclosure facilitates the evaluation of alternatives to paying the new amount due. For example, the proposed disclosure provides an explanation of the circumstances under which any prepayment penalty may be imposed and the maximum amount of the penalty, which highlights the direct cost of refinancing into a different loan. Also, disclosure of key features of the loan like the new allocation of payments for interest-only and negatively-amortizing ARMs, the rate limit per year and over the life of the loan, and warnings about interest-only payments and increases in the loan balance may also facilitate the comparison of the current loan with alternatives. Disclosures required by current § 1026.20(c) do not provide any of this information.

The proposed § 1026.20(c) disclosure provides the same information as the proposed initial interest rate adjustment notice regarding features of the mortgage that affect the accumulation of equity. The disclosure of the loan balance itself is useful for this purpose. For interest-only or negatively-amortizing loans, the disclosure states the amount of the new payment allocated to pay principal, interest, and taxes and insurance in escrow, as applicable, and that the new payment will not be allocated to pay loan principal. If negative amortization will occur due to the interest rate adjustment, the disclosure states the payment required to fully amortize the loan at the new interest rate. The proposed disclosure alerts consumers with these types of loans to features that bear on equity accumulation, and it provides this information at a time when these consumers may be evaluating their mortgage terms and

considering refinancing. In contrast, the current § 1026.20(c) disclosures provide only the loan balance and information about the payment required to fully amortize the loan at the new interest rate if the interest rate adjustment caused the negative amortization.

As noted above, the Bureau recognizes that the benefit to consumers of information in a particular disclosure may be attenuated to the extent that the same information is available in other disclosures that are provided at the same (or nearly the same) time. However, some of the information on the proposed § 1026.20(c) disclosure that also appears on the proposed periodic statement disclosure is provided on the § 1026.20(c) disclosure in order to facilitate comparisons between the current and new payment before the new payment is due. Since the proposed § 1026.20(c) disclosure is provided only if the payment changes, the benefit to consumers from receiving the same information on both disclosures is likely greater than the benefit of receiving this information only on the periodic statement disclosure.<sup>134</sup>

Finally, the Bureau is proposing formatting requirements for the § 1026.20(c) disclosure similar to those for the initial interest rate adjustment notice. As discussed above, these requirements benefit consumers by facilitating consumer understanding of the information in the disclosures. The proposed rule provides that the disclosures must be provided in the form of a table and in the same order as, and with headings and format substantially similar to, certain forms provided with the proposed rule. The Bureau's testing of the same information proposed for inclusion in § 1026.20(c) notice in the proposed § 1026.20(d) notice showed that consumers readily understood the information in the notice when the terms and calculations were presented in the logical order contained in the model forms. As discussed above, while there is no formula for producing the ideal disclosure, the Bureau believes that disclosures that satisfy the proposed formatting requirements likely provide greater benefits to consumers than both the alternatives tested and disclosures that do not satisfy these requirements.

periodic statement, which would provide much of the same information. Thus, eliminating the annual notice reduces costs for servicers with little or no loss in benefits to consumers.

<sup>133</sup> As explained above, the Bureau is aware that for certain ARMs, there is currently less than 60 days between the date on which the index value is selected that serves as the basis for the new payment and the date on which payment at a new level is due. It may therefore be difficult for servicers to provide a notice of interest rate adjustment within 60 days of the date on which payment at a new level is due. The Bureau may provide an accommodation for some of these ARMs by requiring a different minimum time for providing this advance notice. The Bureau solicits comments on the operational changes that would be required to provide § 1026.20(c) notices at least 60 days before payment at a new level is due.

<sup>134</sup> Of course, a consumer who receives the proposed § 1026.20(c) disclosure may derive little additional benefit from shortly thereafter receiving the same information on the proposed periodic statement disclosure. There would, however, likely be little cost saving for servicers in not having to provide the information on the proposed periodic statement disclosure that also appears on the § 1026.20(c) disclosure for just one or two months.

Extrapolating from FHFA data, the Bureau estimates that approximately 650,000 adjustable-rate mortgages will adjust in each of the next three years. To illustrate the possible benefits of the proposed § 1026.20(c) disclosure, suppose that the proposed change in the timing of the disclosure from 25 days to 60 days before payment at a new level is due prompts certain consumers to refinance one month sooner. If the change in timing provides just 5% of consumers with ARMs a one-time benefit of \$50, the annual savings to consumers would be over \$1.6 million.

*Costs to consumers.* As explained further in the discussion of costs to covered persons, the proposed provisions would produce a minimal increase in costs, about 80 cents per disclosure. This estimate takes into account both one-time additional costs (amortized over five years) and additional annual production and distribution costs. Under conservative assumptions, in the illustration above, the benefit to consumers would be \$2.50 per disclosure.

Given the small additional cost per disclosure, the Bureau believes that consumers would not see any increase in fees or charges. Servicers may in general attempt to shift a cost increase onto others and consumers may ultimately bear part of an increase that falls nominally on servicers. For the proposed § 1026.20(c) disclosure, however, the costs to be shifted are very small. Thus, the proposed disclosure is not likely to impose any cost increase on consumers.

As with the proposed initial interest rate adjustment notice, the proposed rule limits how servicers may present the required information in the proposed § 1026.20(c) disclosure. Servicers would have to present the required information in a format substantially similar to the format of the proposed model form. The Bureau recognizes the possibility that constraints on the way servicers present information to consumers may prohibit the use of more effective forms that servicers are using or may develop. The constraints would then impose a cost on consumers. The Bureau does not believe there are any such costs in this case. The Bureau is unaware of any efforts by servicers to develop a payment adjustment notice that meets the requirements of proposed § 1026.20(c) and provides the benefits to consumers of the proposed model forms.

As discussed above, some consumers have adjustable-rate mortgages with look-back periods shorter than 45 days. For example, FHA and VA ARMs often have look-back periods of 15 or 30 days.

These ARMs contractually will not be able to comply with the proposal to require sending the § 1026.20(c) disclosure 60 to 120 days before payment at a new level is due. The Bureau is proposing grandfathering these existing ARMs. Going forward, however, ARMs must be structured to permit compliance with the proposed 60- to 120-day time frame.

Initial outreach suggests that the absence of adjustable-rate mortgages with short look-back periods will not reduce the mortgage options available to consumers. It is possible, however, that mortgages with short look-back periods may have certain cost advantages to servicers or investors in certain interest rate environments (*e.g.*, when rates are rising quickly) and that competition may translate some of these advantages into benefits to consumers. In this case, the proposed 60- to 120-day time frame would impose a cost on consumers. The Bureau seeks comments on both the grandfathering provision and general requirement for compliance with the proposed time frame going forward.

*Benefits to covered persons.* The timing and content of the proposed § 1026.20(c) disclosure may provide certain benefits to servicers. Servicers benefit when distressed consumers contact them in advance of a possible increase in interest rate and payment, since early communication gives servicers and consumers more time to work together constructively. Changing the minimum time for providing advance notice to consumers from 25 days to 60 days before payment at a new level is due provides essential household budgeting information to consumers sooner. Distressed consumers may then contact their servicer sooner, and the servicer and the consumer would then have additional time to work together and if necessary to explore alternatives.

*Costs to covered persons.* The proposed modifications of the § 1026.20(c) disclosure will result in certain compliance costs to covered persons. Servicers (or their vendors) may need to adapt their software and compliance systems to produce the revised disclosure. The revised disclosure would also provide to borrowers information that is not currently disclosed to them, including information that is specific to each loan. Servicers (or their vendors) may not have ready access to all of this additional loan-level information; for example, if some of this additional information is stored in a database that is not regularly accessed by systems that produce the current disclosures. The Bureau solicits information about

servicer and vendor operations regarding the storage of loan-level information and the costs of providing the proposed new loan-level information to consumers.

As discussed above, some of the information provided in the proposed revisions to the § 1026.20(c) disclosure is also provided in the proposed initial interest rate adjustment disclosure. The Bureau believes that harmonizing the two disclosures would mitigate the compliance burden for servicers and reduce the aggregate production costs to servicers.

Based on discussions with servicers and software vendors to date, the Bureau believes that, in general, servicers of all sizes will incur minimal one-time costs to learn about the proposed provision. They will for the most part use vendors for one-time software and IT upgrades and for producing and distributing (*i.e.*, mailing) the disclosure. Under existing vendor contracts, large servicers will not be charged for the upgrades and production but may be charged for distribution. Smaller servicers may be charged for all these costs, but they service relatively few loans so in aggregate these costs are small.

Based on discussions with industry and extrapolating from FHFA data, the Bureau estimates one-time costs of just under \$2 million for the 12,800 servicers overall. Amortizing this cost over five years and combining it with annual costs of \$129,000 gives a total annual cost of \$41 per servicer, or 80 cents per disclosure. For small servicers, the one-time cost is \$1.65 million. This also gives a total additional annual cost of about \$41 per servicer. The Bureau is not aware of any reasonably obtainable data on the loan portfolios of small servicers, so it is not possible to estimate the number of disclosure that small servicers would produce each year. The Bureau seeks comment on these estimates and asks interested parties to provide data, research, and other information that may inform the further consideration of these costs.

The Bureau recognizes that certain financial benefits to consumers from the revised § 1026.20(c) disclosure may have an associated financial cost to covered persons. The discussion of this point for the initial interest rate adjustment notice applies equally to the revised § 1026.20(c) disclosure.

Finally, as discussed above, the Bureau recognizes that there may be costs to covered persons from extending the minimum advance notice period to 60 days. Mortgages with short look-back periods may have certain cost advantages in certain interest rate

environments (e.g., when rates are rising quickly). The Bureau seeks comments on both the grandfathering provision and general requirement for compliance with the proposed time frame going forward.

### 3. New Periodic Statement Disclosure for Certain Mortgages

Section 1420 of the Dodd-Frank Act requires the creditor, assignee, or servicer of any residential mortgage loan to transmit to the consumer, for each billing cycle, a periodic statement that sets forth certain specified information in a clear and conspicuous manner. The statute also gives the Bureau the authority to require servicers<sup>135</sup> to include additional content to be included in the periodic statement. The statute provides an exception to the periodic statement requirement for fixed-rate loans where the consumer is given a coupon book containing substantially the same information as the statement.

The proposed rule would require the periodic statement to include the content listed in the statute, as applicable, as well as billing information, payment application information, and information that may be helpful to distressed or delinquent consumers. In accordance with the statute, the proposed rule provides a coupon book exemption for fixed-rate loans when the consumer is given a coupon book with certain of the information required by the periodic statement. The proposed rule also has exemptions for small servicers, reverse mortgages, and timeshares.

The proposed periodic statement disclosure would be provided to all consumers with a closed-end residential mortgage, unless one of the exemptions applies.

**Benefits to consumers.** The Bureau does not have representative information on the extent to which servicers currently provide consumers with coupon books, billing statements, or periodic statements that may comply with the proposed rule. Servicers do have an incentive to provide consumers with basic billing information. This includes the payment due date, amount of any late payment fee, amount due, and current interest rate. This information also appears on the proposed periodic statement. While this basic information provides benefits to consumers, those benefits are already provided for by current disclosures. The

proposed periodic statement will also contain information that could appear on a coupon book that does provide additional benefits to consumers, for example, the housing counselor information.

There is other information that appears on billing statements and coupon books but is accurate only if the consumer always makes the scheduled payment on time and no other payment. This information is accurate because it follows a set formula. It includes the outstanding principal balance, total payments made since the beginning of the calendar year, and the breakdown of payments into principal, interest, and escrow. This information is not accurate, however, if the borrower makes an extra payment, provides a partial payment, or misses a payment entirely.

All of this aforementioned information appears on the proposed periodic statement. However, on the proposed periodic statement, the information would be accurate even if the consumer makes an extra payment, provides a partial payment, or misses a payment entirely. Consumers generally benefit from having accurate information about payments in order to monitor the servicer, assert errors if necessary, and track the accumulation of equity. However, delinquent consumers may especially benefit from tracking the effects of delinquency on equity so they can effectively determine how to allocate income and consider options for refinancing. For these consumers, the proposed periodic statement may provide large benefits relative to coupon books or billing statements that do not provide the aforementioned information.

Finally, there is information that simply cannot be provided on a coupon book or on a billing statement that provides the same information as a coupon book. This includes fees or charges imposed since the last periodic statement, partial payments, past due payments, and a wide range of delinquency information and information about loan modifications and foreclosure.

Consumers who are more than 45 days delinquent will have a delinquency notice included on the periodic statement (or provided to them if their servicer is using a coupon book) providing specific information about the delinquency of their loan. This is one way the servicer may catch the attention of the consumer. The messages section provides an additional route. The only message the proposed rule requires the servicer to provide concerns partial payments; however, the proposal also

seeks comment on other messages that should be required. Consumers who make partial payments may benefit from knowing what they must do to have the funds in a suspense or unapplied funds account applied to the outstanding balance.

All of this information is useful to distressed or delinquent consumers who may need to assert an error and evaluate alternatives to paying the current mortgage. A consumer with past due amounts on a mortgage, car, and credit card would need information about the past due amounts and how the fees and charges accumulate in order to determine the most advantageous way of reducing total debt. The information generally benefits consumers who are managing a variety of debts and who want to know the least costly way of increasing their total debt or the most advantageous way of reducing their total debt.

The Bureau is proposing grouping requirements in the format of the periodic statement. The grouping requirement presents the information in a logical format and may facilitate consumer understanding of the information in the different components of the disclosure. The General Design Principles discussed in the Macro Final Report, discussed in the section-by-section analysis, include grouping together related concepts and figures because consumers are likely to find it easier to absorb and make sense of financial forms if the information is grouped in a logical way. The Bureau also tested model periodic statement disclosures that satisfy the grouping requirements. As discussed above, while there is no formula for producing the ideal disclosure, the Bureau believes that disclosures that satisfy the grouping requirement are likely to provide greater benefits to consumers than disclosures that do not.

There are two main exceptions to the proposed periodic statement requirement. The first, provided by statute, is an exception for consumers with fixed-rate mortgages and coupon books that contain certain information. As discussed above, the fixed or formulaic information on coupon books will be accurate for consumers who make only scheduled payments. Consumers with fixed-rate mortgages never have to manage a changed payment amount. However, the Bureau does not have ready access to data on whether they are less likely to make additional payments, partial payments or miss a payment and may obtain substantially reduced benefits because of the exception.

<sup>135</sup> Reference in parts VII, VIII, and IX to "servicers" with regard to the proposed rule for the periodic statement, means creditors, assignees, and servicers.

The Bureau is also proposing an exception for small servicers. A small servicer would be defined as a servicer (i) who services 1,000 or fewer mortgage loans and (ii) that only services mortgage loans for which the servicer or an affiliate is the owner or assignee, or for which the servicer or an affiliate is the entity to whom the mortgage loan obligation was initially payable. Such small servicers will not have to provide the proposed periodic statement.

As discussed in the section-by-section analysis on § 1026.41(e)(4), the Bureau believes that servicers that meet both conditions generally provide consumers with ready access to the information on the proposed periodic statement, but possibly through other channels. Servicers that meet the first condition face either a reduction in the value of an asset on its portfolio or the loss of an investment in the relationship with the consumer which was established by originating if they provide poor servicing. Servicers that also service relatively few loans have an incentive to commit to a “high-touch” business model that offers highly responsive customer service. The Bureau believes that servicers that meet both conditions can and generally do provide their customers with ready access to comprehensive information about their payments, amounts due and other account information through a variety of channels. Thus, the Bureau believes that the proposed exemption would produce at most a minimal reduction in benefits to the customers of small servicers.

Using regulatory filings, the Bureau roughly estimates that approximately 49 million consumers would receive the proposed periodic statement disclosure (even taking into account the small servicer exception). To illustrate the possible benefits of the disclosure, suppose 10% save 15 minutes each year because the proposed disclosure provides them with information about their loan or payments that their billing statements or coupon books may not provide (e.g., a past payment breakdown) and they would spend 15 minutes obtaining this information, say by contacting their servicer by phone, mail or some other means. This is a savings of 1.225 million hours per year, or almost \$21 million at the median wage of \$17 per hour.

*Benefits to covered persons.* Providing the proposed content on a regular basis to consumers may reduce the frequency with which consumers contact the servicer for information and reduce the time servicers spend answering consumer questions. Servicers also benefit from reduced costs when they manage fewer partial payments and

delinquencies and can resolve delinquencies sooner.

*Costs to covered persons.* The proposed periodic statement disclosure will result in certain compliance costs to servicers. Servicers (or their vendors) may need to adapt their software and compliance systems to produce the new disclosure. The new proposed disclosure would also provide to borrowers information that is not currently disclosed to them, including information that is specific to each loan. Servicers (or their vendors) may not have ready access to all of this additional loan-level information; for example, if some of this additional information is stored in a database that is not regularly accessed by systems that produce the current disclosures. The Bureau solicits information about servicer and vendor operations regarding the storage of loan-level information and the costs of providing the proposed new loan-level information to consumers.

The Bureau believes that, in general, servicers of all sizes will incur minimal one-time costs to learn about the proposed provision. Based on information provided by servicers and by software vendors, the Bureau believe that servicers will use vendors for one-time software and IT upgrades and for producing and distributing (i.e., mailing) the disclosure. Under existing vendor contracts, large servicers will not be charged for the upgrades and production but may be charged for distribution. Smaller servicers may be charged for all these costs, but they service relatively few loans so in aggregate these costs are small.

The Bureau is not aware of any reasonably obtainable data that would allow an accurate calculation of the additional annual cost from the proposed disclosure per servicer. This calculation would depend critically on the number of servicers not covered by the exception and the number of adjustable-rate mortgages with coupon books that these servicers currently service. A plausible illustration is that 2,013 servicers not covered by the exception begin providing 1 million consumers (i.e., those with coupon books and adjustable rate mortgages) twelve new disclosures per year at fifty cents per disclosure, for an average annual cost of \$2,981 per servicer. This figure does not include the additional annual cost to these servicers of providing the information on the proposed periodic statement disclosure that is not currently provided on their existing billing statements. The Bureau welcomes comment on this estimate and asks interested parties to provide data,

research, and other information that may inform the further consideration of the costs of the proposed periodic statement disclosure.

The small servicer exemption in proposed § 1026.41(e)(4) would benefit small servicers by providing an alternative, and potentially less expensive, means of compliance with the periodic statement requirement. The SBREFA panel stated that a periodic statement requirement would impose significant burdens on small servicers. The panel explained that while much of the information in the proposed periodic statement was already being provided through alternative means and most of the information is available on request, consolidating this information into a single monthly dynamic statement is difficult for small servicers.

The SERs expressed that due to their small size, they would not be able to have in-house expertise and would generally use third-party vendors to develop periodic statements. Due to their small size, they believe they would have no control over these vendor costs. Additionally, the small servicers have a smaller portfolio over which to spread the fixed costs of producing periodic statements. Such servicers stated they are unable to gain cost efficiencies and cannot effectively spread the implementation costs of periodic statements across their loan portfolios. Finally, even the costs of mailing monthly statements could be significant to the extent that small servicers currently use alternative information methods (such as coupon books for adjustable-rate mortgages, or passbooks).

For small servicers, the cost savings from the proposed exception equals the costs not incurred to begin providing periodic statements or to improve existing disclosures to consumers who would be required to receive the periodic statement under the proposal. The only consumers who need not receive the proposed disclosure are those with fixed-rate mortgages and coupon books. The Bureau believes that this is a relatively small fraction of the loans held on portfolio or sold with servicing retained by servicers with less than 1,000 loans. Thus, small servicers would have to increase the content of existing disclosures or begin providing the periodic statement disclosure to almost all of their consumers. However, many of these consumers receive billing statements, so there would not be additional distribution costs from the proposed disclosure, and the exception does not mitigate costs that would not be incurred.

There is no reasonably available data with which the Bureau can accurately

estimate the number of these consumers or the mix of new disclosures and improved disclosures. However, based on regulatory data, the Bureau believes that approximately 10,800 small servicers service 2.3 million mortgages. Based on discussions with industry, the Bureau believes that each periodic statement would cost a range of 20–50 cents to provide. Thus, a reasonable estimate of the cost savings for small servicers from the proposed exception is \$6 million–\$14 million. The Bureau seeks data and other information with which it may further consider the question of the cost savings from the proposed small servicer exception.

#### 4. Prompt Crediting of Payments and Response to Requests for Payoff Amounts

DFA section 1464(a) codifies existing Regulation Z § 1026.36(c)(1)(i) on prompt crediting. The Bureau is proposing an additional requirement for the handling of partial payments (*i.e.*, payments that are not full contractual payments). Under the proposal, if servicers hold partial payments in a suspense account, once the amount in the account equals a full contractual payment, the servicer must credit the payment to the most delinquent outstanding payment. The Bureau proposes to define a full contractual payment as a payment covering principal, interest and escrow (if applicable). A proposed alternative to the definition would include late fees.

DFA section 1464(b) requires that a creditor or servicer of a home loan send an accurate payoff balance within a reasonable time, but in no case more than seven business days, after the receipt of a written request for such balance from or on behalf of the consumer. This generally codifies existing Regulation Z § 1026.36(c)(1)(iii) on payoff statements.

*Benefits and costs to consumers.* The proposed provision on prompt crediting generally ensures that consumers benefit from every effort that they make to pay their mortgage debt. The proposed provision helps consumers manage and reduce default by clarifying the rules servicers must follow when processing partial payments.

As the statute largely codifies an existing regulation, the benefits and costs to consumers from a pre-statute baseline are small. However, the existing regulation does not specifically address the handling of partial payments. As discussed above, the proposed regulation would leave servicers significant flexibility in the handling of partial payments but would also ensure greater consistency in the

handling of suspense accounts. The Bureau believes this proposed approach would clarify servicers' obligations in processing both full contractual payment and partial payments, as well as ensure all payments are properly applied. The proposed disclosures would help consumers understand the processing of their payments. Additionally, requiring application to the oldest outstanding payment when a full payment accumulates will provide protection to consumers, as well as reduce the outstanding principal balance on certain consumer loans. The Bureau requests comment on the benefits and costs to consumers of including late fees in the definition of a full contractual payment. Not including late fees in the definition of a full contractual payment would require servicers to credit a payment that covered principal, interest and escrow even if late fees were outstanding. Consumers who made such a payment would benefit from having that payment credited. While some servicers currently follow this practice, other servicers who hold such payments in suspense accounts until the fees are paid would be required to change their practices.

*Benefits and costs to covered persons.* As the statute largely codifies an existing regulation, the benefits and costs to covered persons from a pre-statute baseline are small. The proposed provision on prompt crediting may cause certain covered persons with different crediting practices to forfeit some fee income or float income, but the Bureau has no data with which to determine whether this is the case. The Bureau requests comment on the benefits and costs to covered persons of including late fees in the definition of a full contractual payment.

#### E. Potential Specific Impacts of the Proposed Rule

##### 1. Depository Institutions and Credit Unions With \$10 Billion or Less in Total Assets, as Described in § 1026

Overall, the impact of the rule on depository institutions and credit unions depends on a number of factors, including the institutions' current software and compliance systems and the current practices of third-party service providers. Based on discussions with industry, the Bureau believes that larger depositories and credit unions will incur only minimal costs from this rulemaking.

The initial interest rate adjustment notice is a new disclosure, but the Bureau believes that the larger depository institutions and credit

unions (of those with \$10 billion or less in total assets) use third-party vendors who will, under current contracts, absorb the information collection and data processing costs. The Bureau believes that vendors do not absorb the costs of mailing disclosures, and based on discussions with industry the Bureau understands that 70–80% of consumers have not elected to receive disclosures electronically. Relatively few adjustable-rate mortgages have been originated in recent years, however, and so the number that will adjust for the first time in the near term will be small.

The costs to the larger depositories and credit unions (of those with \$10 billion or less in total assets) from the proposed changes to the two other proposed disclosures will also be minimal. The Bureau expects that the information collection and data processing costs of the periodic statement disclosure and the proposed changes in the § 1026.20(c) disclosure will largely be absorbed by third-party vendors. The Bureau believes that the mailing costs of the periodic statement disclosure are likely to be the same as those for billing statements that it would replace. The proposed provision on periodic statements would require consumers who use a coupon book for payments on an adjustable-rate mortgage to receive a periodic statement, but the number of such consumers is small. The mailing costs of the proposed § 1026.20(c) disclosure would be the same as the mailing costs of the current disclosure.

The Bureau believes that smaller depositories and credit unions may incur some additional costs from this rulemaking. Smaller depositories also use third-party vendors, but the Bureau believes that contracts with these vendors may allow them to pass along the information collection and data processing costs to the servicers. Even for smaller depository servicers, however, the additional costs from the two proposed disclosures for adjustable-rate mortgage are likely to be small. There will be few initial interest rate adjustments in the near term, and servicers currently are required to send the § 1026.20(c) disclosure. Thus, most new costs will come from the one-time and ongoing costs of providing the periodic statement disclosure. As discussed above, the Bureau is proposing to exempt certain small servicers from the periodic statement disclosure requirement if they service fewer than 1,000 loans and either hold the loans in portfolio or originated them. Using Call Report data, the Bureau concludes that almost all servicers with under \$175 million in

assets would qualify for this exemption, as would many servicers with greater assets. However, the Bureau will examine this question further and requests data and additional information on the small servicers who would qualify for the proposed exemption.

Based on discussions with industry, the Bureau believes that the vast majority of depositories and credit unions, of any size, are already in compliance with the proposed provisions for prompt crediting of payments and response to requests for payoff amounts.

## 2. Impact of the Proposed Provisions on Consumers in Rural Areas

Consumers in rural areas may experience benefits from the proposed rule that are different in certain respects from the benefits experienced by consumers in general. Consumers in rural areas may be more likely to obtain mortgages from small local banks and credit unions that either service the loans in portfolio or sell the loans and retain the servicing rights. These servicers may already provide most of the benefits to consumers that the proposed rule is designed to provide, including the benefits to consumers with adjustable-rate mortgages. On the other hand, it is also possible that a lack of alternatives for consumers in some rural areas regarding lenders who also service mortgages may cause the proposed rule to provide rural consumers with greater benefits than the rule may provide to other consumers.

The Bureau will further consider the impact of the proposed rule on consumers in rural areas. The Bureau therefore asks interested parties to provide data, research results and other factual information on the impact of the proposed rule on consumers in rural areas.

### *F. Additional Analysis Being Considered and Request for Information*

The Bureau will further consider the benefits, costs, and impacts of the proposed provisions and additional proposed modifications before finalizing the proposal. As noted below, there are a number of areas where additional information would allow the Bureau to better estimate the benefits and costs of this proposal.

In addition, the Bureau asks interested parties to provide general information, data, and research results on:

- How consumers might respond to the information proposed for inclusion in the new initial interest rate adjustment disclosure, the additional

information proposed for inclusion in the revised Regulation Z § 1026.20(c) disclosure, and the information proposed for inclusion in the new periodic statement disclosures;

- The coverage and format of these proposed disclosures;
- The benefits to consumers from the disclosures listed above; and
- The potential impact on servicers and on the functioning of the servicing market from the disclosures listed above and the prompt crediting requirement.

The Bureau also requests specific information on the costs to covered persons of complying with the proposal, such as revising compliance software and systems.

To supplement the information discussed in this preamble and any information that the Bureau may receive from commenters, the Bureau is currently working to gather additional data that may be relevant to this and other mortgage-related rulemakings. These data may include additional data from the National Mortgage License System (NMLS) and the NMLS Mortgage Call Report, loan file extracts from various lenders, and data from the pilot phases of the National Mortgage Database. The Bureau expects that each of these datasets will be confidential. This section now describes each dataset in turn.

First, as the sole system supporting licensure/registration of mortgage companies for 53 regulatory agencies for states and territories and mortgage loan originators under the SAFE Act, NMLS contains basic identifying information for non-depository mortgage loan origination companies. Firms that hold a State license or State registration through NMLS are required to complete either a standard or expanded Mortgage Call Report (MCR). The Standard MCR includes data on each firm's residential mortgage loan activity including applications, closed loans, individual mortgage loan originator (MLO) activity, line of credit, and other data repurchase information by State. It also includes financial information at the company level. The expanded report collects more detailed information in each of these areas for those firms that sell to Fannie Mae or Freddie Mac.<sup>136</sup> To date, the Bureau has received basic data on the firms in the NMLS and de-identified data and tabulations of data from the MCR. These data were used, along with HMDA data, to help estimate the number and characteristics of non-

depository institutions active in various mortgage activities. In the near future, the Bureau may receive additional data on loan activity and financial information from the NMLS including loan activity and financial information for identified lenders. The Bureau anticipates that these data will provide additional information about the number, size, type, and level of activity for non-depository lenders engaging in various mortgage origination and servicing activities. As such, it supplements the Bureau's current data for non-depository institutions reported in HMDA and the data already received from NMLS. For example, these new data will include information about the number and size of closed-end first and second loans originated, fees earned from origination activity, levels of servicing, revenue estimates for each firm, and other information. The Bureau may compile some simple counts and tabulations and conduct some basic statistical modeling to better model the levels of various activities at various types of firms. In particular, the information from the NMLS and the MCR may help the Bureau refine its estimates of benefits, costs, and impacts for each of the revisions to the RESPA Good Faith Estimate and settlement statement forms, changes to the HOEPA thresholds, changes to requirements for appraisals, updates to loan originator compensation rules, proposed new servicing requirements, and the new ability to repay standards.

Second, the Bureau is working to obtain a random selection of loan-level data from several lenders. The Bureau intends to request loan file data from lenders of various sizes and geographic locations to construct a representative dataset. In particular, the Bureau will request a random sample of RESPA, GFE, and RESPA settlement statement forms from loan files for closed-end loans. These forms include data on some or all loan characteristics including settlement charges, origination charges, appraisal fees, flood certifications, mortgage insurance premiums, homeowner's insurance, title charges, balloon payments, prepayment penalties, origination charges, and credit charges or points. Through conversations with industry, the Bureau believes that such loan files exist in standard electronic formats allowing for the creation of a representative sample for analysis. The Bureau may use these data to further measure the impacts of certain proposed changes. Calculations of various categories of settlement and origination charges may help the Bureau calculate the various impacts of

<sup>136</sup> More information about the Mortgage Call Report can be found at <http://mortgage.nationwidelicensingsystem.org/slr/common/mcr/Pages/default.aspx>.

proposed changes to the definition of finance charge and other aspects of the proposal, including proposed changes in the number and characteristics of loans that exceed the HOEPA thresholds, loans that would meet the high rate or high risk definitions mandating additional consumer protections, and loans that meet the points and fees thresholds contained in the ability to repay provisions of the Dodd-Frank Act.

Third, the Bureau may also use data from the pilot phases of the National Mortgage Database (NMDB) to refine its proposals and/or its assessments of the benefits, costs, and impacts of these proposals. The NMDB is a comprehensive database, currently under development, of loan-level information on first lien single-family mortgages. It is designed to be a nationally representative sample (1%) and contains data derived from credit reporting agency data and other administrative sources along with data from surveys of mortgage borrowers. The first two pilot phases, conducted over the past two years, vetted the data development process, successfully pretested the survey component and produced a prototype dataset. The initial pilot phases validated that sampled credit repository data are both accurate and comprehensive and that the survey component yields a representative sample and a sufficient response rate. A third pilot is currently being conducted with the survey being mailed to holders of 5,000 newly originated mortgages sampled from the prototype NMDB. Based on the 2011 pilot, a response rate of 50% or higher is expected. These survey data will be combined with the credit repository information of non-respondents, and then de-identified. Credit repository data will be used to minimize non-response bias, and attempts will be made to impute missing values. The data from the third pilot will not be made public. However, to the extent possible, the data may be analyzed to assist the Bureau in its regulatory activities and these analyses will be made publicly available.

The survey data from the pilots may be used by the Bureau to analyze consumers' shopping behavior regarding mortgages. For instance, the Bureau may calculate the number of consumers who use brokers, the number of lenders contacted by borrowers, how often and with what patterns potential borrowers switch lenders, and other behaviors. Questions may also assess borrowers' understanding of their loan terms and the various charges involved with origination. Tabulations of the survey

data for various populations and simple regression techniques may be used to help the Bureau with its analysis.

The Bureau requests commenters to submit data and to provide suggestions for additional data to assess the issues discussed above and other potential benefits, costs, and impacts of the proposed rule. The Bureau also requests comment on the use of the data described above.

### VIII. Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA), as amended by SBREFA, requires each agency to consider the potential impact of its regulations on small entities, including small businesses, small governmental units, and small not-for-profit organizations. 5 U.S.C. 601 *et seq.* The RFA generally requires an agency to conduct an initial regulatory flexibility analysis (IRFA) and a final regulatory flexibility analysis (FRFA) of any rule subject to notice-and-comment rulemaking requirements, unless the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities. 5 U.S.C. 603, 604. The Bureau also is subject to certain additional procedures under the RFA involving the convening of a panel to consult with small business representatives prior to proposing a rule for which an IRFA is required. 5 U.S.C. 609.

The Bureau has not certified that the proposed rule would not have a significant economic impact on a substantial number of small entities within the meaning of the RFA. Accordingly, the Bureau convened and chaired a SBREFA Panel to consider the impact of the proposed rule on small entities that would be subject to that rule and to obtain feedback from representatives of such small entities. The SBREFA Panel for this rulemaking is discussed below in part VIII.A.

The Bureau is publishing an IRFA. Among other things, the IRFA estimates the number of small entities that will be subject to the proposed rule and describes the impact of that rule on those entities. The IRFA for this rulemaking is set forth below in part VIII.B.

#### A. Small Business Review Panel

Under section 609(b) of the RFA, as amended by SBREFA and the Dodd-Frank Act, the Bureau seeks, prior to conducting the IRFA, information from representatives of small entities that may potentially be affected by its proposed rules to assess the potential impacts of that rule on such small entities. 5 U.S.C. 609(b). Section 609(b) sets forth a series of procedural steps

with regard to obtaining this information. The Bureau first notifies the Chief Counsel for Advocacy (Chief Counsel) of the SBA and provides the Chief Counsel with information on the potential impacts of the proposed rule on small entities and the types of small entities that might be affected. 5 U.S.C. 609(b)(1). Not later than 15 days after receipt of the formal notification and other information described in section 609(b)(1) of the RFA, the Chief Counsel then identifies the SERs, the individuals representative of affected small entities for the purpose of obtaining advice and recommendations from those individuals about the potential impacts of the proposed rule. 5 U.S.C. 609(b)(2). The Bureau convenes a SBREFA Panel for such rule consisting wholly of full-time Federal employees of the office within the Bureau responsible for carrying out the proposed rule, the Office of Information and Regulatory Affairs (OIRA) within the OMB, and the Chief Counsel. 5 U.S.C. 609(b)(3). The SBREFA Panel reviews any material the Bureau has prepared in connection with the SBREFA process and collects the advice and recommendations of each individual small entity representative identified by the Bureau after consultation with the Chief Counsel on issues related to sections 603(b)(3) through (b)(5) and 603(c) of the RFA.<sup>137</sup> 5 U.S.C. 609(b)(4). Not later than 60 days after the date the Bureau convenes the SBREFA Panel, the panel reports on the comments of the SERs and its findings as to the issues on which the SBREFA Panel consulted with the SERs, and the report is made public as part of the rulemaking record. 5 U.S.C. 609(b)(5). Where appropriate, the Bureau modifies the rule or the IRFA in light of the foregoing process. 5 U.S.C. 609(b)(6).

On April 9, 2012, the Bureau provided the Chief Counsel with the formal notification and other information required under section 609(b)(1) of the RFA. To obtain feedback

<sup>137</sup> As described in the IRFA in part VIII.B, below, sections 603(b)(3) through (b)(5) and 603(c) of the RFA, respectively, require a description of and, where feasible, provision of an estimate of the number of small entities to which the proposed rule will apply; a description of the projected reporting, record keeping, and other compliance requirements of the proposed rule, including an estimate of the classes of small entities which will be subject to the requirement and the type of professional skills necessary for preparation of the report or record; an identification, to the extent practicable, of all relevant Federal rules which may duplicate, overlap, or conflict with the proposed rule; and a description of any significant alternatives to the proposed rule which accomplish the stated objectives of applicable statutes and which minimize any significant economic impact of the proposed rule on small entities. 5 U.S.C. 603(b)(3), 603(b)(4), 603(b)(5), 603(c).

from small entity representatives to inform the SBREFA Panel pursuant to sections 609(b)(2) and 609(b)(4) of the RFA, the Bureau, in consultation with the Chief Counsel, identified five categories of small entities that may be subject to the proposed rule for purposes of the IRFA: Commercial banks/savings institutions, credit unions, non-depositories engaged primarily in lending funds with real estate as collateral (included in NAICS 522292), non-depositories primarily engaged in loan servicing (included in NAICS 522390), and certain non-profit organizations. Section 3 of the IRFA, in part VIII.B.3, below, describes in greater detail the Bureau's analysis of the number and types of entities that may be affected by the proposed rule. Having identified the categories of small entities that may be subject to the proposed rule for purposes of an IRFA, the Bureau then, in consultation with the Chief Counsel, selected 16 small entity representatives to participate in the SBREFA process. As described in chapter 7 of the SBREFA Final Report, described below, the SERs selected by the Bureau in consultation with the Chief Counsel included representatives from each of the categories identified by the Bureau and comprised a diverse group of individuals with regard to geography and type of locality (*i.e.*, rural, urban, suburban, or metropolitan areas).

On April 10, 2012, the Bureau convened the SBREFA Panel pursuant to section 609(b)(3) of the RFA. Afterwards, to collect the advice and recommendations of the SERs under section 609(b)(4) of the RFA, the SBREFA Panel held an outreach meeting/teleconference with the small entity representatives on April 24, 2012. To help the small entity representatives prepare for the outreach meeting beforehand, the SBREFA Panel circulated briefing materials prepared in connection with section 609(b)(4) of the RFA that summarized the proposals under consideration at that time, posed discussion issues, and provided information about the SBREFA process generally.<sup>138</sup> All 16 small entity representatives participated in the outreach meeting either in person or by telephone. The SBREFA Panel also provided the small entity representatives with an opportunity to

submit written feedback until May 1, 2012. In response, the SBREFA Panel received written feedback from five of the representatives.<sup>139</sup>

On June 11, 2012, the SBREFA Panel submitted to the Director of the Bureau, Richard Cordray, a written SBREFA Final Report that includes the following: Background information on the proposals under consideration at the time; information on the types of small entities that would be subject to those proposals and on the small entity representatives who were selected to advise the SBREFA Panel; a summary of the SBREFA Panel's outreach to obtain the advice and recommendations of those small entity representatives; a discussion of the comments and recommendations of the small entity representatives; and a discussion of the SBREFA Panel findings, focusing on the statutory elements required under section 603 of the RFA. 5 U.S.C. 609(b)(5).<sup>140</sup>

In preparing this proposed rule and the IRFA, the Bureau has carefully considered the feedback from the small entity representatives participating in the SBREFA process and the findings and recommendations in the SBREFA Final Report. The section-by-section analysis of the proposed rule in part VI, above, and the IRFA discuss this feedback and the specific findings and recommendations of the SBREFA Panel, as applicable. The SBREFA process provided the SBREFA Panel and the Bureau with an opportunity to identify and explore opportunities to minimize the burden of the rule on small entities while achieving the rule's purposes. It is important to note, however, that the SBREFA Panel prepared the SBREFA Final Report at a preliminary stage of the proposal's development and that the SBREFA Final Report—in particular, the SBREFA Panel's findings and recommendations—should be considered in that light. Also, any options identified in the SBREFA Final Report for reducing the proposed rule's regulatory impact on small entities were expressly subject to further consideration, analysis, and data collection by the Bureau to ensure that the options identified were practicable, enforceable, and consistent with TILA, the Dodd-Frank Act, and their statutory purposes. The proposed rule and the IRFA reflect further consideration, analysis, and data collection by the Bureau.

## B. Initial Regulatory Flexibility Analysis

Under RFA section 603(a), an IRFA “shall describe the impact of the proposed rule on small entities.” 5 U.S.C. 603(a). Section 603(b) of the RFA sets forth the required elements of the IRFA. Section 603(b)(1) requires the IRFA to contain a description of the reasons why action by the agency is being considered. 5 U.S.C. 603(b)(1). Section 603(b)(2) requires a succinct statement of the objectives of, and the legal basis for, the proposed rule. 5 U.S.C. 603(b)(2). The IRFA further must contain a description of and, where feasible, provision of an estimate of the number of small entities to which the proposed rule will apply. 5 U.S.C. 603(b)(3). Section 603(b)(4) requires a description of the projected reporting, recordkeeping, and other compliance requirements of the proposed rule, including an estimate of the classes of small entities that will be subject to the requirement and the types of professional skills necessary for the preparation of the report or record. 5 U.S.C. 603(b)(4). In addition, the Bureau must identify, to the extent practicable, all relevant Federal rules which may duplicate, overlap, or conflict with the proposed rule. 5 U.S.C. 603(b)(5). The Bureau, further, must describe any significant alternatives to the proposed rule which accomplish the stated objectives of applicable statutes and which minimize any significant economic impact of the proposed rule on small entities. 5 U.S.C. 603(b)(6). Finally, as amended by the Dodd-Frank Act, RFA section 603(d) requires that the IRFA include a description of any projected increase in the cost of credit for small entities, a description of any significant alternatives to the proposed rule which accomplish the stated objectives of applicable statutes and which minimize any increase in the cost of credit for small entities (if such an increase in the cost of credit is projected), and a description of the advice and recommendations of representatives of small entities relating to the cost of credit issues. 5 U.S.C. 603(d)(1); DFA section 1100G(d)(1).

### 1. Description of the Reasons Why Agency Action Is Being Considered

As discussed in the Overview, part I above, mortgage servicing has been marked by pervasive and profound consumer protection problems. As a result of these problems, Congress included a number of provisions in the Dodd-Frank Act specifically to address mortgage servicing. These provisions are DFA sections 1418 (initial rate adjustment notice for adjustable-rate

<sup>138</sup> The Bureau posted these materials on its website and invited the public to email remarks on the materials. See <http://www.consumerfinance.gov/pressreleases/consumer-financial-protection-bureau-outlines-borrower-friendly-approach-to-mortgage-servicing/> (the materials are accessible via the links within this document).

<sup>139</sup> This written feedback is attached as appendix A to the SBREFA Final Report, discussed below.

<sup>140</sup> SBREFA Final Report, *supra* note 22.

mortgages (ARMs)), 1420 (periodic statement), 1463 (amending RESPA), and 1464 (prompt crediting of mortgage payments and response to requests for payoff amounts). The Bureau also proposes to amend current rule § 1026.20(c) to harmonize with DFA section 1418, although not required by statute.

The Dodd-Frank Act and TILA authorize the Bureau to adopt implementing regulations for the statutory provisions provided by DFA sections 1418, 1420, and 1464. The Bureau is using this authority to propose regulations in order to provide servicers with clarity about their statutory obligations under these three provisions. The Bureau is also proposing to adjust servicers' statutory obligations, including the obligations of small servicers, in certain circumstances. The Bureau is taking this action in order to ease burden when doing so would not sacrifice adequate protection of consumers.

Elsewhere in today's Federal Register, the Bureau is publishing a proposed rule issued under RESPA that would implement DFA section 1463, the 2012 RESPA Servicing Proposal, which addresses procedures for obtaining force-placed insurance; procedures for investigating and resolving alleged errors and responding to requests for information; reasonable information management policies and procedures; early intervention for delinquent borrowers; and continuity of contact for delinquent borrowers.

The new statutory requirements take effect automatically on January 21, 2013, as written in the statute, unless final rules are issued prior to that date. The Dodd-Frank Act provides the Bureau with limited authority to extend the effective date of statutory requirements when adopting implementing regulations. The Bureau will consider the time servicers need to come into compliance in determining the effective date.

The Bureau's proposed rules under Regulation Z and X represent another important step towards establishing uniform minimum national standards. As discussed in part II above, other Federal regulatory agencies have issued guidance on mortgage servicing and loan modifications and taken enforcement actions against mortgage servicers (including that National Mortgage Settlement, discussed in part II.C above).

These varied regulatory responses are understandable when viewed as a response to an unprecedented mortgage crisis and significant problems in the servicing of mortgage loans. Ultimately,

however, both borrowers and mortgage servicers will be better served by having uniform national standards that govern mortgage servicing. When adopted in final form, the Bureau's rules will generally apply to all mortgage servicers, whether depository institutions or non-depository institutions, and to all segments of the mortgage market, regardless of the ownership of the loan.

## 2. Succinct Statement of the Objectives of, and Legal Basis for, the Proposed Rule

DFA section 1418 requires servicers to provide a new disclosure to consumers who have hybrid ARMs. The disclosure concerns the initial interest rate adjustment and must be given either (a) between six and seven months prior to such initial interest rate adjustment or (b) at consummation of the mortgage if the initial interest rate adjustment occurs during the first six months after consummation. The Bureau proposes implementing TILA section 128A(b) by broadening the scope of the proposed rule generally to adjustable-rate mortgages, not just hybrid ARMs.

The proposed new ARM disclosure for the initial interest rate adjustment provides the content listed in the statute and certain additional information. The disclosure provides, among other things, information about the terms of the loan, a description of the way the new rate and upcoming payment would be determined, a good faith estimate of the upcoming payment, and information that may be especially useful to distressed and delinquent borrowers. The proposed revisions to the Regulation Z § 1026.20(c) disclosure would harmonize the timeframe and content requirements with those of the new ARM disclosure.

The Bureau believes that the current era of declining interest rates has reduced the payment shock that can result from ARM interest rate adjustments. If interest rates increase quickly, however, then payment shock may also increase. Furthermore, the popularity of adjustable-rate mortgages, which provide the opportunity for reduced interest rates during an introductory period, likely would increase along with the advent of higher interest rates.

The proposed rule is intended to mitigate the consequences of payment shock by ensuring that consumers have sufficient time to identify and execute the best course of action. As explained above, the proposed rule would implement DFA section 1418 requirements for the initial ARM interest rate adjustment notice, which

generally will be provided to consumers between six and seven months prior to the initial interest rate adjustment. The Bureau also proposes to revise the timeframe of the Regulation Z § 1026.20(c) disclosure for rate adjustments that result in an accompanying payment change, from the current 25 to 120 days before payment at a new level is due to 60 to 120 days before payment at a new level is due.

DFA section 1420 generally requires the creditor, assignee, or servicer of a residential mortgage loan to transmit to the borrower, for each billing cycle, a periodic statement that sets forth certain specified information in a clear and conspicuous manner. The statute also gives the Bureau the authority to require additional content to be included in the periodic statement. The statute provides an exception to the periodic statement requirement for fixed-rate loans where the consumer is given a coupon book containing substantially the same information as the statement.

The proposed periodic statement disclosure would require the periodic statement to include the content listed in the statute, as well as additional loan information, billing information, and information that may be helpful to distressed or delinquent borrowers. In accordance with the statute, the proposed rule has a coupon book exemption for fixed-rate loans when the borrower is given a coupon with certain information required by the periodic statement and information to access other information included in the periodic statement. The proposed rule also has exemptions for certain small servicers, reverse mortgages, and timeshares.

The proposed periodic statement is designed to serve a variety of purposes. These purposes include informing consumers of their payment obligation, providing consumers with information about their mortgage in an easily read and understood format, creating a record of the transaction to aid in error detection and resolution, and providing information to distressed or delinquent borrowers.

The Bureau understands that most borrowers will need only some of the information in the disclosure on a regular basis. However, distressed and delinquent borrowers will likely need more information. The proposed periodic statement disclosure was subjected to three rounds of consumer testing and refinement to identify the content and format that best promote consumer understanding.

DFA section 1464 generally codifies requirements for the prompt crediting of

mortgage payments received by servicers in connection with consumer credit transactions secured by a consumer's principal dwelling. The statute also generally codifies the requirement to provide an accurate and timely response to a borrower request for payoff amounts for home loans.

The proposed rule would require that once funds in a suspense account equal a full contractual payment that the servicer must credit the payment to the most delinquent outstanding payment. The proposed rule also would require a servicer to send an accurate payoff balance, in no case more than seven business days, after the receipt of a written request for such balance from or on behalf of the consumer.

The objective of the prompt crediting requirement is to ensure that consumers benefit from every effort that they make to pay their mortgage debt. However, the Bureau understands that requiring immediate crediting of partial payments might induce some servicers to return partial payments. The Bureau believes that this outcome would not serve the interests of consumers who have demonstrated that they are trying to pay their mortgage debt.

The objective of the payoff statement provision is to ensure that consumers can obtain this basic information about their mortgage debt in a timely way. This information is generally useful to

consumers but must be provided in a timely way for selling or refinancing a home or modifying a mortgage loan.

### 3. Description and, Where Feasible, Provision of an Estimate of the Number of Small Entities to Which the Proposed Rule Will Apply

As discussed in the SBREFA Final Report, for purposes of assessing the impacts of the proposed rule on small entities, "small entities" is defined in the RFA to include small businesses, small nonprofit organizations, and small government jurisdictions. 5 U.S.C. 601(6). A "small business" is determined by application of SBA regulations and reference to the North American Industry Classification System (NAICS) classifications and size standards.<sup>141</sup> 5 U.S.C. 601(3). Under such standards, banks and other depository institutions are considered "small" if they have \$175 million or less in assets, and for other financial businesses, the threshold is average annual receipts (*i.e.*, annual revenues) that do not exceed \$7 million.<sup>142</sup>

During the SBREFA Panel process, the Bureau identified five categories of small entities that may be subject to the proposed rule for purposes of the RFA: Commercial banks/savings institutions<sup>143</sup> (NAICS 522110 and 522120), credit unions (NAICS 522130), firms providing real estate credit

(NAICS 522292), firms engaged in other activities related to credit intermediation (NAICS 522390), and small non-profit organizations. Commercial banks, savings institutions, and credit unions are small businesses if they have \$175 million or less in assets. Firms providing real estate credit and firms engaged in other activities related to credit intermediation are small businesses if average annual receipts do not exceed \$7 million.

A small non-profit organization is any not-for-profit enterprise which is independently owned and operated and is not dominant in its field. Small non-profit organizations engaged in mortgage servicing typically perform a number of activities directed at increasing the supply of affordable housing in their communities. Some small non-profit organizations originate and service mortgage loans for low and moderate income individuals while others purchase loans or the mortgage servicing rights on loans originated by local community development lenders. Servicing income is a substantial source of revenue for some small non-profit organizations while others receive most of their income from grants or investments.<sup>144</sup>

The following table provides the Bureau's estimate of the number and types of entities that may be affected by the proposals under consideration:

TABLE 1—ESTIMATED NUMBER OF AFFECTED ENTITIES AND SMALL ENTITIES BY NAICS CODE AND ENGAGEMENT IN CLOSED-END MORTGAGE LOAN SERVICING

| Category                                                                     | NAICS          | Small entity threshold | Total entities | Small entities | Entities engaged in mortgage loan servicing | Small entities engaged in mortgage loan servicing |
|------------------------------------------------------------------------------|----------------|------------------------|----------------|----------------|---------------------------------------------|---------------------------------------------------|
| Commercial banks & savings institutions.                                     | 522110, 522120 | \$175,000,000 assets   | 7,724          | 4,250          | 7,502                                       | 4,098                                             |
| Credit unions .....                                                          | 522130         | \$175,000,000 assets   | 7,491          | 6,568          | 5,190                                       | 4,270                                             |
| Real estate credit .....                                                     | 522292         | \$7,000,000 revenues   | 5,791          | 5,152          |                                             |                                                   |
| Other activities related to credit intermediation (includes loan servicing). | 522390         | \$7,000,000 revenues   | 5,494          | 5,319          | 1,388                                       | 800                                               |

For commercial banks, savings institutions, and credit unions, the number of entities and asset sizes were obtained from December 2010 Call Report data as compiled by SNL Financial. Banks and savings institutions are counted as engaging in mortgage loan servicing if they hold closed-end loans secured by one to four

family residential property or they are servicing mortgage loans for others. Credit unions are counted as engaging in mortgage loan servicing if they have closed-end one to four family mortgages in portfolio, or hold real estate loans that have been sold but remain serviced by the institution.

For firms providing real estate credit and firms engaged in other activities related to credit intermediation, the total number of entities and small entities comes from the 2007 Economic Census. The total number of these entities engaged in mortgage loan servicing is based on a special analysis of data from the Nationwide Mortgage

<sup>141</sup> The current SBA size standards are found on SBA's Web site at <http://www.sba.gov/content/table-small-business-size-standards>.

<sup>142</sup> See *id.*

<sup>143</sup> Savings institutions include thrifts, savings banks, mutual banks, and similar institutions.

<sup>144</sup> The Bureau is continuing to refine its description of small non-profit organizations engaged in mortgage loan servicing and working to estimate the number of these entities, but it is not possible to estimate the number of these entities at this time. Non-profits and small non-profits

engaged in mortgage loan servicing would be included under real estate credit if their primary activity is originating loans and under other activities related to credit intermediation if their primary activity is servicing.

Licensing System and Registry and is current as of Q1 2011. The total equals the number of non-depositories that engage in mortgage loan servicing, including tax-exempt entities, except for those mortgage loan servicers (if any) that do not engage in any mortgage-related activities that require a State license. The estimated number of small entities engaged in mortgage loan servicing is based on predicting the likelihood that an entity's revenue is less than the \$7 million threshold based on the relationship between servicer portfolio size and servicer rank in data from Inside Mortgage Finance.<sup>145</sup>

#### 4. Projected Reporting, Recordkeeping, and Other Compliance Requirements of the Proposed Rule, Including an Estimate of the Classes of Small Entities Which Will Be Subject to the Requirement and the Type of Professional Skills Necessary for the Preparation of the Report

The proposed rule does not impose new reporting or recordkeeping requirements. The possible compliance costs for small entities from each major component of the proposed rule are presented below. The Bureau presents these costs against a pre-statute baseline. Benefits to consumers from the proposed rule are discussed in the DFA section 1022 analysis in part VII above.

##### (i) ARM—Notice 6 Months Prior to Initial Interest Rate Adjustment

DFA section 1418 amends TILA by adding a new requirement that a creditor or servicer provide a notice regarding the initial interest rate adjustment of a hybrid adjustable-rate mortgage at the end of the introductory period either (a) between six and seven months prior to the adjustment, or (b) at consummation of the mortgage if the first adjustment occurs during the first six months after consummation. The Bureau proposes to use the authority granted by TILA section 128A(b) to require this notice for hybrid as well as ARMs that are not hybrid ( $\frac{1}{4}$ ,  $\frac{3}{8}$ ,  $\frac{5}{8}$ , etc.).<sup>146</sup>

The proposed form would require the content listed in the statute. This includes, in part, a good faith estimate of the amount of the resulting payment; a list of alternatives that the consumer may pursue, including refinancing and

loan modification; and information on how to contact housing counselors approved by HUD or a State housing finance authority. Additionally, the Bureau is proposing certain required additional information including details about the loan, key terms of the ARM, and information about the upcoming payment.

The new disclosure may provide some benefit to servicers. Distressed borrowers who contact servicers well in advance of a possible increase in the interest rate and payment may have more time in which to pursue an alternative financing solution. Information about loss mitigation alternatives and the availability of housing counseling may prompt borrowers to work proactively and constructively with their servicers.

The new disclosure will likely impose one-time and ongoing costs on servicers. Servicers will need to obtain system upgrades from vendors or make programming changes themselves. One SER reported the changes could take two to four days of IT support. These would be one-time costs. The Bureau is mitigating the one-time cost by providing servicers with tested model forms.

SERs noted that producing and sending the new disclosures would impose new costs on them either directly or through vendor charges. The ongoing costs are mitigated somewhat since the disclosures can be provided to consumers in electronic form with consumer consent. One SER noted that vendors have not provided cost quotes at this point.

A number of SERs expressed concern that the proposed initial ARM interest rate adjustment disclosure would confuse borrowers because it would only provide an estimate that would not accurately reflect the actual adjusted rate. The costs and benefits to consumers of the initial interest rate adjustment disclosure are discussed in the DFA section 1022 analysis in part VII above.

##### (ii) Revised 1026.20(c) Notice

The Bureau is also proposing changes to existing Regulation Z § 1026.20(c). The existing provision applies to all ARMs and requires a disclosure prior to each interest rate adjustment that effects a change in payment and annually for interest rate adjustments that do not cause payment changes. The Bureau is proposing to eliminate the annual notice. The Bureau also proposes to amend the current disclosures requiring a notice each time an interest rate adjustment causes a corresponding change in payment.

Regarding timing, the Bureau proposes changing the timeframe for providing the payment change notice to consumers from 25 to 120 days before payment at a new level is due to 60 to 120 days before payment at a new level is due. SERs did not identify any costs associated with this change and two reported they already provide the disclosure 60 to 100 days before payment at a new level is due. One SER reported that the new rate is calculated 45 days prior to the rate change date. This SER provides the borrower with a notice a minimum of 25 days, and typically 42 days, prior to the new interest rate becoming effective. This SER stated that the new interest rate becomes effective 55–72 days prior to the due date of the new payment. Another SER reported substantially similar numbers. The timing of the disclosures reported by these SERs is consistent with the proposed new timeframe.

Regarding content, the Bureau is considering proposing content for the revised 1026.20(c) notices that closely tracks the content it is proposing for the ARM initial interest rate adjustment notices pursuant to DFA section 1418. Servicers will need to obtain one-time system upgrades from vendors or make programming changes themselves. Given the substantial similarity of the revised 1026.20(c) form and the initial ARM interest rate adjustment notice, the Bureau believes that the additional ongoing cost of producing the revised form, on top of the initial ARM interest rate adjustment form, will be minimal.

##### (iii) Periodic Statements

As discussed in the section-by-section analysis above, DFA section 1420 amends TILA by adding a new requirement that a servicer of any residential mortgage loan provide a periodic statement to the consumer for each billing cycle. The Bureau tested a model periodic statement with consumers.

The proposed rule has the following exemptions: Fixed-rate mortgages with coupon books, certain small servicers, reverse mortgages, and timeshares. These proposed provisions are discussed separately below.

The proposed periodic statement requirement imposes one-time and ongoing costs on small servicers. The specific types of costs incurred by a servicer depend on whether the servicer produces the proposed periodic statement in-house or uses a third-party vendor.

In-house one-time costs include the development of a new form, system reprogramming or acquisition, and

<sup>145</sup> The CFPB is continuing to refine its estimate of the number of firms providing real estate credit and engaging in other activities related to credit intermediation that are small and which engage in mortgage loan servicing.

<sup>146</sup> Conventional ARMs, unlike hybrid ARMs which have a period with a fixed rate of interest, start with an adjustable rate and that rate readjusts at even intervals.

perhaps new or updated software. In-house ongoing costs for production include additional system use and staff time. In-house ongoing costs would also include paper, printing, and mailing costs for distributing the periodic statement to borrowers who do not give permission to receive the disclosure electronically.

Vendors may also charge an initial one-time cost for developing a new form as well as ongoing costs for producing and distributing the statement. The SERs who use vendors stated that they did not know what their vendors would charge so they could comply with the new periodic statement requirement. The SERs agreed that the one-time charge would be different from what they would be charged if they were the only entity making the change. Vendors can spread the one-time costs of new regulatory requirements over many servicers.

Small servicers reported a range of one-time costs of complying with the proposed provision. One non-depository SER estimated it would cost \$150,000–\$500,000 to convert to a new periodic statement system, a depository institution SER estimated a cost of \$150,000–\$200,000, and a credit union SER estimated a cost of \$30,000–\$40,000. Estimates of ongoing costs ranged from \$11,000 per month from a non-depository SER to \$2,200 per month from a depository SER; the latter estimated ongoing costs would be approximately \$1 per statement. One depository SER estimated \$5,000–\$6,000 per month in production costs, before postage.

The Bureau understands that the estimates of ongoing costs from the SERs did not exclude the costs of periodic statements, coupon books, or other payment mechanisms that they currently provide borrowers. Some of the SERs stated that they currently provide borrowers with a periodic statement that contains much of the information required under the proposal. However, none of the SERs stated that they include contact information for housing counseling agencies or programs of the type required by DFA section 1420. As explained above in the section-by-section analysis, the Bureau is proposing to use authority under TILA sections 105(a) and (f) and DFA Section 1405(b) to require periodic statements to provide only information about where a borrower can access a complete list of housing counselors. The Bureau believes that the proposed provision will impose a substantially smaller burden than the statutory requirement.

In accordance with DFA section 1420, the proposed rule would include a coupon book exemption for fixed-rate loans where the consumer is given a coupon book with certain of the information required by the periodic statement. It is not possible to estimate the share of residential mortgage loans serviced by small servicers that would qualify for this exception. If this provision is included in the final rule, it is possible that small servicers would provide coupon books to all borrowers with fixed-rate mortgages. Many of the SERs reported that they provide consumers with coupon books for ARMs. However, there is no data with which to estimate the fraction of small servicer portfolio loans that are in fixed-rate mortgages; in fact, the Bureau understands that many small servicer portfolio loans are adjustable-rate mortgages.

The Bureau is also proposing a small servicer exemption. Servicers servicing 1,000 or fewer loans, all of which they must either own or have originated, would be eligible. A preliminary analysis indicates that all but 13 small insured depositories and credit unions would be covered by the exemption and would not have to provide the proposed periodic statement disclosure. The Bureau does not currently have the data necessary to estimate the number of small entity non-depositories that would be covered by the exemption. However, data from depositories suggests that approximately 584 small entity non-depositories (65% of the 800 small entity non-depositories) would be covered by the exemption.<sup>147</sup> As discussed in the DFA section 1022 analysis in part VII.F, the Bureau is currently working to gather additional data that may be relevant to estimating the number of small non-depositories covered by the small servicer exemption. These data may include additional data from the National Mortgage License System (NMLS) and the NMLS Mortgage Call Report, loan file extracts from various lenders, and data from the pilot phases of the National Mortgage Database. The Bureau is also continuing its outreach efforts with industry and requests interested parties to provide data, research results, and other information relating to this issue.

<sup>147</sup> Roughly 35% of depositories that earn less than \$7 million from servicing also have too many loans to qualify for the small servicer exemption. Extrapolating to non-depositories, roughly 35% of non-depositories that earn less than \$7 million from servicing—and are small entities—also service too many loans to qualify for the small servicer exemption.

Finally, the proposed rule has exemptions for reverse mortgages and timeshares. Information that would be relevant and useful on a reverse mortgage statement differs substantially from the information required on the periodic statement; *see* the section-by-section analysis for further discussion. The proposed rule also exempts timeshares as these are not residential mortgage loans as defined in TILA.

(iv) Prompt Crediting and Request for Payoff Amounts

DFA section 1464(a) generally codifies existing Regulation Z § 1026.36 on prompt crediting. The Bureau is further proposing a new requirement for the handling of partial payments (*i.e.*, payments that are not full contractual payments). Under the proposal, if servicers hold partial payments in a suspense account, then once the amount in the account equals a full contractual payment, the servicer must credit the payment to the most delinquent outstanding payment.

DFA section 1464(b) requires that a creditor or servicer of a home loan send an accurate payoff balance within a reasonable time, but in no case more than seven business days, after the receipt of a written request for such balance from or on behalf of the borrower. This essentially codifies existing Regulation Z § 1026.36 on payoff statements, except that Regulation Z requires payoff statements to be sent within a reasonable time and creates a safe harbor for responses sent within five business days.

The SERs generally reported that these provisions would have no impact on them as they are already in compliance. In correspondence, one SER suggested that the seven day maximum for payoff amounts should be even shorter, to prevent other servicers from delaying closings.

(v) Estimate of the Classes of Small Entities Which Will Be Subject to the Requirement and the Type of Professional Skills Necessary for the Preparation of the Report or Record

Section 603(b)(4) of the RFA requires an estimate of the classes of small entities which will be subject to the requirement. The classes of small entities which will be subject to the reporting, recordkeeping, and compliance requirements of the proposed rule are the same classes of small entities that are identified above in part VIII.B.3.

Section 603(b)(4) of the RFA also requires an estimate of the type of professional skills necessary for the preparation of the reports or records.

The Bureau anticipates that the professional skills required for compliance with the proposed rule are the same or similar to those required in the ordinary course of business of the small entities affected by the proposed rule. Compliance by the small entities that will be affected by the proposed rule will require continued performance of the basic functions that they perform today: Generating disclosure forms and crediting partial payments from borrowers either immediately or when they constitute a full payment.

#### 5. Identification, to the Extent Practicable, of All Relevant Federal Rules Which May Duplicate, Overlap, or Conflict With the Proposed Rule

The Dodd-Frank Act codified certain requirements contained in existing regulations and in some cases imposed new requirements that expand or vary the scope of existing regulations. The Bureau is working to eliminate conflicts and to harmonize the earlier rules with the new statutory requirements. In general, the existing and expanded regulations cover the following topics:

- New Regulation Z ARM disclosures, as required by DFA section 1418, will be provided six to seven months prior to the initial adjustment of interest rates. These disclosures will provide similar information to existing Regulation Z § 1026.20(c) notices, however there are timing differences, and the new notice is required only for the first rate adjustment. The DFA section 1418 notice is intended to be sent early enough for the consumer to take action (*i.e.* refinance or apply for a loan modification) before the monthly payment increases.

- Regulation Z § 1026.36(c)(1)(i) contains a prompt crediting provision that is generally codified by the prompt crediting provision in DFA section 1464(a).

- Regulation Z § 1026.36(c) addresses the application of payments. The Bureau is proposing modifying this rule to mandate the application of funds to the most delinquent outstanding payment if a full contractual payment has accumulated in any suspense or unapplied funds account.

- Regulation Z 1026.36(c)(1)(iii) contains a provision regarding payoff amount requests that is generally codified by the Dodd Frank Act.

Elsewhere in today's Federal Register, the Bureau is publishing a proposed rule that would implement DFA section 1463 and is issued under RESPA. The RESPA proposal addresses procedures for obtaining force-placed insurance; procedures for investigating and resolving alleged errors and responding

to requests for information; reasonable information management policies and procedures; early intervention for delinquent borrowers; and continuity of contact for delinquent borrowers.

These regulations do not duplicate, overlap, or conflict and the Bureau is not aware of any other Federal regulations that currently duplicate, overlap, or conflict with the proposals under consideration.

#### 6. Description of Any Significant Alternatives to the Proposed Rule Which Accomplish the Stated Objectives of Applicable Statutes and Minimize Any Significant Economic Impact of the Proposed Rule on Small Entities

##### (i) New Initial Interest Rate Adjustment Notice for Adjustable-Rate Mortgages

As discussed above, DFA section 1418 requires servicers to provide a new disclosure to consumers who have hybrid ARMs regarding the initial interest rate adjustment. The Bureau is proposing to use its discretionary authority to require the initial interest rate adjustment notice for ARMs that are not hybrid (*e.g.*,  $\frac{1}{4}$ ,  $\frac{3}{8}$ ,  $\frac{5}{8}$ , etc.) as well. Thus, the disclosure under the original statutory language would have a smaller economic impact on small entities.

The Bureau opted for its current proposal because all ARMs, not just hybrid ARMs, may subject consumers to the same payment shock after the introductory period expires. Consumers with ARMs that are not hybrid would therefore also benefit from the protections provided by the new disclosure.

The Bureau also considered whether to except small servicers from the proposed initial ARM interest rate adjustment notice. The SERs did express some concern about the one-time and ongoing costs of providing the proposed notice. They expressed concern that consumers would be confused by receiving estimates rather than their actual new interest rate and payment.

The Bureau believes an exception would deprive certain consumers of the seven to eight months advance notice before payment at a new level is due provided by the disclosure. This advance notice is designed to allow consumers time to weigh their alternatives and pursue alternative actions. An exception would also deprive certain consumers of the information provided in the notice about alternatives and how to contact their State housing finance authority and counseling agencies and programs.

The Bureau recognizes that the proposed initial ARM interest rate

adjustment notice will impose some burden on small servicers, but it does not believe that it will impose a significant burden since it is a one-time notice. The Bureau seeks comment on whether the burden imposed on small entities by the requirements of the initial rate adjustment notice outweighs the consumer protection benefits it affords.

##### (ii) Regulation Z § 1026.20(c) Disclosure for Adjustable-Rate Mortgages

The Bureau is proposing to change the timing of the ARM payment change notice required under current § 1026.20(c) to be provided to consumers from 25 to 120 days before payment at a new level is due to 60 to 120 days before payment at a new level is due. The longer lead time is designed to give consumers time to refinance or take other ameliorative actions if they are not financially equipped to pay their mortgages at an increased adjusted rate. The Bureau recognizes that the longer lead time may impose a burden on small servicers.

According to outreach conducted by the Bureau, small servicers often are able to send out the ARM payment change notices required by § 1026.20(c) on the same day the index value is selected. In that case, for a loan with a 45-day look-back period, the notice is ready 45 days before the change date and, with the 28 to 31 days between the change date and the date payment at the new level is due, the interest rate adjustment notice goes out to the consumer 73 to 76 days before the new payment is due. Under these circumstances, small servicers could provide the payment change notice within the 60 day minimum period. The Bureau is also proposing an alternative 25-day minimum period for certain existing adjustable-rate mortgages in which the mortgage note requires a look-back period of less than 45 days.

##### (iii) Periodic Statements

As discussed above, DFA section 1420 requires servicers to provide a new periodic statement to the consumer for each billing cycle. The proposed rule would generally require both the content listed in the statute, additional billing information, and information about how to dispute and resolve errors. The Bureau is proposing to use its discretionary authority to require the additional information. Thus, the disclosure under the original statutory language would impose a smaller economic impact on small entities that must provide the periodic statement disclosure.

The Bureau believes the additional information provides important consumer benefits. Only some of the information in the disclosure will be required to be provided to consumers on a regular basis. However, distressed or delinquent borrowers will likely need more information. The proposed periodic statement disclosure was the subject of three rounds of consumer testing and refinement to identify the form, content, headings, and format that best promotes consumer understanding.

As discussed above, the Bureau is proposing a small servicer exemption. Servicers servicing 1,000 or fewer loans, all of which they must either own or have originated, would be eligible. As discussed above, the Bureau believes that almost all small insured depositories and credit unions would be covered by the exemption. The Bureau does not currently have the data necessary to estimate the number of small entity non-depositories that would be covered by the exemption. However, the Bureau is currently working to gather additional data that may be relevant to estimating the number of small non-depositories covered by the small servicer exemption.

#### (iv) Prompt Crediting and Request for Payoff Amounts

As discussed above, the SERs generally reported that the proposed provisions regarding prompt crediting and payoff amounts would have no impact on them as they are already in compliance. In correspondence, one SER suggested that the seven day maximum for payoff amounts should be even shorter, to prevent other servicers from delaying closings.

#### 7. Discussion of Impact on Cost of Credit for Small Entities

Section 603(d) of the RFA requires the Bureau to consult with small entities regarding the potential impact of the proposed rule on the cost of credit for small entities and related matters. 5 U.S.C. 603(d). To satisfy these statutory requirements, the Bureau provided notification to the Chief Counsel on April 9, 2012 that the Bureau would collect the advice and recommendations of the same SERs identified in consultation with the Chief Counsel through the SBREFA Panel process concerning any projected impact of the proposed rule on the cost of credit for small entities as well as any significant alternatives to the proposed rule which accomplish the stated objectives of applicable statutes and which minimize any increase in the cost of credit for

small entities.<sup>148</sup> The Bureau sought to collect the advice and recommendations of the SERs during the SBREFA Panel outreach meeting regarding these issues because, as small financial service providers, the SERs could provide valuable input on any such impact related to the proposed rule.<sup>149</sup>

At the time the Bureau circulated the SBREFA materials to the SERs in advance of the SBREFA Panel outreach meeting, it had no evidence that the proposals under consideration would result in an increase in the cost of business credit for small entities. Instead, the summary of the proposals stated that the proposals would apply only to mortgage loans obtained by consumers primarily for personal, family, or household purposes and the proposals would not apply to loans obtained primarily for business purposes.<sup>150</sup>

At the SBREFA Panel outreach meeting, the Bureau asked the SERs a series of questions regarding cost of business credit issues.<sup>151</sup> The questions were focused on two areas. First, the SERs from commercial banks/savings institutions, credit unions, and mortgage companies were asked whether, and how often, they extend to their customers closed-end mortgage loans to be used primarily for personal, family, or household purposes but that are used secondarily to finance a small business, and whether the proposals then under consideration would result in an increase in their customers' cost of credit. Second, the Bureau inquired as to whether, and how often, the SERs take out closed-end, home-secured loans to be used primarily for personal, family, or household purposes and use them secondarily to finance their small businesses, and whether the proposals under consideration would increase the SERs' cost of credit.

The SERs had few comments on the impact on the cost of business credit. While they took this time to express concerns that these regulations would increase their costs, they said these regulations would have little to no impact on the cost of business credit. When asked, one SER mentioned that at times people may use a home-secured loan to finance a business, which was

corroborated by a different SER based on his personal experience with starting a business. The Bureau is generally interested in the use of personal home-secured credit to finance a business and invites interested parties to provide data and other factual information on this issue.

Based on the feedback obtained from SERs at the outreach meeting, the Bureau currently does not anticipate that the proposed rule will result in an increase in the cost of credit for small business entities. To further evaluate this question, the Bureau solicits comment on whether the proposed rule will have any impact on the cost of credit for small entities.

#### IX. Paperwork Reduction Act

The Bureau's information collection requirements contained in this proposed rule, and identified as such, will be submitted to OMB for review under section 3507(d) of the Paperwork Reduction Act of 1995 (44 U.S.C. 3501 *et seq.*) (Paperwork Reduction Act" or PRA). Under the Paperwork Reduction Act, the Bureau may not conduct or sponsor, and a person is not required to respond to, an information collection unless the information collection displays a valid OMB control number.

The title of this information collection is 2012 Truth in Lending Act (Regulation Z) Mortgage Servicing. The frequency of response is on-occasion. This proposed rule would amend Regulation Z. Regulation Z currently contains collections of information approved by OMB, and the Bureau's OMB control number for Regulation Z is 3170-0015 (Truth in Lending Act (Regulation Z) 12 CFR 1026). As described below, the proposed rule would amend the collections of information currently in Regulation Z.

The information collection would be required to provide benefits for consumers and would be mandatory. See 15 U.S.C. 1601 *et seq.* Because the Bureau does not collect any information, no issue of confidentiality arises. The likely respondents would be federally-insured depository institutions (such as commercial banks, savings banks, and credit unions) and non-depository institutions that service consumer mortgage loans.

Under the proposed rule, the Bureau generally would account for the paperwork burden associated with Regulation Z for the following respondents pursuant to its administrative enforcement authority: Insured depository institutions with more than \$10 billion in total assets, their depository institution affiliates (together, the Bureau depository

<sup>148</sup> See 5 U.S.C. 603(d)(2). The Bureau provided this notification as part of the notification and other information provided to the Chief Counsel with respect to the SBREFA Panel process pursuant to RFA section 609(b)(1).

<sup>149</sup> See 5 U.S.C. 603(d)(2)(B).

<sup>150</sup> See TILA section 104(1); RESPA section 7(a)(1).

<sup>151</sup> See SBREFA Final Report, *supra* note 22, at 154–55 (appendix D, PowerPoint slides from the SBREFA Panel outreach meeting, "Topic 7: Impact on the Cost of Business Credit").

respondents), and certain non-depository servicers (the Bureau non-depository respondents). The Bureau and the FTC generally both have enforcement authority over non-depository institutions under Regulation Z. Accordingly, the Bureau has allocated to itself half of its estimated burden to Bureau non-depository respondents. Other Federal agencies, including the FTC, are responsible for estimating and reporting to OMB the total paperwork burden for the institutions for which they have administrative enforcement authority. They may, but are not required to, use the Bureau's burden estimation methodology.

Using the Bureau's burden estimation methodology, the total estimated burden under the proposed changes to Regulation Z for the roughly 12,813 institutions, including Bureau respondents,<sup>152</sup> that are estimated to service consumer mortgages subject to the proposed rule would be approximately 25,000 one-time burden hours and 74,000 ongoing burden hours per year. The aggregate estimates of total burdens presented in this part IX are based on estimates averaged across respondents. The Bureau expects that the amount of time required to implement each of the proposed changes for a given institution may vary based on the size, complexity, and practices of the respondent.

#### A. Information Collection Requirements

The Bureau is proposing four changes to the information collection requirements in Regulation Z. First, as previously discussed, proposed § 1026.20(d) regarding adjustable-rate mortgages would require creditors, assignees, and servicers to send a new initial rate adjustment disclosure at least 210, but not more than 240, days before the date the first payment is due after the initial rate adjustment. The new disclosure includes, among other things, information regarding the calculation of the new interest rate and information to assist consumers in the event the consumer requires alternative financing. Second, proposed § 1026.20(c) regarding adjustable-rate mortgages would change

the format, content, and timing of the existing rate adjustment disclosure. The proposed rule would change the minimum time for providing advance notice to consumers from 25 days to 60 days before payment at a new level is due. Servicers would be required to provide certain information that they may not currently disclose, but would no longer be required to notify consumers of a rate adjustment if the payment is unchanged.

Third, proposed § 1026.41 would require a new periodic statement disclosure. The required content would include billing information, such as the amount due, payment due date, and information on any late fees; information on recent transaction activity and how payments were applied; general loan information, such as the interest rate and when it may next adjustment, outstanding principal balance, etc.; and other information that may be helpful to troubled borrowers. Certain small servicers (those servicing less than 1,000 mortgages and own or originated all the loans they are servicing) would be exempt from this requirement. Fixed-rate mortgages would be exempt if the servicer provides the consumer with a coupon book that contained certain information, and makes other information available to the consumer.

Fourth, proposed § 1026.36 would make changes to the existing requirements on servicers to promptly credit borrower payments that satisfy payment rules specified by a servicer. Proposed § 1026.36 would also make changes to the existing requirements on creditors and servicers to provide an accurate payoff balance upon request. An information collection is created by the proposed requirement to provide accurate payoff statements.

#### B. Burden Analysis Under the Four Proposed Information Collection Requirements<sup>153</sup>

##### 1. New Initial Rate Adjustment Notice for Adjustable-Rate Mortgages

All CFPB respondents would have a one-time burden under this requirement

associated with reviewing the regulation. Certain CFPB respondents would have a one-time burden from creating software and IT capability to produce the new disclosure. The Bureau estimates this one-time burden to be 140 hours for CFPB depository respondents and 1,488 hours and \$115,000 for CFPB non-depository respondents.<sup>154</sup>

Certain CFPB respondents would have ongoing burden associated with the IT used in producing the disclosure. All CFPB respondents would have ongoing costs associated with distributing (e.g., mailing) the disclosure. The Bureau estimates this ongoing burden to be 600 hours and \$63,000 for CFPB depository respondents and 70 hours and \$3,400 for CFPB non-depository respondents.

##### 2. Changes in the Regulation Z § 1026.20(c) Disclosure for Adjustable-Rate Mortgages

All CFPB respondents would have a one-time burden under this requirement associated with reviewing the regulation. Certain CFPB respondents would have one-time burden from creating software and IT capability to provide the additional content in the disclosure. The Bureau estimates this one-time burden to be 165 hours for CFPB depository respondents and 600 hours and \$58,000 for CFPB non-depository respondents.

Regarding ongoing burden, the Bureau is proposing to require the disclosure only when the interest rate adjustment results in a corresponding change in the required payment. The Bureau believes it would be usual and customary to provide consumers with a disclosure under these circumstances. Thus, the Bureau believes there is no burden from distribution costs for purposes of PRA from the proposed § 1026.20(c) disclosure. The Bureau recognizes that there is content in the proposed disclosure beyond what may be usual and customary to provide. Bureau respondents that do not use vendors and certain small respondents that use vendors will incur production costs associated with this extra content, and this is burden for purposes of PRA. The Bureau estimates the ongoing burden to be 1,400 hours for CFPB depository respondents and 110 hours and \$8,000 for CFPB non-depository respondents.

to which third-party vendors charge various costs to different types of respondents, and the Bureau seeks data and other factual information from interested parties on these issues.

<sup>154</sup> Dollar figures include estimated costs to vendors.

<sup>152</sup> For purposes of this PRA analysis, the Bureau's depository respondents under the proposed rule are 130 depository institutions and depository institution affiliates that service closed-end consumer mortgages. The Bureau's non-depository respondents are an estimated 1,388 non-depository servicers. Unless otherwise specified, all references to burden hours and costs for the Bureau respondents for the collection requirements under the proposed rule are based on a calculation of the burden from all of the Bureau's depository respondents and half of the burden from the Bureau's non-depository respondents.

<sup>153</sup> Based on discussions with industry, the Bureau assumes that all depository respondents except for one large entity and 95% of non-depository respondents (100% of small non-depository respondents) use third-party vendors for one-time software and IT capability and for ongoing production and distribution activities associated with disclosures. The Bureau believes at this time that under existing mortgage servicing contracts, vendors would absorb the one-time software and IT costs and ongoing production costs of disclosures for large- and medium-sized respondents but pass along these costs to small respondents. The Bureau will further consider the extent to which respondents use third-party vendors and the extent

### 3. New Periodic Statement

All CFPB respondents that are not exempt would have a one-time burden under this requirement associated with reviewing the regulation. Certain CFPB respondents would have a one-time burden from creating software and IT capability to modify existing periodic disclosures or produce a new disclosure. The proposed disclosure incorporates all of the information in billing statements that many respondents already provide. However, the additional data fields and formatting requirements may not be usual and customary. The Bureau estimates this one-time burden to be 170 hours for CFPB depository respondents and 600 hours and \$20,000 for CFPB non-depository respondents.

Regarding ongoing burden, consumers who currently receive a periodic statement or billing statement are receiving these disclosures in the normal course of business. The Bureau believes that most other consumers with mortgages receive a coupon book or other type of payment medium, such as a passbook. The statute provides that servicers do not have to provide the periodic statement disclosure to

consumers who have both a fixed-rate mortgage and a coupon book. Thus, the only consumers who are not already receiving a billing statement or periodic disclosure to whom servicers will have to begin providing the periodic statement disclosure under the proposed rule are those with both an adjustable-rate mortgage and a coupon book. The burden of distributing the proposed periodic statement disclosure to these consumers is, for purposes of PRA, the ongoing burden from distribution costs from the proposed periodic statement disclosure. The Bureau recognizes that there is content in the proposed periodic statement disclosure beyond what may be usual and customary to provide in existing billing statements. The Bureau estimates the ongoing burden to be 52,000 hours and \$5,600,000 for CFPB depository respondents and 6,300 hours and \$300,000 for CFPB non-depository respondents.

### 4. Prompt Crediting of Payments and Response to Requests for Payoff Amounts

All CFPB respondents would have a one-time burden under this requirement

associated with reviewing the regulation. Certain CFPB respondents would have a one-time burden from creating software and IT costs associated with changes in the payoff statement disclosure. The Bureau estimates this one-time burden to be 110 hours for CFPB depository respondents and 500 hours and \$115,000 for CFPB non-depository respondents.

Regarding ongoing burden, the Bureau understands that the proposed payoff statement will replace a pre-existing disclosure that respondents are currently providing in the normal course of business. The Bureau does not believe that proposed changes to the content and timing of the existing disclosure will significantly change the ongoing production or distribution costs of the notice currently provided in the normal course of business. The Bureau estimates the ongoing burden to be 1,650 hours and \$178,000 for CFPB depository respondents and 200 hours and \$9,600 for CFPB non-depository respondents.

### C. Summary of Burden Hours for CFPB Respondents

|                                            | Respondents | Disclosures per respondent | Hours burden per disclosure | Total burden hours | Total vendor costs |
|--------------------------------------------|-------------|----------------------------|-----------------------------|--------------------|--------------------|
| <b>Ongoing:</b>                            |             |                            |                             |                    |                    |
| ARM 20(c) Notice .....                     | 824         | 700                        | 0.002777778                 | 1,000              | \$8,000            |
| ARM 20(d) Notice .....                     | 824         | 300                        | 0.002881756                 | 1,000              | 67,000             |
| Periodic Statements .....                  | 564         | 35,800                     | 0.002881756                 | 58,000             | 5,914,000          |
| Prompt Crediting & Payoff Statements ..... | 824         | 800                        | 0.002881756                 | 2,000              | 188,000            |
| <b>One-Time:</b>                           |             |                            |                             |                    |                    |
| ARM 20(c) Notice .....                     | 824         | 1                          | 0.93                        | 1,000              | 58,000             |
| ARM 20(d) Notice .....                     | 824         | 1                          | 1.97                        | 2,000              | 115,000            |
| Periodic Statements .....                  | 564         | 1                          | 1.36                        | 1,000              | 20,000             |
| Prompt Crediting & Payoff Statements ..... | 824         | 1                          | 0.77                        | 1,000              | 115,000            |

### D. Comments

Comments are specifically requested concerning: (i) Whether the proposed collections of information are necessary for the proper performance of the functions of the Bureau, including whether the information will have practical utility; (ii) the accuracy of the estimated burden associated with the proposed collections of information; (iii) how to enhance the quality, utility, and clarity of the information to be collected; and (iv) how to minimize the burden of complying with the proposed collections of information, including the application of automated collection techniques or other forms of information technology. All comments will become a matter of public record. Comments on the collection of information requirements should be sent to the

Office of Management and Budget (OMB), Attention: Desk Officer for the Consumer Financial Protection Bureau, Office of Information and Regulatory Affairs, Washington, DC 20503, or by the Internet to [http://oira\\_submission@omb.eop.gov](http://oira_submission@omb.eop.gov), with copies to the Bureau at the Consumer Financial Protection Bureau (Attention: PRA Office), 1700 G Street NW., Washington, DC 20552, or by the Internet to [CFPB\\_Public\\_PRA@cfpb.gov](mailto:CFPB_Public_PRA@cfpb.gov).

### Text of the Proposed Revisions

Certain conventions have been used to highlight the proposed changes to the text of the regulation and official interpretation. New language is shown inside ►bold-faced arrows◄, while language that would be removed is set off with [bold-faced brackets].

### List of Subjects in 12 CFR Part 1026

Advertising, Consumer protection, Credit, Credit unions, Mortgages, National banks, Reporting and recordkeeping requirements, Savings associations, Truth in lending.

### Authority and Issuance

For the reasons set forth above, the Bureau of Consumer Financial Protection proposes to amend 12 CFR part 1026, as follows:

### PART 1026—TRUTH IN LENDING (REGULATION Z)

1. The authority citation for part 1026 continues to read as follows: 12 U.S.C. 5512, 5581; 15 U.S.C. 1601 et seq.

**Subpart C—Closed-End Credit**

2. Section 1026.17 is amended by revising paragraphs (a)(1) and (b) to read as follows:

**§ 1026.17 General disclosure requirements.**

(a) *Form of disclosures.* (1) The creditor shall make the disclosures required by this subpart clearly and conspicuously in writing, in a form that the consumer may keep. The disclosures required by this subpart may be provided to the consumer in electronic form, subject to compliance with the consumer consent and other applicable provisions of the Electronic Signatures in Global and National Commerce Act (E-Sign Act) (15 U.S.C. 7001 *et seq.*). The disclosures required by §§ 1026.17(g), 1026.19(b), and 1026.24 may be provided to the consumer in electronic form without regard to the consumer consent or other provisions of the E-Sign Act in the circumstances set forth in those sections. ► Except for § 1026.20(d), which requires disclosures to be provided separate and distinct from all other correspondence, the [The] disclosures shall be grouped together, shall be segregated from everything else, and shall not contain any information not directly related to the disclosures required under § 1026.18►, § 1026.20(c),◄ or § 1026.47. The disclosures may include an acknowledgment of receipt, the date of the transaction, and the consumer's name, address, and account number. The following disclosures may be made together with or separately from other required disclosures: The creditor's identity under § 1026.18(a), the variable rate example under § 1026.18(f)(1)(iv), insurance or debt cancellation under § 1026.18(n), and certain security interest charges under § 1026.18(o). The itemization of the amount financed under § 1026.18(c)(1) must be separate from the other disclosures under § 1026.18, except for private education loan disclosures made in compliance with § 1026.47.

\* \* \* \* \*

(b) *Time of disclosures.* The creditor shall make disclosures before consummation of the transaction. In certain residential mortgage transactions, special timing requirements are set forth in § 1026.19(a). In certain variable-rate transactions, special timing requirements for variable-rate disclosures are set forth in § 1026.19(b) and § 1026.20(c)► and (d)◄. For private education loan disclosures made in compliance with § 1026.47, special timing requirements are set forth in

§ 1026.46(d). In certain transactions involving mail or telephone orders or a series of sales, the timing of disclosures may be delayed in accordance with paragraphs (g) and (h) of this section.

\* \* \* \* \*

3. Section 1026.20 is amended by revising the section heading and paragraphs (c) and (d) to read as follows:

**§ 1026.20 [Subsequent d]►D◄disclosure requirements► regarding post-consummation events◄.**

\* \* \* \* \*

(c) [Variable-rate]►Rate◄ adjustments. ►The creditor, assignee, or servicer of an adjustable-rate mortgage shall provide disclosures to consumers, as described in § 1026.20(c), in connection with the adjustment of interest rates resulting in a corresponding adjustment to the payment. To the extent that other provisions of subpart C apply to the disclosures required by this section, those provisions apply to assignees and servicers as well as to creditors. The disclosures required under this section also shall be provided for an interest rate adjustment resulting from the conversion of an adjustable-rate mortgage to a fixed-rate transaction, if that interest rate adjustment results in a corresponding payment change.◄ [Except as provided in paragraph (d) of this section, an adjustment to the interest rate with or without a corresponding adjustment to the payment in a variable-rate transaction subject to § 1026.19(b) is an event requiring new disclosures to the consumer. At least once each year during which an interest rate adjustment is implemented without an accompanying payment change, and at least 25, but no more than 120, calendar days before a payment at a new level is due, the following disclosures, as applicable, must be delivered or placed in the mail:

- (1) The current and prior interest rates.
- (2) The index values upon which the current and prior interest rates are based.
- (3) The extent to which the creditor has foregone any increase in the interest rate.
- (4) The contractual effects of the adjustment, including the payment due after the adjustment is made, and a statement of the loan balance.
- (5) The payment, if different from that referred to in paragraph (c)(4) of this section, that would be required to fully amortize the loan at the new interest rate over the remainder of the loan term.]

►(1) *Coverage of rate adjustment disclosures.* (i) *In General.* For purposes of § 1026.20(c), an adjustable-rate mortgage or "ARM" is a closed-end consumer credit transaction secured by the consumer's principal dwelling in which the annual percentage rate may increase after consummation.

(ii) *Exceptions.* The requirements of § 1026.20(c) do not apply to:

(A) Construction loans with terms of one year or less; or

(B) The first adjustment to an ARM if the first payment at the adjusted level is due within 210 days after consummation and the actual, not estimated, new interest rate was disclosed at consummation pursuant to § 1026.20(d).

(2) *Timing and content of rate adjustment disclosures with a change in payment.* Disclosures required by § 1026.20(c) must be provided to consumers at least 60, but no more than 120 days before a payment at a new level is due. Disclosures must be provided to consumers at least 25, but no more than 120 days before a payment at a new level is due for ARMs originated prior to July 21, 2013 in which the mortgage note requires the adjusted interest rate and payment to be calculated based on the index figure available as of a date that is less than 45 days prior to the adjustment date. Disclosures must be provided to consumers as soon as practicable, but not less than 25 days before a payment at a new level is due for the first adjustment to an ARM if it occurs within 60 days of consummation and the actual, not estimated, new interest rate was not disclosed at consummation. The disclosures must provide the following information:

(i) A statement providing:

(A) An explanation that under the terms of the consumer's adjustable-rate mortgage, the specific time period in which the current interest rate has been in effect is ending and that the interest rate and mortgage payment will change;

(B) The effective date of the interest rate adjustment, and when additional future interest rate changes are scheduled to occur; and

(C) Any other changes to loan terms, features, or options taking effect on the same date as the interest rate adjustment, such as the expiration of interest-only or payment-option features;

(ii) A table containing the following information:

(A) The current and new interest rates;

(B) The current and new payments and the date the first new payment is due; and

(C) For interest-only or negatively-amortizing payments, the amount of the current and new payment allocated to principal, interest, and taxes and insurance in escrow, as applicable. The current payment allocation disclosed shall be based on the expected payment allocation for the last payment prior to the date of the disclosure. The new payment allocation disclosed shall be based on the expected payment allocation for the first payment for which the new interest rate will apply;

(iii) An explanation of how the interest rate is determined, including:

(A) The specific index or formula used in making adjustments and a source of information about the index or formula; and

(B) Any adjustment to the index, including the amount of any margin and an explanation that the margin is the addition of a certain number of percentage points to the index;

(iv) Any limits on the interest rate or payment increases at each adjustment and over the life of the loan, as applicable, including the extent to which such limits result in the creditor, assignee, or servicer foregoing any increase in the interest rate and the earliest date that such foregone interest may apply to additional future interest rate adjustments, subject to those limits;

(v) An explanation of how the new payment is determined, including:

(A) The index or formula used;

(B) The amount of any adjustment to the index or formula, for example, by the addition of a margin or application of previously foregone interest increase;

(C) The loan balance expected on the date of the interest rate adjustment; and

(D) The length of the remaining loan term expected on the date of the interest rate adjustment. Any change in the term or maturity of the loan caused by the adjustment also shall be disclosed;

(vi) For interest-only or negatively-amortizing loans, a statement that the new payment will not be allocated to pay loan principal. If negative amortization occurs as a result of the adjustment, the statement shall set forth the payment required to fully amortize the loan at the new interest rate over the remainder of the loan term or to fully amortize the loan without extending the loan term; and

(vii) The circumstances under which any prepayment penalty, as defined in subpart E by § 1026.41(d)(7)(iv), may be imposed when consumers fully repay their adjustable-rate mortgages, such as when selling or refinancing their principal residence, the time period during which the penalty may be imposed, and the maximum amount (in

dollars) of the penalty possible during that time period.

(3) *Format of disclosures.* (i) The disclosures required by § 1026.20(c) shall be provided in the form of the table and in the same order as, and with headings and format substantially similar to, Forms H-4(D)(1) and (2) in Appendix H to this part; and

(ii) The disclosures required by paragraph (c)(2)(ii) shall be in the form of a table located within the table described in paragraph (c)(3)(i) of this section. These disclosures shall appear in the same order as, and with headings and format substantially similar to, the table inside the larger table in Forms H-4(D)(1) and (2) in Appendix H to this part. ◀

(d) **Information provided in accordance with variable-rate subsequent disclosure regulations of other Federal agencies may be substituted for the disclosure required by paragraph (c) of this section.** ▶  
*Initial rate adjustments.* The creditor, assignee, or servicer of an adjustable-rate mortgage shall provide disclosures to consumers, as described in § 1026.20(d), in connection with the initial interest rate adjustment. To the extent that other provisions of subpart C apply to the disclosures required by this section, those provisions apply to assignees and servicers as well as to creditors. The disclosures shall be provided in writing, separate and distinct from all other correspondence. The disclosures shall be provided at least 210, but no more than 240, days before the first payment at the adjusted level is due. If the first payment at the adjusted level is due within the first 210 days after consummation, the disclosures shall be provided at consummation.

(1) *Coverage of initial rate adjustment disclosures.* (i) *In general.* For purposes of § 1026.20(d), an adjustable-rate mortgage or “ARM” is a closed-end consumer credit transaction secured by the consumer’s principal dwelling in which the annual percentage rate may increase after consummation.

(ii) *Exceptions.* The requirements of § 1026.20(d) do not apply to construction loans with terms of one year or less.

(2) *Content of initial rate adjustment disclosures.* If the new interest rate (or the new payment calculated from the new interest rate) is not known as of the date of the disclosure, an estimate shall be disclosed and labeled as such. This estimate shall be based on the index figure reported in the source of information described in paragraph (d)(2)(iv)(A) within fifteen business days prior to the date of the disclosure. The

disclosures required by § 1026.20(d) shall provide the following:

(i) The date of the disclosure;

(ii) A statement providing:

(A) An explanation that under the terms of the consumer’s adjustable-rate mortgage, the specific time period in which the current interest rate has been in effect is ending and that any change in the interest rate may result in a change in the mortgage payment;

(B) The effective date of the interest rate adjustment and when additional future interest rate changes are scheduled to occur; and

(C) Any other changes to loan terms, features, or options taking effect on the same date as the interest rate adjustment, such as the expiration of interest-only or payment-option features;

(iii) A table containing the following information:

(A) The current and new interest rates;

(B) The current and new payments and the date the first new payment is due; and

(C) For interest-only or negatively-amortizing payments, the amount of the current and new payment allocated to principal, interest, and taxes and insurance in escrow, as applicable. The current payment allocation disclosed shall be based on the expected payment allocation for the last payment prior to the date of the disclosure. The new payment allocation disclosed shall be based on the expected payment allocation for the first payment for which the new interest rate will apply;

(iv) An explanation of how the interest rate is determined, including:

(A) The specific index or formula used in making adjustments and a source of information about the index or formula; and

(B) Any adjustment to the index, including the amount of any margin and an explanation that the margin is the addition of a certain number of percentage points to the index;

(v) Any limits on the interest rate or payment increases at each adjustment and over the life of the loan, as applicable, including the extent to which such limits result in the creditor, assignee, or servicer foregoing any increase in the interest rate and the earliest date that such foregone interest may apply to additional future interest rate adjustments, subject to those limits;

(vi) An explanation of how the new payment is determined, including:

(A) The index or formula used;

(B) The amount of any adjustment to the index or formula, for example, by the addition of a margin;

(C) The loan balance expected on the date of the interest rate adjustment;

(D) The length of the remaining loan term expected on the date of the interest rate adjustment. Any change in the term or maturity of the loan caused by the adjustment also shall be disclosed; and

(E) If the new interest rate or new payment provided is an estimate, a statement that another disclosure containing the actual new interest rate and new payment will be provided to the consumer 2 to 4 months prior to the date the first new payment is due for interest rate adjustments that result in a corresponding payment change, pursuant to § 1026.20(c);

(vii) For interest-only or negatively-amortizing loans, a statement that the new payment will not be allocated to pay loan principal. If negative amortization occurs as a result of the adjustment, the statement shall set forth the payment required to fully amortize the loan at the new interest rate over the remainder of the loan term or to fully amortize the loan without extending the loan term;

(viii) A list of the following alternatives to paying at the new rate that consumers may pursue and a brief explanation of each alternative:

(A) Refinancing the loan with the current or other lender;

(B) Selling the property and using the proceeds to pay off the loan;

(C) Modifying the terms of the loan with the lender; or

(D) Arranging payment forbearance with the lender;

(ix) The circumstances under which any prepayment penalty, as defined in subpart E by § 1026.41(d)(7)(iv), may be imposed when consumers fully repay their adjustable-rate mortgages, such as when selling or refinancing their principal residence, the time period during which the penalty may be imposed, and the maximum amount (in dollars) of the penalty possible during that time period;

(x) The telephone number of the creditor, assignee, or servicer for consumers to call if they anticipate not being able to make the new payment; and

(xi) The mailing and Internet addresses and telephone number to access the State housing finance authority (as defined in Section 1301 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989) for the State in which the consumer resides, and the Web site and telephone number to access either the Bureau list or the HUD list of homeownership counselors or counseling organizations.

(3) *Format of initial rate adjustment disclosures.* (i) Except for the disclosures provided by paragraph (d)(2)(i), the disclosures required by

§ 1026.20(d) shall be provided in the form of a table and in the same order as, and with headings and format substantially similar to, Forms H-4(D)(3) and (4) in Appendix H to this part;

(ii) The disclosures required by paragraph (d)(2)(i) shall appear outside of and above the table required in paragraph (d)(3)(i); and

(iii) The disclosures required by paragraph (d)(2)(iii) shall be in the form of a table located within the table described in paragraph (d)(3)(i) of this section. These disclosures shall appear in the same order as, and with headings and format substantially similar to, the table inside the larger table in Forms H-4(D)(3) and (4) in Appendix H to this part. ◀

#### Subpart E—Special Rules for Certain Home Mortgage Transactions

4. Section 1026.36 is amended by revising paragraph (c) to read as follows:

##### **§ 1026.36 Prohibited acts or practices in connection with a credit secured by a dwelling.**

\* \* \* \* \*

(c) *Servicing practices.* ▶ For purposes of this paragraph (c), the terms “servicer” and “servicing” have the same meanings as provided in 12 CFR 1024.2(b).

(1) *Payment Processing.* In connection with a consumer credit transaction secured by a consumer’s principal dwelling:

(i) *Full contractual payments.* No servicer shall fail to credit a full contractual payment to the consumer’s loan account as of the date of receipt, except when a delay in crediting does not result in any charge to the consumer or in the reporting of negative information to a consumer reporting agency, or except as provided in paragraph (c)(1)(iii) of this section. A full contractual payment is an amount sufficient to cover principal, interest, and escrow (if applicable) for a given billing cycle. A payment qualifies as a full contractual payment even if it does not include amounts required to cover late fees or other fees that have been assessed.

(ii) *Partial payments.* Any servicer that retains a partial payment, meaning any payment less than a full contractual payment, in a suspense or unapplied funds account shall:

(A) Disclose to the consumer the total amount of funds held in such suspense or unapplied funds account on the periodic statement required by § 1026.41, if a periodic statement is required.

(B) Promptly apply funds held in the suspense or unapplied funds account to the oldest outstanding payment when sufficient funds accumulate in such account to cover a full contractual payment.

(iii) *Non-conforming payments.* If a servicer specifies in writing requirements for the consumer to follow in making payments, but accepts a payment that does not conform to the requirements, the servicer shall credit the payment as of 5 days after receipt.

(2) *No pyramiding of late fees.* In connection with a consumer credit transaction secured by a consumer’s principal dwelling, a servicer shall not impose any late fee or delinquency charge for a payment if:

(i) Such a fee or charge is attributable solely to failure of the consumer to pay a late fee or delinquency charge on an earlier payment; and

(ii) The payment is otherwise a full contractual payment received on the due date, or within any applicable grace period.

(3) *Payoff Statements.* In connection with a consumer credit transaction secured by a consumer’s dwelling, a creditor, assignee or servicer, as applicable, must provide an accurate statement of the total outstanding balance that would be required to pay the consumer’s obligation in full as of a specified date. The statement shall be provided within a reasonable time, but in no case more than 7 business days, after receiving a written request from the consumer or any person acting on behalf of the consumer. ◀

[(1) In connection with a consumer credit transaction secured by a consumer’s principal dwelling, no servicer shall:

(i) Fail to credit a payment to the consumer’s loan account as of the date of receipt, except when a delay in crediting does not result in any charge to the consumer or in the reporting of negative information to a consumer reporting agency, or except as provided in paragraph (c)(2) of this section;

(ii) Impose on the consumer any late fee or delinquency charge in connection with a payment, when the only delinquency is attributable to late fees or delinquency charges assessed on an earlier payment, and the payment is otherwise a full payment for the applicable period and is paid on its due date or within any applicable grace period; or

(iii) Fail to provide, within a reasonable time after receiving a request from the consumer or any person acting on behalf of the consumer, an accurate statement of the total outstanding balance that would be required to satisfy

the consumer's obligation in full as of a specified date.

(2) If a servicer specifies in writing requirements for the consumer to follow in making payments, but accepts a payment that does not conform to the requirements, the servicer shall credit the payment as of 5 days after receipt.

(3) For purposes of this paragraph (c), the terms "servicer" and "servicing" have the same meanings as provided in 12 CFR 1024.2(b), as amended.】

\* \* \* \* \*

5. Section 1026.41 is added to read as follows:

**▶§ 1026.41 Periodic statements for residential mortgage loans.**

(a) *In general.* A servicer of a closed-end consumer credit transaction secured by a dwelling, must transmit to the consumer for each billing cycle a periodic statement meeting the requirements of paragraphs (b), (c), and (d) of this section, unless an exemption in paragraph (e) of this section applies. If a loan has a billing cycle shorter than a period of 31 days (for example, a bi-weekly billing cycle), a periodic statement covering an entire month may be used. For the purposes of this section, *servicer* is defined to mean creditor, assignee, or servicer, as applicable.

(b) *Timing of the periodic statement.* The periodic statement must be delivered or placed in the mail within a reasonably prompt time after the payment due date or the end of any grace period provided for the previous billing cycle. The first periodic statement must be sent no later than 10 days before the first payment is due.

(c) *Form of the periodic statement.* The creditor, assignee, or servicer must make the disclosures required by this section clearly and conspicuously in writing, or electronically if the consumer agrees, and in a form that the consumer may keep. Sample forms for periodic statements are provided in Appendix H–28. Proper use of these forms will be deemed in compliance with this section.

(d) *Content and layout of the periodic statement.* The periodic statement shall contain the information in this paragraph (d), in the manner described below.

(1) *Amount due.* The following disclosures must be grouped together in close proximity to each other, and be located at the top of the first page of the statement:

(i) The payment due date;

(ii) The amount of any late payment fee, and the date on which that fee will be imposed if payment has not been received; and

(iii) The amount due. The amount due must be more prominent than other disclosures on the page. If a loan has multiple payment options, the amount due under each of the payment options must be listed.

(2) *Explanation of amount due.* The following items must be grouped together in close proximity to each other and located on the first page of the statement:

(i) The monthly payment amount, including a breakdown showing how much, if any, will be applied to principal, interest, and escrow. If a loan has multiple payment options, a breakdown of each of the payment options must be listed along with a statement whether the principal balance will increase, decrease or stay the same for each option listed;

(ii) The total sum of any fees or charges imposed since the last statement; and

(iii) Any payment amount past due.

(3) *Past Payment Breakdown.* The following items must be grouped together in close proximity to each other and located on the first page of the statement:

(i) The total of all payments received since the last statement, including a breakdown showing how much, if any, of those payments was applied to principal, interest, escrow, fees and charges, and any partial payment or suspense account; and

(ii) The total of all payments received since the beginning of the current calendar year, including a breakdown of how much, if any, of those payments was applied to principal, interest, escrow, fees and charges, and the amount currently held in any partial payment or suspense account.

(4) *Transaction activity.* A list of all the transaction activity that occurred since the last statement must be included on the periodic statement. For purposes of this paragraph (d)(4), *transaction activity* means any activity that credits or debits the outstanding account balance. The transaction activity must include the date of the transaction, a brief description of the transaction, and the amount of the transaction for each activity on the list.

(5) *Messages.* If a statement reflects a partial payment that was placed in a suspense or unapplied funds account, the periodic statement must state what must be done for the funds to be applied. Such statement must be on the front page of the statement.

(6) *Contact information.* The periodic statement must include a toll-free telephone number and, if applicable, an electronic mailing address that may be used by the consumer to obtain

information about the mortgage, on the front page of the statement.

(7) *Account information.* The following items must be provided on the statement:

(i) The amount of the outstanding principal balance;

(ii) The current interest rate in effect for the loan;

(iii) The date on which the interest rate may next change; and

(iv) The amount of any prepayment penalty that may be charged. For the purposes of this paragraph (d)(7)(iv), *prepayment penalty* means a charge imposed for paying all or part of a transaction's principal before the date on which the principal is due.

(v) *Housing counselor information.* The periodic statement must include the website address, if applicable, and telephone number to access:

(A) any State housing finance authority (as defined in Section 1301 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989) for the State in which the property is located; and

(B) Either the Bureau list or the HUD list of homeownership counselors or counseling organizations.

(8) *Delinquency information.* If the consumer is more than 45 days delinquent, the following items must be grouped together in close proximity to each other and located on the first page of the statement:

(i) The date on which the consumer became delinquent;

(ii) A statement alerting the consumer to possible risks, such as foreclosure, and expenses that may be incurred if the delinquency is not cured;

(iii) An account history showing the consumer, for the lesser of the past 6 months or the period since the last time the account was current, the amount due for each billing cycle, or if a payment was fully paid, the date on which it was considered fully paid;

(iv) Notice of any loan modification programs (trial or permanent) to which the consumer has been accepted, if applicable;

(v) Notice that the loan has been referred to foreclosure, if applicable;

(vi) The total payment amount needed to bring the loan current; and

(vii) A statement directing the consumer to the housing counselor information required by (d)(7)(v).

(e) *Exemptions.* (1) *Reverse Mortgages.* Reverse mortgage transactions, as defined by § 1026.33(a), are exempt from the requirements of this section.

(2) *Timeshare.* Timeshare plans, as defined by 11 U.S.C. 101(53(D)), are exempt from the requirements of this section.

(3) *Coupon Book Exemption.* The requirements of paragraph (a) do not apply to fixed-rate loans if the creditor, assignee, or servicer:

(i) Provides the consumer with a coupon book that includes on each coupon the information listed in paragraph (d)(1) of this section;

(ii) Provides the consumer with a coupon book that includes anywhere in the coupon book:

(A) The account information listed in paragraph (d)(7) of this section;

(B) The contact information for the servicer, listed in paragraph (d)(6) of this section; and

(C) Information on how the consumer can obtain the information listed in paragraph (e)(3)(iii) of this section.

(iii) Makes the following information available to the consumer by telephone, writing or electronically, if the consumer consents:

(A) The information in Explanation of Amount Due, listed in paragraph (d)(2) of this section;

(B) The past payment breakdown information, listed in paragraph (d)(3) of this section; and

(C) The transaction activity information listed in paragraph (d)(4) of this section;

(iv) Provides the consumer the information listed in paragraphs (d)(8)

of this section in writing, for any billing cycle during which the borrower is more than 45 days delinquent.

(4) *Small Servicer Exemption.* A creditor, assignee or servicer is exempt from the requirements of this section for loans serviced by a small servicer. To qualify as a small servicer, a servicer must meet all of the following requirements:

(i) Service 1,000 or fewer mortgage loans. In determining whether a small servicer services 1,000 mortgage loans or fewer, a servicer is evaluated based on its size as of January 1 for the remainder of the calendar year. A servicer that, together with its affiliates, crosses the threshold will have six months or until the beginning of the next calendar year, whichever is later, to begin compliance other than as a small servicer.

(ii) Only service mortgage loans for which the servicer (or an affiliate) is the owner or assignee or the servicer (or an affiliate) is the entity to whom the mortgage loan obligation was initially payable. ◀

6. Appendix H to Part 1026 is amended by removing the entry for H-4(D) Variable-Rate Model Clauses (§ 1026.20(c)), adding entries for H-4(D)(1), H-4(D)(2), H-4(D)(3), and H-

4(D)(4), adding entries for H-28(A), H-28(B), H-28(C), and H-28(D), and removing and adding entries in the table of contents at the beginning of the appendix to read as follows:

#### Appendix H to Part 1026—Closed-End Model Forms and Clauses

\* \* \* \* \*

▶ H-4(D) Variable-Rate Model Clauses (§ 1026.20(c)) ▶

▶ H-4(D)(1) Adjustable-Rate Mortgage Model Form (§ 1026.20(c))

H-4(D)(2) Adjustable-Rate Mortgage Sample Form (§ 1026.20(c))

H-4(D)(3) Adjustable-Rate Mortgage Model Form (§ 1026.20(d))

H-4(D)(4) Adjustable-Rate Mortgage Sample Form (§ 1026.20(d)) ◀

\* \* \* \* \*

▶ H-28(A) Sample Form of Periodic Statement

H-28(B) Sample Form of Periodic Statement with Delinquency Box

H-28(C) Sample Form of Periodic Statement for a Payment-Options Loan

H-28(D) Sample Clause for Housing Counselor Contact Information ◀

\* \* \* \* \*

BILLING CODE 4810-AM-P

[

#### H-4(D)—Variable-Rate Model Clauses

Your new interest rate will be \_\_\_\_\_%, which is based on an index value of \_\_\_\_\_%.

Your previous interest rate was \_\_\_\_\_%, which was based on an index value of \_\_\_\_\_%.

[The new interest rate does not reflect a change of \_\_\_\_\_ percentage point in the index value which was not added because of \_\_\_\_\_.]

[The new payment will be \$\_\_\_\_\_.]

[Your new loan balance is \$\_\_\_\_\_.]

[Your (new) (existing) payment will not be sufficient to cover the interest due and the difference will be added to the loan amount. The payment amount needed to pay your loan in full by the end of the term at the new interest rate is \$\_\_\_\_\_.]

[The following interest rate adjustments have been implemented this year without changing your payment: \_\_\_\_\_.]

These interest rates were based on the following index values: \_\_\_\_\_.]

▶

H-4(D)(1) Model Form for § 1026.20(c)

**Changes to Your Mortgage Interest Rate and Payments on (date)**

Under the terms of your Adjustable Rate Mortgage (ARM), you had a (duration) period during which your interest rate stayed the same. That period ends on (date), so on that date your interest rate and mortgage payment change. After that, your interest rate may change (frequency) for the rest of your loan term. [Also, as of (date) your mortgage (change to loan terms, features or options).]

|                                  | Current Rate<br>and (frequency) Payment | New Rate<br>and (frequency) Payment   |
|----------------------------------|-----------------------------------------|---------------------------------------|
| Interest Rate                    | ____%                                   | ____%                                 |
| [Principal]                      | [\$_____]                               | [\$_____]                             |
| [Interest]                       | [\$_____]                               | [\$_____]                             |
| [Escrow (Taxes and Insurance)]   | [\$_____]                               | [\$_____]                             |
| <b>Total (frequency) Payment</b> | <b>\$_____</b>                          | <b>\$_____</b><br><b>(due (date))</b> |

**Interest Rate:** We calculated your interest rate by taking a published "index rate" and adding a certain number of percentage points, called the "margin." Under your loan agreement, your index rate is (index) and your margin is \_\_\_\_%. The (index) is published (frequency) in (source of information).

**[Rate Limit[s]]:** [Your rate cannot go higher than \_\_\_\_% over the life of the loan.] [Your rate can change each year by no more than \_\_\_\_%.] [We did not include an additional \_\_\_\_% interest rate increase to your new rate because a rate limit applied. This additional amount may be applied when your interest rate adjusts again on (date).]

**New Interest Rate and Monthly Payment:** The table above shows your new interest rate and new monthly payment. Your new payment is based on the (index), your margin of \_\_%, [other adjustment to the index], your loan balance of \$\_\_\_\_\_ and your remaining loan term of \_\_\_\_ months.

**[Interest-Only Payments:]** Your new payment will not cover any principal. Therefore, making this payment will not reduce your loan balance. In order to fully pay off your loan by the end of the loan term at the new interest rate, you would have to pay \$\_\_\_\_\_ per month.]

**[Warning about Increase in Your Loan Balance:]** Your new payment covers only part of the interest and no principal. Therefore, the unpaid interest will add to the balance of the loan or will increase the term of your loan. In order to fully pay off your loan by the end of the loan term at the new interest rate, you would have to pay \$\_\_\_\_\_ per month.]

**[Prepayment Penalty:]** Keep in mind that if you pay off your loan, refinance or sell your home before (date), you could be charged a penalty of up to \$\_\_\_\_\_.]

July 20, 2012

Jordan and Dana Smith  
4700 Jones Drive  
Memphis, TN 38109

Springside Mortgage  
1234 Main St  
Memphis, TN 31801

**Changes to Your Mortgage Interest Rate and Payments on September 1, 2012**

Under the terms of your Adjustable Rate Mortgage (ARM), you had a three-year period during which your interest rate stayed the same. That period ends on September 1, 2012, so on that date your interest rate and mortgage payment change. After that, your interest rate may change annually for the rest of your loan term.

|                       | Current Rate<br>and Monthly Payment | New Rate<br>and Monthly Payment     |
|-----------------------|-------------------------------------|-------------------------------------|
| Interest Rate         | 4.25%                               | 6.25%                               |
| Total Monthly Payment | \$983.88                            | \$1,211.81<br>(due October 1, 2012) |

**Interest Rate:** We calculated your interest rate by taking a published "index rate" and adding a certain number of percentage points, called the "margin." Under your loan agreement, your index rate is the 1-year LIBOR and your margin is 2.25%. The LIBOR index is published daily in the Wall Street Journal.

**Rate Limits:** Your rate cannot go higher than 11.625% over the life of the loan. Your rate can change each year by no more than 2.00%.

**New Interest Rate and Monthly Payment:** The table above shows your new interest rate and new monthly payment. Your new payment is based on the LIBOR index, your margin of 2.25%, your loan balance of \$189,440 and your remaining loan term of 324 months.

**Prepayment Penalty:** Keep in mind that if you pay off your loan, refinance or sell your home before September 1, 2012, you could be charged a penalty of up to \$3,400.00.

(Date)

**Changes to Your Mortgage Interest Rate and Payments on (date)**

Under the terms of your Adjustable Rate Mortgage (ARM), you had a (duration) period during which your interest rate stayed the same. That period ends on (date), so on that date your interest rate may change. After that, your interest rate may change (frequency) for the rest of your loan term. Any change in your interest rate may also change your mortgage payment. [Also, as of (date) your mortgage (change to loan terms, features or options).]

|                                  | Current Rate<br>and (frequency) Payment | [Estimated] New Rate<br>and (frequency) Payment |
|----------------------------------|-----------------------------------------|-------------------------------------------------|
| Interest Rate                    | ____%                                   | ____%                                           |
| [Principal]                      | [\$ ____]                               | [\$ ____]                                       |
| [Interest]                       | [\$ ____]                               | [\$ ____]                                       |
| [Escrow (Taxes and Insurance)]   | [\$ ____]                               | [\$ ____]                                       |
| <b>Total (frequency) Payment</b> | <b>\$ ____</b>                          | <b>\$ ____<br/>(due (date))</b>                 |

**Interest Rate:** We [will] calculate your interest rate by taking a published "index rate" and adding a certain number of percentage points, called the "margin." Under your loan agreement, your index rate is (index) and your margin is \_\_\_\_%. The (index) is published (frequency) in (source of information).

**[Rate Limit(s)]:** [Your rate cannot go higher than \_\_\_\_% over the life of the loan.] [Your rate can change each year by no more than \_\_\_\_%.] [We did not include an additional \_\_\_\_% interest rate increase to your new rate because a rate limit applied. This additional amount may be applied when your interest rate adjusts again on (date).]

**New Interest Rate and Monthly Payment:** The table above shows [our estimate of] your new interest rate and new monthly payment. These amounts are based on the (index), your margin of \_\_\_\_%, [other adjustment to the index], your loan balance of \$\_\_\_\_ and your remaining loan term of \_\_\_\_ months. [However, if the (index) has changed when we calculate the exact amount of your new interest rate and payment, your new interest rate and payment may be different from the estimate above. We will send you another notice with the exact amount of your new interest rate and payment 2 to 4 months before the first new payment is due, if your new payment will be different from your current payment.]

**[Interest-Only Payments]:** Your new payment will not cover any principal. Therefore, making this payment will not reduce your loan balance. In order to fully pay off your loan by the end of the loan term at the new interest rate, you would have to pay \$ \_\_\_\_ per month.]

**[Warning about Increase in Your Loan Balance:** Your new payment covers only part of the interest and no principal. Therefore, the unpaid interest will add to the balance of the loan or will increase the term of your loan. In order to fully pay off your loan by the end of the loan term at the new interest rate, you would have to pay \$ \_\_\_\_ per month.]

**Possible Alternatives:** If you seek an alternative to the upcoming changes to your interest rate and payment, the following options may be possible (most are subject to lender approval):

- Refinance your loan with us or another lender.
- Sell your home and use the proceeds to pay off your current loan.
- Modify your loan terms with us.
- Payment forbearance temporarily gives you more time to pay your monthly payment.

**[Prepayment Penalty:** Keep in mind that if you pay off your loan, refinance or sell your home before (date), you could be charged a penalty of up to \$ \_\_\_\_.]

(Continued on other side)

**If You Anticipate Problems Making Your Payments:** Contact *(mortgage company)* at *(telephone number)* [or *(email address)*] as soon as possible. If you would like counseling or assistance, you can contact the following:

- [U.S. Department of Housing and Urban Development (HUD): For a list of counseling agencies or programs in your area, go to *(internet address of the U.S. Department of Housing and Urban Development)* or call *(telephone number)*.] [U.S. Consumer Financial Protection Bureau (CFPB) Counseling Agency List: For a list of counseling agencies and programs in your area, go to *(internet address of U.S. Consumer Financial Protection Bureau Counseling Agency List)* or call *(telephone number)*.]
- *(State Housing Finance Agency)*  
*(Address)*  
*(Telephone Number)*  
*(Internet Address)*

February 15, 2012

Jordan and Dana Smith  
4700 Jones Drive  
Memphis, TN 38109

Springside Mortgage  
1234 Main St  
Memphis, TN 31801

**Changes to Your Mortgage Interest Rate and Payments on September 1, 2012**

Under the terms of your Adjustable Rate Mortgage (ARM), you had a three-year period during which your interest rate stayed the same. That period ends on September 1, 2012, so on that date your interest rate may change. After that, your interest rate may change annually for the rest of your loan term. Any change in your interest rate may also change your mortgage payment. Also, as of September 1, 2012 your mortgage payment will include principal as well as interest.

|                              | Current Rate<br>and Monthly Payment | Estimated New Rate<br>and Monthly Payment         |
|------------------------------|-------------------------------------|---------------------------------------------------|
| Interest Rate                | 4.25%                               | 6.25%                                             |
| Principal                    | - none -                            | \$237.70                                          |
| Interest                     | \$708.33                            | \$1,041.66                                        |
| Escrow (Taxes and Insurance) | \$450.00                            | \$450.00                                          |
| <b>Total Monthly Payment</b> | <b>\$1,158.33</b>                   | <b>\$1,729.36</b><br><b>(due October 1, 2012)</b> |

**Interest Rate:** We will calculate your interest rate by taking a published "index rate" and adding a certain number of percentage points, called the "margin." Under your loan agreement, your index rate is the 1-year LIBOR and your margin is 2.25%. The LIBOR index is published daily in the Wall Street Journal.

**Rate Limits:** Your rate cannot go higher than 11.625% over the life of the loan. Your rate can change each year by no more than 2.00%. We did not include an additional 1.00% interest rate increase to your new rate because a rate limit applied. This additional amount may be applied when your interest rate adjusts again on September 1, 2013.

**New Interest Rate and Monthly Payment:** The table above shows our estimate of your new interest rate and new monthly payment. These amounts are based on the LIBOR index, your margin of 2.25%, your loan balance of \$200,000 and your remaining loan term of 324 months. **However, if the LIBOR index has changed when we calculate the exact amount of your new interest rate and payment, your new interest rate and payment may be different from the estimate above. We will send you another notice with the exact amount of your new interest rate and payment 2 to 4 months before the first new payment is due, if your new payment will be different from your current payment.**

**Possible Alternatives:** If you seek an alternative to the upcoming changes to your interest rate and payment, the following options may be possible (most are subject to lender approval):

- Refinance your loan with us or another lender.
- Sell your home and use the proceeds to pay off your current loan.
- Modify your loan terms with us.
- Payment forbearance temporarily gives you more time to pay your monthly payment.

**Prepayment Penalty:** Keep in mind that if you pay off your loan, refinance or sell your home before September 1, 2012, you could be charged a penalty of up to \$3,400.

**If You Anticipate Problems Making Your Payments:** Contact Springside Mortgage at 1-800-555-4567 as soon as possible. If you would like counseling or assistance, you can contact the following:

*(Continued on other side)*

- U.S. Department of Housing and Urban Development (HUD): For a list of counseling agencies or programs in your area, go to <http://www.hud.gov/offices/hsg/sfh/hcc/hcs.cfm> or call 800-569-4287.
- Tennessee Housing Development Agency  
404 James Robertson Pkwy, Ste 1200  
Nashville, TN 37243-0900  
615-815-2200 or 1-800-228-THDA  
[www.thda.org](http://www.thda.org)



\* \* \* \* \*

►H-28(A) Sample Form of Periodic  
Statement

**Springside Mortgage**

Customer Service: 1-800-555-1234  
[www.springsidemortgage.com](http://www.springsidemortgage.com)

Jordan and Dana Smith  
 4700 Jones Drive  
 Memphis, TN 38109

**Mortgage Statement**

Statement Date: 3/20/2012

|                                                                              |                   |
|------------------------------------------------------------------------------|-------------------|
| Account Number                                                               | 1234567           |
| Payment Due Date                                                             | 4/1/2012          |
| <b>Amount Due</b>                                                            | <b>\$2,079.71</b> |
| <i>If payment is received after 4/15/12, \$160 late fee will be charged.</i> |                   |

| Account Information                |              |
|------------------------------------|--------------|
| Outstanding Principal              | \$264,776.43 |
| Interest Rate (Until October 2012) | 4.75%        |
| Prepayment Penalty                 | \$3,500.00   |

| Explanation of Amount Due        |                   |
|----------------------------------|-------------------|
| Principal                        | \$386.46          |
| Interest                         | \$1,048.07        |
| Escrow (for Taxes and Insurance) | \$235.18          |
| <b>Regular Monthly Payment</b>   | <b>\$1,669.71</b> |
| Total Fees Charged               | \$410.00          |
| <b>Total Amount Due</b>          | <b>\$2,079.71</b> |

| Transaction Activity (2/20 to 3/19) |                                                                   |          |            |
|-------------------------------------|-------------------------------------------------------------------|----------|------------|
| Date                                | Description                                                       | Charges  | Payments   |
| 3/16/12                             | Late Fee (charged because full payment not received by 3/15/2012) | \$160.00 |            |
| 3/17/12                             | Payment Received -- Thank you                                     |          | \$1,669.71 |
| 3/19/12                             | Property Inspection Fee                                           | \$250.00 |            |

| Past Payments Breakdown      |                   |                   |
|------------------------------|-------------------|-------------------|
|                              | Paid Last Month   | Paid Year to Date |
| Principal                    | \$384.93          | \$1,150.25        |
| Interest                     | \$1,049.60        | \$3,153.34        |
| Escrow (Taxes and Insurance) | \$235.18          | \$705.54          |
| Fees                         | \$0.00            | \$0.00            |
| <b>Total</b>                 | <b>\$1,669.71</b> | <b>\$5,009.13</b> |

**Springside Mortgage**

Springside Mortgage  
 P.O. Box 11111  
 Memphis, TN 38101

| Amount Due                                          |                   |
|-----------------------------------------------------|-------------------|
| <b>Due By 4/1/2012:</b>                             | <b>\$2,079.71</b> |
| <i>\$160 late fee will be charged after 4/15/12</i> |                   |
| Additional Principal                                | \$ .              |
| Additional Escrow                                   | \$ .              |
| <b>Total Amount Enclosed</b>                        | <b>\$ .</b>       |

*Make check payable to Springside Mortgage.*

1234567 34571892

342359127

**Springside Mortgage**

Customer Service: 1-800-555-1234  
[www.springsidemortgage.com](http://www.springsidemortgage.com)

Jordan and Dana Smith  
 4700 Jones Drive  
 Memphis, TN 38109

**Mortgage Statement**

Statement Date: 3/20/2012

|                                                                              |                   |
|------------------------------------------------------------------------------|-------------------|
| Account Number                                                               | 1234567           |
| Payment Due Date                                                             | 4/1/2012          |
| <b>Amount Due</b>                                                            | <b>\$4,339.13</b> |
| <i>If payment is received after 4/15/12, \$160 late fee will be charged.</i> |                   |

| Account Information                |              |
|------------------------------------|--------------|
| Outstanding Principal              | \$264,776.43 |
| Interest Rate (Until October 2012) | 4.75%        |
| Prepayment Penalty                 | \$3,500.00   |

| Explanation of Amount Due      |                   |
|--------------------------------|-------------------|
| Principal                      | \$386.46          |
| Interest                       | \$1,048.07        |
| Escrow (Taxes and Insurance)   | \$235.18          |
| <b>Regular Monthly Payment</b> | <b>\$1,669.71</b> |
| Total Fees and Charges         | \$410.00          |
| Overdue Payment                | \$2,259.42        |
| <b>Total Amount Due</b>        | <b>\$4,339.13</b> |

| Transaction Activity (2/20 to 3/19) |                                                                   |          |            |
|-------------------------------------|-------------------------------------------------------------------|----------|------------|
| Date                                | Description                                                       | Charges  | Payments   |
| 3/13/12                             | Partial Payment Received*                                         |          | \$1,000.00 |
| 3/16/12                             | Late Fee (charged because full payment not received by 3/15/2012) | \$160.00 |            |
| 3/19/12                             | Property Inspection Fee                                           | \$250.00 |            |

| Past Payments Breakdown      |                   |                   |
|------------------------------|-------------------|-------------------|
|                              | Paid Last Month   | Paid Year to Date |
| Principal                    | \$0.00            | \$383.31          |
| Interest                     | \$0.00            | \$1,051.22        |
| Escrow (Taxes and Insurance) | \$0.00            | \$235.18          |
| Fees                         | \$0.00            | \$410.00          |
| Partial Payment (Unapplied)* | \$1,000.00        | \$1,490.00        |
| <b>Total</b>                 | <b>\$1,000.00</b> | <b>\$3,569.71</b> |

**Important Messages**

**\*Partial Payments:** Any partial payments that you make are not applied to your mortgage, but instead are held in a separate suspense account. If you pay the balance of a partial payment, the funds will then be applied to your mortgage.

**\*\*Delinquency Notice\*\***

**You are late on your mortgage payments.** Failure to bring your loan current may result in fees and foreclosure—the loss of your home. As of March 20, you are 49 days delinquent on your mortgage loan.

**Recent Account History**

- Payment due 12/1/11: Fully paid on time
- Payment due 1/1/12: Fully paid on 2/3/12
- Payment due 2/1/12: Unpaid balance of \$589.71
- Payment due 3/1/12: Unpaid balance of \$2,079.71
- Current payment due 4/1/12: \$1,669.71
- **Total: \$4,339.13 due. You must pay this amount to bring your loan current.**

**If You Are Experiencing Financial Difficulty:** See back for information about mortgage counseling or assistance.

**Springside Mortgage**

Springside Mortgage  
 P.O. Box 11111  
 Los Angeles, CA 90010

| Amount Due                                          |                   |
|-----------------------------------------------------|-------------------|
| <b>Due By 4/1/2012:</b>                             | <b>\$4,339.13</b> |
| <i>\$160 late fee will be charged after 4/15/12</i> |                   |
| Additional Principal                                | \$ .              |
| Additional Escrow                                   | \$ .              |
| <b>Total Amount Enclosed</b>                        | <b>\$ .</b>       |

*Make check payable to Springside Mortgage.*

1234567 34571892

342359127 DN

**Springside Mortgage**

Customer Service: 1-800-555-1234  
[www.springsidemortgage.com](http://www.springsidemortgage.com)

Jordan and Dana Smith  
 4700 Jones Drive  
 Memphis, TN 38109

**Mortgage Statement**

Statement Date: 3/20/2012

|                                                                       |                                      |
|-----------------------------------------------------------------------|--------------------------------------|
| Account Number                                                        | 1234567                              |
| Payment Due Date                                                      | 4/1/2012                             |
| <b>Amount Due</b>                                                     | Option 1 (Full): \$1,829.71          |
|                                                                       | Option 2 (Interest-Only): \$1,443.25 |
|                                                                       | Option 3 (Minimum): \$1,156.43       |
| If payment is received after 4/15/12, \$160 late fee will be charged. |                                      |

| Account Information                |              |
|------------------------------------|--------------|
| Outstanding Principal              | \$260,000.00 |
| Interest Rate (Until October 2012) | 4.75%        |
| Prepayment Penalty                 | \$3,500.00   |

| Explanation of Amount Due      |                                                                                                   |                                                                                                                   |                                                                                                                    |
|--------------------------------|---------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------|
|                                | Option 1 (Full)                                                                                   | Option 2 (Interest-Only)                                                                                          | Option 3 (Minimum)                                                                                                 |
| Principal                      | \$386.46                                                                                          | \$0                                                                                                               | \$0                                                                                                                |
| Interest                       | \$1,048.07                                                                                        | \$1,048.07                                                                                                        | \$761.25                                                                                                           |
| Escrow (Taxes and Insurance)   | \$235.18                                                                                          | \$235.18                                                                                                          | \$235.18                                                                                                           |
| <b>Regular Monthly Payment</b> | <b>\$1,669.71</b>                                                                                 | <b>\$1,283.25</b>                                                                                                 | <b>\$996.43</b>                                                                                                    |
| Total Fees and Charges         | \$160.00                                                                                          | \$160.00                                                                                                          | \$160.00                                                                                                           |
| <b>Total Amount Due</b>        | <b>\$1,829.71</b>                                                                                 | <b>\$1,443.25</b>                                                                                                 | <b>\$1,156.43</b>                                                                                                  |
| If you make this payment...    | ... your principal balance will <u>decrease</u> , and you will be closer to paying off your loan. | ... your principal balance will <u>stay the same</u> , and you will <u>not</u> be closer to paying off your loan. | ... <b>your principal balance will increase</b> . You will be borrowing more money and losing equity in your home. |

| Transaction Activity (2/20 to 3/19) |                                                                 |          |            |
|-------------------------------------|-----------------------------------------------------------------|----------|------------|
| Date                                | Description                                                     | Charges  | Payments   |
| 3/16/12                             | Late Fee (charged because payment was received after 3/15/2012) | \$160.00 |            |
| 3/19/12                             | Payment Received – Thank you                                    |          | \$1,669.71 |

| Past Payments Breakdown      |                   |                   |
|------------------------------|-------------------|-------------------|
|                              | Paid Last Month   | Paid Year to Date |
| Principal                    | \$384.93          | \$1,150.25        |
| Interest                     | \$1,049.60        | \$3,153.34        |
| Escrow (Taxes and Insurance) | \$235.18          | \$705.54          |
| Fees                         | \$0.00            | \$0.00            |
| <b>Total</b>                 | <b>\$1,669.71</b> | <b>\$5,009.13</b> |

**Springside Mortgage**

Springside Mortgage  
 P.O. Box 11111  
 Los Angeles, CA 90010

| Amount Due                                                                 |                   |
|----------------------------------------------------------------------------|-------------------|
| <input type="checkbox"/> Option 1 (Full):                                  | \$1,829.71        |
| <b>Due By 4/1/2012:</b> <input type="checkbox"/> Option 2 (Interest-Only): | <b>\$1,443.25</b> |
| <input type="checkbox"/> Option 3 (Minimum):                               | <b>\$1,156.43</b> |
| \$160 late fee will be charged after 4/15/12                               |                   |
| Additional Principal                                                       | \$                |
| Additional Escrow                                                          | \$                |
| <b>Total Amount Enclosed</b>                                               | <b>\$</b>         |

Make check payable to Springside Mortgage.

1234567 34571892

342359127 P

**BILLING CODE 4810-AM-C**

H-28(D) Sample Clause for Housing  
 Counselor Contact Information

*Housing Counselor Information:* If you would like counseling or assistance, you can contact the following:

- U.S. Department of Housing and Urban Development (HUD): For a list of counseling agencies or programs in your area, go to

<http://www.hud.gov/offices/hsg/sfh/hcc/hcs.cfm> or call 800-569-4287.

- Tennessee Housing Development Agency, 404 James Robertson Pkwy, Ste 1200, Nashville, TN 37243-0900, 615-815-2200 or 1-800-228-THDA, [www.thda.org](http://www.thda.org).

7. In Supplement I to Part 1026:

A. Under Section 1026.17—*General Disclosure Requirements*, revise paragraphs 17(a)(1)–2.ii and 17(c)(1)–1.

B. Under Section 1026.18—*Content of Disclosures*, revise paragraph 18(f)–1.

C. Under Section 1026.19—*Certain Mortgage and Variable-Rate Transactions*, revise paragraphs 19(b)–4, 19(b)–5.i.C and 19(b)(2)(xi).

D. Under *Section 1026.20—*

*Subsequent Disclosure Requirements:*

- i. Revise the section heading.
- ii. Amend *20(c) Variable-Rate Adjustments* by revising paragraphs 1. and 2. and removing paragraph 3.
- iii. Remove subheading *Paragraph 20(c)(1)* and remove paragraph 1. under this subheading.
- iv. New subheading *Paragraph 20(c)(1)(i)* is added and paragraph 1. under this subheading is added.
- v. New subheading *Paragraph 20(c)(1)(ii)* is added and paragraphs 1., 2., and 3. under this subheading are added.
- vi. Amend *Paragraph 20(c)(2)* by revising paragraph 1.
- vii. New subheading *Paragraph 20(c)(2)(ii)(A)* is added and paragraph 1. under this subheading is added.
- viii. New subheading *Paragraph 20(c)(2)(iv)* is added and paragraph 1. under this subheading is added.
- ix. New subheading *Paragraph 20(c)(2)(v)(B)* is added and paragraph 1. under this subheading is added.
- x. New subheading *Paragraph 20(c)(2)(vi)* is added and paragraphs 1. and 2. under this subheading are added.
- xi. Remove subheading *Paragraph 20(c)(3)* and remove paragraph 1. under this subheading.
- xii. Remove subheading *Paragraph 20(c)(4)* and remove paragraph 1. under this subheading.
- xiii. Remove subheading *Paragraph 20(c)(5)* and remove paragraph 1. under this subheading.
- xiv. New subheading *Paragraph 20(d)* is added and paragraphs 1., 2., and 3. under this subheading are added.
- xv. New subheading *Paragraph 20(d)(1)(i)* is added and paragraph 1. under this subheading is added.
- xvi. New subheading *Paragraph 20(d)(1)(ii)* is added and paragraphs 1. and 2. under this subheading are added.
- xvii. New subheading *Paragraph 20(d)(2)(i)* is added and paragraph 1. under this subheading is added.
- xviii. New subheading *Paragraph 20(d)(2)(iii)(A)* is added and paragraph 1. under this subheading is added.
- xix. New subheading *Paragraph 20(d)(2)(v)* is added and paragraph 1. under this subheading is added.
- xx. New subheading *Paragraph 20(d)(2)(vii)* is added and paragraphs 1. and 2. under this subheading are added.
- xxi. New subheading *Paragraph 20(d)(2)(viii)* is added and paragraph 1. under this subheading is added.

E. Under *Section 1026.36(c)—*  
*Servicing Practices:*

- i. Under subheading *Paragraph 36(c)(1)(iii)*, remove paragraph 1.
- ii. New subheading *Paragraph 36(c)(3)* is added and paragraph 1. under this subheading is added.

- iii. Redesignate existing paragraphs 2., 3., and 4. under subheading *Paragraph 36(c)(1)(iii)* as new paragraphs 2., 3., and 4., respectively, under subheading *Paragraph 36(c)(3)*.

- iv. Redesignate existing paragraphs 1., 2., and 3. under subheading *Paragraph 36(c)(2)* as new paragraphs 1., 2., and 3., respectively, under subheading *Paragraph 36(c)(1)(iii)*.

- v. Redesignate existing paragraph 1 under subheading *Paragraph 36(c)(1)(ii)* as paragraph 1 under subheading *Paragraph 36(c)(2)*.

- vi. Under subheading *Paragraph 36(c)(1)(ii)*, add new paragraph 1.

- vii. Under subheading *Paragraph 36(c)(3)*, revise the first sentence of new paragraph 1 and the first sentence of new paragraph 2.

F. Add new *Section 1026.41—*

*Periodic Statements for Residential Mortgage Loans:*

- i. New section heading *Section 41—Periodic Statements for Residential Mortgage Loans* is added.
- ii. New subheading *41(a) In General* is added and paragraphs 1., 2., 3., and 4. under this subheading are added.
- iii. New subheading *41(b) Timing of the Periodic Statement* is added and paragraph 1. under this subheading is added.

- iv. New subheading *41(c) Form of the Periodic Statement* is added and paragraphs 1., 2., and 3. under this subheading are added.

- v. New subheading *41(d) Content and Format of the Periodic Statement* is added and paragraphs 1., 2., and 3. under this subheading are added.

- vi. New subheading *41(d)(3) Past Payment Breakdown* is added and paragraph 1. under this subheading is added.

- vii. New subheading *41(d)(4) Transaction Activity* is added and paragraphs 1., 2., and 3. under this subheading are added.

- viii. New subheading *41(d)(6) Contact Information* is added and paragraphs 1. and 2. under this subheading are added.

- ix. New subheading *41(d)(7)(iv) Prepayment Penalty* is added and paragraphs 1. and 2. under this subheading are added.

- x. New subheading *41(e) Exemptions* is added and paragraph 1. under this subheading is added.

- xi. New subheading *41(e)(3) Coupon Book Exemption* is added and paragraphs 1., 2., 3., and 4. under this subheading are added.

- xii. New subheading *41(e)(4) Small Servicers* is added and paragraphs 1., 2., 3., and 4. under this subheading are added.

G. Under *Appendices G and H—Open-End and Closed-End Model Forms and Clauses*, revise paragraph 1.

H. Under *Appendix H—Closed-End Model Forms and Clauses*, revise paragraph 7(i).

The revisions and additions read as follows:

**Supplement I to Part 1026—Official Interpretations**

\* \* \* \* \*

**Subpart C—Closed-End Credit**

\* \* \* \* \*

*Section 1026.17—General Disclosures Requirements*

*17(a) Form of Disclosures*

*Paragraph 17(a)(1)*

\* \* \* \* \*

*2. \* \* \**

(ii) The general segregation requirement described in this subparagraph does not apply to the disclosures required under **[§ 1026.19(b) and 1026.20(c)]** although the disclosures must be clear and conspicuous.

\* \* \* \* \*

*17(c) Basis of Disclosures and Use of Estimates*

*Paragraph 17(c)(1)*

1. *Legal obligation.* The disclosures shall reflect the credit terms to which the parties are legally bound as of the outset of the transaction. In the case of disclosures required under § 1026.20(c) ► and (d) ◀, the disclosures shall reflect the credit terms to which the parties are legally bound when the disclosures are provided. The legal obligation is determined by applicable state law or other law. (Certain transactions are specifically addressed in this commentary. See, for example, the discussion of buydown transactions elsewhere in the commentary to § 1026.17(c).) The fact that a term or contract may later be deemed unenforceable by a court on the basis of equity or other grounds does not, by itself, mean that disclosures based on that term or contract did not reflect the legal obligation.

\* \* \* \* \*

*Section 1026.18—Content of Disclosures*

\* \* \* \* \*

*18(f)—Variable Rate*

1. *Coverage.* The requirements of § 1026.18(f) apply to all transactions in which the terms of the legal obligation allow the creditor to increase the rate originally disclosed to the consumer. It includes not only increases in the interest rate but also increases in other components, such as the rate of required credit life insurance. The provisions, however, do not apply to increases resulting from delinquency (including late payment), default, assumption, acceleration or transfer of the collateral. Section 1026.18(f)(1) applies to variable-rate transactions that are not secured by the consumer's principal dwelling and to those that are secured by the principal dwelling but have a term of one year or less.

Section 1026.18(f)(2) applies to variable-rate transactions that are secured by the consumer's principal dwelling and have a term greater than one year. Moreover, transactions subject to § 1026.18(f)(2) are subject to the special early disclosure requirements of § 1026.19(b). (However, "shared-equity" or "shared-appreciation" mortgages are subject to the disclosure requirements of § 1026.18(f)(1) and not to the requirements of §§ 1026.18(f)(2) and 1026.19(b) regardless of the general coverage of those sections.) Creditors are permitted under § 1026.18(f)(1) to substitute in any variable-rate transaction the disclosures required under § 1026.19(b) for those disclosures ordinarily required under § 1026.18(f)(1). Creditors who provide variable-rate disclosures under § 1026.19(b) must comply with all of the requirements of that section, including the timing of disclosures, and must also provide the disclosures required under § 1026.18(f)(2). [Creditors substituting § 1026.19(b) disclosures for § 1026.18(f)(1) disclosures may, but need not, also provide disclosures pursuant to § 1026.20(c)]. (Substitution of disclosures under § 1026.18(f)(1) in transactions subject to § 1026.19(b) is not permitted.)

\* \* \* \* \*

#### Section 1026.19—Certain Mortgage and Variable-Rate Transactions

##### 19(b) Certain Variable-Rate Transactions

\* \* \* \* \*

4. *Other variable-rate regulations.* Transactions in which the creditor is required to comply with and has complied with the disclosure requirements of the variable-rate regulations of other Federal agencies are exempt from the requirements of § 1026.19(b), by virtue of § 1026.19(d), and are exempt from the requirements of § 1026.20(c), by virtue of § 1026.20(d). The exception is also available to creditors that are required by State law to comply with the Federal variable-rate regulations noted above. Creditors using this exception should comply with the timing requirements of those regulations rather than the timing requirements of Regulation Z in making the variable-rate disclosures.

5. \* \* \* i. \* \* \*

A. \* \* \*

B. \* \* \*

C. "Price-level-adjusted mortgages" or other indexed mortgages that have a fixed rate of interest but provide for periodic adjustments to payments and the loan balance to reflect changes in an index measuring prices or inflation. The disclosures under § 1026.19(b)(1) are not applicable to such loans, nor are the following provisions to the extent they relate to the determination of the interest rate by the addition of a margin, changes in the interest rate, or interest rate discounts: § 1026.19(b)(2)(i), (iii), (iv), (v), (vi), (vii), (viii), and (ix). (See comments 20(c)[–2]►(1)(ii)–3.ii, 20(d)(1)(ii)–2.ii, and 30–1 regarding the inapplicability of variable-rate adjustment notices and interest rate limitations to price-level-adjusted or similar mortgages.)

\* \* \* \* \*

#### Paragraph 19(b)(2)(xi)

1. *Adjustment notices.* A creditor must disclose to the consumer the type of information that will be contained in subsequent notices of adjustments and when such notices will be provided. (See the commentary to § 1026.20(c)► and (d)◄ regarding notices of adjustments.) For example, the disclosure► provided pursuant to § 1026.20(d)◄ might state, "You will be notified► at least 210, but not more than 240, days before the first payment at the adjusted level is due after the initial adjustment of the loan. This notice will contain information about the adjustment, including the interest rate, payment amount, and loan balance." The disclosure provided pursuant to § 1026.20(c) might state, "You will be notified◄ at least [25]►60◄, but no more than 120, days before the due date of a payment at a new level. This notice will contain information about the► adjustment, including the◄[index and] interest [rates]► rate◄, payment amount, and loan balance." [In transactions where there may be interest rate adjustments without corresponding payment adjustments in a year, the disclosure might read, "You will be notified once each year during which interest rate adjustments, but no payment adjustments, have been made to your loan. This notice will contain information about the index and interest rates, payment amount, and loan balance."]

\* \* \* \* \*

#### Section 1026.20 [Subsequent] Disclosure Requirements► Regarding Post-Consummation Events◄

##### 20(c) [Variable-]► R◄ate adjustments

1. ► *Creditors, assignees, and servicers.* Creditors, assignees, and servicers are subject to the requirements of § 1026.20(c), unless they no longer own the applicable adjustable-rate mortgage or the mortgage servicing rights. Creditors, assignees, and servicers are also subject to the requirements of any provision of subpart C that applies to § 1026.20(c). For example, the form requirements of § 1026.17(a) apply to § 1026.20(c) disclosures and thus, assignees and servicers, as well as creditors, are subject to those requirements.

2. *Conversions.* In addition to the disclosures required by this section for the interest rate adjustment of an adjustable-rate mortgage, § 1026.20(c) disclosures are also required for an ARM converting to a fixed-rate transaction when the adjustment to the interest rate results in a corresponding payment change. When an open-end account converts to a closed-end adjustable-rate mortgage, § 1026.20(c) disclosures are not required until the implementation of an interest rate adjustment post-conversion that results in a corresponding payment change. For example, for an open-end account that converts to a closed-end 3/1 hybrid ARM, the first § 1026.20(c) disclosure would not be required until three years after conversion, and only if that first adjustment resulted in payment change. ◄[Timing of adjustment notices. This section requires a creditor (or a subsequent holder) to provide certain disclosures in cases where an adjustment to

the interest rate is made in a variable-rate transaction subject to § 1026.19(b). There are two timing rules, depending on whether payment changes accompany interest rate changes. A creditor is required to provide at least one notice each year during which interest rate adjustments have occurred without corresponding payment adjustments. For payment adjustments, a creditor must deliver or place in the mail notices to borrowers at least 25, but not more than 120, calendar days before a payment at a new level is due. The timing rules also apply to the notice required to be given in connection with the adjustment to the rate and payment that follows conversion of a transaction subject to § 1026.19(b) to a fixed-rate transaction. (In cases where an open-end account is converted to a closed-end transaction subject to § 1026.19(b), the requirements of this section do not apply until adjustments are made following conversion.)

2. *Exceptions.* Section 1026.20(c) does not apply to "shared-equity," "shared-appreciation," or "price level adjusted" or similar mortgages.

3. *Basis of disclosures.* The disclosures required under this section shall reflect the terms of the parties' legal obligation, as required under § 1026.17(c)(1).

#### Paragraph 20(c)(1)

1. *Current and prior interest rates.* The requirements under this paragraph are satisfied by disclosing the interest rate used to compute the new adjusted payment amount (current rate) and the adjusted interest rate that was disclosed in the last adjustment notice, as well as all other interest rates applied to the transaction in the period since the last notice (prior rates). (If there has been no prior adjustment notice, the prior rates are the interest rate applicable to the transaction at consummation, as well as all other interest rates applied to the transaction in the period since consummation.) If no payment adjustment has been made in a year, the current rate is the new adjusted interest rate for the transaction, and the prior rates are the adjusted interest rate applicable to the loan at the time of the last adjustment notice, and all other rates applied to the transaction in the period between the current and last adjustment notices. In disclosing all other rates applied to the transaction during the period between notices, a creditor may disclose a range of the highest and lowest rates applied during that period.]

#### ► Paragraph 20(c)(1)(i)

1. *In general.* An adjustable-rate mortgage, as defined under this section, is a variable-rate transaction as that term is used in subpart C, except as distinguished by commentary to § 1026.20(c)(1)(ii)–3. The requirements of this section are not limited to transactions financing the initial acquisition of the consumer's principal dwelling.

#### Paragraph 20(c)(1)(ii)

1. *Construction loans.* In determining the term of a construction loan that may be permanently financed by the same creditor or assignee, the creditor or assignee may treat

the construction and the permanent phases as separate transactions with distinct terms to maturity or as a single combined transaction.

2. *First new payment due within 210 days after consummation.* Section 1026.20(c) disclosures are not required for ARMs if the first payment at the adjusted level is due within 210 days after consummation, when the actual new interest rate (not an estimate) is disclosed at consummation pursuant to § 1026.20(d). This exception is intended to avoid duplicative disclosures, since § 1026.20(d) requires disclosures at consummation if the first payment at the adjusted level is due within 210 days after consummation. For example, the creditor, assignee, or servicer would not be required to provide the disclosures required by § 1026.20(c) for the first time the interest rate adjusts for an ARM if the first payment at the adjusted level was due 120 days after consummation and the actual adjusted interest rate was disclosed at consummation pursuant to § 1026.20(d).

3. *Non-adjustable-rate mortgages.* For purposes of this section, the following transactions, if structured as fixed-rate and not adjustable-rate mortgages, are not subject to § 1026.20(c):

- i. Shared-equity or shared-appreciation mortgages;
- ii. Price-level adjusted or other indexed mortgages that have a fixed rate of interest but provide for periodic adjustments to payments and the loan balance to reflect changes in an index measuring prices or inflation;
- iii. Graduated-payment mortgages or step-rate transactions;
- iv. Renewable balloon-payment instruments; or
- v. Preferred-rate loans. ◀

#### Paragraph 20(c)(2)

1. **Current and prior index values.** This section requires disclosure of the index or formula values used to compute the current and prior interest rates disclosed in § 1026.20(c)(1). The creditor need not disclose the margin used in computing the rates. If the prior interest rate was not based on an index or formula value, the creditor also need not disclose the value of the index that would otherwise have been used to compute the prior interest rate.]

► **Timing.** The requirement that the disclosures must be provided between 60 to 120 days “before a payment at the new level is due” requires the creditor, assignee, or servicer to provide the notice to consumers 60 to 120 days prior to the due date, excluding any grace period, of the first payment calculated using the adjusted interest rate. For example, assume an ARM has a 45-day “look-back” period. In such an ARM, the most recent index figure available as of the date 45 days before a new interest rate goes into effect is used to determine the new interest rate. Because interest generally is paid in arrears, the first payment at the new level would not be due until the end of the billing cycle after the new interest rate goes into effect, typically a period of 28 to 31 days. Assume also that the creditor, assignee, or servicer has a 3-day verification period in which to verify the interest rate and

perform other quality control measures before providing the notice to consumers. In this case, depending on the delivery method, the creditor, assignee, or servicer can provide the notice to consumers as early as 70 to 73 days before payment at the new level is due.

Because creditors, assignees, or servicers cannot comply with the disclosure timing requirements for ARMs adjusting for the first time within 60 days of consummation when the new interest rate is not known at consummation, the disclosures required under § 1026.20(c) for such loans must be provided as soon as practicable, but not less than 25 days before payment at a new level is due.

#### Paragraph 20(c)(2)(ii)(A)

1. **The current and new interest rates.** The current interest rate is the interest rate that applies on the date the disclosure is provided to the consumer. The new interest rate is the actual interest rate that will apply on the date of the adjustment. The new interest rate is used to determine the new payment. The “new interest rate” has the same meaning as the “adjusted interest rate.”

#### Paragraph 20(c)(2)(iv)

1. **Rate limits and unapplied index increases.** The disclosures regarding foregone interest increases apply only to transactions permitting interest rate carryover. The amount of increase foregone at any adjustment is the amount that, subject to rate caps, can be added to future interest rate adjustments to increase, or offset decreases in, the rate determined by using the index or formula.

#### Paragraph 20(c)(2)(v)(B)

1. **Application of a previously foregone interest increase.** The disclosures regarding foregone interest increases apply only to transactions permitting interest rate carryover. Foregone interest is any percentage added or carried over to the new interest rate because a rate cap prevented the increase at an earlier adjustment.

#### Paragraph 20(c)(2)(vi)

1. **Amortization statement.** For interest-only loans, § 1026.20(c)(2)(vi) requires a statement that the new payment covers all of the interest but none of the principal, and therefore will not reduce the loan balance. For negatively-amortizing loans, § 1026.20(c)(2)(vi) requires a statement that the new payment covers only part of the interest and none of the principal, and therefore the unpaid interest will be added to the balance of the loan or will increase the term of the loan.

2. **Amortization payment.** Disclosure of the payment needed to fully amortize the loan at the new interest rate is required only when negative amortization occurs as a result of the adjustment. The disclosure is not required simply because a loan has interest-only or partially-amortizing payments. For example, an ARM with a five-year term and payments based on a longer amortization schedule, in which the final payment will equal the periodic payment plus the remaining unpaid balance, does not require disclosure of the payment necessary to fully amortize the loan in the remainder of the five-year term. A

disclosure is also not required when the new payment is sufficient to prevent negative amortization but the final loan payment will be a different amount due to rounding. ◀

#### Paragraph 20(c)(3)

1. **Unapplied index increases.** The requirement that the consumer receive information about the extent to which the creditor has foregone any increase in the interest rate applies only to those transactions permitting interest rate carryover. The amount of increase that is foregone at an adjustment is the amount that, subject to rate caps, can be applied to future adjustments independently to increase, or offset decreases in, the rate that is determined according to the index or formula.

#### Paragraph 20(c)(4)

1. **Contractual effects of the adjustment.** The contractual effects of an interest rate adjustment must be disclosed including the payment due after the adjustment is made whether or not the payment has been adjusted. A contractual effect of a rate adjustment would include, for example, disclosure of any change in the term or maturity of the loan if the change resulted from the rate adjustment. In transactions in which paying the periodic payments will not fully amortize the outstanding balance at the end of the loan term and where the final payment will equal the periodic payment plus the remaining unpaid balance, the amount of the adjusted payment must be disclosed if such payment has changed as a result of the rate adjustment. A statement of the loan balance also is required. The balance required to be disclosed is the balance on which the new adjusted payment is based. If no payment adjustment is disclosed in the notice, the balance disclosed should be the loan balance on which the payment disclosed under § 1026.20(c)(5) is based, if applicable, or the balance at the time the disclosure is prepared.

#### Paragraph 20(c)(5)

1. **Fully-amortizing payment.** This paragraph requires a disclosure only when negative amortization occurs as a result of the adjustment. A disclosure is not required simply because a loan calls for interest-only or partially amortizing payments. For example, in a transaction with a five-year term and payments based on a longer amortization schedule, and where the final payment will equal the periodic payment plus the remaining unpaid balance, the creditor would not have to disclose the payment necessary to fully amortize the loan in the remainder of the five-year term. A disclosure is required, however, if the payment disclosed under § 1026.20(c)(4) is not sufficient to prevent negative amortization in the loan. The adjustment notice must state the payment required to prevent negative amortization. (This paragraph does not apply if the payment disclosed in § 1026.20(c)(4) is sufficient to prevent negative amortization in the loan but the final payment will be a different amount due to rounding.)

► *Paragraph 20(d)*

1. *Creditors, assignees, and servicers.* Creditors, assignees, and servicers are subject to the requirements of § 1026.20(d), unless they no longer own the applicable adjustable-rate mortgage or the mortgage servicing rights. Creditors, assignees, and servicers are also subject to the requirements of any provision of subpart C that applies to § 1026.20(d). For example, the requirements of § 1026.17(a) with regard to providing disclosures to consumers electronically, apply to § 1026.20(d) disclosures and thus, assignees and servicers, as well as creditors, are subject to those requirements.

2. *Timing and form of initial rate adjustment.* The requirement that the disclosures be provided in writing, separate and distinct from all other correspondence, means that the initial ARM interest rate adjustment notice must be mailed or delivered separately from any other material. For example, in the case of mailing the disclosure, there should be no material in the envelope other than the § 1026.20(d) initial ARM interest rate adjustment notice. In the case of emailing the disclosure, the only attachment should be the initial ARM interest rate adjustment notice. The requirement that the disclosures be provided between 210 to 240 days “before the first payment at the adjusted level is due” means the creditor, assignee, or servicer must provide the notice to consumers 210 to 240 days prior to the due date, excluding any grace period, of the first payment calculated using the adjusted interest rate. Creditors, assignees, or servicers may provide the initial ARM interest rate adjustment notices to consumers in electronic form if they comply with the electronic delivery requirements in § 1026.17(a)(1).

3. *Conversions.* When an open-end account converts to a closed-end adjustable-rate mortgage, § 1026.20(d) disclosures are not required until the implementation of the initial interest rate adjustment post-conversion. For example, for an open-end account that converts to a closed-end 3/1 hybrid ARM, § 1026.20(d) disclosures would not be required until three years after conversion, when the interest rate adjusts for the first time.

*Paragraph 20(d)(1)(i)*

1. *In general.* An adjustable-rate mortgage, as defined under this section, is a variable-rate transaction as that term is used in subpart C, except as distinguished by commentary to § 1026.20(d)(1)(ii)–2. The requirements of this section are not limited to transactions financing the initial acquisition of the consumer's principal dwelling.

*Paragraph 20(d)(1)(ii)*

1. *Construction loans.* In determining the term of a construction loan that may be permanently financed by the same creditor or assignee, the creditor or assignee may treat the construction and the permanent phases as separate transactions with distinct terms to maturity or as a single combined transaction.

2. *Non-adjustable-rate mortgages.* For purposes of this section, the following transactions, if structured as fixed-rate and

not adjustable-rate mortgages, are not subject to § 1026.20(d):

- i. Shared-equity or shared-appreciation mortgages;
- ii. Price-level adjusted or other indexed mortgages that have a fixed rate of interest but provide for periodic adjustments to payments and the loan balance to reflect changes in an index measuring prices or inflation;
- iii. Graduated-payment mortgages or step-rate transactions;
- iv. Renewable balloon-payment instruments; or
- v. Preferred-rate loans.

*Paragraph 20(d)(2)(i)*

1. *Date of the disclosure.* The date that appears on the disclosure is the date the creditor, assignee, or servicer generates the notice to be provided to the consumer.

*Paragraph 20(d)(2)(iii)(A)*

1. *The current and new interest rates.* The current interest rate is the interest rate that applies on the date of the disclosure, pursuant to § 1026.20(d)(2). The new interest rate is the interest rate used to calculate the new payment and may be an estimate pursuant to § 1026.20(d)(2). The “new interest rate” has the same meaning as the “adjusted interest rate.”

*Paragraph 20(d)(2)(v)*

1. *Rate limits and unapplied index increases.* The disclosures regarding foregone interest increases apply only to transactions permitting interest rate carryover. The amount of increase foregone at the first interest rate adjustment is the amount that, subject to rate caps, can be added to future interest rate adjustments to increase, or offset decreases in, the rate determined by using the index or formula.

*Paragraph 20(d)(2)(vii)*

1. *Amortization statement.* For interest-only loans, § 1026.20(d)(2)(vii) requires a statement that the new payment covers all of the interest but none of the principal, and therefore will not reduce the loan balance. For negatively-amortizing loans, § 1026.20(d)(2)(vii) requires a statement that the new payment covers only part of the interest and none of the principal, and therefore the unpaid interest will add to the balance of the loan or will increase the term of the loan.

2. *Amortization payment.* Disclosure of the payment needed to fully amortize the loan at the new interest rate is required only when negative amortization occurs as a result of the adjustment. The disclosure is not required simply because a loan has interest-only or partially-amortizing payments. For example, an ARM with a five-year term and payments based on a longer amortization schedule, in which the final payment will equal the periodic payment plus the remaining unpaid balance, does not require disclosure of the payment necessary to fully amortize the loan in the remainder of the five-year term. A disclosure is also not required when the new payment is sufficient to prevent negative amortization but the final loan payment will be a different amount due to rounding.

*Paragraph 20(d)(2)(viii)*

1. *List of alternatives.* The list of alternatives provided to consumers should avoid technical terms and explain the alternatives using the terms and explanations in Form H-4(D)(3) and (4) in Appendix H to this part. For the alternative “payment forbearance,” the disclosure should explain that payment forbearance temporarily gives the consumer more time to pay. ◀

\* \* \* \* \*

**Subpart E—Special Rules for Certain Home Mortgage Transactions**

\* \* \* \* \*

*Section 1026.36—Prohibited Acts or Practices in Connection With Credit Secured by a Dwelling*► *Paragraph 36(c)(1)(ii)*

1. *Handling of Partial Payments.* If a servicer receives a partial payment from a consumer, to the extent not prohibited by applicable law and the legal obligation between the parties, the servicer may take any of the following actions:

(i) Credit the partial payment upon receipt; or

(ii) Return the partial payment to the consumer; or

(iii) Hold the payment in a suspense or unapplied funds account. If the payment is held in a suspense or unapplied funds account, this must be reflected on the periodic statement, in accordance with § 1026.41. When sufficient funds accumulate to cover a full contractual payment, they must be applied to the oldest outstanding payment.

*Paragraph 36(c)(1)(iii)*

1. *Payment requirements.* The servicer may specify reasonable requirements for making payments in writing, such as requiring that payments be accompanied by the account number or payment coupon; setting a cut-off hour for payment to be received, or setting different hours for payment by mail and payments made in person; specifying that only checks or money orders should be sent by mail; specifying that payment is to be made in U.S. dollars; or specifying one particular address for receiving payments, such as a post office box. The servicer may be prohibited, however, from requiring payment solely by preauthorized electronic fund transfer. (See Section 913 of the Electronic Fund Transfer Act, 15 U.S.C. 1693k.)

2. *Payment requirements—limitations.* Requirements for making payments must be reasonable; it should not be difficult for most consumers to make conforming payments. For example, it would be reasonable to require a cut-off time of 5 p.m. for receipt of a mailed check at the location specified by the servicer for receipt of such check.

3. *Implied guidelines for payments.* In the absence of specified requirements for making payments, payments may be made at any location where the servicer conducts business; any time during the servicer's normal business hours; and by cash, money order, draft, or other similar instrument in

properly negotiable form, or by electronic fund transfer if the servicer and consumer have so agreed. ◀

**[Paragraph 36(c)(1)(ii)]**

**▶ Paragraph 36(c)(2) ◀**

1. *Pyramiding of late fees.* The prohibition on pyramiding of late fees in this subsection should be construed consistently with the “credit practices rule” of the Federal Trade Commission, 16 CFR 444.4.

**[Paragraph 36(c)(1)(iii)]**

**▶ Paragraph 36(c)(3) ◀**

**[1. Reasonable time.** The payoff statement must be provided to the consumer, or person acting on behalf of the consumer, within a reasonable time after the request. For example, it would be reasonable under most circumstances to provide the statement within five business days of receipt of a consumer’s request. This time frame might be longer, for example, when the servicer is experiencing an unusually high volume of refinancing requests.]

▶ 1. *As Applicable.* A creditor who no longer owns the mortgage loan or the mortgage servicing rights is not “applicable” and therefore is not subject to the requirements of this section to provide a periodic statement. ◀

2. *Person acting on behalf of the consumer.* For purposes of § 1026.36(c) **[1(iii)]** ▶ (3) ◀, a person acting on behalf of the consumer may include the consumer’s representative, such as an attorney representing the individual, a non-profit consumer counseling or similar organization, or a creditor with which the consumer is refinancing and which requires the payoff statement to complete the refinancing. A servicer may take reasonable measures to verify the identity of any person acting on behalf of the consumer and to obtain the consumer’s authorization to release information to any such person before the “reasonable time” period begins to run.

3. *Payment requirements.* The servicer may specify reasonable requirements for making payoff requests, such as requiring requests to be **[in writing and]** directed to a mailing address, email address, or fax number specified by the servicer **[or orally to a telephone number specified by the servicer.]** or any other reasonable requirement or method. If the consumer does not follow these requirements, a longer time frame for responding to the request would be reasonable.

4. *Accuracy of payoff statements.* Payoff statements must be accurate when issued.

**[Paragraph 36(c)(2)]**

1. *Payment requirements.* The servicer may specify reasonable requirements for making payments in writing, such as requiring that payments be accompanied by the account number or payment coupon; setting a cut-off hour for payment to be received, or setting different hours for payment by mail and payments made in person; specifying that only checks or money orders should be sent by mail; specifying that payment is to be made in U.S. dollars; or specifying one particular address for receiving payments,

such as a post office box. The servicer may be prohibited, however, from requiring payment solely by preauthorized electronic fund transfer. (See Section 913 of the Electronic Fund Transfer Act, 15 U.S.C. 1693k.)

2. *Payment requirements—limitations.* Requirements for making payments must be reasonable; it should not be difficult for most consumers to make conforming payments. For example, it would be reasonable to require a cut-off time of 5 p.m. for receipt of a mailed check at the location specified by the servicer for receipt of such check.

3. *Implied guidelines for payments.* In the absence of specified requirements for making payments, payments may be made at any location where the servicer conducts business; any time during the servicer’s normal business hours; and by cash, money order, draft, or other similar instrument in properly negotiable form, or by electronic fund transfer if the servicer and consumer have so agreed.]

\* \* \* \* \*

**▶ Section 41—Periodic Statements for Residential Mortgage Loans**

**41(a) In General**

1. *Recipient of Periodic Statement.* When two consumers are joint obligors with primary liability on a mortgage loan, the disclosures may be given to either one of them. For example, if a husband and wife jointly own a home, the servicer need not send statements to both the husband and the wife; a single statement may be sent.

2. *Billing Cycles Shorter than a 31-Day Period.* If a loan has a billing cycle shorter than a period of 31 days (for example, a bi-weekly billing cycle), a periodic statement covering an entire month may be used. Such statement should separately list the upcoming payment due dates and amounts due, as required by paragraph (d)(1), and list all transaction activity that occurred during the related time period, as required by paragraph (d)(4). Such statement may aggregate the information for the Explanation of Amount Due, as required by paragraph (d)(2), and Past Payment Breakdown, as required by paragraph (d)(3).

3. *One Statement per Billing Cycle.* The periodic statement requirement applies to the “creditor, assignee, or servicer as applicable.” The creditor, assignee, or servicer are all subject to this requirement, however only one statement must be sent to the consumer each billing cycle. When two or more parties are subject to this requirement, they may decide among themselves who will send the statement.

4. *As Applicable.* A creditor who no longer owns the mortgage loan or the mortgage servicing rights is not “applicable” and therefore is not subject to the requirements of this section to provide a periodic statement.

**41(b) Timing of the Periodic Statement**

1. *Reasonably Prompt Time.* Delivering or placing the periodic statement in the mail within 4 days of close the grace period of the previous billing cycle would be considered reasonably prompt.

**41(c) Form of the Periodic Statement**

1. *Clear and Conspicuous Standard.* The “clear and conspicuous” standard generally requires that disclosures be in a reasonably understandable form. Except where otherwise provided, the standard does not prohibit adding to the required disclosures, as long as the additional information does not overwhelm or obscure the required disclosures. For example, while certain information about the escrow account (such as the account balance) is not required on the periodic statement, this information may be included.

2. *Additional information; disclosures required by other laws.* Nothing in this subpart prohibits a servicer from including additional information or combining disclosures required by other laws with the disclosures required by this subpart, unless such prohibition is expressly set forth in this subpart, such as the grouping requirements of paragraph 41(d) or other applicable law.

3. *Electronic Distribution.* The periodic statement may be provided electronically if the consumer agrees. The consumer must give affirmative consent to receive statements electronically. Due to concerns about information security, if statements are provided electronically, the creditor, assignee or servicer may send the consumer a notification that their statement is available, with a link to where the statement can be accessed.

**41(d) Content and Format of the Periodic Statement**

1. *Close Proximity.* Paragraph (d) requires several disclosures to be provided in close proximity. To meet this requirement, the items to be provided in close proximity must be grouped together, and set off from the other groupings of items. This could be accomplished in a variety of ways, for example, by presenting the information in boxes, or by arranging the items on the document and including spacing between the groupings. Items in close proximity may not have any intervening text between them.

2. *Not Applicable.* If an item required by paragraph (d) or (e) of this section is not applicable to the loan, it may be omitted from the periodic statement or coupon book. For example, if there is no prepayment penalty associated with a loan, the prepayment penalty disclosures need not be provided on the periodic statement.

3. *Terminology.* A servicer may use terminology other than that found on the sample periodic statement, so long as the new terminology is commonly understood. For example, servicers may take into consideration regional differences in terminology and refer to the account for the collection of taxes and insurance, commonly referred to as the “escrow account,” as an “impound account.”

**41(d)(3) Past Payment Breakdown**

1. *Partial Payments.* The disclosure of any portion of payments since the last statement that was applied to a partial payment or suspense account as required by (d)(3)(i) should reflect any funds that were received in the time period covered by the transaction activity of that statement and that were sent

to a suspense or unapplied funds account. The disclosure of any portion of payments since the beginning of the calendar year that was sent to a partial payment or suspense account as required by (d)(3)(ii) should reflect all funds that are currently held in a suspense or unapplied funds account. For example:

(i) Suppose a payment of \$1000 is due, but the consumer only sends in \$600 on January 1, which is held in a suspense account. Further assume there are no fees charged on this account. Assuming there are no other funds in suspense account, the January statement should reflect: Unapplied funds since last statement—\$600. Unapplied funds YTD—\$600.

(ii) Assuming the same facts as Example (i) above, except that during February the consumer sends in \$300 and this too is held in the suspense account. The statement should reflect: Unapplied funds since last statement—\$300. Unapplied funds YTD—\$900.

(iii) Assuming the same facts as Example (ii) above, except that during March the consumer sends in \$400. Of this payment, \$100 completes a full contractual payment when added to the \$900 in funds already held in the suspense account. This \$1000 should be applied to the January payment, and the remaining \$300 would be held in the suspense account. The statement should reflect: Unapplied funds since last statement—\$300. Unapplied Funds YTD—\$300.

#### 41(d)(4) Transaction Activity

1. *Meaning.* Transaction activity includes any activity that credits or debits the outstanding account balance. Examples of transactions include, without limitation:

- (i) Payments received and applied;
- (ii) Payments received and held in a suspense account;
- (iii) The imposition of any fees (for example late fees); and
- (iv) The imposition of any charges (for example, private mortgage insurance).

2. *Description of Late Fees.* The description of any late fee charges includes the date of the late fee, the amount of the late fee, and the fact that a late fee was imposed.

3. *Partial Payments.* If a partial payment is sent to a suspense or unapplied funds account, this fact must be in the transaction description along with the date and amount of the payment, an explanation of what must be done for the payments to be applied must be provided on the front of the statement, and the funds must be included as unapplied funds in the information required by (d)(3) Past Payment Breakdown.

#### 41(d)(6) Contact Information

1. A toll-free telephone number is required. Additional contact information, such as a web address, may also be provided at the servicer's option.

2. If servicer has provided a telephone number for error resolution and inquiries pursuant to 12 CFR 1024.35 and § 1024.36, that number should be provided in the contact information section.

#### 41(d)(7)(iv) Prepayment Penalty

1. *Examples of prepayment penalties.* For purposes of § 1026.41(d)(7)(iv), the following are examples of prepayment penalties:

i. A charge determined by treating the loan balance as outstanding for a period of time after prepayment in full and applying the interest rate to such "balance," even if the charge results from interest accrual amortization used for other payments in the transaction under the terms of the loan contract. "Interest accrual amortization" refers to the method by which the amount of interest due for each period (e.g., month) in a transaction's term is determined. For example, "monthly interest accrual amortization" treats each payment as made on the scheduled, monthly due date even if it is actually paid early or late (until the expiration of any grace period). Thus, under the terms of a loan contract providing for monthly interest accrual amortization, if the amount of interest due on May 1 for the preceding month of April is \$3,000, the loan contract will require payment of \$3,000 in interest for the month of April whether the payment is made on April 20, on May 1, or on May 10. In this example, if the consumer prepays the loan in full on April 20 and if the accrued interest as of that date is \$2,000, then assessment of a charge of \$3,000 constitutes a prepayment penalty of \$1,000 because the amount of interest actually earned through April 20 is only \$2,000.

ii. A fee, such as an origination or other loan closing cost, that is waived by the creditor on the condition that the consumer does not prepay the loan.

iii. A minimum finance charge in a simple interest transaction.

iv. Computing a refund of unearned interest by a method that is less favorable to the consumer than the actuarial method, as defined by section 933(d) of the Housing and Community Development Act of 1992, 15 U.S.C. 1615(d). For purposes of computing a refund of unearned interest, if using the actuarial method defined by applicable State law results in a refund that is greater than the refund calculated by using the method described in section 933(d) of the Housing and Community Development Act of 1992, creditors should use the State law definition in determining if a refund is a prepayment penalty.

2. *Fees that are not prepayment penalties.* For purposes of § 1026.41(d)(7)(iv), fees which are not prepayment penalties include, for example:

i. Fees imposed for preparing and providing documents when a loan is paid in full, if such fees are imposed whether or not the loan is prepaid. Examples include a loan payoff statement, a reconveyance document, or another document releasing the creditor's security interest in the dwelling that secures the loan.

ii. Loan guarantee fees.

#### 41(e) Exemptions

1. *Information made available.* Information made available by the servicer may be obtained through the inquiry process in § 1024.36.

#### 41(e)(3) Coupon Book Exemption

1. *Fixed Rate.* "Fixed rate" is to be construed consistently with § 1026.18(s)(7)(iii).

2. *Coupon Book.* A coupon book is a booklet provided to the consumer with a page for each billing cycle during a set period of time (often covering one year). These pages are designed to be torn off and returned to the servicer with a payment for each billing cycle. Additional information about the loan is often included on or inside the front or back cover, or on filler pages in the coupon book.

3. *Information location.* The information required by paragraph (e)(3)(ii) need not be provided on each coupon, but should be provided somewhere in the coupon book. Such information could be located e.g., on or inside the front or back cover, or on filler pages in the coupon book.

#### 4. Outstanding Principal Balance.

Paragraph (e)(3)(ii)(A) requires the information listed in paragraph (d)(7) to be included in the coupon book. Paragraph (d)(7)(i) requires the disclosure of amount of the outstanding principal balance. For the purposes of the coupon book, the servicer need only disclose the principal balance at the beginning of the time period covered by the coupon book.

#### 41(e)(4) Small Servicers

1. *Loans obtained by merger or acquisition.* Any mortgage loans obtained by a servicer or an affiliate as part of a merger or acquisition, or as part of the acquisition of all of the assets or liabilities of a branch office of a lender should be considered mortgage loans for which the servicer or an affiliate are the lender to whom the mortgage loan is initially payable. A branch office means either an office of a depository institution that is approved as a branch by a Federal or state supervisory agency or an office of a for-profit mortgage lending institution (other than a depository institution) that takes applications from the public for mortgage loans.

2. *Threshold.* In determining whether a small servicer services 1,000 mortgage loans or less, a servicer is evaluated based on its size as of January 1 for the remainder of the calendar year. A servicer that, together with its affiliates, crosses the threshold will have six months or until the beginning of the next calendar year, whichever is later, to begin compliance other than as a small servicer. Examples:

i. A servicer that crosses the loan threshold on October 1 would no longer be considered a small servicer on April 1 of the following year.

ii. A servicer that crosses the loan threshold on February 1 would no longer be considered a small servicer on January 1 of the following year.

3. *Small servicers that do not qualify for the exemption.* A servicer that services any mortgage loans that are not owned by the servicer or an affiliate or for which the servicer or an affiliate were not the entity to whom the obligation was initially payable is not a small servicer. For example, if a servicer acquires mortgage servicing rights to service mortgage loans the servicer or an affiliate does not own and did not originate is not a small servicer.

4. *Master servicing responsibilities.* The periodic statement requirements apply to master servicers. A subservicer that meets the small servicer definition cannot claim the benefit of any small servicer exemption for mortgage loans that are master serviced by an entity that does not qualify for the small servicer exemption.◀

\* \* \* \* \*

Appendices G and H—Open-End and Closed-End Model Forms and Clauses

1. *Permissible changes.* Although use of the model forms and clauses is not required, creditors using them properly will be deemed to be in compliance with the regulation with regard to those disclosures.▶For purposes of the model forms and samples in H-4(D), the term creditors refers to creditors, assignees, and servicers.◀Creditors may make certain changes in the format or content of the forms and clauses and may delete any disclosures that are inapplicable to a transaction or a plan without losing the Act’s protection from liability, except formatting changes may not be made to model forms and samples in ▶H-4(D),◀H-18, H-19, H-20, H-21, H-22, H-23, G-2(A), G-3(A), G-4(A),

G-10(A)–(E), G-17(A)–(D), G-18(A) (except as permitted pursuant to § 1026.7(b)(2), G-18(B)–(C), G-19, G-20, and G-21, or to the model clauses in H-4(E), H-4(F), H-4(G), and H-4(H). Creditors may modify the heading of the second column shown in Model Clause H-4(H) to read “first adjustment” or “first increase,” as applicable, pursuant to § 1026.18(s)(2)(i)(C). The rearrangement of the model forms and clauses may not be so extensive as to affect the substance, clarity, or meaningful sequence of the forms and clauses. Creditors making revisions with that effect will lose their protection from civil liability. Except as otherwise specifically required, acceptable changes include, for example:

i. Using the first person, instead of the second person, in referring to the borrower.

ii. Using “borrower” and “creditor” instead of pronouns.

iii. Rearranging the sequences of the disclosures.

iv. Not using bold type for headings.

v. Incorporating certain State “plain English” requirements.

vi. Deleting inapplicable disclosures by whiting out, blocking out, filling in “N/A” (not applicable) or “0,” crossing out, leaving

blanks, checking a box for applicable items, or circling applicable items. (This should permit use of multipurpose standard forms.)

vii. Using a vertical, rather than a horizontal, format for the boxes in the closed-end disclosures.

\* \* \* \* \*

Appendix H—Closed Model Forms and [Clause]

\* \* \* \* \*

7. \* \* \*

i. Model H-4(D) illustrates the adjustment [notice]▶notices◀ required under § 1026.20(c)▶and (d)◀, and provides examples of ▶§ 1026.20(c)◀payment change notices and ▶§ 1026.20(d) initial◀[annual] notices of interest rate [changes] ▶adjustments◀.

\* \* \* \* \*

Dated: August 9, 2012.

**Richard Cordray,**  
*Director, Bureau of Consumer Financial Protection.*

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