BILLING CODE: 4810-AM-P

BUREAU OF CONSUMER FINANCIAL PROTECTION

12 CFR Part 1026

[Docket No. CFPB-2012-0033]

RIN 3170-AA14

Mortgage Servicing Rules under the Truth in Lending Act (Regulation Z)

AGENCY: Bureau of Consumer Financial Protection.

ACTION: Final rule; official interpretations.

SUMMARY: The Bureau of Consumer Financial Protection is amending Regulation Z, which implements the Truth in Lending Act and the official interpretation to the regulation, which interprets the requirements of Regulation Z. This final rule implements provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act regarding mortgage loan servicing. Specifically, this final rule implements Dodd-Frank Act sections addressing initial rate adjustment notices for adjustable-rate mortgages, periodic statements for residential mortgage loans, prompt crediting of mortgage payments, and responses to requests for payoff amounts. This final rule also amends current rules governing the scope, timing, content, and format of disclosures to consumers regarding the interest rate adjustments of their variable-rate transactions. Concurrently with the issuance of this final rule, the Bureau is amending Regulation X, which contains companion rules implementing amendments to the Real Estate Settlement Procedures Act of 1974.

DATES: This final rule is effective on January 10, 2014.

FOR FURTHER INFORMATION CONTACT:

Regulation Z (TILA): Whitney Patross, Attorney; Marta Tanenhaus or Mitchell E. Hochberg, Senior Counsels, Office of Regulations, at (202) 435-7700.

Regulation X (RESPA): Whitney Patross, Attorney; Jane Gao, Terry Randall or Michael Scherzer, Counsels; Lisa Cole or Mitchell E. Hochberg, Senior Counsels, Office of Regulations, at (202) 435-7700.

SUPPLEMENTARY INFORMATION:

I. Summary of the Final Rule

The Bureau of Consumer Financial Protection (Bureau) is amending Regulation Z, which implements the Truth in Lending Act (TILA) and the official interpretation to the regulation (the 2013 TILA Servicing Final Rule). The final rule implements provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act regarding mortgage loan servicing.[1] Specifically, this final rule implements Dodd-Frank Act sections addressing initial interest rate adjustment notices for adjustable-rate mortgages (ARMs), periodic statements for residential mortgage loans, prompt crediting of mortgage payments, and responses to requests for payoff amounts. This final rule also amends current rules governing the scope, timing, content, and format of disclosures to consumers occasioned by the interest rate adjustments of their variable-rate transactions. Concurrently with the issuance of this final rule, the Bureau is amending Regulation X, which contains companion rules implementing amendments to the Real Estate Settlement Procedures Act of 1974 (the 2013 RESPA Servicing Final Rule).

On August 10, 2012, the Bureau issued proposed rules that would have amended Regulation X, which implements RESPA,[2] as well as Regulation Z, which implements TILA,[3]

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[1] Public Law 111-203, 124 Stat. 1376 (2010).

[2] *See* Press Release, U.S. Consumer Fin. Prot. Bureau, *Consumer Financial Protection Bureau Proposes Rules to Protect Mortgage Borrowers* (Aug. 10, 2012) available at http://www.consumerfinance.gov/pressreleases/consumer-

regarding mortgage servicing requirements.[4] The Proposed Servicing Rules proposed to implement the Dodd-Frank Act amendments to TILA and RESPA with respect to, among other things, periodic mortgage statements, disclosures for ARMs, prompt crediting of mortgage loan payments, requests for mortgage loan payoff statements, error resolution, information requests, and protections relating to force-placed insurance. In the 2012 RESPA Servicing Proposal, the Bureau also proposed to use its authority to adopt requirements relating to servicer policies and procedures, early intervention with delinquent borrowers, continuity of contact, and procedures for evaluating and responding to loss mitigation applications.[5] The proposals sought to address fundamental problems that underlie many consumer complaints and recent regulatory and enforcement actions, as set forth in more detail below.

The Bureau is finalizing the Proposed Servicing Rules with respect to nine major topics, as summarized below, as well as certain technical and streamlining amendments. The goals of the Final Servicing Rules are to provide better disclosure to consumers of their mortgage loan obligations and to better inform consumers of, and assist consumers with, options that may be available for consumers having difficulty with their mortgage loan obligations. The amendments also address critical servicer practices relating to, among other things, correcting errors,

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financial-protection-bureau-proposes-rules-to-protect-mortgage-borrowers/. The proposal was published in the *Federal Register* on September 17, 2012. 77 FR 57200 (Sept. 17 2012) (2012 RESPA Servicing Proposal).

[3] *See* Press Release, U.S. Consumer Fin. Prot. Bureau, *Consumer Financial Protection Bureau Proposes Rules to Protect Mortgage Borrowers* (August 10, 2012) available at http://www.consumerfinance.gov/pressreleases/consumer-financial-protection-bureau-proposes-rules-to-protect-mortgage-borrowers/. This proposal was also published in the *Federal Register* on September 17, 2012. 77 FR 57318 (Sept. 17, 2012) (2012 TILA Servicing Proposal; and, together with the 2012 RESPA Servicing Proposal, the Proposed Servicing Rules).

[4] The 2013 RESPA Servicing Final Rule and the 2013 TILA Servicing Final Rule are referred to collectively as the Final Servicing Rules.

[5] For ease of discussion, this notice uses the term "discretionary rulemakings" to refer to a set of regulations implemented using the Bureau's authorities under section 6(j), 6(k)(1)(E), or 19(a) of RESPA to expand requirements beyond those explicit in RESPA. The "discretionary rulemakings" include requirements relating to servicer policies and procedures, early intervention with delinquent borrowers, continuity of contact, and procedures for evaluating and responding to loss mitigation applications, as set forth in §§ 1024.38-41.

imposing charges for force-placed insurance, crediting mortgage loan payments, and providing payoff statements. The Bureau's final rules are set forth in two separate notices because some provisions implement requirements that Congress imposed under TILA while other provisions implement requirements Congress imposed under RESPA.[6]

A. Major Topics in the Final Servicing Rules

1. Periodic billing statements (2013 TILA Servicing Final Rule). Creditors, assignees, and servicers must provide a periodic statement for each billing cycle containing, among other things, information on payments currently due and previously made, fees imposed, transaction activity, application of past payments, contact information for the servicer and housing counselors, and, where applicable, information regarding delinquencies. These statements must meet the timing, form, and content requirements provided in the rule. The rule contains sample forms that may be used. The periodic statement requirement generally does not apply to 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 specified in the rule is made available to the consumer. The rule also includes an exemption for small servicers as discussed below.

2. Interest rate adjustment notices (2013 TILA Servicing Final Rule). Creditors, assignees, and servicers must provide a consumer whose mortgage has an adjustable rate with a notice between 210 and 240 days prior to the first payment due after the rate first adjusts. This notice may contain an estimate of the new rate and new payment. Creditors, assignees, and servicers also must provide a notice between 60 and 120 days before payment at a new level is due when a rate adjustment causes the payment to change. The current annual notice that must

[6] Note that TILA and RESPA differ in their terminology. Whereas Regulation Z generally refers to "consumers" and "creditors," Regulation X generally refers to "borrowers" and "lenders."

be provided for ARMs for which the interest rate, but not the payment, has changed over the course of the year is no longer required. The rule contains model and sample forms that servicers may use.

3. *Prompt payment crediting and payoff statements (2013 TILA Servicing Final Rule).* Servicers must promptly credit periodic payments from borrowers as of the day of receipt. A periodic payment consists of principal, interest, and escrow (if applicable). If a servicer receives a payment that is less than the amount due for a periodic payment, the payment may be held in a suspense account. When the amount in the suspense account covers a periodic payment, the servicer must apply the funds to the consumer's account. In addition, creditors, assignees, and servicers must provide an accurate payoff balance to a consumer no later than seven business days after receipt of a written request from the consumer for such information.

4. Force-placed insurance (2013 RESPA Servicing Final Rule). Servicers are prohibited from charging a borrower for force-placed insurance coverage unless the servicer has a reasonable basis to believe the borrower has failed to maintain hazard insurance, as required by the loan agreement, and has provided required notices. An initial notice must be sent to the borrower at least 45 days before charging the borrower for force-placed insurance coverage, and a second reminder notice must be sent no earlier than 30 days after the first notice. The rule contains model forms that servicers may use. If a borrower provides proof of hazard insurance coverage, the servicer must cancel any force-placed insurance policy and refund any premiums paid for overlapping periods in which the borrower's coverage was in place. The rule also provides that charges related to force-placed insurance (other than those subject to State regulation as the business of insurance or authorized by Federal law for flood insurance) must be for a service that was actually performed and must bear a reasonable relationship to the

servicer's cost of providing the service. Where the borrower has an escrow account for the payment of hazard insurance premiums, the servicer is prohibited from obtaining force-place insurance where the servicer can continue the borrower's homeowner insurance, even if the servicer needs to advance funds to the borrower's escrow account to do so. The rule against obtaining force-placed insurance in cases in which hazard insurance may be maintained through an escrow account exempts small servicers, as discussed below, so long as any force-placed insurance purchased by the small servicer is less expensive to a borrower than the amount of any disbursement the servicer would have made to maintain hazard insurance coverage.

5. Error resolution and information requests (2013 RESPA Servicing Final Rule). Servicers are required to meet certain procedural requirements for responding to written information requests or complaints of errors. The rule requires servicers to comply with the error resolution procedures for certain listed errors as well as any error relating to the servicing of a mortgage loan. Servicers may designate a specific address for borrowers to use. Servicers generally are required to acknowledge the request or notice of error within five days. Servicers also generally are required to correct the error asserted by the borrower and provide the borrower written notification of the correction, or to conduct an investigation and provide the borrower written notification that no error occurred, within 30 to 45 days. Further, within a similar amount of time, servicers generally are required to acknowledge borrower written requests for information and either provide the information or explain why the information is not available.

6. General servicing policies, procedures, and requirements (2013 RESPA Servicing Final Rule). Servicers are required to establish policies and procedures reasonably designed to achieve objectives specified in the rule. The reasonableness of a servicer's policies and procedures takes into account the size, scope, and nature of the servicer's operations. Examples

of the specified objectives include accessing and providing accurate and timely information to borrowers, investors, and courts; properly evaluating loss mitigation applications in accordance with the eligibility rules established by investors; facilitating oversight of, and compliance by, service providers; facilitating transfer of information during servicing transfers; and informing borrowers of the availability of written error resolution and information request procedures. In addition, servicers are required to retain records relating to each mortgage loan until one year after the mortgage loan is discharged or servicing is transferred, and to maintain certain documents and information for each mortgage loan in a manner that enables the servicers to compile it into a servicing file within five days. This section includes an exemption for small servicers as discussed below. The Bureau and prudential regulators will be able to supervise servicers within their jurisdiction to assure compliance with these requirements but there will not be a private right of action to enforce these provisions.

7. Early intervention with delinquent borrowers (2013 RESPA Servicing Final Rule). Servicers must establish or make good faith efforts to establish live contact with borrowers by the 36th day of their delinquency and promptly inform such borrowers, where appropriate, that loss mitigation options may be available. In addition, a servicer must provide a borrower a written notice with information about loss mitigation options by the 45th day of a borrower's delinquency. The rule contains model language servicers may use for the written notice. This section includes an exemption for small servicers as discussed below.

8. Continuity of contact with delinquent borrowers (2013 RESPA Servicing Final Rule). Servicers are required to maintain reasonable policies and procedures with respect to providing delinquent borrowers with access to personnel to assist them with loss mitigation options where applicable. The policies and procedures must be reasonably designed to ensure that a servicer

assigns personnel to a delinquent borrower by the time a servicer provides such borrower with the written notice required by the early intervention requirements, but in any event, by the 45th day of a borrower's delinquency. These personnel should be accessible to the borrower by phone to assist the borrower in pursuing loss mitigation options, including advising the borrower on the status of any loss mitigation application and applicable timelines. The personnel should be able to access all of the information provided by the borrower to the servicer and provide that information, when appropriate, to those responsible for evaluating the borrower for loss mitigation options. This section includes an exemption for small servicers as discussed below. The Bureau and the prudential regulators will be able to supervise servicers within their jurisdiction to assure compliance with these requirements but there will not be a private right of action to enforce these provisions.

9. Loss Mitigation Procedures (2013 RESPA Servicing Final Rule). Servicers are required to follow specified loss mitigation procedures for a mortgage loan secured by a borrower's principal residence. If a borrower submits an application for a loss mitigation option, the servicer is generally required to acknowledge the receipt of the application in writing within five days and inform the borrower whether the application is complete and, if not, what information is needed to complete the application. The servicer is required to exercise reasonable diligence in obtaining documents and information to complete the application.

For a complete loss mitigation application received more than 37 days before a foreclosure sale, the servicer is required to evaluate the borrower, within 30 days, for all loss mitigation options for which the borrower may be eligible in accordance with the investor's eligibility rules, including both options that enable the borrower to retain the home (such as a loan modification) and non-retention options (such as a short sale). Servicers are free to follow

"waterfalls" established by an investor to determine eligibility for particular loss mitigation options. The servicer must provide the borrower with a written decision, including an explanation of the reasons for denying the borrower for any loan modification option offered by an owner or assignee of a mortgage loan with any inputs used to make a net present value calculation to the extent such inputs were the basis for the denial. A borrower may appeal a denial of a loan modification program so long as the borrower's complete loss mitigation application is received 90 days or more before a scheduled foreclosure sale.

The rule restricts "dual tracking," where a servicer is simultaneously evaluating a consumer for loan modifications or other alternatives at the same time that it prepares to foreclose on the property. Specifically, the rule prohibits a servicer from making the first notice or filing required for a foreclosure process until a mortgage loan account is more than 120 days delinquent. Even if a borrower is more than 120 days delinquent, if a borrower submits a complete application for a loss mitigation option before a servicer has made the first notice or filing required for a foreclosure process, a servicer may not start the foreclosure process unless (1) the servicer informs the borrower that the borrower is not eligible for any loss mitigation option (and any appeal has been exhausted), (2) a borrower rejects all loss mitigation offers, or (3) a borrower fails to comply with the terms of a loss mitigation option such as a trial modification.

If a borrower submits a complete application for a loss mitigation option after the foreclosure process has commenced but more than 37 days before a foreclosure sale, a servicer may not move for a foreclosure judgment or order of sale, or conduct a foreclosure sale, until one of the same three conditions has been satisfied. In all of these situations, the servicer is responsible for promptly instructing foreclosure counsel retained by the servicer not to proceed

with filing for foreclosure judgment or order of sale, or to conduct a foreclosure sale, as applicable.

This section includes an exemption for small servicers as defined above. However, a small servicer is required to comply with two requirements: (1) a small servicer may not make the first notice or filing required for a foreclosure process unless a borrower is more than 120 days delinquent, and (2) a small servicer may not proceed to foreclosure judgment or order of sale, or conduct a foreclosure sale, if a borrower is performing pursuant to the terms of a loss mitigation agreement.

All of the provisions in the section relating to loss mitigation can be enforced by individuals. Additionally, the Bureau and the prudential regulators can also supervise servicers within their jurisdiction to assure compliance with these requirements.

B. Scope of the Final Servicing Rules

The Final Servicing Rules have somewhat different scopes, with respect to the types of mortgage loan transactions covered and the loans that are exempted. With respect to the 2013 TILA Servicing Final Rule, certain requirements, specifically the periodic statement and ARM disclosure requirements, only apply to closed-end mortgage loans, whereas other requirements, specifically the requirements for crediting of payments and providing payoff statements, apply to both open-end and closed-end mortgage loans. Reverse mortgage transactions and timeshare plans are exempt from the periodic statement requirement. ARMs with terms of one year or less are exempt from the ARM disclosure requirements.

With respect to the 2013 RESPA Servicing Final Rule, certain requirements generally apply to federally related mortgage loans that are closed-end, with certain exemptions for loans on property of 25 acres or more, business-purpose loans, temporary financing, loans secured by

vacant land, and certain loan assumptions or conversions. Open-end lines of credit (home equity plans) are generally exempt from the requirements in the 2013 RESPA Servicing Final Rule. The general servicing policies, procedure, and requirements, early intervention, continuity of contact, and loss mitigation procedures provisions are generally inapplicable to servicers of reverse mortgage transactions or to servicers of mortgage loans for which the servicers are also qualified lenders under the Farm Credit Act of 1971.

In the 2013 TILA Servicing Final Rule, the Bureau is exercising its authority under TILA to provide an exemption from the periodic statement requirement for small servicers, defined as servicers that service 5,000 mortgage loans or less and only service mortgage loans the servicer or an affiliate owns or originated (small servicers). In the 2013 RESPA Servicing Final Rule, the Bureau has elected not to extend to these small servicers most provisions of the Final Rule that are not being promulgated to implement specific mandates in the Dodd-Frank Act but are, instead, being issued by the Bureau, in the exercise of its discretion, pursuant to its general rulemaking authority under RESPA, as amended by the Dodd-Frank Act. The exemptions from the discretionary rulemakings include those relating to general servicing policies, procedures, and requirements; early intervention with delinquent borrowers; continuity of contact; and most of the requirements for evaluating and responding to loss mitigation applications. Further, the Bureau is not restricting small servicers from purchasing force-placed insurance for borrowers with escrow accounts for the payment of hazard insurance, so long as the cost to the borrower of the force-placed insurance obtained by a small servicer is less than the amount the small servicer would be required to disburse from the borrower's escrow account to ensure that the borrower's hazard insurance premium charges were paid in a timely manner. Small servicers are required to comply with limited loss mitigation procedure requirements. These include (1) a prohibition on

making the first notice or filing required for a foreclosure process unless a borrower is more than 120 days delinquent and (2) a prohibition on making the first notice or filing or moving for foreclosure judgment or order of sale, or conducting a foreclosure sale, when a borrower is performing pursuant to the terms of a loss mitigation agreement. The exemptions applicable to small servicers in the 2013 TILA Servicing Rule and the 2013 RESPA Servicing Rule are also being extended to Housing Finance Agencies, without regard to the number of mortgage loans serviced by any such agency, and these agencies are included within the definition of small servicer.

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.[7] 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.[8] Over 60 percent of mortgage loans are serviced by mortgage servicers for investors.

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[7] Inside Mortg. Fin., *Outstanding 1-4 Family Mortgage Securities, in* 2 The 2012 Mortgage Market Statistical Annual 7 (2012). For general background on the market and the recent crisis, *see* the 2012 TILA-RESPA Proposal available at http://www.consumerfinance.gov/knowbeforeyouowe/ (last accessed Jan. 10, 2013).

[8] As of June 2012, approximately 36% of outstanding mortgage loans were held in portfolio; 54% of mortgage loans were owned through mortgage-backed securities issued by Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac), together referred to as the government-sponsored enterprises (GSEs), as well as securities issued by the Government National Mortgage Association (Ginnie Mae); and 10% of loans were owned through private label mortgage-backed securities. *Strengthening the Housing Market and Minimizing Losses to Taxpayers, Hearing Before the S. Comm. on Banking, Housing and Urban Affairs* (2012)(Testimony of Laurie Goodman, Amherst Securities), available at http://banking.senate.gov/public/index.cfm?FuseAction=Hearings.Testimony&Hearing_ID=53bda60f-64c1-43d8-9adf-a693c31eb56b&Witness_ID=b06f2fb1-59dd-4881-86cb-1082464d3119. 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

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 questionable whether a secondary market for mortgage-backed securities would exist in this country.[9] Given the nature of their activities, servicers can have a direct and profound impact on borrowers.

Mortgage servicing is performed by banks, thrifts, credit unions, and non-banks 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.[10]

These different servicing structures can create difficulties for borrowers if a servicer makes mistakes, fails to invest sufficient resources in its servicing operations, or avoids opportunities to work with borrowers for the mutual benefit of both borrowers and owners or assignees of mortgage loans. Although the mortgage servicing industry has numerous participants, the industry is highly concentrated, with the five largest servicers servicing

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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).

[9] *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.").

[10] *See, e.g.*, Diane E. Thompson, *Foreclosing Modifications: How Servicer Incentives Discourage Loan Modifications*, 86 Wash. L. Rev. 755, 763 (2011) ("Thompson").

approximately 53 percent of outstanding mortgage loans in this country.[11] 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.[12]

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 owners or assignees of mortgage loans can transfer servicing rights to a different servicer. Further, servicer contracts govern servicer requirements to advance payments to owners of mortgage loans, and to recoup advances made by servicers, including from ultimate recoveries on liquidated properties.

Compensation structures vary somewhat for loans held in portfolio and securitized loans,[13] but have tended to make pure mortgage servicing (where the servicer has no role in origination) a high-volume, low-margin business. Such compensation structures incentivize servicers to ensure that investment in operations closely tracks servicer expectations of

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[11] *See Top 100 Mortgage Servicers in 2012*, Inside Mortg. Fin., Sept. 28, 2012, at 13 (As of the end of the fourth quarter of 2011, the top five largest servicers serviced $5.66 trillion of mortgage loans).

[12] Fitch Ratings, *U.S. Residential and Small Balance Commercial Mortgage Servicer Rating Criteria*, at 14-15 (Jan. 31, 2011), *available at* http://www.fitchratings.com. (account required to access information).

[13] 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. Keefe, Bruyette & Woods, Inc., PowerPoint Presentation, *KBW Mortgage Matters: Mortgage Servicing Primer* (Apr. 2012).

delinquent accounts, and an increase in the number of delinquent accounts a servicer must service beyond that projected by the servicer strains available servicer resources. A servicer will expect to recoup its investment in purchasing mortgage servicing rights and earn a profit primarily through a net servicing fee (which is typically expressed as a constant rate assessed on unpaid mortgage balances), 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 will have limited incentives to provide other customer service. Servicers greatly vary in the extent to which they invest in customer service infrastructure. For example, servicer staffing ratios have varied between approximately 100 loans per full-time employee to over 4,000 loans per full time employee.[14] Servicers are generally not subject to market discipline from consumers because consumers have little opportunity to switch servicers. Rather, servicers compete to obtain business from the owners of loans—investors, assignees, and creditors—and thus competitive pressures tend to drive servicers to lower the price of servicing and scale their investment in providing service to consumers accordingly.

Servicers also earn revenue from fees assessed on borrowers, including fees on late payments, fees for obtaining force-placed insurance, and fees for services, such as responding to

[14] Richard O'Brien, *High Time for High-Touch*, Mortg. Banking, Feb. 1, 2009, at 39. Industry participants generally indicated to the Bureau that servicers targeted a loan to employee ratio of 1,000 – 1,200 mortgage loans per full time employee for mortgage loans that are current, and 125 – 150 mortgage loans per full time employee for mortgage loans that are delinquent. Between 1992 and 2000, as servicers sought to make their operations more efficient, loans serviced per full time employee increased from approximately 700 loans in 1992 to over 1,200 loans by 2000. Michael A. Stegman et al., *Preventative Servicing is Good for Business and Affordable Homeownership Policy*, 18 Housing Pol'y Debate 243, 274 (2007). As an example of current mortgage servicing staffing levels, Ocwen services 162 mortgage loans per servicing employee. *See* Morningstar Credit Ratings, LLC, *Operational Risk Assessment – Ocwen Loan Servicing, LLC*, at 7 (2012) available at http://www.ocwen.com/docs/Morningstar-Sept-2012.pdf.

telephone inquiries, processing telephone payments, and providing payoff statements.[15] As a result, servicers have an incentive to look for opportunities to impose fees on borrowers to enhance revenues.

These attributes of the servicing market created problems for certain borrowers even prior to the financial crisis. For example, borrowers experienced problems with mortgage servicers even during regional mortgage market downturns that preceded the financial crisis.[16] There is evidence that borrowers were subjected to improper fees that servicers had no reasonable basis to impose, improper force-placed insurance practices, and improper foreclosure and bankruptcy practices.[17]

When the financial crisis erupted, many servicers—and especially the larger servicers with their scale business models—were ill-equipped to handle the high volumes of delinquent mortgages, loan modification requests, and foreclosures they were required to process. Mortgage loan delinquency rates nearly doubled between 2007 and 2009 from 5.4 percent of first-lien mortgage loans to 9.4 percent of first-lien mortgage loans.[18] Many servicers lacked the infrastructure, trained staff, controls, and procedures needed to manage effectively the flood of

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[15] *See, e.g.*, Bank of America, Mortgage Servicing Fees, available at https://www8.bankofamerica.com/home-loans/mortgage-servicing-fees.go (last accessed Jan. 11, 2013); Metro Credit Union, Mortgage Servicing Fee Schedule, available at http://www.metrocu.org/home/fiFiles/static/documents/Mortgage_Servicing_Fee_Schedule.pdf (last accessed Jan. 6, 2013); Acqura Loan Services, Mortgage Loan Servicing Fee Schedule, available at http://www.acqurals.com/feeschedule.html (last accessed Jan. 11, 2013); Sovereign Bank, FAQ—*What are the* Mortgage Loan Servicing Fees*?*, available at https://customerservice.sovereignbank.com/app/answers/detail/a_id/22/~/what-are-the-mortgage-loan-servicing-fees%3F (last accessed Jan. 11, 2013).

[16] *See Problems in Mortgage Servicing from Modification to Foreclosure: Hearings Before the S. Comm. on Banking, Hous., & Urban Affairs*, 111th Cong. 53-54 (2010) (statement of Thomas J. Miller, Iowa Att'y Gen.) ("Miller Testimony"). *See also*, Kurt Eggert, *Limiting Abuse and Opportunism by Mortgage Servicers*, 15 Housing Pol'y Debate 753 (2004), available at http://ssrn.com/abstract=992095.

[17] *See* Kurt Eggert, *Limiting Abuse and Opportunism by Mortgage Servicers*, 15 Housing Pol'y Debate 753 (2004), available at http://ssrn.com/abstract=992095 (collecting cases).

[18] U.S. Census Bureau, *Table 1194: Mortgage Originations and Delinquency and Foreclosure Rates: 1990 to 2010*, in The 2012 Statistical Abstract of the United States, (2012), available at http://www.census.gov/compendia/statab/2012/tables/12s1194.pdf (last accessed Jan. 6, 2013).

delinquent mortgages they were forced to handle.[19] One study of complaints to the HOPE Hotline reported that over half of the complaints (27,000 out of 48,000) were from borrowers who could not reach their servicers and obtain information about the status of applications they had submitted for options to avoid foreclosure.[20]

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 Board of Governors of the Federal Reserve System (Board), following on-site reviews of foreclosure processing at 14 federally regulated mortgage servicers, found significant deficiencies at each of the servicers reviewed. As a result, the OCC and the Board undertook formal enforcement actions against several major servicers for unsafe and unsound residential mortgage loan servicing practices.[21] 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

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[19] *See* U.S. Dep't of the Treasury, *Making Contact: The Path to Improving Mortgage Industry Communication with Homeowners*, at 3 (2012), *available at* http://www.treasury.gov/initiatives/financial-stability/reports/Documents/SPOC%20Special%20Report_Final.pdf (last accessed Jan. 6, 2013).

[20] *See* U.S. Gov't Accountability Office, GAO-10-634, *Troubled Asset Relief Program: Further Actions Needed to Fully and Equitably Implement Foreclosure Mitigation Programs*, at 15 (2010).

[21] Press Release, Office of the Comptroller of the Currency, NR 2011-47, *OCC Takes Enforcement Action Against Eight Servicers for Unsafe and Unsound Foreclosure Practices* (Apr. 13, 2011), available at http://www.occ.gov/news-issuances/news-releases/2011/nr-occ-2011-47.html; Press Release, Fed. Reserve Bd., *Federal Reserve Issues Enforcement Actions Related to Deficient Practices in Residential Mortgage Loan Servicing* (April 13, 2011) ("Fed Press Release"), available at http://www.federalreserve.gov/newsevents/press/enforcement/20110413a.htm. In addition to enforcement actions against major servicers, Federal agencies have also undertaken formal enforcement actions against major service providers to mortgage servicers.

procedures, compliance risk management, internal audit, third-party management, and training to foreclosure processes; and (5) failing to oversee sufficiently outside counsel and other third-party providers handling foreclosure-related services.[22]

Other investigations of servicers have found similar problems. For example, the Government Accountability Office (GAO) has found pervasive problems in broad segments of the mortgage servicing industry impacting delinquent borrowers, such as servicers who have 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. It has been recognized in Inspector General reports, and the Bureau has learned from outreach with mortgage investors, that servicers may be acting to maximize their self-interests in the handling of delinquent borrowers, rather than the interests of owners or assignees of mortgage loans.[23]

The mortgage servicing industry, however, is not monolithic. Some servicers provide high levels of customer service. Some of these servicers are compensated by investors in a way that incentivizes them to provide this level of service in order to optimize investor outcomes.[24]

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[22] Press Release, Federal Reserve Bd., *Federal Reserve Issues Enforcement Actions Related to Deficient Practices in Residential Mortgage Loan Servicing* (April 13, 2011), available at http://www.federalreserve.gov/newsevents/press/enforcement/20110413a.htm. None of the servicers admitted or denied the OCC's or Federal Reserve Board's findings.

[23] *See, e.g.*, Jody Shenn, *PIMCO: This is who's actually going to be punished by the mortgage fraud settlement*, Bloomberg News, February 10, 2012; *cf.*, Office of Inspector Gen., Fed. Hous. Fin. Agency, *Evaluation of FHFA's Oversight of Fannie Mae's Transfer of Mortgage Servicing Rights from Bank of America to High Touch Servicers*, at 12 (Sept. 18, 2012) ("FHA OIG MSR Report"). The Inspector General for FHFA observed that "Fannie Mae may have had (what one of its executives described as) a 'misalignment of interests' with its servicers. As guarantor or loan holder, Fannie Mae could face significant losses from a default. However, a servicer earns only a fraction of a percent of the unpaid balance of a mortgage it services and, thus, the fees derived from any particular loan may not – at least for the servicer – provide adequate incentive to undertake anything more than the bare minimum of effort in order to prevent a default. This will typically include sending out delinquency notices to borrowers who have not made timely payments, telephoning delinquent borrowers, and, ultimately, initiating foreclosure proceedings."

[24] For example, Fannie Mae rewards servicers that provide high levels of customer service by compensating them through (1) base servicing fees, (2) incentive payments for mortgage modifications, and (3) a performance payment based on the servicer's success as contrasted with that of a benchmark portfolio. *See* FHA OIG MSR Report at 12.

Other servicers provide high levels of customer service because they are servicing loans of their own retail customers within their local community or (in the case of credit unions) membership base. These servicers seek to provide other products and services to consumers—and to others within the community or membership base—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 the Small Business Regulatory Enforcement Fairness Act of 1996 (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.[25]

B. The National Mortgage Settlement and Other Regulatory Requirements

In response to the unprecedented financial 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.

For example, the Federal government, joined by 49 State Attorneys General,[26] entered into settlements with the nation's five largest servicers in February 2012 (the National Mortgage

[25] *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 (Jun, 11, 2012)("Small Business Review Panel Report"), available at http://www.regulations.gov/#!documentDetail;D=CFPB-2012-0033-0002.

[26] Oklahoma elected not to participate in the National Mortgage Settlement and executed a separate settlement with the servicers that are parties to the National Mortgage Settlement. *See* State of Oklahoma, Oklahoma Mortgage Settlement Fact Sheet (Feb. 9, 2012), available at http://www.oag.ok.gov/oagweb.nsf/0/2737eec87426c427862579c10003c950/$FILE/Oklahoma%20Mortgage%20Settlement%20FAQs.pdf (last accessed Jan. 10, 2013).

Settlement).[27] 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.[28] 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.

Apart from the National Mortgage Settlement, Federal regulatory agencies have also issued guidance on mortgage servicing and loan modifications,[29] conducted coordinated reviews of the nation's largest servicers,[30] and taken enforcement actions against individual companies.[31] Further, the Bureau and other Federal agencies have been engaged since spring 2011 in informal discussions about the potential development of national mortgage servicing standards through interagency regulations and guidance.

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[27] 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.

[28] *See* Attys. Gen., *National Mortgage Settlement*, .

[29] *See* Press Release, Fed. Res. Bd., *Federal Reserve Board releases action plans and engagement letter to correct deficiencies in residential mortgage loan servicing and foreclosure processing* (May 24, 2012), *available at* ; Press Release, Fed. Res. Bd., *Federal Reserve Board releases action plans for supervised financial institutions to correct deficiencies in residential mortgage loan servicing and foreclosure processing* (Feb. 27, 2012), *available at* ; Press Release, Office of the Comptroller of the Currency, *OCC Takes Enforcement Action Against Eight Servicers for Unsafe and Unsound Foreclosure Practices* (Apr. 13, 2011), *available at* .

[30] *See* Fed. Res. Bd., *Federal Reserve Board releases action plans and engagement letter to correct deficiencies in residential mortgage loan servicing and foreclosure processing* (May 24, 2012), *available at* .

[31] *See* Press Release, Fed. Res. Bd., Federal Reserve Board *releases action plans and engagement letter to correct deficiencies in residential mortgage loan servicing and foreclosure processing* (May 24, 2012), available at; Press Release, Fed. Res. Bd., Federal Reserve Board *releases action plans for supervised financial institutions to correct deficiencies in residential mortgage loan servicing and foreclosure processing* (Feb. 27, 2012), available at; Press Release, Office of the Comptroller of the Currency, *OCC Takes Enforcement Action Against Eight Servicers for Unsafe and Unsound Foreclosure Practices* (Apr. 13, 2011), available at http://www.occ.gov/news-issuances/news-releases/2011/nr-occ-2011-47.html.

Servicers are currently required to navigate overlapping requirements governing their servicing responsibilities. Servicers must comply with requirements established by owners or assignees of mortgage loans. These include, as applicable, (1) servicing guidelines required by Fannie Mae, Freddie Mac, and 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.

Servicers are also required to consider the impact of State and even local regulation on mortgage servicing. Significantly, New York, California, and Oregon have all adopted varying statutory or regulatory restrictions on mortgage servicers. For example, the Superintendent of Banks of the State of New York has repeatedly adopted short-term emergency regulations governing mortgage servicers on a continuous basis since July 2010.[32] These regulations impose obligations on servicers with respect to, among other things, consumer complaints and inquiries, statements of accounts, crediting of payments, payoff balances, and loss mitigation procedures.[33] The California Homeowner Bill of Rights, which was enacted in 2012, imposes requirements on servicers with respect to evaluations of borrowers for loss mitigation options before various foreclosure documents may be filed for California's non-judicial foreclosure process.[34] Further, Oregon implemented regulations on mortgage servicers not to engage in unfair or deceptive conduct by: assessing fees for payments made on or before a payment due date; assessing or collecting fees not authorized by a security instrument or mortgage, misrepresenting information relating to a loan modification or set forth in an affidavit, declaration, or other sworn statement

[32] New York State Department of Financial Services, Explanatory All Institutions Letter (October 7, 2012), available at http://www.dfs.ny.gov/legal/regulations/emergency/banking/ar419lt.htm (last accessed Dec. 7, 2012).
[33] 3 N.Y.C.R.R. 419.1 *et seq.*
[34] *See* Cal. Civ. Code § 2923.6.

detailing a borrower's default and the servicer's right to foreclose; failing to comply with certain provisions of RESPA; or failing to deal with a borrower in good faith.[35] Further, Massachusetts has recently proposed new regulations to protect consumers with respect to mortgage servicing practices, including with respect to loss mitigation procedures.[36]

C. TILA and Regulation Z

In 1968, Congress enacted TILA, 15 U.S.C. 1601 *et seq.*, based on findings that the informed use of credit resulting from consumers' awareness of the cost of credit would enhance economic stability and competition among consumer credit providers. One of the purposes of TILA is to promote the informed use of consumer credit by requiring disclosures about its costs and terms. TILA requires additional disclosures for loans secured by consumers' homes and permits consumers to rescind certain transactions secured by their principal dwellings when the required disclosures are not provided. Section 105(a) of TILA directs the Bureau (and formerly directed the Board) to prescribe regulations to carry out TILA's purposes and specifically authorizes the Bureau, among other things, to issue regulations that contain such additional requirements, classifications, differentiations, or other provisions, or that provide for such adjustments and exceptions for all or any class of transactions, that in the Bureau's judgment are necessary or proper to effectuate the purposes of TILA, facilitate compliance with TILA, or prevent circumvention or evasion thereof. *See* 15 U.S.C. 1604(a).

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[35] OAR 137-020-0805. Notably, Oregon's regulations initially implemented mortgage servicing requirements with respect to open-end lines of credit (home equity plans) and, further, required servicers to comply with GSE guidelines for loan modifications. Oregon suspended these requirements and reissued the rule as OAR 137-020-0805 on the basis that such suspension was necessary to facilitate compliance. *See* In the matter of: Suspension of OAR 137-020-0800 and Adoption of OAR 137-020-0805 (February 15, 2012), available at http://www.oregonmla.org/WebsiteAttachments/Misc%20Events%20Attachments/OAR%20137-020-0805%202%2015%2012%20AG%20Servicing%20Rules%20(00540177).pdf (last accessed Jan. 6, 2013).

[36] *See* Press Release, Massachusetts Division of Banks Proposes New Standards for Mortgage Servicing (Nov. 8, 2012), available at http://www.mass.gov/ocabr/docs/dob/standards-for-mort-servicing2012.pdf (last accessed Jan. 6, 2013).

General rulemaking authority for TILA transferred to the Bureau in July 2011, other than for certain motor vehicle dealers in accordance with Dodd-Frank Act section 1029, 12 U.S.C. 5519. Pursuant to the Dodd-Frank Act and TILA, as amended, the Bureau published for public comment an interim final rule establishing a new Regulation Z, 12 CFR part 1026, implementing TILA (except with respect to persons excluded from the Bureau's rulemaking authority by section 1029 of the Dodd-Frank Act). 76 FR 79768 (Dec. 22, 2011). This rule did not impose any new substantive obligations but did make technical and conforming changes to reflect the transfer of authority and certain other changes made by the Dodd-Frank Act. The Bureau's Regulation Z took effect on December 30, 2011. The Official Interpretation interprets the requirements of the regulation and provides guidance in applying the rules to specific transactions. *See* 12 CFR part 1026, Supp. I.

Prior to the adoption of the Dodd-Frank Act, 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 impose certain limited requirements directly on servicers, such as requirements to credit payments timely and provide payoff balances, as well as a prohibition on pyramiding of late fees.[37]

ARM 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.[38] 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 the first

[37] *See* 12 CFR 1026.36(c).
[38] 52 FR 48665 (Dec. 24, 1987).

payment at the new level is due to track the rules of the OCC and to provide creditors with flexibility in giving adjustment notices for a variety of ARMs.[39] 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.[40]

Prompt crediting and payoff statements. In 2008 the Board published a final rule amending Regulation Z to establish new regulatory protections for consumers in the residential mortgage market from unfair, abusive, or deceptive lending and servicing practices.[41] Among other protections, this rule established 12 CFR 226.36(c), prohibiting certain practices of servicers of consumer credit transactions secured by a consumers principal dwelling. This rule provided that no servicer shall: (1) fail to credit a consumer's periodic payment as of the date received; (2) impose a late fee or delinquency charge where the late fee or delinquency charge is due only to a consumer's failure to include in a current payment a late fee or delinquency charge imposed on earlier payments; or (3) fail to provide an accurate payoff statement within a reasonable time of request.

D. The Dodd-Frank Act

The Dodd-Frank Act imposes certain new requirements related to mortgage servicing. As set forth above, some of these new requirements are amendments to TILA addressed in this final rule and others are amendments to RESPA, addressed in the 2013 RESPA Servicing Final Rule. Sections 1418, 1420, and 1464 amend TILA to include protections with respect to mortgage servicing. 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

[39] 74 FR 43232, 43269 (Aug. 26, 2009) (*citing* 52 FR 48665, 48668 (Dec. 24, 1987)).
[40] 74 FR 43232, 43272.
[41] 73 FR 44522 (July 30, 2008)

the Dodd-Frank Act adds a new section 128A to TILA. 15 U.S.C. 1638a. TILA section 128A states that, for hybrid ARMs with a fixed interest rate for an introductory period that adjusts or resets to an adjustable 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 consumer, for each billing cycle, a periodic statement that sets forth certain specified information in a conspicuous and prominent manner. 15 U.S.C. 1638(f). The statute also gives the Bureau the authority to require additional content to be included in the periodic statement. The statute provides an exemption 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.

Third, section 1464 of the Dodd-Frank Act adds sections 129F and 129G to TILA, which generally codifies 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 and requirements for a creditor or servicer to send accurate and timely responses to consumer requests for payoff amounts for home loans. 15 U.S.C. 1639f, 1639g.

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). TILA and title X of the Dodd-Frank Act are Federal consumer financial laws. Accordingly, the Bureau proposed to exercise its authority under section 1022(b) of the

Dodd-Frank Act to prescribe rules to carry out the purposes of TILA and title X and prevent evasion of those laws.

III. Summary of the Rulemaking Process

A. Outreach and Consumer Testing

The Bureau has conducted extensive outreach in developing the Final Servicing Rules. Prior to issuing the Proposed Servicing Rules on August 10, 2012, Bureau staff met with consumers, consumer advocates, mortgage servicers, force-placed insurance carriers, industry trade associations, other Federal regulatory agencies, and other interested parties to discuss various aspects of the statute, servicing industry operations, and consumer harm impacts. Outreach included meetings with numerous individual servicers to understand their operations and the potential benefits and burdens of the proposed mortgage servicing rules. 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 rules and the need for and potential contents of national mortgage servicing standards in general.

Further, the Bureau solicited input from small servicers through a Small Business Review Panel (Small Business Review Panel) with the Chief Counsel for Advocacy of the Small Business Administration (Advocacy) and the Administrator of the Office of Information and Regulatory Affairs within the Office of Management and Budget (OMB).[42] The Small Business Review Panel's findings and recommendations are contained in the Small Business Review

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

Panel Report.[43] The Bureau has adopted recommendations provided by the participants on the Small Business Review Panel and includes below a discussion of such recommendations in connection with the applicable requirement.

Further, prior to the issuing the Proposed Servicing Rules on August 10, 2012, 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 the ARM interest rate adjustment notices and the periodic statement disclosure set forth in this rule as well as the forced-placed insurance notices set forth in the 2013 RESPA Servicing Final Rule.

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, 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, and how

[43] *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.

they would use the information presented in each of the disclosures. The disclosures were revised after each round of testing.

After the Bureau issued the Proposed Servicing Rules, Macro conducted a fourth round of one-on-one cognitive interviews with eight participants in Philadelphia, Pennsylvania. Again, participants were consumers who held a mortgage loan and represented a range of ages and education levels. During the interviews, participants were asked to review two different versions of a servicing transfer notice and early intervention model clauses, which relate to requirements the Bureau is implementing under RESPA. Participants were asked specific questions to test their reaction to and understanding of the content of the servicing transfer notice and the early intervention model clauses. This process was repeated for each of the five clauses being tested. Specific findings from the consumer testing are discussed in detail throughout where relevant.[44]

One commenter, identifying itself as a research organization, observed that the consumer testing the Bureau has conducted with respect to the mortgage servicing disclosures follows the path of evidence-based decision-making. This commenter asserted, however, that the Bureau should consider undertaking steps in evaluating the proposed forms, including possibly undertaking additional testing because other consumer financial disclosures, including the forms the Bureau proposed with the 2012 TILA-RESPA Proposal, have gone through more testing. At the same time, however, the commenter observed that the decreased level of testing might be justified on various grounds, such as, for example, the fact that studies have found that small numbers of individuals can identify the vast majority of usability problems, the fact that the testing was done with participants familiar with mortgages, and the fact that the Bureau is

[44] ICF Int'l, Inc., *Summary of Findings: Design and Testing of Mortgage Servicing Disclosures* (Aug. 2012) ("Macro Report"), *available at* http://www.regulations.gov/#!documentDetail;D=CFPB-2012-0033-0003.

working on a tight schedule to finalize rules by January 21, 2013 when statutory provisions would go into effect.

The Bureau believes that the testing it conducted is appropriate. The Bureau observes that the forms the Bureau proposed as part of the 2012 TILA-RESPA Proposal contained significantly more complicated financial information than the forms finalized as part of the current rulemakings. Additionally, the 2012 TILA-RESPA Proposal, when finalized, would substantially change consumers' mortgage shopping experience; by contrast, the Final Mortgage Servicing Rules are intended to improve, but not substantially alter, consumers' experience with their mortgage servicers. These differences, in terms of level of complication and degree of change from current practice, justify the different levels of resources the Bureau allocated to the two different testing projects. Lastly, Macro's findings show that there was notable consistency across the different rounds of testing in terms of participant comprehension that, in combination with the Bureau's expertise and knowledge of consumer understanding and behavior, gave the Bureau confidence to rely on the forms that were developed and refined through testing as a basis for the model forms included in the Final Servicing Rules.

The Bureau further emphasizes that it is not relying solely on the consumer testing to determine that any particular disclosure will be effective. The Bureau is also relying on its knowledge of, and expertise in, consumer understanding and behavior, as well as principles of effective disclosure design.

B. Small Business Regulatory Enforcement Fairness Act

As required by SBREFA, the Bureau convened a Small Business Review 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. Thus, on April 9, 2012, the Bureau provided Advocacy with the formal notification and other information required under section 609(b)(1) of the Regulatory Flexibility Act (RFA) to convene the panel.

In order to obtain feedback from small servicers, the Bureau, in consultation with Advocacy, identified five categories of small entities that may be subject to the proposed rule: commercial banks/savings institutions, credit unions, non-depositories engaged primarily in lending funds with real estate as collateral, non-depositories primarily engaged in loan servicing, and certain non-profit organizations. The Bureau, in consultation with Advocacy, selected 16 representatives to participate in the Small Business Review Panel process from the categories of entities that may be subject to the Proposed Servicing Rules. The participants 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), as described in chapter 7 of the Small Business Review Panel Report.

On April 10, 2012, the Bureau convened the Small Business Review Panel. In order to collect the advice and recommendations of Small Entity Representatives, the Panel held an outreach meeting/teleconference on April 24, 2012 (Panel Outreach Meeting). To help the Small Entity Representatives prepare for the Panel Outreach Meeting, the Panel circulated briefing materials that summarized the proposals under consideration at that time, posed discussion issues, and provided information about the SBREFA process generally.[45] All 16 small entities participated in the Panel Outreach Meeting either in person or by telephone. The Small Business

[45] The Bureau posted these materials on its website and invited the public to email remarks on the materials. Press Release, U.S. Consumer Fin. Prot. Bureau, *Consumer Financial Protection Bureau Outlines Borrower-Friendly Approach to Mortgage Servicing* (Apr. 9, 2012), *available at* http://www.consumerfinance.gov/pressreleases/consumer-financial-protection-bureau-outlines-borrower-friendly-approach-to-mortgage-servicing/ (last accessed Jan. 6, 2013).

Review Panel also provided the Small Entity Representatives with an opportunity to submit written feedback until May 1, 2012. In response, the Small Business Review Panel received written feedback from five of the representatives.[46]

On June 11, 2012, the Small Business Review Panel submitted to the Director of the Bureau the written Small Business Review Panel Report, which 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 participants who were selected to advise the Small Business Review Panel; a summary of the Panel's outreach to obtain the advice and recommendations of those participants; a discussion of the comments and recommendations of the participants; and a discussion of the Small Business Review Panel findings, focusing on the statutory elements required under section 603 of the RFA, 5 U.S.C. 609(b)(5).

In connection with issuing the Proposed Servicing Rules, the Bureau carefully considered the feedback from the small entities and the findings and recommendations in the Small Business Review Panel Report. The section-by-section analyses for the Final Servicing Rules discuss this feedback and the specific findings and recommendations of the Small Business Review Panel, as applicable. The SBREFA process provided the Small Business Review Panel and the Bureau with an opportunity to identify and explore opportunities to mitigate the burden of the rule on small entities while achieving the rule's purposes. It is important to note, however, that the Small Business Review Panel prepared the Small Business Review Panel Report at a preliminary stage of the proposal's development and that the report—in particular, the findings and recommendations—should be considered in that light. Any options identified in the Small

[46] This written feedback is attached as appendix A to the Small Business Review Panel Report.

Business Review Panel 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 RESPA, TILA, the Dodd-Frank Act, and their statutory purposes.

C. Summary of the Proposed Servicing Rule

The 2012 TILA Servicing Proposal would have amended Regulation Z to implement requirements relating to interest rate adjustment disclosures, periodic mortgage statements, payoff statements, and prompt crediting of payments. The 2012 TILA Servicing Proposal would have amended current § 1026.20(c) to revise the timeframe for providing the ARM adjustment notice from the current requirement of between 25 and 120 days before the first payment at a new level is due to between 60 and 120 days. The proposed rule also would have grandfathered 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. The proposed rule also would have required the disclosure required by current § 1026.20(c) to include additional information. Such additional information would have included: (1) a statement that the consumer's interest rate is scheduled to adjust, a statement that 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, (2) the date when the new payment is due after the adjustment, (3) any interest rate or payment limits; any unapplied carryover interest and the earliest date it could be applied, (4) additional amortization information for negatively-amortizing and interest-only loans, and (5) the amount and expiration date of any prepayment penalty.

The proposed rule would also have implemented section 1418 of the Dodd-Frank Act by requiring creditors, assignees, or servicers to provide a new one-time notice to consumers six to

seven months prior to the first time the interest rate of their adjustable-rate mortgages adjusts. The initial interest rate adjustment notices proposed in § 1026.20(d) would have included much of the same information listed above for proposed § 1026.20(c). The proposed notice in § 1026.20(d) would have disclosed additional information, including 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 proposed rule would have included model and sample forms for the requirements in § 1026.20(c) and (d).

The 2012 TILA Servicing Proposal further would have required creditors, assignees, and servicers to provide consumers with a periodic statement. The proposed rule would have established requirements for the timing, form, content, and layout of the statement. The proposed rule also would have included sample forms. The proposed rule would have required that certain related pieces of information must be grouped together on the periodic statement. Moreover, the proposed rule would have clarified how periodic statements should be disclosed in particular situations. For example, the proposed rule would have clarified the disclosure of partial payments, funds held in a suspense or unapplied funds account, and payments for payment-option loans. Further, the proposed rule would have required that delinquent consumers receive important information in several places on the periodic statement, such as information regarding the overdue amount and any fees applied to the consumer's account. Finally, the proposed rules would have exempted certain products and servicers from the periodic statement requirement. Fixed-rate loans with coupon books that meet certain requirements, timeshares, and reverse mortgages would have been exempt from the periodic

statement requirements. Further, small servicers as defined in the proposed rule (that is, servicers that service 1,000 mortgage loans or less and only service mortgage loans that the servicer or an affiliate owns or originated) would have been exempt from the periodic statement requirement.

The 2012 TILA Servicing Proposal would have imposed requirements on servicers with respect to the handling of partial payments from consumers. The proposed rule would have limited the application of the current prompt crediting provision, existing § 1026.36(c)(1)(i), to full contractual payments (as opposed to all payments). The proposed rule would have added a new provision, § 1026.36(c)(1)(ii), to address the handing of partial payments (anything less than a full contractual payment). The proposed rule would have implemented requirements on servicers to provide payoff statements, with modifications relating to the scope and timing of the requirement, and a limitation to written requests for payoff statements. Further, the proposed rule would have reorganized the requirements in § 1026.36(c).

D. Overview of the Comments Received

The Bureau received approximately 300 comments on the Proposed Servicing Rules. The comments came from individual consumers, consumer advocates, community banks, large bank holding companies, secondary market participants, credit unions, non-bank servicers, State and national trade associations for financial institutions in the mortgage business, local and national community groups, Federal and State regulators, academics, and others. Commenters provided feedback on all aspects of the Proposed Servicing Rules. Most commenters tended to focus on specific aspects of the proposals. Accordingly, in general, the comments are discussed below in the section-by-section analysis.

The majority of comments were submitted by mortgage servicers, industry groups representing servicers and businesses involved in the servicing industry. Large banks, community banks and credit unions, non-bank servicers, and industry trade associations submitted nearly all of these comments. The Small Business Administration Office of Advocacy submitted a comment and the remaining comments were submitted by vendors and attorney's representing industry interests. The Bureau also received a significant number of comments from consumer advocacy groups. The record also includes a 49-page comment by the Cornell e-Rulemaking Initiative synthesizing submissions of 144 registered participants to Cornell's Regulation Room project. Regulation Room is a pilot project designed 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. Finally, the Bureau also received comments from the Federal Housing Finance Agency, the GSEs, and from vendors and attorneys representing industry interests.

Industry commenters and their trade associations also provided comments regarding the rulemaking process, and those comments are addressed here. [47] In that regard, community banks and their trade associations stated that the Bureau should consider cumulative burden when writing regulations, setting comment deadlines, and effective dates. These commenters believed

[47] Some commenters provided comments strictly with respect to the rulemaking process. One trade association commented that small servicers that participated in the Small Business Review Panel process did not have adequate time to prepare for the panel discussion and provide appropriate data, while another trade association commented that because the Bureau's proposed rules are lengthy and because some rules have overlapping comment periods, each of which has been limited to 60 days, the trade association has had difficulty dedicating staff to comment on the Bureau's proposals. As set forth in this section, the Bureau has conducted the rulemaking process, including the SBREFA process and the public comment period, in a manner that provided as much flexibility as possible to receive feedback from the SBREFA participants and public commenters in light of the deadlines required for the rulemaking. The Bureau assisted the SBA in calls and outreach with small entity participants to obtain any comments not set forth during the panel outreach with the small entity representatives. Further, with respect to public comments, the Bureau believes that the public had a meaningful opportunity to comment, which is evidenced by the significant number of comments received and their length. The Bureau offered 61 days from August 10, 2012 through October 9, 2012, for comment; and 22 days after the proposal was published in the Federal Register on September 17.

that the combination of the Bureau's rules as well as the impact of Basel III requirements with respect to accounting for mortgage servicing rights in Tier I capital may cause disruptions across all mortgage market segments. A community bank trade association indicated that community banks are likely to feel the impact of the rules more acutely, as they cannot take advantage of economies of scale in mitigating the compliance burden. A community bank trade association stated that the Bureau should consider the wide diversity among servicer business models and adapt regulations to preserve diversity within the servicing industry. The commenter emphasized that community banks have strong reputation and performance incentives to ensure that consumers are provided a high level of service.

A large bank and a number of trade association commenters stated that the Bureau should be cognizant of imposing requirements and standards potentially inconsistent with those required by settlement agreements, consent orders, and GSE or government insurance program requirements. One commenter stated that the Bureau should consider preempting State law mortgage servicing requirements to provide legal and regulatory certainty to industry participants that are evaluating the future desirability of maintaining servicing operations. A number of trade associations stated that the Bureau should not issue regulations that would impose requirements substantially similar to the National Mortgage Settlement on mortgage servicers that are not parties to the National Mortgage Settlement.

The Bureau has considered each of these comments relating to the cumulative impact of mortgage regulation, including the mortgage servicing rules; the potential for inconsistent results with current servicing obligations, including State law and the National Mortgage Settlement; and comments regarding the diversity of servicing business models and servicer sizes. The Bureau's consideration of those comments is reflected below in the section-by-section analysis

with respect to various determinations made in finalizing the 2012 TILA Servicing Proposal, including the determination to create clear requirements, the determination to maintain consistency with current servicing obligations, including those imposed by State law and the National Mortgage Settlement, and the consideration of exemptions for small servicers.

With respect to preemption of state law, the Final Servicing Rules generally do not have the effect of prohibiting state law from affording borrowers broader consumer protections relating to mortgage servicing than those conferred under the Final Servicing Rules. However, in certain circumstances, the effect of specific requirements of the Final Servicing Rules is to preempt certain limited aspects of state law. Specifically, as set forth in the 2013 RESPA Servicing Final Rule, § 1024.41(f) bars a servicer from making the first notice or filing required for a foreclosure process unless a borrower is more than 120 days delinquent, notwithstanding that state law may permit any such filing. Further, § 1024.33(d) incorporates a pre-existing provision in Regulation X that implements RESPA with respect to preemption of certain state law disclosures relating to mortgage servicing transfers. In other circumstances, the Bureau explicitly took into account existing standards (both State and Federal) and either built in flexibility or designed its rules to coexist with those standards. For example, as discussed in the 2013 RESPA Servicing Final Rule, the Bureau took into account the loss mitigation timelines and "dual-tracking" provisions in the National Mortgage Settlement and the California Homeowner Bill of Rights and designed timelines that are consistent with those standards. Similarly, in designing its early intervention provision the Bureau included a statement that nothing in that provision shall require a servicer to make contact with a borrower in a manner that would be prohibited under applicable law.

A number of commenters provided comments regarding language access and community

blight. Two national consumer groups urged the Bureau to take action to remove barriers borrowers with limited English-proficiency face with respect to understanding the terms of their mortgages because such barriers might make these borrowers more vulnerable to bad servicing practices. One national consumer group urged the Bureau to mandate translation of all notices, documents, and bills going to borrowers. Another national consumer group urged the Bureau to consider requiring servicers to provide disclosures and services in a borrower's preferred language, noting that it represents a population that speaks more than 100 different dialects. Finally, one commenter suggests that the Bureau should not only mandate disclosures in other languages but also should require servicers to provide language-capable staff to assist borrowers with limited English skills. With respect to neighborhood blight, a coalition of consumer advocacy groups and a consumer advocate that participated in outreach with the Bureau commented that the Bureau should consider implementing regulations to manage neighborhood blight by requiring servicers to maintain real estate owned (REO) property to decent, safe, and sanitary standards capable of purchase by borrowers with FHA financing.

Although some of these specific requests exceed the scope of the rulemaking, the Bureau takes seriously the important considerations of avoiding neighborhood blight and language access. The Bureau recognizes the challenges borrowers with limited English proficiency face in understanding the terms of their mortgage. The Bureau believes that servicers should communicate with borrowers clearly, including in the borrower's native language, where possible, and especially when lenders advertise in the borrower's native language. The Bureau conducted Spanish testing to support proposed rules and forms combining the TILA mortgage loan disclosure with the Good Faith Estimate (GFE) and statement required under RESPA. *See* 77 FR 54843. That testing underscores both the value of disclosures in other languages but also

the challenges in translating forms using English terms of art into other languages to assure that the foreign-language version of the form effectively communicates the required information to its readers.

Although the Bureau has tested the disclosures it is adopting, it has not had the opportunity to test the disclosures in other languages. Accordingly, the Bureau is not imposing mandatory foreign language translation requirements or other language access requirements at this time with respect to the mortgage servicing disclosures and other requirements the Bureau is adopting. Although the Bureau declines at this time to implement requirements regarding language access, other than those currently in TILA, the Bureau will continue to consider language access generally in connection with developing disclosures and will consider further requirements on servicer communication with borrowers if appropriate. With respect to REO properties, the Bureau continues to consider whether regulations are appropriate to address the maintenance of properties owned by lenders and any potential resulting harm from community blight.

E. Other Dodd-Frank Act Mortgage-Related Rulemakings

In addition to the Final Servicing Rules, the Bureau is adopting several other final rules and issuing one proposal, all relating to mortgage credit, to implement requirements of title XIV of the Dodd-Frank Act. The Bureau is also issuing a final rule and planning to issue a proposal jointly with other Federal agencies to implement requirements for mortgage appraisals in title XIV. Each of the final rules follows a proposal issued in 2011 by the Board or in 2012 by the Bureau alone or jointly with other Federal agencies. Collectively, these proposed and final rules are referred to as the Title XIV Rulemakings.

- *Ability to Repay*: The Bureau recently issued a rule, following a May 2011 proposal issued by the Board (the Board's 2011 ATR Proposal),[48] to implement provisions of the Dodd-Frank Act (1) requiring creditors to determine that a consumer has a reasonable ability to repay covered mortgage loans and establishing standards for compliance, such as by making a "qualified mortgage," and (2) establishing certain limitations on prepayment penalties, pursuant to TILA section 129C as established by Dodd-Frank Act sections 1411, 1412, and 1414. 15 U.S.C. 1639c. The Bureau's final rule is referred to as the 2013 ATR Final Rule. Simultaneously with the 2013 ATR Final Rule, the Bureau issued a proposal to amend the final rule implementing the ability-to-repay requirements, including by the addition of exemptions for certain nonprofit creditors and certain homeownership stabilization programs and a definition of a "qualified mortgage" for certain loans made and held in portfolio by small creditors (the 2013 ATR Concurrent Proposal). The Bureau expects to act on the 2013 ATR Concurrent Proposal on an expedited basis, so that any exceptions or adjustments to the 2013 ATR Final Rule can take effect simultaneously with that rule.
- *Escrows*: The Bureau recently issued a rule, following a March 2011 proposal issued by the Board (the Board's 2011 Escrows Proposal),[49] to implement certain provisions of the Dodd-Frank Act expanding on existing rules that require escrow accounts to be established for higher-priced mortgage loans and creating an exemption for certain loans held by creditors operating predominantly in rural or underserved areas, pursuant to TILA section 129D as established by Dodd-Frank Act sections 1461. 15 U.S.C. 1639d. The Bureau's final rule is referred to as the 2013 Escrows Final Rule.

[48] 76 FR 27390 (May 11, 2011).
[49] 76 FR 11598 (Mar. 2, 2011).

- *HOEPA*: Following its July 2012 proposal (the 2012 HOEPA Proposal),[50] the Bureau recently issued a final rule to implement Dodd-Frank Act requirements expanding protections for "high-cost mortgages" under the Homeownership and Equity Protection Act (HOEPA), pursuant to TILA sections 103(bb) and 129, as amended by Dodd-Frank Act sections 1431 through 1433. 15 U.S.C. 1602(bb) and 1639. The Bureau also is finalizing rules to implement certain title XIV requirements concerning homeownership counseling, including a requirement that lenders provide lists of homeownership counselors to applicants for federally related mortgage loans, pursuant to RESPA section 5(c), as amended by Dodd-Frank Act section 1450. 12 U.S.C. 2604(c). The Bureau's final rule is referred to as the 2013 HOEPA Final Rule.
- *Loan Originator Compensation*: Following its August 2012 proposal (the 2012 Loan Originator Proposal),[51] the Bureau is issuing a final rule to implement provisions of the Dodd-Frank Act requiring certain creditors and loan originators to meet certain duties of care, including qualification requirements; requiring the establishment of certain compliance procedures by depository institutions; prohibiting 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; and establishing restrictions on mandatory arbitration and financing of single premium credit insurance, pursuant to TILA sections 129B and 129C as established by Dodd-Frank Act sections 1402, 1403, and 1414(a). 15 U.S.C. 1639b, 1639c. The Bureau's final rule is referred to as the 2013 Loan Originator Final Rule.

[50] 77 FR 49090 (Aug. 15,2012).
[51] 77 FR 55272 (Sept. 7, 2012).

- *Appraisals*: The Bureau, jointly with other Federal agencies,[52] is issuing a final rule implementing Dodd-Frank Act requirements concerning appraisals for higher-risk mortgages, pursuant to TILA section 129H as established by Dodd-Frank Act section 1471. 15 U.S.C. 1639h. This rule follows the agencies' August 2012 joint proposal (the 2012 Interagency Appraisals Proposal).[53] The agencies' joint final rule is referred to as the 2013 Interagency Appraisals Final Rule. As discussed in that final rule, the agencies plan to issue a supplemental proposal addressing potential additional exemptions to the appraisal requirements. In addition, following its August 2012 proposal (the 2012 ECOA Appraisals Proposal),[54] the Bureau is issuing a final rule to implement provisions of the Dodd-Frank Act requiring 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, pursuant to section 701(e) of the Equal Credit Opportunity Act (ECOA) as amended by Dodd-Frank Act section 1474. 15 U.S.C. 1691(e). The Bureau's final rule is referred to as the 2013 ECOA Appraisals Final Rule.

The Bureau is not at this time finalizing proposals concerning various disclosure requirements that were added by title XIV of the Dodd-Frank Act, integration of mortgage disclosures under TILA and RESPA, or a simpler, more inclusive definition of the finance charge for purposes of disclosures for closed-end mortgage transactions under Regulation Z. The Bureau expects to finalize these proposals and to consider whether to adjust regulatory thresholds under the Title XIV Rulemakings in connection with any change in the calculation of the finance charge later in 2013, after it has completed quantitative testing, and any additional

[52] Specifically, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the National Credit Union Administration, and the Federal Housing Finance Agency.
[53] 77 FR 54722 (Sept. 5, 2012).
[54] 77 FR 50390 (Aug. 21, 2012).

qualitative testing deemed appropriate, of the forms that it proposed in July 2012 to combine TILA mortgage disclosures with the good faith estimate (RESPA GFE) and settlement statement (RESPA settlement statement) required under the Real Estate Settlement Procedures Act, pursuant to Dodd-Frank Act section 1032(f) and sections 4(a) of RESPA and 105(b) of TILA, as amended by Dodd-Frank Act sections 1098 and 1100A, respectively (the 2012 TILA-RESPA Proposal).[55] Accordingly, the Bureau already has issued a final rule delaying implementation of various affected title XIV disclosure provisions.[56]

Coordinated Implementation of Title XIV Rulemakings

As noted in all of its foregoing proposals, the Bureau regards each of the Title XIV Rulemakings as affecting aspects of the mortgage industry and its regulations. Accordingly, as noted in its proposals, the Bureau is coordinating carefully the Title XIV Rulemakings, particularly with respect to their effective dates. The Dodd-Frank Act requirements to be implemented by the Title XIV Rulemakings 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. *See* Dodd-Frank Act section 1400(c), 15 U.S.C. 1601 note. In addition, some of the Title XIV Rulemakings are required by the Dodd-Frank Act to take effect no later than one year after they are issued. *Id.*

The comments on the appropriate effective date for this final rule are discussed in detail below in part VI of this notice. In general, however, consumer advocates requested that the Bureau put the protections in the Title XIV Rulemakings into effect as soon as practicable. In contrast, the Bureau received some industry comments indicating that implementing so many new requirements at the same time would create a significant cumulative burden for creditors. In

[55] 77 FR 51116 (Aug. 23, 2012).
[56] 77 FR 70105 (Nov. 23, 2012).

addition, many commenters also acknowledged the advantages of implementing multiple revisions to the regulations in a coordinated fashion.[57] Thus, a tension exists between coordinating the adoption of the Title XIV Rulemakings and facilitating industry's implementation of such a large set of new requirements. Some have suggested that the Bureau resolve this tension by adopting a sequenced implementation, while others have requested that the Bureau simply provide a longer implementation period for all of the final rules.

The Bureau recognizes that many of the new provisions will require creditors to make changes to automated systems and, further, that most administrators of large systems are reluctant to make too many changes to their systems at once. At the same time, however, the Bureau notes that the Dodd-Frank Act established virtually all of these changes to institutions' compliance responsibilities, and contemplated that they be implemented in a relatively short period of time. And, as already noted, the extent of interaction among many of the Title XIV Rulemakings necessitates that many of their provisions take effect together. Finally, notwithstanding commenters' expressed concerns for cumulative burden, the Bureau expects that creditors actually may realize some efficiencies from adapting their systems for compliance with multiple new, closely related requirements at once, especially if given sufficient overall time to do so.

Accordingly, the Bureau is requiring that, as a general matter, creditors and other affected persons begin complying with the final rules on January 10, 2014. As noted above, section

[57] Of the several final rules being adopted under the Title XIV Rulemakings, six entail amendments to Regulation Z, with the only exceptions being the 2013 RESPA Servicing Final Rule (Regulation X) and the 2013 ECOA Appraisals Final Rule (Regulation B); the 2013 HOEPA Final Rule also amends Regulation X, in addition to Regulation Z. The six Regulation Z final rules involve numerous instances of intersecting provisions, either by cross-references to each other's provisions or by adopting parallel provisions. Thus, adopting some of those amendments without also adopting certain other, closely related provisions would create significant technical issues, *e.g.*, new provisions containing cross-references to other provisions that do not yet exist, which could undermine the ability of creditors and other parties subject to the rules to understand their obligations and implement appropriate systems changes in an integrated and efficient manner.

1400(c) of the Dodd-Frank Act requires that some provisions of the Title XIV Rulemakings take effect no later than one year after the Bureau issues them. Accordingly, the Bureau is establishing January 10, 2014, one year after issuance of the Bureau's 2013 ATR, Escrows, and HOEPA Final Rules (*i.e.*, the earliest of the Title XIV Rulemakings), as the baseline effective date for most of the Title XIV Rulemakings. The Bureau believes that, on balance, this approach will facilitate the implementation of the rules' overlapping provisions, while also affording creditors sufficient time to implement the more complex or resource-intensive new requirements.

The Bureau has identified certain rulemakings or selected aspects thereof, however, that do not present significant implementation burdens for industry. Accordingly, the Bureau is setting earlier effective dates for those final rules or certain aspects thereof, as applicable. Those effective dates are set forth and explained in the **Federal Register** notices for those final rules.

IV. Legal Authority

The final rule was issued on January 17, 2013, in accordance with 12 CFR 1074.1. The Bureau is issuing this final 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."[58] TILA is a Federal consumer financial law.[59] Accordingly, the Bureau has authority to issue regulations

[58] 12 U.S.C. 5581(a)(1).
[59] 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 RESPA), Dodd-Frank section

pursuant to TILA, including implementing 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 rate resets or adjusts. Additionally, the savings clause in TILA section 128A(c) allows the Bureau, among other things, to require this notice for adjustable-rate mortgage loans that are not hybrid adjustable-rate loans. Dodd-Frank Act 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 contains 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 include such other information as the Bureau may prescribe in regulations. Dodd-Frank Act 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. The final rule, in addition to implementing these TILA provisions of the Dodd-Frank Act, amends the interest rate adjustment disclosures currently required by § 1026.20(c). The final 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

1400(b), 15 U.S.C. 1601 note (defining "enumerated consumer laws" to include certain subtitles and provisions of title XIV).

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 therewith. 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).

Historically, TILA section 105(a) has served as a broad source of authority for rules that promote the informed use of credit and the avoidance of 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 therewith. 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[60] 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 adopting regulations to carry out TILA's purposes and 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 therewith. In developing these aspects of the rule 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 consumer, including—(1) Any related financial arrangements of the consumer, as determined by the Bureau; (2) The financial sophistication of the consumer relative to the type of transaction; and (3) The importance to the consumer of the

[60] 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.

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 exempting certain transactions from the requirements of TILA pursuant to its authority under TILA section 105(f). In developing this final rule under TILA section 105(f), the Bureau has considered the relevant factors and determined that the proposed exemptions may be appropriate.

TILA section 122. Section 122 of TILA, 15 U.S.C. 1632, authorizes the Bureau to regulate, among other things, the form and content of disclosures for credit transactions made pursuant to Chapter 2 of TILA. Specifically, 122(a) requires that information required by this title must be disclosed clearly and conspicuously.

For the reasons discussed in this notice, the Bureau is requiring the provision of disclosures to consumers in certain forms and with certain content pursuant to its authority under TILA section 122. In developing this final rule under TILA section 122, the Bureau has considered the relevant factors and determined that the form and content requirements are appropriate.

Title X of 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). TILA and title X of the Dodd-Frank Act are Federal consumer financial laws. Accordingly, in adopting this final rule, the Bureau is

exercising its authority under Dodd-Frank Act section 1022(b) to prescribe rules to carry out the purposes of TILA and title X and prevent evasion of those laws.

Dodd-Frank Act section 1032. Section 1032(a) of the Dodd-Frank Act 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 Dodd-Frank Act 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 Dodd-Frank Act 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 the final rule under Dodd-Frank Act section 1032(a), 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 issuing portions of this rule pursuant to its authority under Dodd-Frank Act section 1032(a).

In addition, Dodd-Frank Act 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, uses a clear format and design, such as readable type font, and succinctly explains the information that must be communicated to the consumer. Dodd-Frank Act section 1032(b)(2); 12 U.S.C. 5532(b)(2). As discussed in the section-by-section analysis of §§ 1026.20(c) and (d) and 1026.41, the Bureau is issuing model and sample forms for ARM interest rate adjustment notices and sample forms for periodic statements. As discussed in this notice, the Bureau is adopting these model forms pursuant to its authority under Dodd-Frank Act section 1032(b)(1). As required under Dodd-Frank Act section 1032(b)(3), the Bureau has validated model forms issued under Dodd-Frank Act section 1032(b) through consumer testing.

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, section 1405(b) confers authority to "modify or exempt from disclosure requirements," in whole or in part, applies to 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, and is not limited to a specific statute or statutes. Accordingly, Dodd-Frank Act section 1405(b) is a broad source of authority to modify or exempt the disclosure requirements of TILA.

In developing rules for residential mortgage loans under Dodd-Frank Act section 1405(b), 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 issuing portions of this rule pursuant to its authority under Dodd-Frank Act section 1405(b). See the section-by-section analysis of each section of this final rule for further elaboration on legal authority.

V. 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 that govern many of the disclosures under subpart C of Regulation Z, including current ARM disclosures. The Bureau proposed revising the rule with regard to both the § 1026.20(c) ARM interest rate adjustment payment change notices and the § 1026.20(d) initial ARM interest rate adjustment notices.

Section 1026.17(a)(1) requires, among other things, that certain disclosures contain only information directly related to that disclosure. Section 1026.20(c) is not included in the list of rules governed by this general segregation requirement and commentary to § 1026.17(a)(1) confirms that § 1026.20(c) is not subject to this requirement.

The Bureau proposed revising § 1026.17(a)(1) and comment 17(a)(1)-2.ii to add § 1026.20(c) to the list of disclosures required to contain only information directly related to the disclosure and to include § 1026.20(c) among the subpart C disclosures required to be grouped together and segregated from other information. The Bureau stated that the purpose of the § 1026.20(c) payment change notices is to inform consumers of upcoming changes to their interest rate and mortgage payments and to give them time to explore alternatives. The Bureau stated that it believed that the current form requirements to which the § 1026.20(c) notices are subject were insufficient to highlight and emphasize important information consumers needed to make decisions about their adjustable-rate mortgages. The Bureau said that the revisions to § 1026.17(a)(1) and comment 17(a)(1)-2.ii would enhance consumers' awareness of this important information. The proposal also clarified that providers of § 1026.20(c) notices would have remained subject to the other § 1026.17(a)(1) form requirements, including that the disclosures be clear and conspicuous and in writing and that the disclosures could be provided electronically subject to compliance with Electronic Signatures in Global and National Commerce Act (E-Sign Act) (15 U.S.C. 7001 et seq.).

Although the Bureau received comments opposed to the revision of § 1026.20(c) in general, which are discussed below, the Bureau did not receive specific comments regarding its proposed changes to § 1026.17(a)(1). One bank did suggest that E-Sign Act not apply to the ARM disclosures such that they could be provided to consumers without their demonstrated

consent, which the bank said was difficult to obtain. The Bureau notes that E-Sign Act requirements apply to current § 1026.20(c) as well as to the other disclosures required under subpart C. Further, TILA section 128A specifically requires the ARM initial interest rate notices to be provided to consumers in written form. The Bureau believes these requirements can ensure that consumers receive the required disclosures and therefore declines to scale back this consumer protection. For the reasons discussed above, the Bureau is adopting as proposed revised § 1026.17(a)(1) and comment 17(a)(1)-2.ii. Thus, the disclosures required by § 1026.20(c) must comply with the form requirements of § 1026.17(a)(1) as revised.

As with § 1026.20(c) above, the proposal clarified that providers of the § 1026.20(d) notices would have been subject to the same § 1026.17(a)(1) form requirements, including that the disclosures be clear and conspicuous, in writing, and that they be permitted to be provided electronically subject to compliance with the E-Sign Act. However, the final rule revises § 1026.17(a)(1) with respect to the delivery of the notices required by § 1026.20(d). TILA section 128A, as added by Dodd-Frank Act section 1418 and implemented in § 1026.20(d), requires that initial ARM interest rate adjustment notices be "separate and distinct from all other correspondence to the consumer." Accordingly, the Bureau proposed that the § 1026.20(d) ARM initial interest rate adjustment notices must be provided to consumers separate and distinct from all other correspondence and, thus, that they would not be subject to the general segregation requirements of § 1026.17(a)(1). Proposed comment 20(d)(1)-2 interpreted the "separate and distinct" requirement as requiring the § 1026.20(d) notices to be provided to consumers in a separate envelope or as its own separate email apart from other servicer correspondence.

For the reasons discussed in the section-by-section analysis of § 1026.20(d) below, the Bureau is adopting comment 20(d)-3, which interprets the new TILA statutory language to

require that § 1026.20(d) notices be provided to consumers as a separate document, but permits it to be mailed in the same envelope or as a separate attachment in an email with other servicer correspondence. Accordingly, the final rule revises § 1026.17(a)(1) to require that § 1026.20(d) ARM notices be provided to consumers as a separate document, but not necessarily in a separate envelope or email. As a result of this change, both § 1026.20(c) and (d) are subject to revised § 1026.17(a)(1) and comment 17(a)(1)-2.i.

Legal Authority

The application of § 1026.17(a)(1), as modified, to § 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 final rule's 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 ARM notices.

TILA section 128A(b), as established by Dodd-Frank Act section 1418, specifically provides that the disclosures shall be in writing, separate and distinct from all other correspondence, which the Bureau interprets as consistent with the Regulation Z form requirements of § 1026.17(a)(1), as amended. In addition, the Bureau believes, consistent with Dodd-Frank Act section 1032(a), that the application of § 1026.17(a)(1) 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.

17(b) Time of Disclosures

Section 1026.17(b) generally establishes timing requirements for certain Regulation Z disclosures, among them rules with special timing requirements. The Bureau proposed revising § 1026.17(b) to add § 1026.20(d) to the list of variable-rate disclosure provisions with special timing requirements. This amendment would have alerted creditors, assignees, and servicers that, as with the § 1026.20(c) payment adjustment notices, there are timing requirements particular to the § 1026.20(d) initial interest rate adjustment notices. The Bureau received no comments regarding this revision and is adopting revised 1026.17(b).

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 by § 1026.20(c), the disclosures shall reflect the credit terms to which the parties are legally bound when the disclosures are provided. The Bureau proposed revising comment 17(c)(1)-1 to make clear that the disclosures required by § 1026.20(d), like those required by § 1026.20(c), must reflect the credit terms to which the parties are legally bound when the disclosures are provided, rather than at the outset of the transaction. The Bureau received no comments regarding this revision and is adopting revised comment 17(c)(1)-1.

Section 1026.18 Content of Disclosures

18(f) Variable Rate

Section 1026.18(f) sets forth the contents of disclosures required for certain variable-rate transactions. 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 § 1026.20(c). Under current § 1026.20(c), disclosures are permissive in such cases because the § 1026.19(b) substitution is permitted only for variable-rate transactions not secured by the consumer's principal dwelling or variable-rate transactions secured by the consumer's principal dwelling, with a term of one year or less. These types of transactions are not covered by current § 1026.20(c). Thus, comment 18(f)-1 does not alter the legal requirements applicable to creditors. The clarification was included in the comment, however, because § 1026.20(c) cross-references § 1026.19(b) and applies to transactions covered by § 1026.19(b).

The Bureau proposed removing this reference to § 1026.20(c) from comment 18(f)-1 because it would no longer have been helpful because proposed § 1026.20(c) and (d) did not cross-reference § 1026.19(b) and defined their scope of coverage without reference to § 1026.19(b). Moreover, § 1026.20(c) and (d) would have applied to some ARMs with terms of one year or less, such that applying the current comment would have created an unwarranted exemption from the requirement to provide ARM notices to consumers with such ARMs. For these reasons, the Bureau proposed to remove the reference to § 1026.20(c) in comment 18(f)-1.

The Bureau received no comments on this issue. However, as discussed below in the section-by-section analysis of § 1026.20(c)(1)(ii) and (d)(1)(ii), the final rule expands the construction loan exemption to all ARMs with terms of one year or less, thereby eliminating any need to revise comment 18(f)(1)-1. Thus, the Bureau is not adopting the proposed revision of comment 18(f)(1)-1.

Section 1026.19 Certain Mortgage and Variable-Rate Transactions

19(b) Certain Variable-Rate Transactions

Section 1026.19(b) requires disclosures for consumers applying for certain variable-rate transactions. 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 § 1026.20(d). Consistent with the proposed removal of current § 1026.20(d), discussed below, which exempts creditors, assignees, and servicers from the requirements of § 1026.20(c) if they have complied with disclosure requirements of other Federal agencies, the Bureau proposed revising comment 19(b)-4 to remove the reference to § 1026.20(c) and (d). The Bureau is issuing this aspect of the final rule as proposed, having received no comment on this issue.

The Bureau proposed revising comment 19(b)-5.i.C to cross-reference other commentary that makes clear that § 1026.20(c) and (d) would 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. Having received no comments on the above proposed change, the Bureau is issuing this aspect of the final rule as proposed.

The Bureau proposed revising comment 19(b)(2)(xi)-1 to include a reference to § 1026.20(d). 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 proposed adding to the comment a reference to § 1026.20(d), because those disclosures also would have

been provided to consumers under the Bureau's proposed rule. The proposed comment also made conforming changes to the text suggested for describing the ARM notices to reflect the timing and content of the § 1026.20(c) and (d) disclosures. Having received no comments on this change, the Bureau is adopting comment 19(b)(2)(xi)-1 as proposed.

Section 1026.20 Disclosure Requirements Regarding Post-Consummation Events

20(c) Rate Adjustments with a Corresponding Change in Payment

Overview

Section 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 non-payment change annual notice and the notices required each time the interest rate adjustment results in a corresponding payment change. Section 1026.20(c) also 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 amortize fully the loan at the new interest rate over the remainder of the loan term.

The Bureau proposed two major changes to § 1026.20(c). First, the Bureau proposed eliminating the non-payment change 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 stated that it believed that the 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 this annual notice, thereby greatly minimizing the need for its protections. Second, the Bureau's proposal would have amended current § 1026.20(c) by adding disclosures that the Bureau stated it believed would enhance protections for consumers with ARMs. The revisions to § 1026.20(c) also would have harmonized that section with the requirements the Bureau proposed for the initial ARM interest rate adjustment notice under § 1026.20(d), thereby promoting consistency between the Regulation Z ARM provisions.

The Bureau also would have revised the heading to § 1026.20 from "Subsequent Disclosure Requirements" to "Disclosure Requirements Regarding Post-Consummation Events." The Bureau proposed revising the heading for clarification because interest rate adjustments occur post-consummation, but, under certain circumstances, the ARM notices required under § 1026.20(d) may be provided at consummation and thus are not "subsequent disclosures". See the section-by-section analysis of § 1026.20(d) below. The Bureau also proposed revising the heading to § 1026.20(c) from "Variable-Rate Adjustments" to "Rate Adjustments with a Corresponding Change in Payment" to clarify that, pursuant to the proposed revision of § 1026.20(c), the disclosure would have been required only when the interest rate adjustment caused a change in the mortgage payment.

Elimination of annual disclosure. The Bureau proposed to eliminate the § 1026.20(c) annual notice required when an ARM's interest rate adjusts one or more times over the course of a year without any corresponding payment change. The Bureau noted that consumers who receive the current non-payment change 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 periodic statement would have provided consumers with comprehensive information about their mortgages each billing cycle. The periodic statement would have included 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 have provided other information that might be useful to consumers receiving the § 1026.20(c) annual notice, including information about any prepayment penalty; allocation of the consumer's payment by principal, interest, and escrow; the amount of the outstanding principal; contact information for the relevant State housing finance authority; and information to access a list of Federally-certified homeownership counselors.

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

The Bureau also proposed to remove current comments 20(c)(1)-1 and 20(c)(4)-1 which, among other things, address the content of the § 1026.20(c) non-payment change annual notice the Bureau proposed to eliminate. 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 period. 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 of the loan if the change resulted from the rate adjustment. The Bureau proposed removing these comments even though they also relate to the recurring disclosures that would have been required by proposed § 1026.20(c) for interest rate adjustments resulting in a corresponding payment change. The Bureau proposed replacing these comments with new commentary discussed below.

Many industry commenters, including a large bank and a national trade association, supported eliminating the § 1026.20(c) annual notice, which they characterized as costly and time consuming. One non-bank servicer, conversely, stated that the elimination of the annual notice did not provide any benefit for industry. A State enforcement agency and some consumer advocates supported discontinuation of the notice. Two comment letters from consumer groups recommended retaining the annual notice but this was based on their understanding that the annual notice is required whether or not any interest rate adjustment over the course of the year caused a corresponding adjustment to the payment. The Bureau clarifies that the current rule requires an annual notice only when, over the course of a year, one or more interest rate adjustments have occurred *without* any payment change. These consumer groups pointed to payment-option ARMs, which one consumer group recommended be made illegal because they are inherently unfair, as a reason for retaining the annual notice. They said such loans can have multiple interest rate adjustments without a payment change and payment changes occur only when the loan resets, which can be infrequent (resets generally occur when the principal balance reaches some maximum, such as 125 percent of the original loan amount).

For the reasons set forth in the proposal, the Bureau is adopting § 1026.20(c) as proposed, with respect to the elimination of the non-payment change annual notice. With regard to

concerns for consumers with payment-option ARMs, the Bureau believes that the comprehensive information that will be disclosed to consumers every billing cycle in the periodic statement the Bureau is adopting under § 1026.41—most notably the consumer's current interest rate and the date after which the interest rate will adjust and payment allocation information—provides information to such consumers that is superior to the information currently provided by the non-payment change annual notice under § 1026.20(c). The Bureau believes that the costs of requiring industry to provide both notices would outweigh the benefits consumers would garner from receiving this annual notice in addition to the periodic statement. The Bureau also notes that comment 20(c)(3)-1 recognizes that creditors, assignees, and servicers may provide consumers with the non-payment change annual notice voluntarily, in their own discretion.

Amendment of payment change disclosure. The Bureau proposed amending existing § 1026.20(c) as it relates to interest rate adjustments that result in a corresponding payment change. The proposed rule retained much of the content required in the current notice and added information that the Bureau stated it believed would help consumers better understand and manage their adjustable-rate mortgages. The revisions to current § 1026.20(c) would have harmonized that section with the requirements for the initial ARM interest rate adjustment notices the Bureau proposed in § 1026.20(d).[61] In addition, the revisions would have required the interest rate adjustment notice be provided earlier than is currently required. The Bureau noted that promoting consistency between the ARM disclosures required by § 1026.20(c) and (d) would reduce compliance burdens on industry and minimize consumer confusion.

[61] The Bureau worked with Macro to design and test model and sample forms (the model forms) for § 1026.20(d), but did not specifically test § 1026.20(c) model forms. Because of the similarity in the model forms for both rules, however, the results of the testing of § 1026.20(d) forms is relevant for § 1026.20(c) as well. Thus, throughout the section-by-section analysis below of § 1026.20(c), the Bureau refers to the testing results for § 1026.20(d), as appropriate.

A large servicer and several trade associations opposed the revision of § 1026.20(c), except for, as stated above, the Bureau's proposal to eliminate the non-payment change annual notice. These industry commenters questioned the Bureau's basis for revising a regulation they believed was not in need of improvement. Moreover, they noted that TILA section 128A, as established by Dodd-Frank Act section 1418, required the new § 1026.20(d) disclosure but did not mandate a revision of the existing ARM rule. In response to the proposal's reference to the Board's sweeping 2009 Closed-End Proposal, which proposed similar revisions to § 1026.20(c), these commenters pointed out that the Board never adopted a final rule. These commenters stated that the industry cost to revise the current disclosures, including compelling portfolio lenders to revise their proprietary product offerings, would outweigh the consumer benefits. They stated that the FHA, VA, and GSEs could not comply with the new timing requirements. One commenter stated that the current rule is superior to the one proposed by the Bureau. A few commenters stated that the ARM products that had contributed to the mortgage crisis have been largely removed from the market though refinancing or loan modification, thereby neutralizing any need to revise the current rule to provide heightened consumer protections. A research organization, a large bank, a trade association, and a credit union said that post-implementation testing was warranted to determine whether the Bureau's contention that consumers would be better informed as a result of receiving the revised § 1026.20(c) disclosures is correct. Further, three small banks stated that the Bureau's efforts to harmonize the two disclosures would not alleviate industry burden because the disclosures differed enough to require customized programming for each. Three comment letters from consumer groups, on the other hand, recommended expanding the content of the proposed § 1026.20(c) notice to include additional disclosures from the § 1026.20(d) notice, particularly the loss mitigation information.

The Bureau is adopting § 1026.20(c), with modifications to the revisions proposed by the Bureau. For the reasons stated above and throughout this final rule, the Bureau believes revision of the current rule furthers the purposes of TILA. Specifically, the Bureau believes the revision is appropriate and beneficial because consumers will better understand the costs and terms of adjustable-rate mortgages if they receive the ARM disclosures required by § 1026.20(c) and (d) in notices with consistent formatting and clear information. Further, consumers will be better able to make an informed use of credit if they receive this information with enough time to budget for any increase or to take appropriate action, such as pursuing refinancing or options offered by servicers relating to individual hardship. The Bureau believes that the additional time and clearer information provide benefits to consumers anticipating payment changes that outweigh the costs to servicers to implement these changes. Moreover, as discussed in the section-by-section analyses below, the Bureau believes that the § 1026.20(c) notice, which consumers may receive periodically, strikes an appropriate balance between disclosure of key information and overloading consumers with additional information that may or may not be applicable to their situations, such as loss mitigation options. For these reasons, the reasons set forth in the proposed rule, and the reasons discussed below in the analysis of each section of the rule, the Bureau is issuing its revision of § 1026.20(c).

Creditors, assignees, and servicers. The Bureau also proposed amending § 1026.20(c) to apply explicitly to creditors, assignees, and servicers. The Bureau stated that current § 1026.20(c) applied to creditors and existing comment 20(c)-1 clarified that the requirements of § 1026.20(c) also apply to subsequent holders, *i.e.*, assignees. Under the Bureau's proposal, the requirements of § 1026.20(c) would have applied to servicers, as well as to creditors and assignees. Proposed comment 20(c)-1 clarified, among other things, that a creditor, assignee, or

servicer that no longer owned the mortgage loan or the mortgage servicing rights would not have been subject to the requirements of § 1026.20(c).

In its proposal, the Bureau stated that it was appropriate to apply proposed § 1026.20(c) to servicers, as well as to creditors and assignees. The Bureau pointed out that 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 mortgages 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 mortgages. Moreover, it can be difficult for consumers to ascertain the identity of the creditor or assignee, even though servicers would have been required to identify the owner of a mortgage under the 2012 RESPA Servicing Proposal, pursuant to Dodd-Frank Act section 1463. The Bureau stated a similar rationale for its proposal that the requirements of § 1026.20(d) apply to assignees as well as to creditors and servicers.

For the reasons discussed above, proposed § 1026.20(c) would have required, as clarified by comment 20(c)-1, that any provision of subpart C governing § 1026.20(c) also would have applied to creditors, assignees, and servicers—even where the other provisions of subpart C referred only to creditors. The proposal also would have removed current comment 20(c)-1, which, among other things, referred to "subsequent holders," in favor of consistent usage of the term "assignee" in proposed § 1026.20(c) and (d). It also would have removed comment 20(c)-3 as duplicative of the § 1026.17(c)(1) requirement that the disclosures reflect the terms of the parties' legal obligations.

A trade association and a non-bank servicer commented on this portion of the proposed rule. They stated that civil liability for violations of TILA is determined by TILA sections 130 and 131 and that civil liability cannot be extended to servicers beyond the scope authorized under TILA. A State enforcement agency, in the other hand, commented that consumers should be able to seek relief against servicers for violations of § 1026.20(c).

The Bureau is adopting the rule as proposed. The Bureau is adopting comment 20(c)-1, with added language clarifying that, (1) creditors, assignees, and servicers that own either the applicable ARM or the applicable mortgage servicing rights, or both, are subject to the requirements of § 1026.20(d) and (2) although the rule applies to creditors, assignees, and servicers, those parties may decide among themselves which of them will provide the required disclosures.

The Bureau notes that current § 1026.20(c) does not mention creditors, assignees, or servicers. Thus, although the commentary explicitly references creditors and subsequent holders, neither the existing rule nor its commentary expressly exclude servicers from its requirements. The Bureau believes it is logical and appropriate to apply the requirements of § 1026.20(c) to servicers, as well as creditors and assignees of a mortgage loan. It is widely recognized that, since the implementation of § 1026.20(c) approximately 25 years ago, servicers have been providing the required disclosures to consumers with ARMs, as opposed to the creditors or assignees of those loans that are not otherwise considered servicers. As noted above, the servicer is the party with which consumers have contact on an ongoing basis regarding their mortgages. Servicers receive consumers' payments. Consumers communicate with their servicers regarding questions or problems 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. Thus, it is appropriate that servicers be included among the entities required to provide consumers with the disclosures under § 1026.20(c).

The Bureau further notes that the rule would have required creditors, assignees, and servicers to provide consumers with the disclosures required by § 1026.20(c) without referencing creditor, assignee, or servicer civil liability. Consistent with the proposal, the final rule and commentary set forth the obligations of creditors, assignees, and servicers but do not specifically address the issue of civil liability of any covered person in an action brought by a consumer. That issue is governed by TILA sections 130 and 131, and the Bureau's revisions do not purport to impose requirements inconsistent with TILA. For these reasons, and the reasons articulated in the proposal, the Bureau is adopting the final rule as proposed and comment 20(c)-1 as modified with regard to the application of § 1026.20(c) to creditors, assignees, and servicers.

As discussed in the legal authority section below, including servicers as covered persons under the requirements of § 1026.20(c) is authorized under, among other authorities, TILA section 105(a). Section 1026.20(c) is a servicing requirement and, as such, the Bureau believes that subjecting servicers to its requirements is 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. Also, TILA section 128(f), which applies to creditors, assignees, and servicers, provides authorization to include servicers within the scope of this rule. Finally, the Bureau notes that this revision of § 1026.20(c) is consistent with the scope of § 1026.20(d), such that both § 1026.20(c) and (d) now apply to creditors, assignees and servicers.

Loan modifications. A large bank and a national trade association recommended that the Bureau exempt loan modifications for financially-distressed consumers from the requirements of

§ 1026.20(c). They said that, among other reasons, requiring the notices in the context of a loan modification would delay execution of the loan modification by the 60 to 120 days advance notice required under the rule and that the § 1026.20(c) notice was not appropriate for loan modifications.

The Bureau notes that current § 1026.20(c) does not exempt loan modifications from its requirements. However, the Bureau agrees with this recommendation, and therefore, § 1026.20(c) limits coverage to interest rate adjustments pursuant to the ARM contract. Because interest rate adjustments occurring pursuant to a loan modification do not occur pursuant to the loan contract, they will not be subject to this rule and thus, will not delay execution of loan modification agreements. See comment 20(c)-2, which the Bureau is adopting in the final rule. The Bureau believes that an interest rate adjustment causing a payment change pursuant to a loan modification in a loss mitigation context does not require the consumer protections contemplated by § 1026.20(c). Such consumers have either agreed to the new interest rate prior to execution of the loan modification or are receiving the benefit of a lower rate and thus, are not at risk of payment shock. Because the loan modification is the actual result of pursuing alternatives to the payments otherwise required under their adjustable-rate mortgages, the advance notice afforded by the rule does not benefit such consumers.

For these reasons, as adopted, § 1026.20(c) exempts from its coverage interest rate changes occurring in the context of a loan modification executed as a loss mitigation measure. Comment 20(c)-2 clarifies, however, that the requirements of § 1026.20(c) do apply to interest rate changes that occur subsequent to the execution of a loan modification agreement, if the interest rate changes occur pursuant to the terms of the ARM contract as modified.

Conversions. In its proposal, the Bureau also stated that § 1026.20(c) would apply to ARMs converting to fixed-rate mortgages when the adjustment to the interest rate resulted in a corresponding payment change. Providing this notice would have alerted consumers to their new interest rate and payment following conversion from an ARM to a fixed-rate mortgage. Proposed comment 20(c)-2 explained that, in the case of an open-end account converting to a closed-end adjustable-rate mortgage, § 1026.20(c) disclosures would not be required until the implementation of the first interest rate adjustment that resulted in a corresponding payment change post-conversion. The Bureau analogized the conversion to consummation. Thus, like other ARMs subject to the requirements of proposed §1026.20(c), disclosures for these types of converted ARMs would not have been required until the first interest rate adjustment following the conversion which resulted in a corresponding payment change. The proposed rule would have been consistent with existing comment 20(c)-1 and proposed § 1026.20(d) regarding conversions.

A large bank and a national trade association requested that the Bureau clarify that the requirement of § 1026.20(c) to provide disclosures in the case of an ARM converting to a fixed-rate transaction does not apply to loan modifications made as part of loss mitigation efforts. Applying this measure to loan modifications, they stated, would harm the consumer by, among other things, needlessly delaying execution of the loan modification to comply with the rule. This recommendation is moot in view of the Bureau's decision to limit the scope of coverage of § 1026.20(c) to ARMs adjusting pursuant to the loan contract, thereby exempting all loan modifications executed as a loss mitigation measure from the requirements of § 1026.20(c).

A credit union stated that providing this disclosure would be redundant and confusing to consumers. The Bureau believes that consumers whose interest rates will change as a result of

such conversions would benefit from receiving the § 1026.20(c) notice alerting them to the upcoming change, especially if the conversion occurs automatically under the loan contract. The Bureau is adopting proposed § 1026.20(c) without modification. The Bureau also is adopting comment 20(c)-3, originally proposed as 20(c)-2, which interprets § 1026.20(c) with regard to conversions. The final rule removes current comment 20(c)-1.

Legal Authority

The Bureau amends § 1026.20(c) pursuant to its authority under TILA section 105(a). For the reasons discussed in the section-by-section analysis of each of the amendments to § 1026.20(c), the Bureau believes that the amendments are necessary and proper to effectuate the purposes of TILA, including to assure a meaningful disclosure of credit terms, avoid the uninformed use of credit, and protect consumers against inaccurate and unfair credit billing practices, as well as to prevent circumvention or evasion of TILA. Section 1026.20(c) is further authorized under Dodd-Frank Act section 1405(b), which permits the Bureau to modify disclosure requirements where such modification is in the interest of consumers and the public. For the reasons discussed above and below, the Bureau believes that its modification of 1026.20(c) serves the interests of both consumers and the public.

Section 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." Although TILA section 128(f) authorizes the Bureau to require that the content of periodic disclosures, such as those required by § 1026.20(c), be included in the periodic statement, for the reasons set forth above and below, the Bureau believes that providing this information as a separate disclosure would

better serve consumers. Under § 1026.17(a), as discussed above, the § 1026.20(c) ARM payment adjustment notice must be separate and distinct from the periodic statement but may be provided to consumers together with the periodic statement and, depending on the mode of delivery, in the same envelope or as an additional email attachment. The Bureau also believes that the interest of consumers and the public interest are better served by receiving the § 1026.20(c) ARM notice, within the timeframe discussed below, each time ARM interest rate adjustments result in a corresponding payment change, rather than with each billing cycle of the periodic statement.

Further, the Bureau believes, consistent with Dodd-Frank Act section 1032(a), that the formatting requirements ensure that the features of the ARM loans covered by § 1026.20(c) 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.

20(c)(1) Coverage

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

Proposed § 1026.20(c)(1)(i) defined an adjustable-rate mortgage or ARM, 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. The proposed rule used the wording from the definitions of "adjustable-rate" and "variable-rate" mortgage in subpart C of Regulation Z to promote consistency within the regulation. Proposed comment 20(c)(1)(i)-1 explained that the definition of "ARM" meant "variable-rate mortgage" as that term is used elsewhere in subpart C of Regulation Z, except as would have been provided in proposed

comment 20(c)(1)(ii)-3. Having received no comment on this issue, the Bureau is adopting the final rule and comment 20(c)(1)(i)-1 is adopted as proposed.

In its proposal, the Bureau noted that 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 proposed deleting the cross-reference to § 1026.19(b), which otherwise would have expanded the scope of § 1026.20(c) to include loans with terms of one year or less. Current § 1026.20(c) and comment 20(c)-1would have been removed in favor of proposed § 1026.20(c)(1)(i) with regard to which loans are subject to the interest rate adjustment disclosures. Having received no comment on the proposed elimination of the cross-reference to § 1026.19(b), the Bureau is adopting the final rule as proposed.

The Bureau proposed 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 clarified that the term "variable-rate transaction," as used in § 1026.19(b) and elsewhere in Regulation Z, was synonymous with the term "adjustable-rate mortgage" or "ARM," except where specifically distinguished. The Bureau proposed this revision because "adjustable-rate mortgage" and "ARM" are the terms commonly used for mortgages covered by current and proposed § 1026.20(c) and (d). Having received no comments on this topic, the Bureau is adopting the final rule as proposed.

Proposed comment 20(c)(1)(i)-1 also clarified that the requirements of § 1026.20(c)(1)(i) would not be limited to transactions financing the initial acquisition of the consumer's principal dwelling, but 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). Having

received no comments on this subject, the Bureau is adopting the final rule and comment 20(c)(1)(i)-1 as proposed.

20(c)(1)(ii) Exemptions

In General

Proposed § 1026.20(c)(1)(ii) set forth two exemptions from the disclosure requirements of § 1026.20(c). These exemptions applied 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 was 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 have been required by proposed § 1026.20(d). Section 1026.20(d) also proposed the same construction loan exemption. Proposed comments 20(c)(1)(ii)-1 and -2 provided clarification of these exemptions, and proposed comment 20(c)(1)(ii)-3 clarified that certain loans are not ARMs if the interest rate or payment change is based on factors other than a change in the value of an index or a formula.

In response to comments received from industry representatives, the final rule expands the construction loan exemption to all ARMs with terms of one year or less. Industry commenters requested other exemptions from § 1026.20(c) that the Bureau declines to adopt, for the reasons discussed below.

Exemptions from the Rule

ARMs with terms of one year or less. The proposed rule would have included an exemption for construction ARMs with terms of one year or less. As set forth in the proposal, the Bureau said it believed that 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 the completion of construction and permanent financing can be put into place. The Bureau stated that consumers with construction ARMs were not at risk of payment shock as they may be with other ARMs where interest rates changed less frequently. Moreover, given the frequency of interest rate adjustments on construction loans, creditors, assignees, and servicers would have experienced difficulty complying with the proposed requirement to provide the notice to consumers between 60 and 120 days before the first payment at a new level was due for each adjustment that resulted in a corresponding payment change. The Bureau concluded that requiring § 1026.20(c) notices for these loans would not have provided a meaningful benefit to the consumer nor would it have improved consumers' awareness and understanding of their construction ARMs with terms of one year or less.

The Bureau solicited comments on whether there were other ARMs with terms of one year or less, and whether such ARMs should be exempt from the requirements of § 1026.20(c). If the time period of the advance notice for consumers required by the Bureau's proposal was not appropriate for these short-term ARMs, the Bureau solicited comments on what period would have been appropriate that also would have provided consumers with sufficient notice of the upcoming interest rate adjustment and new payment.

A number of commenters, including two large servicers, a home builder trade association, and a bank trade association, recommended that the Bureau expand the proposed short-term construction exemption to other short-term financing originated by consumers for consumer purposes. In addition to construction ARMs, such ARMs would include home improvement, bridge, and other short-term consumer loans. Commenters echoed the reasoning articulated above by the Bureau in favor of the construction loan exemption to support their

recommendation to extend the exemption to all consumer ARMs with terms of one year or less. They reasoned that the short term and frequent creditor contact with consumers common to these loans insulates consumers from the payment shock risk occasioned by ARMs without these characteristics. Commenters also pointed out that the rate changes of such short-term ARMs are often tied to movement in an index, rather than a date certain, making compliance with the 60- to 120-day advance notice requirement virtually impossible to satisfy. One trade association also recommended the Bureau clarify that the exemption is restricted to ARMs taken out by consumers as opposed to those made directly to home builders and that the exemption extends to construction loans structured in a variety of ways.

The Bureau is persuaded that, as in the case of 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 the consumer distinguish these additional forms of short-term consumer financing from other ARMs. For the same reasoning underpinning the Bureau's decision to adopt an exemption for construction ARMs with terms of one year of less, the final rule exempts from the requirements of § 1026.20(c) all ARMs taken out by consumers with terms of one year or less. The Bureau notes that the ARM rules apply only to consumer loans and that comment 20(c)(1)(ii)-1, which the Bureau is adopting as proposed, applies the standards in current comment 19(b)-1 for determining the term of a construction loan and adds clarification regarding what other types of loans qualify for the expanded short-term ARM exemption.

New payment due for the first time within 210 days after consummation. The Bureau also proposed an exemption from the requirements of § 1026.20(c) for the first ARM adjustment causing a change in payment, if the first payment at the adjusted level was due within 210 days

after consummation. As clarified by proposed comment 20(c)(1)(ii)-2, this exemption would have applied only if the exact interest rate, not an estimate, was disclosed at consummation. For ARMs adjusting within six months of consummation, which may be within 210 days before the first payment was due at the new level, the disclosures proposed by § 1026.20(d) would have been required at consummation. The Bureau reasoned that having received the exact amount of the new interest rate and payment at consummation and the recency of consummation would have obviated the need for the first § 1026.20(c) notice in this circumstance because consumers would have been apprised of the actual upcoming adjustment and payment change by receiving the § 1026.20(d) notice just months prior to its occurrence. Thus, the Bureau reasoned, providing § 1026.20(c) disclosures in these circumstances would have been duplicative, would not have contributed to consumer awareness and understanding, and would not have provided a meaningful benefit to consumers. On the basis of this reasoning and in the absence of comments on this issue, the Bureau integrates this exemption in § 1026.20(c) and is adopting comment 20(c)(1)(ii)-2.

Non-ARM loans. Proposed comment 20(c)(1)(ii)-3 discussed other loans to which the rule would not have applied. Proposed comments 20(c)(1)(ii)-3 and 20(d)(1)(ii)-2 were consistent with regard to the loans which would not have been 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 clarified that, for purposes of § 1026.20(c), the following loans, if fixed-rate transactions, would not have been considered ARMs and therefore would not have been 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 Bureau observed that the particular features of these types of loans might trigger interest rate or payment changes over the term of the loan or at the time the consumer pays off the final balance. However, the Bureau stated that these changes were based on factors other than a change in the value of an index or a formula. Because the enumerated loans would not have been ARMs under the proposed rule they would not have been covered by proposed § 1026.20(c) and, thus, would not have required disclosures.

The Bureau stated that proposed and current § 1026.20(c) were generally consistent with regard to the ARMs to which they would not apply. The principal difference was that current § 1026.20(c) applied to renewable balloon-payment instruments and preferred-rate loans, even if structured as fixed-rate transactions, while proposed § 1026.20(c) would not have applied to such loans. *See* § 1026.19(b) and comment 19(b)-5.i.A and B. Also, as discussed above, current § 1026.20(c) would not have applied to loans with terms of one year or less. This category included construction loans, which would have been exempted from coverage under proposed § 1026.20(c). The Bureau also noted that its proposed exemption for certain initial § 1026.20(c) ARM adjustments would have been inapplicable to the current rule because proposed § 1026.20(d) would not yet have been implemented to replace at consummation the disclosures required by current § 1026.20(c) for the first (and all ensuing) interest rate adjustments.

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). Thus, these loans are not subject to current § 1026.20(c) nor would they have been subject to the proposed rule.

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, under the Bureau's proposal, these loans would not have been considered adjustable-rate mortgages and therefore would not have been subject to the disclosures required in proposed § 1026.20(c). The Bureau explained that the particular features of these types of loans might trigger interest rate or payment changes over the term of the loan or at the time the consumer pays off the final balance but that these changes would have been based on factors other than a change in the value of an index or a formula. To illustrate that point, the Bureau explained that whether or when the interest rate would adjust for a preferred-rate loan with a fixed interest rate would likely not be knowable to the creditor, assignee, or servicer between 60 and 120 days in advance of the due date for the first payment at a new level after the adjustment. The Bureau went on to explain that this was because the loss of the preferred rate would have been based on factors other than a formula or change in the value of an index agreed to at consummation. The Bureau pointed out the Board had also proposed to remove renewable balloon-payment instruments and preferred-rate loans from coverage under § 1026.20(c) in its 2009 Closed-End Proposal.[62] The Bureau received no comments on this topic and, thus, is adopting the rule and comment 20(c)(1)(ii)-3 as proposed.

Requested Exemptions

[62] 74 FR 43232, 43264, 43387 (Aug. 26, 2009).

No small servicer exemption or integration of ARM notices into the periodic statement. The proposed and final rules do not exempt small servicers from the requirements of § 1026.20(c) and (d), despite the recommendation for such an exemption from many community banks and credit unions and the trade associations representing them. Also, after considering comments received in response to its solicitation of whether § 1026.20(c) and (d) disclosures should be permitted to be integrated into the periodic statement, the Bureau is not adopting this measure. For a full discussion of the Bureau's consideration of these issues for both § 1026.20(c) and (d), see the section-by-section analysis of § 1026.20(d)(1)(ii) below as well as the regulatory flexibility analysis in part VIII.

Other exemptions requested. For a discussion of requests regarding payment-option ARMs and reverse mortgage ARMs, see the section-by-section analysis of § 1026.20(d)(1)(ii) below. One large bank recommended an exemption from the requirements of § 1026.20(c) for consumers in bankruptcy, because it said the § 1026.20(c) notice would be redundant and conflict with the timing of the interest rate adjustment required under Federal bankruptcy law 21 days in advance of the payment change. The Bureau declines to use its exception authority for this purpose. The Bureau notes that these ARMs are subject to the current rule and it does not agree that the requirements of § 1026.20(c) are redundant or conflict with bankruptcy law. On the contrary, providing the § 1026.20(c) notice earlier than the timeframe required under the bankruptcy law enhances consumer protection by providing these consumers with additional time to adjust to an increase in their mortgage payments.

A large bank requested exemption from the requirements of § 1026.20(c) when a consumer with an ARM has been referred to foreclosure, the servicer has determined that the consumer has abandoned the property at issue, or the servicer has received no payment nor had

any contact with the consumer in more than six months. The Bureau notes that these ARMs are subject to the current rule and the commenter neither showed evidence of undue burden nor otherwise set forth reasoning justifying scaling back existing consumer protections. The Bureau believes that even consumers who have ceased making payments or abandoned the property can benefit from being alerted to and understanding the rate at which interest is accruing. Further, in some cases, the disclosures may cause consumers to take action to mitigate their losses.

20(c)(2) Timing and Content

Rate Adjustment Disclosures

Timing

Proposed § 1026.20(c)(2) would have required ARM disclosures to be provided to consumers between 60 and 120 days before the first payment at the adjusted level was due. Under current § 1026.20(c), notices must be provided to consumers between 25 and 120 days before the first payment at a new level is due. Thus, the proposed rule would have increased the minimum advance notice to consumers from 25 to 60 days before a new payment amount was due for the first time. The two circumstances under which the rule proposed a timeframe that differed from the proposed general rule are discussed below. Proposed comment 20(c)(2)-1 would have replaced current comment 20(c)-1 regarding timing.

60 to 120 day advance notice. Current § 1026.20(c) requires disclosure of the new interest rate and payment between 25 and 120 days before the first payment at the adjusted level is due. Under the proposed rule, the notice would have been required between 60 and 120 days before the first payment at the new level is due. The longer timeframe under the proposal, the Bureau explained, was intended to give consumers more time to adjust their finances to the actual amount of the increase in their mortgage payments caused by a rise in interest rates.

Further, for consumers who were not able to make the higher payment, the longer timeframe would have provided additional time to refinance or take other loss mitigating actions. The Bureau stated that the current minimum time of 25 days did not give consumers sufficient time either to adjust their finances or to pursue meaningful alternatives such as refinancing, home sale, loan modification, forbearance, or deed-in-lieu of foreclosure. The Bureau cited research conducted for the years 2004 through 2007 suggesting that a requirement to provide ARM adjustment disclosures 60, rather than 25, days before the first payment at the adjusted level is due more closely reflects the time needed for consumers to refinance a loan.[63] In the current market, the Bureau said, the nation's biggest mortgage lenders take an average of more than 70 days to complete a refinance.[64]

The Bureau said that for most adjustable-rate mortgages, the proposed 60-day minimum timeframe would have provided sufficient time for creditors, assignees, and servicers to comply with the rule. Through outreach to servicers of adjustable-rate mortgages, the Bureau learned that, for most ARMs, servicers knew the index value from which the new interest rate and payment would be calculated at least 45 days before the date of the interest rate adjustment. Because interest on consumer mortgage credit generally is paid one month in arrears, this meant that, for most ARMs, servicers would 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 began 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

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[63] Robert B. Avery et al., *The 2007 HMDA Data*, Fed. Reserve Bull., Dec. 23, 2008, at A107.
[64] 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.

change date on which the index value would be selected which would serve as the basis for the new interest rate and payment. In general, the Bureau observed, 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 would fall on the first of the month following the change date.

Based on outreach conducted by the Bureau, it appeared that small servicers often sent out the payment change notices required by § 1026.20(c) on the same day the index value was selected. In that case, for a loan with a 45-day look-back period, the notice would be ready 45 days before the change date and, with an approximately 30-day billing cycle between the change date and the date the first payment at the new level would be due, the interest rate adjustment notice could be provided to the consumer approximately 75 days before the new payment was 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 was due.

On the other hand, the Bureau observed in the proposed rule that many large creditors, assignees, and 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 ensure the notices are correct.[65] In these cases, for a loan with a 45-day look-back period, the payment change notices could be provided between approximately 42 and 35 days prior to the change date, which was either 70 to 73 or 63 to 66 days before the new payment was 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 13 days. For loans with the shortest

[65] The Bureau noted that no creditor, assignee, or servicer it contacted used a system employing an automatic feed of information from the publisher of an index source. All data was entered and verified manually.

verification period of three days, the payment change notice could be provided to consumers 70 days prior to payment due at a new level.

The Bureau therefore concluded that for most ARMs, creditors, assignees, and servicers could, consistent with their current practices, comply with the 60-day time period the Bureau proposed. The Bureau solicited comments about the proposed timing of the § 1026.20(c) notice, including the feasibility of applying the 60-day period to ARMs that have look-back periods of less than 45 days, whether a look-back period of 45 days or longer was feasible going forward for loan products that currently used shorter look-back periods and, if not, why not. The Bureau also solicited comments on the extent, if any, to which the relative length of the look-back period might affect the interest rate risk for the creditor, assignee, or servicer. It also queried about the operational changes that would be required to provide § 1026.20(c) notices at least 60 days before the first payment at a new level was due. Comment was requested on any factors that would hinder compliance with this timeframe. In light of technological and other advances since the promulgation in 1987 of current § 1026.20(c), the Bureau also solicited comments on whether, and if so why, lengthy verification periods were necessary and on the feasibility of reducing the length of these verification periods.

Three consumer groups and a research organization suggested modifying the proposed rule to allow advance notice of at least 70 to 90 days or more instead of the proposed 60 days advance notice. These entities stated that the proposed time was insufficient for consumers to take steps to ameliorate losses posed by a rise in ARM interest rates and payments. Because loan modifications and refinancings with existing lenders are likely to fail, said one consumer group, consumers should have additional advance warning to allow for consideration of additional loss mitigation applications with prospective lenders. The research organization noted that 60 days

may be too short in a market, such as the current one, in which refinancing takes approximately 70 days.

The Bureau recognizes that longer advance notice provides consumers with more of an opportunity to adjust to an interest rate increase. The Bureau also realizes that, at least in today's market, certain types of transactions, such as refinancing or a home sale, often cannot be completed within 60 days. Nonetheless, the Bureau believes that the proposed 60-day notice effectively balances consumer protection considerations against the practical realities and costs that would be entailed in requiring even longer notice periods. Whether or not consumers can complete loss mitigating options pursued during this 60-day period, they can advance towards that goal and take measures to financially prepare for the payment change. Further, the advance notice shortens the time period in which consumers would have to pay at a higher level before completing a refinancing or other alternative. Also, 45-day look-back periods are the norm for ARM contracts and, once the grandfather period expires, their dominance in the market likely will grow as look-back periods of less than 45 days become obsolete. As discussed above, many entities servicing ARMs with look-back periods of less than 45 days would not be able to meet even the 70-day, let alone the 90-day or longer, deadline recommended. For these reasons, the final rule requires that the § 1026.20(c) ARM disclosures be provided to consumers at least 60, and not 70 or more, days in advance of the date the first payment at a new level is due after a rate adjustment. The portion of proposed comment 20(c)(2)-1 setting forth a scenario for providing the payment change notices for an ARM with a look-back periods of 45 days, is removed as unnecessary. The one industry commenter addressing the issue of verification periods, stated that no institution, large or small, should require a verification period in excess of three days.

Many industry commenters opposed the new timeframe as unworkable—even for ARMs with 45-day look-back periods. This opposition, however, appears to be based on the erroneous perception that the proposed rule would require them to provide the § 1026.20(c) notice between 60 and 120 days before *the interest rate adjustment date*, rather than before the *date the first payment at a new level is due*. As discussed above, in addition to an ARM's look-back period of 45 days, there is an additional 30 days before the new payment is due because interest for consumer mortgages generally is paid one month in arrears.

One small bank requested clarification as to whether "provided" means the date the notice is produced or mailed. Comment 20(c)(2)-1 is modified in the final rule to clarify that the requirement that § 1026.20(c) disclosures be provided to consumers within a certain timeframe means that the disclosures must be delivered or placed in the mail within that timeframe. Thus, creditors, assignees, and servicers need not calculate delivery or mailing time into the 60- to 120-day timeframe and those servicing ARMs with look-back periods of 45 days or longer can comply with the proposed timeframe. The final comment also is modified to clarify that the timeframe excludes courtesy, as well as grace, periods.

Some industry commenters opposed revision of § 1026.20(c), in part, on the grounds that, in their view, the current rule provides for sufficient notice to consumers, the Bureau had not shown that consumers need lengthier advance warning, and the additional advance warning was an insignificant change or would not provide sufficient time for consumers to refinance in any event. Two national trade groups and a credit union opposed the revision of the rule because, among other things, they claimed that the cost of an ARM product increases with the length of its look-back period. They also stated that it would be difficult and costly to change from the current to the proposed notice.

For the reasons articulated above in the proposed rule and for the following reasons, the Bureau is adopting § 1026.20(c) as proposed with regard to the advance notice requirements. The Bureau also is adopting comment 20(c)(2)-1, with modification to clarify, that "provide" means deliver or place in the mail and to clarify that the 60- to 120-day timeframe excludes any courtesy, as well as grace, period.

Through the first eight months of 2012, ARMs financed approximately 10 percent of the outstanding balance of new home-purchase.[66] Of the three million ARMs with outstanding balances at the end of October 2012, the Bureau was able to ascertain the length of the look-back period for the 1.9 million ARMs guaranteed by Freddie Mac, Fannie Mae, or Ginnie Mae.[67] Seventy-five percent of those ARMs have 45-day look-back periods. Thus, creditors, assignees, and servicers can comply with the new 60- to 120-day timeframe without changing the look-back periods of their ARMs for 75 percent of the approximately 2/3s of all outstanding ARMs for which the length of the look-back period is known.

The commenters stating that the cost of an ARM increases with the length of the look-back period did not submit any data to support this point. The Bureau's research found no causal relationship between the level of an ARM's margin and a 15-, 30- or 45-day look-back period, when controlling for consumer characteristics such as Loan-to-Value (LTV), credit score, and Debt-to-Income (DTI) ratios.[68] Thus, the Bureau believes it is unlikely that, for the minority of ARM products with look-back periods of 15 or 30 days, requiring that new ARMs incorporate a slightly longer look-back period will meaningfully impact the manner in which the product is

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[66] CoreLogic, TrueStandings Service, *available at* http://www.corelogic.com/about-us/data.aspx#container-Mortgage (data service accessible only through paid subscription) (reflects first-lien mortgage loans).
[67] Core Logic, TrueStandings Service.
[68] Fed. Hous. Fin. Agency (dataset derived from FHFA's Historical Loan Performance (HLP), a confidential supervisory database).

priced. For example, it is unlikely that a creditor offering a 3/1 ARM could reasonably determine a substantial difference in valuation at origination between an interest rate adjustment 1,050 days in the future as opposed to 1,065 days in the future.

The Bureau disagrees with commenters stating that the current rule provides for sufficient notice to consumers, that the Bureau has not shown that consumers need lengthier advance warning, or that the additional advance warning would not provide sufficient time for consumers to pursue alternatives such as refinancing. Knowing the exact amount of their interest rate and payment between 60 and 120 days before the first new payment is due allows consumers more time to sell their homes or seek loss mitigating alternatives such as refinancing, loan modification, or deed-in-lieu of foreclosure—or at least to adjust their finances to an upcoming increase in rate and payment. The Bureau believes the current rule does not provide consumers with sufficient time to pursue these loss mitigation options. While each consumer electing to pursue alternatives may not be able to finalize a loss mitigation option by the time the first payment at the new level is due, increasing the minimum advance notice from 25 to 60 days provides consumers with enough time to at least make significant progress toward, if not complete, a refinancing or a loss mitigation option, or adjust their finances in anticipation of the increased payment. As a result, even for consumers who cannot complete an alternative within 60 days, the additional advance notice shortens the time period in which consumers would have to pay at a higher level before completing a refinancing or other alternative.

25 to 120 day advance notice permitted for some ARMs. As discussed above, in putting forward its proposal, the Bureau recognized that some ARMs have look-back periods shorter than 45 days. Specifically, the Bureau noted that ARMs backed by the FHA and VA have look-back periods of 15 or 30 days. The Bureau also noted that for some ARMs the adjustment is

based on the published index as of the first business day of the month preceding the effective date of the interest rate change. Because 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's proposal would have permitted a time period other than between 60 and 120 days.

First, the Bureau proposed to alter the timing requirements for ARMs adjusting for the first time within 60 days of consummation where the new interest rate disclosed at consummation pursuant to § 1026.20(d) was an estimate, rather than the actual rate that would go into effect when the ARM adjusts. (Under the proposal, if the actual rate had been disclosed at consummation, such loans would have been exempt from the rule pursuant to § 1026.20(c)(1)(ii)(B) The Bureau noted that compliance with the 60- to 120-day timeframe would not have been possible for such loans. For this reason, for such loans, the Bureau proposed that the § 1026.20(c) payment change notice be provided to consumers as soon as practicable, but not less than 25 days before the first payment at a new level was due. The Bureau received no comments on this altered timeframe and is adopting the rule as proposed.

Second, the Bureau proposed retention of the current timeframe of between 25 and 120 days before the first payment at the new level is due for ARMs with look-back periods of less than 45 days originated before July 21, 2013. The Bureau realized that the creditors, assignees, and servicers of existing ARMs with shorter look-back periods would not have been able to comply with the proposed timeframe and would need some time to adjust their products so that they could originate ARMs that could comply. Although this timeframe would have provided less advance notice to some consumers than generally provided under the proposed rule, the Bureau proposed to grandfather these ARMs to prevent altering existing contractual agreements

regarding the look-back period. The Bureau made clear that after July 21, 2013, new ARMs would have had to be structured to permit compliance with the 60- to 120-day timeframe. The Bureau solicited comments regarding this proposed grandfather period. It also queried whether the proposed, or some other, expiration date for the grandfather time period would be preferable. Finally, the Bureau solicited comments on whether other ARMs should be allowed to comply with a 25- to 120- day notice period.

Many industry entities commented on the proposed grandfather period for ARMs with look-back periods of less than 45 days and on the issue of an effective date for the final TILA mortgage servicing rules in general and the ARM rules in particular. Two credit unions recommended against grandfathering; one stated that it was unnecessary and the other that it would create dual procedures for § 1026.20(c) notices. Two trade associations noted that their members would have to maintain bifurcated system functionalities for grandfathered versus non-grandfathered ARMs, which could lead to potential errors and reduced customer service. A large bank recommended allowing two timeframes for ARMs: the 60-day minimum advance notice for ARMs with look-back periods of 45 days or more and the 25-day minimum advance notice for ARMs with shorter look-back periods. That bank went on to say that no grandfather period was needed because, once government agencies no longer insured ARMs with look-back periods of less than 45 days, ARMs with short look-back periods would disappear. A large non-bank servicer agreed with the Bureau's proposed timing. One large bank recommended grandfathering ARMs where it would have to determine an index rate on a business day and thus, must look back 46 or 47 days. The Bureau notes that it received no other comments on this last point and refers to its analysis above illustrating how ARMs with look-back periods of 45 days or longer can comply with the proposed rule.

Industry commenters generally recommended an implementation period longer than one year. They stressed the added burden of having to simultaneously implement other Bureau-mandated rules. Generally, commenters said that one year was insufficient for servicers to design, develop, and implement the required system enhancements to provide the capability to generate the new automated 60-day ARM notices and to permit time for necessary adjustments by other parties, such as lenders, technology and form vendors, and attorneys. A large bank reported that these system changes would include reprogramming origination and servicing systems to board loans originated after the grandfather period. In general, commenters recommended an implementation period of between 18 to 30 months after publication of the final rule.

Many commenters recommended that the Bureau tie the grandfather period to the effective date of the final rule rather than impose a date certain. Several large- and medium-sized servicers and national industry trade groups recommended the Bureau grandfather all ARMs with look-back periods of less than 45 days until one year or longer after the GSEs, FHA, and VA issued final changes to their mortgage contracts. This way, they said, creditors could make the changes necessary to issue ARMs that could comply with requirements of § 1026.20(c). Other commenters requested tying the grandfather deadline to when investors in GSEs and government mortgage programs have completed the required changes to their guidelines because creditors, in turn, have to revise their products and work with investors to update their documents and guidelines. One large bank recommended an 18 to 24 month phase-in period, taking into account any additional time necessary for the FHA, VA, and GSEs to adjust their loan contracts, with a minimum of at least 12 months for compliance after they finalize the required changes. This bank suggested the alternative of making compliance

voluntary 12 months after publication of the final rule in the **Federal Register** and mandatory by July 2014.

The Bureau understands that creditors originating loans insured by FHA and VA must satisfy the requirements established by those agencies. These creditors will not be able to originate FHA or VA ARMs with look back periods of 45 days or longer until those agencies modify their policies governing look-back periods. Based on discussions with those agencies, the Bureau has decided to grandfather ARMs with look-back periods of less than 45 days originated prior to one year after the effective date of the final rule. Thus, for such ARMs, the final rule provides a year beyond the one year implementation period for the transition to ARMs with look-back periods of 45 days or more.

Consultation with government agencies that guarantee ARMs with look-back periods of less than 45 days revealed, in addition to there being no substantive reason to retain those specific look-back periods, an expectation that they could complete their processes, including any required rulemaking, well within the grandfather period. In addition, the Bureau expects that any other investors or guarantors will make conforming changes to the look-back periods of their loan products by the time the grandfather period expires. In light of this, the Bureau believes that establishing a date certain for the expiration of the grandfather period is preferable to adopting an indeterminate period and pinning consumer protections to the indefinite future date. To provide consumers with the protections contemplated by § 1026.20(c) and for the reasons discussed above, the Bureau is extending the proposed grandfather period by 18 months such that § 1026.20(c) grandfathers ARMs with look-back periods of less than 45 days originated prior to one year after the effective date of the final rule, *i.e.*, such ARMs originated prior to

January 10, 2015. See part VI below for a discussion of the effective date for the 2013 TILA Servicing Rule.

Four trade associations and a credit union recommended grandfathering all ARMs originated prior to the effective date of the rule. The Bureau believes that, for all the reasons discussed throughout the section-by-section analysis, consumers with ARMs originated prior to the effective date of the rule but which, after that date, have an interest rate adjustment with a corresponding payment change can benefit from the consumer protections afforded by § 1026.20(c) as much as consumers with ARMs originated after the effective date. In many of these cases, adjustments will occur a year or more after the effective date of the rule, exposing those consumers to the same risk of payment shock as those whose ARMs originate after the effective date. Therefore, once the final rule takes effect, except for ARMs with look-back periods of less than 45 days covered by the grandfather period, it applies to all ARMs with interest rate adjustments causing payment changes.

A large bank affiliate originating mortgage loans to clients of its affiliated wealth management businesses submitted comments in favor of retaining the 25- to 120- day compliance period to preserve short-term index loans, *i.e.*, ARMs with frequent interest rate adjustments. The commenter stated that these loans are in demand by certain sectors of the marketplace and offer benefits to those consumers. Because the interest rates of most short- term index loans adjust at least monthly, under the proposed 60- to 120-day timeframe, creditors would have no choice but discontinue such products.

The Bureau agrees with the commenter's rationale for preserving these frequently adjusting ARMs. Unlike most ARMs with interest rates that adjust annually or every three, five, seven, or ten years, short-term index loans adjust so often as to obviate the risk of payment

shock. Consumers whose interest rates adjust monthly run little risk of surprise at a changed payment compared to consumers whose ARM interest rates have not adjusted for one, three, five, or seven years before the payment change. Moreover, each interest rate adjustment for such loans occurs only 30 days or so after the last adjustment, further insulating these consumers from the market fluctuations more likely to occur over the course of a year or more. In sum, short-term index ARMs are not the types of loans the Bureau intends to target with the requirement of § 1026.20(c) to provide consumers with between 60 and 120 days of advance notice prior to the first due date of a new payment after an interest rate adjustment causing a payment change. For the above-stated reasons, the final rule permits the notice required by § 1026.20(c) to be provided to consumers between 25 and 120 days before the first payment at new level is due after an interest rate adjustment for ARMs with a uniform schedule of interest rate adjustments occurring every 60 days or less, which, as clarified in comment 20(c)(2)-1, means ARMs that adjust regularly at a maximum of every 60 days and that this time period excludes any grace or courtesy periods.

The Bureau also proposed to alter the timing requirements for ARMs adjusting for the first time within 60 days of consummation where the interest rate disclosed at consummation was an estimate, rather than the actual interest rate. (Under the proposal, if the actual interest rate had been disclosed at consummation, such ARMs would have been exempted from the rule pursuant to proposed § 1026.20(c)(1)(ii)(2) The Bureau noted that creditors, assignees, and servicers of such ARMs would not have been able to comply with the 60-day timeframe. For such loans, the disclosures proposed by § 1026.20(c) would have had to be provided to consumers as soon as practicable, but not less than 25 days before a payment at a new level was due. The Bureau received no comments on this topic and is adopting the rule as proposed.

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 have required creditors, assignees, and servicers to inform consumers that, under the terms of their adjustable-rate mortgage, the specific period in which their current interest rate has been in effect would end on a certain date and that their interest rate and mortgage payment will change on that date. This information, the Bureau stated, is similar to the pre-consummation disclosures required by current § 1026.19(b)(2)(i) and § 1026.37(j) as proposed in the 2012 TILA-RESPA Proposal. Proposed comment 20(c)(2)(ii)(A)-1 clarified that the current interest rate was the interest rate that would be in effect on the date of the disclosure.

Proposed § 1026.20(c)(2)(i)(B) would have required the ARM payment change notices to include the dates of the impending and future interest rate adjustments. Proposed § 1026.20(c)(2)(i)(C) also would have required disclosure of any other loan changes 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 Bureau explained that the first ARM model form it tested did not contain the 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 would adjust 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 rounds two and three of testing understood that, under the scenario presented to them, their

interest rate would change on an annual basis.[69] In the absence of comments regarding this provision, the Bureau is adopting the final rule as proposed.

20(c)(2)(ii)

Table with Current and New Interest Rates and Payments

Proposed § 1026.20(c)(2)(ii) would have required 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 have appeared within the larger table containing all the required disclosures.

This table would have followed the same order as, and had headings and format substantially similar to, those in the table in model forms H-4(D)(1) and (2) in appendix H of subpart C. The Bureau stated that it confirmed through consumer testing that, when presented with information in a logical order, participants more easily grasped the complex concepts contained in the proposed § 1026.20(c) notice. For example, the form would have begun by informing consumers of the basic purpose of the notice: their interest rate was going to adjust, when it would adjust, and the adjustment would change their mortgage payment. This introduction would have been immediately followed by a visual illustration of this information in the form of a table comparing consumers' current and new interest rates. Based on its consumer testing, the Bureau stated it believed that the understanding of the consumers tested was enhanced by presenting the information in a simple manner, grouped together by concept, and in

[69] Macro Report, at vii.

a specific order that allows consumers the opportunity to build upon knowledge gained. For these reasons, the Bureau proposed that creditors, assignees, and servicers disclose the information in the table as set forth in model forms H-4(D)(1) and (2) in appendix H.

Proposed § 1026.20(c)(2)(ii) would have replaced current § 1026.20(c)(1) and (4), but would have retained the requirement to disclose the current and new interest rates and the amount of the new payment. Proposed § 1026.20(c)(2)(ii)(A) also would have required disclosure of the date when the consumer would have to start making the new payment and proposed comment § 1026.20(c)(2)(ii)(A)-1 would have clarified that the new interest rate would have had to be the actual rate, not an estimate. Proposed § 1026.20(c)(2)(ii) also replaced the language "prior" and "current" in the current rule with the terms "current" and "new," respectively, and removed comment 20(c)(2)-1 which, among other things, used the terms "prior" and "current." This change was designed to make clear that "current" meant the interest rate and payment in effect prior to the interest rate adjustment and "new" meant the interest rate and payment resulting from the interest rate adjustment.

Proposed comment 20(c)(2)(ii)(A)-1 defined the term "current" interest rate as the one in effect on the date of the disclosure. This more succinct definition replaced the lengthy definition of "prior interest rates," which current comment 20(c)(1) defines 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 were projected to increase as a result

of the adjustment. All participants in all rounds of testing understood that their interest rate and payment were projected to increase and when these changes would occur.[70]

Current ARM notices are not required to show the allocation of payments among principal, interest, and escrow accounts for any ARM. The Bureau proposed including this information in the table for interest-only and negatively-amortizing ARMs only. The Bureau stated it believed that providing the payment allocation would have helped consumers better understand the risk of these products by demonstrating that their payments would not have reduced the loan principal. The Bureau also said that providing the payment allocation would have helped 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. Because payment allocation might change over time, the rule would have required disclosure of the expected payment allocation for the first payment period during which the adjusted interest rate would have applied.

The Bureau explained that the notice disclosing an allocation of payment for interest-only or negatively-amortizing ARMs was not tested until the third round of testing. The notice tested set forth the following scenario to consumers: the first adjustment of a 3/1 hybrid ARM—an ARM with a fixed interest rate for three years followed by annual interest rate 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 the 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

[70] Macro Report, at vii.

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. [71]

The Bureau recognized that certain Dodd-Frank Act amendments to TILA pose restrictions on the origination of non-amortizing and negatively-amortizing loans. For example, TILA section 129C requires creditors to determine that consumers have the ability to repay the mortgage loan before lending to them and that this assumes a fully-amortizing payment. The Bureau thought it possible that this law and its implementing regulation would restrict the origination of risky mortgages such as interest-only and negatively-amortizing ARMs.

The Bureau stated that other Dodd-Frank Act amendments to TILA, such as the proposed periodic statement provisions discussed below, would provide payment allocation information to consumers for each billing cycle. Thus, consumers with interest-only or negatively-amortizing loans, or those who might obtain such loans in the future, would receive information about the interest-only or negatively-amortizing features of their loans through the payment allocation information in the periodic statement. Also, as stated above, consumer testing showed that participants tested were confused by the allocation table. In view of these changes to the law and the outcome of consumer testing, the Bureau solicited comments on whether to include allocation information for interest-only and negatively-amortizing ARMs in the proposed table described above.

A trade association generally supported the tabular format, stating that consumer testing has repeatedly proven its effectiveness. A large bank recommended eliminating altogether the table with the current and new interest rates and payments because, it said, the table tested poorly with consumers and would confuse them as well as be duplicative of the proposed periodic

[71] Macro Report, at vii- viii. The allocation table for interest-only and negatively-amortizing ARMs was revised after the third and final round of testing and is identical in both § 1026.20(c) and (d).

statement. Other commenters recommended eliminating only the portion of the table disclosing allocation information for interest-only and negatively-amortizing ARMs while one large bank commended the Bureau for adding these disclosures to the § 1026.20(c) notice. Those commenters in favor of eliminating allocation information for these ARMs said the information was not fully consumer tested, would be based on projections that would confuse and distract consumers, and would require costly software upgrades. Most of these commenters recommended substituting the statement for interest-only and negatively-amortizing ARMs required by § 1026.20(c)(2)(vi) in place of the allocation information; one large bank suggested expanding the language in these statements as a substitute for the allocation information. The large bank also said the allocation information would confuse consumers because, in the case of a negatively-amortizing ARM, the portion allocated to principal would have to be expressed as a negative number. One trade association recommended allowing estimated escrow payments for the new payment allocation table, which is what the rule proposed and the Bureau is adopting in § 1026.20(c)(2)(ii)(C).

The Bureau is adopting § 1026.20(c)(2)(ii) as proposed for the reasons set forth in the proposal and those set forth below. The table is the centerpiece of the § 1026.20(c) disclosure and contains some of the disclosure's most important information: the consumers' upcoming new interest rate and payment set forth next to their current rate and payment, such that consumers can make comparisons. This information informs consumers of the exact amount of the new mortgage payment the consumer must make starting in the next few months and the table allows easy comparison with their current charges, helping consumers decide on how best to proceed. Also, the periodic statement will provide consumers with only part of the information in the table: the date after which the interest rate will adjust and the amount of the

next payment. Moreover, the periodic statement generally would provide consumers with a month warning before a payment increase, rather than the minimum 60-day advance notice required by § 1026.20(c).

Because interest-only and negatively-amortizing ARMs pose more potential risk to consumers than conventional ARMs, the Bureau believes that providing consumers with the specific payment allocations for when their interest rates adjust will provide a comprehensible snapshot of the consequences of the upcoming adjustments and better enable those consumers to manage their mortgages. The table itself tested well with consumers; the allocation breakdown for the new payment for interest-only and negatively-amortizing ARMs did not test as well. As discussed above, the Bureau revised the model forms to address that problem. Moreover, the periodic statement contains a similar allocation table for the upcoming mortgage payment and testing of the periodic statement went well and raised no concerns regarding projected principal, interest, and escrow—including for payment-option loans.[72] In addition, as set forth in the periodic statement sample form in appendix H-30(C), the allocation of principal for negatively-amortizing loans is zero, and not a negative number.

Also, the proposed rule clearly set forth the bases upon which to make the projections for the allocation table for these ARMs, as well as for loan balances. See the section-by-section analysis of § 1026.20(c)(2)(v) below regarding loan balances. For certain consumers, such as those who are delinquent, who may choose to pay ahead, or who have payment-option ARMs, the projected amount may not prove to be the actual amount. However, servicers routinely project expected payment allocations and loan balances any time they provide consumers with a future payment amount, such as in the periodic statement. The Bureau also notes that the use of

[72] Macro Report, at 15.

allocation tables showing projected payments is an established practice in Regulation Z, as illustrated, for example, in appendices H-4(E) and (F). Also, the Bureau expects the origination of these risky loans will continue to decline in light of the qualified mortgage rules implementing TILA section 129C, thereby reducing the burden on servicers to provide the § 1026.20(c) allocation table. For these reasons and the reasons set forth in the proposed rule, the Bureau is adopting the final rule as proposed. The Bureau is adopting comment 20(c)(2)(ii)(A)-1 with the additional clarification that creditors, assignees, and servicers may round the interest rate, pursuant to the requirements of the ARM contract.

20(c)(2)(iii)

Explanation of How the Interest Rate is Determined

Proposed § 1026.20(c)(2)(iii) would have required the ARM disclosures to explain how the interest rate was determined. Consumer testing revealed that participants generally had difficulty understanding the relationship of the index, margin, and interest rate.[73] The Bureau said this was the reason it proposed a relatively brief and simple explanation that the new interest rate would be calculated by taking the published index rate and adding a certain number of percentage points, called the "margin." Proposed § 1026.20(c)(2)(iii) also would have required disclosure of the specific amount of the margin.

The Bureau noted that the proposed explanation of how the consumer's new interest rate was determined, such as adjustment of the index by the addition of a margin, mirrored 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 paralleled the pre-consummation disclosure of the index and margin in the 2012 TILA-RESPA Proposal.

[73] Macro Report, at viii.

Proposed § 1026.20(c) also would have required disclosure of the index 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 have replaced current § 1026.20(c)(2), which required disclosure of the index values upon which the "current" and "prior" interest rates are based. The Bureau said that it believed that providing consumers with index values is less valuable than providing them with their actual interest rates. The Bureau also proposed removal of current comment 20(c)(2)-1, which addressed the requirement to disclose current and prior interest rate.

Consumer testing indicated that the explanation helped participants better understand the relationship between interest rate, index, and margin. As stated in the proposal, it also helped dispel the notion held by many consumers in the initial rounds of testing that creditors subjectively determined their new interest rate at each adjustment.[74] The Bureau stated that it believed the proposed rule and forms struck an appropriate balance between providing consumers with key information necessary to understand the basis of their ARM interest rate adjustment without overloading consumers with complex and confusing technical information.

The Bureau received one comment regarding the explanation of how the interest rate is determined. A large bank recommended including adjustments to the index other than the margin, such as the addition of previously unapplied carryover interest.[75] The Bureau points out that the proposed rule contemplated including the addition of previously unapplied carryover interest increase in the explanation of how the *new payment* is calculated. The Bureau notes that, in the proposed rule, the new payment explanation came after the explanation of how the new

[74] Macro Report, at viii.

[75] Carryover interest, or foregone interest rate increases, is the amount of interest rate increase foregone at any ARM interest rate adjustment that, subject to rate caps, can be added to future interest rate adjustments to increase, or to offset decreases in, the rate determined by using the index or formula.

interest rate is calculated. The Bureau agrees with the commenter that logically, and for accuracy and completeness, any previously unapplied carryover interest added to the index and margin to formulate the new interest rate should be disclosed to the consumer in the explanation of how the interest rate is calculated, rather than initially disclosing it in the later explanation of how the new payment is calculated.

The Bureau also notes that proposed § 1026.20(c)(2)(iv) would have required, among other things, disclosure of any previously unapplied carryover interest at each adjustment, as applicable. The Bureau solicited comments regarding this proposed requirement.[76] A credit union and a State trade association recommended that the Bureau eliminate disclosure of carryover interest altogether, asserting that it is too complex and unnecessary for consumers to understand and it would distract consumers from other information contained in the § 1026.20(c)(2) notices. A large servicer suggested the alternative of including this information in the periodic statement instead of the ARM disclosure.

The Bureau does not agree with these commenters. To provide consumers with candid and accurate information about the adjustments to their adjustable-rate mortgages, the Bureau has decided to issue the final rule including disclosure of applicable information regarding carryover interest. Excluding this information would present consumers with an incomplete and incorrect portrait of their loan. Complexity is inherent in a disclosure dealing with indices, margins, adjusting interest rates, and changing payments. The Bureau has attempted to distill these complex concepts into their simplest elements without compromising substance. The Bureau hopes that consumers confused by the disclosure of the application of previously

[76] Because the issue of carryover interest arose first in the context of the explanation of how the interest rate is determined, the Bureau addresses the issue in depth here rather than in the following section § 1026.20(c)(2)(iv), Rate and Payment Limits and Unapplied Carryover Interest.

foregone interest rate increases, or any of the other complex concepts addressed in the § 1026.20(c) disclosure, will consult with the servicer, homeownership counselors or other housing finance professionals, or knowledgeable personal contacts.

Because the Bureau agrees with the large bank commenter that informing consumers of the application of carryover interest in the explanation of how their new interest rate is calculated is both logical and would improve the accuracy of the disclosure, the Bureau is adopting § 1026.20(c)(2)(iii) with the addition of information regarding the adjustments to the index other than the margin, such as the application of previously unapplied carryover interest. The final rule modifies the proposed rule by requiring disclosure of the *type and amount* of any adjustment to the index including, in addition to any margin, the application of previously foregone interest rate increases. Because the final rule requires disclosure of this information in § 1026.20(c)(2)(iii), the Bureau removes as repetitive the proposed disclosure in § 1026.20(c)(2)(v) of the *amounts* of the margin, applied carryover interest, or any other adjustment to the index. The Bureau also is issuing the rule with comment 20(c)(2)(v)(B)-1, which provides clarification about the application of previously foregone interest rate increases, or applied carryover interest.

20(c)(2)(iv)

Rate and Payment Limits and Unapplied Carryover Interest

Proposed § 1026.20(c)(2)(iv) would have required 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 have required disclosure of the extent to which the creditor, assignee, or servicer had 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 stated that it believed 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 pursuing alternatives. The Bureau gave the example that if an adjustment caused a significant increase in the consumer's payment, knowing how much more the interest rate or payment could increase would better inform the consumer's decision whether or not to seek alternative financing.

The Bureau pointed out that proposed § 1026.20(c)(2)(iv) would have required, as current § 1026.20(c)(3) requires, disclosure of the extent to which the creditor, assignee, or servicer had foregone an increase in the interest rate due to a limit, called unapplied carryover interest, and the earliest date such foregone interest rate increase could be applied. Proposed comment 20(c)(2)(iv)-1 regarding unapplied interest rate increases closely paralleled, and would have replaced, current comment 20(c)(3)-1. The comment would have explained that disclosure of foregone interest rate increases would apply only to transactions permitting interest rate carryover. It further would have explained that the amount of the foregone interest rate increase was the amount that, subject to rate caps, could be added to future interest rate adjustments to increase, or offset decreases in, the rate determined according to the index or formula.

The Bureau reported that the consumers tested had difficulty understanding the concept of interest rate carryover when it was introduced during the third round of testing. The Bureau attributed this difficulty 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. However, the Bureau also simplified the explanation of carryover interest to address this possible confusion.[77]

[77] Macro Report, at viii-ix. "If not for this rate limit, your estimated rate on [date] would be [x]% higher" was replaced with "We did not include an additional [x]% interest rate increase to your new rate because a rate limit applied."

In its proposed rule, the Bureau recognized that the disclosure of rate limits and unapplied carryover interest would have provided information that might help consumers better understand their ARMs. However, the Bureau stated that it was considering whether the assistance this information would have provided outweighed its potential distraction from other more key information. Also, as explained above, consumers had difficulty understanding the concept of carryover interest and the Bureau was concerned that this difficulty might diminish the effectiveness of its proposed § 1026.20(c) disclosures. The Bureau solicited comments on whether to include rate limits and unapplied carryover interest in the proposed § 1026.20(c) disclosures.

The Bureau received few comments regarding the proposed disclosure of rate limits and unapplied carryover interest. A credit union supported inclusion of the rate and payment limits in the § 1026.20(c) notice and a large bank servicer and a large non-bank servicer recommended against it. A large bank servicer commented that consumers do not need this information because they receive it at consummation and including it in the § 1026.20(c) notice would distract and confuse them. The non-bank servicer and a trade association said the unapplied carryover interest was unrelated to the interest rate adjustment and would confuse consumers. See the section-by-section analysis of § 1026.20(c)(2)(iii) above for a discussion of disclosure of applying previously foregone carryover interest.

In addition, a credit union and a State trade association recommended the Bureau eliminate disclosure of carryover interest altogether, asserting that it is too complex and unnecessary for consumers to understand and it would distract consumers from other information contained in the § 1026.20(c) notices. A large servicer suggested the alternative of including this information in the periodic statement instead of in the § 1026.20(c) notice.

Because most ARMs covered by this rule will adjust a year or more after consummation, the Bureau disagrees that information provided at consummation suffices to adequately inform consumers about carryover interest and rate limits. Moreover, carryover interest is an essential element in the determination of the new interest rate and payment. For these reasons and the reasons in the Bureau's proposed rule, the Bureau is adopting the final rule as proposed. The Bureau also is adopting proposed comment 20(c)(2)(iv)-1, with slight modifications to clarify the definition of carryover interest.

20(c)(2)(v)

Explanation of How the New Payment is Determined

Proposed § 1026.20(c)(2)(v) would have required ARM disclosures to explain how the new payment was 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 would have been consistent with the disclosures provided at the time of application pursuant to § 1026.19(b)(2)(iii). The Bureau also stated that it would have been consistent with the requirement in TILA section 128A to disclose the assumptions upon which the new payment is based, which the Bureau had proposed to implement in § 1026.20(d), and thus would have promoted consistency among Regulation Z ARM disclosures.

The current rule 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 have required 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 explained that a

disclosure regarding the application of previously foregone interest would have been required only for transactions that permitted interest rate carryover. The proposed comment further explained that foregone interest was 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 stated that it believed that this explanation would have helped consumers better understand how the index or formula and margin would determine their new payment and would have dispelled the notion held by many consumers in the initial rounds of testing that the creditor subjectively determined their new interest rate, and thus the new payment, at each adjustment.

The proposal would have required 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 of the balance differed 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 proposed 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 of the loan caused by the adjustment.

The Bureau stated that disclosure of the four key assumptions upon which the new payment would be based would have provided a succinct overview of how the interest rate adjustment works. It also would have demonstrated that factors other than the index could increase consumers' interest rates and payments. Disclosures of these factors, the Bureau said, would have provided 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 clarifies that disclosure of certain information related to loans that are not fully amortizing is required. The Bureau proposed disclosure of similar information in § 1026.20(c)(2)(vi), discussed below.

Two commenters voiced concern over having to project an estimate of the loan balance, as required in the proposed rule. For a discussion of the use of projections of scheduled payments for interest-only and negatively-amortizing ARMs, as well as for the loan balance, see the section-by-section analysis of § 1026.20(c)(2)(ii) above. The Bureau did not receive any other specific comments regarding § 1026.20(c)(2)(v) apart from one community bank recommending against the inclusion of similar information in both the explanation of how the interest rate is calculated and the explanation of how the new payment is determined. The Bureau points out that the components of the interest rate calculation are also components of how the new payment is determined and therefore, the Bureau will retain these common components in § 1026.20(c)(2)(v). However, to avoid redundancy, the final rule does not require reiteration of the amount of the margin, applied carryover interest, or any other adjustment to the index.

For these reasons and the reasons articulated in the proposed rule, the Bureau is issuing § 1026.20(c)(2)(v) and comment 20(c)(2)(v)(B)-1 as proposed, except the final rule does not require disclosure of the specific amount of any adjustment to the margin, because that data is provided in the final rule under § 1026.20(c)(2)(iii).

20(c)(2)(vi)

Interest-Only and Negative-Amortization Statement and Payment

Proposed § 1026.20(c)(2)(vi) would have required § 1026.20(c) notices to include a statement regarding the allocation of payments to principal and interest for interest-only or negatively-amortizing ARMs. If negative amortization occurred as a result of the interest rate adjustment, the proposed rule would have required disclosure of the payment necessary to amortize fully such loans at the new interest rate over the remainder of the loan term. As the Bureau explained in proposed comment 20(c)(2)(vi)-1, for interest-only loans, the statement would have informed the consumer that the new payment would cover all of the interest but none of the principal owed and, therefore, would not reduce the loan balance. For negatively-amortizing ARMs, the statement would have informed the consumer that the new payment would cover only part of the interest and none of the principal, and therefore the unpaid interest would add to the balance. The current rule, clarified by current comment 20(c)(5)-1, requires disclosure of the payment necessary to amortize fully 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 have replaced 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 amortize fully those loans at the new interest rate over the remainder of the loan term. However, the Bureau pointed to countervailing considerations regarding whether to include this information in proposed § 1026.20(c).

The Bureau recognized that certain Dodd-Frank Act amendments to TILA pose restrictions on the origination of non-amortizing and negatively-amortizing loans. For example, TILA section 129C requires creditors to make a reasonable and good faith determination that

consumers have the ability to repay the mortgage loan before lending to them, and that in making such a determination the creditor generally must assess the consumer's ability to repay based upon a fully-amortizing payment. The Bureau thought it possible that this law and its implementing regulations would restrict the origination of risky mortgages such as interest-only and negatively-amortizing ARMs. The Bureau also noted that other Dodd-Frank Act amendments to TILA, such as TILA section 128(f), which, as implemented by proposed § 1026.41, would have included information about non-amortizing and negatively-amortizing loans in each billing cycle, such as an allocation of payments.

Thus, consumers with interest-only and negatively-amortizing ARMs, or those who may obtain such loans in the future, would receive certain information about the interest-only or negatively-amortizing features of their loans in another disclosure, although this would not include the payment required to amortize fully negatively-amortizing loans. 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 said it would weigh the value of disclosing specific information regarding amortization, such as the payment needed to amortize fully negatively-amortizing ARMs against possible confusion to consumers. In view of these changes to the law and the outcome of consumer testing, the Bureau solicited comments on whether to include the payment required to amortize ARMs that would become negatively amortizing as a result of an interest rate adjustment.

Some industry commenters said that the statements regarding interest-only and negatively-amortizing ARMs should be disclosed instead of the proposed allocation information for these loans. *See* section-by-section analysis of § 1026.20(c)(2)(ii). Several consumer groups commended the Bureau for requiring the amortization statements but recommended additional

warning language for negatively-amortizing ARMs, which they characterized as dangerous. The Bureau believes that the statements regarding amortization are clear and succinct and that additional warning language is not needed. Moreover, the Bureau points out that other new mortgage rules more directly address the risks posed by non-amortizing mortgage products.

The Bureau is modifying the wording of § 1026.20(c)(2)(vi) and comment 20(c)(2)(vi)-1 to clarify that § 1026.20(c) notices for "interest-only ARMs" as well as any other ARMs for which consumers are paying only interest, must include the statement discussed above regarding the amortization consequences of such payments. The Bureau also is modifying the language of § 1026.20(c)(2)(vi) to conform with the proposed language in comment 20(c)(2)(vi)-1 and the section-by-section analysis of the proposed rule regarding the amortization statements required for ARMs for which consumers pay only interest and for negatively-amortizing ARMs. The final rule requires § 1026.20(c) notices to disclose, for consumers whose ARM payments consist of only interest, that their payment will not be allocated to pay loan principal and will not reduce the loan balance or, for negatively-amortizing ARMs, that the new payment will not be allocated to pay loan principal and will pay only part of the interest, thereby adding to the balance of the loan. No comments were received regarding the § 1026.20(c)(2)(vi) requirement to disclose the amount necessary to amortize negatively-amortizing ARMs. For these reasons and those stated in the proposed rule, the Bureau is adopting the rule and comments 20(c)(2)(vi)-1 and -2 with the addition of the amortization language discussed above.

20(c)(2)(vii)

Prepayment Penalty

Proposed § 1026.20(c)(2)(vii) would have required disclosure of the circumstances under which any prepayment penalty could be imposed, such as selling or refinancing the principal

dwelling, the time period during which such penalty could apply, and the maximum dollar amount of the penalty. The proposed rule would have cross-referenced the definition of prepayment penalty in § 1026.41(d)(7)(iv), the proposed periodic statements.

The Bureau reasoned that interest rate adjustments might cause payment shock or require consumers to pay their mortgage at a rate they might no longer be able to afford, prompting them to consider alternatives such as refinancing. To fully understand the implications of such actions, the Bureau stated that consumers should know whether prepayment penalties might apply. Under the proposed rule, such information would have included the maximum penalty in dollars that might apply and the time period during which the penalty might be imposed. The Bureau stated that the dollar amount of the penalty, as opposed to a percentage, would be more meaningful to consumers.

The Bureau also proposed disclosure of any prepayment penalty in § 1026.20(d) ARM initial rate adjustment notices and in the periodic statements in proposed § 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.[78] For this reason, the Bureau proposed to clarify the circumstances giving rise to a prepayment penalty which creditors, assignees, and servicers must disclose to the consumer in the payment change notice. The proposed forms included model language to alert consumers that a prepayment penalty might apply if they pay off their loan, refinance, or sell their home before the stated date.

[78] Macro Report, at vi.

The Bureau recognized that Dodd-Frank Act amendments to TILA, such as TILA section 129C and its implementing regulations, would significantly restrict a lender's ability to impose prepayment penalties. Other Dodd-Frank Act amendments to TILA, such as TILA section 128(f) and its implementing regulations, would have provided consumers with information about prepayment penalties in the periodic statement they receive each billing cycle. Thus, consumers who have ARMs with prepayment penalty provisions or who might 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 solicited comments on whether to include information regarding prepayment penalties in § 1026.20(c).

A national trade association, a State trade association, a credit union, a large servicer, and a non-bank servicer recommended against inclusion of the prepayment penalty information. The primary reasons for their opposition was the onerousness of calculating the prepayment penalty and the burden of having dynamic information fields that would require calculating the prepayment penalty amount for each individual loan requiring a § 1026.20(c) notice. These commenters recommended use of more standardized static language in place of the dynamic fields. These commenters stated variously that the amount of a prepayment penalty is determined by a number of dynamic factors and there are variations on how to calculate it, servicers do not currently include prepayment penalty information on the file they send to their print vendors because many servicing systems are unable to calculate and store this information as it may be stored in a separate system, and this information may be computed by hand. The non-bank servicer pointed out that prepayment penalties are vanishing as a result of market forces and new regulations. It recommended listing the minimum finance charges as an example

and disclosing the dollar amount of the prepayment penalty on the periodic statement instead of on ARM disclosures.

The Bureau is adopting the rule, with significant modification from the proposed rule. In the final rule, in place of requiring disclosure of the maximum dollar amount of the penalty, the consumer is directed by the required disclosure to contact the servicer for additional information, including the maximum amount of the prepayment penalty. Comment 20(c)(2)(vii)-1 clarifies that the creditor, assignee, or servicer has the option of either deleting this field entirely from the § 1026.20(c) disclosure for consumers who do not have prepayment penalties or retaining the field and inserting a word such as "None" after the prepayment penalty heading. Thus, the final rule retains information crucial for consumers to make decisions regarding whether or not to retain their ARMs in the face of an interest rate and payment increase while reducing the burden on industry by eliminating a field that was both dynamic and particularly difficult to calculate. The Bureau believes that encouraging consumers to contact the servicer for the exact dollar amount of the maximum penalty or for other questions, rather than including that information in the disclosure, does not significantly compromise consumer protection because contacting the servicer should yield the most up-to-date information as well as encourage contact with the servicer for consumers facing financial distress. The Bureau also notes that the periodic statement required by the final rule likewise does not contain specific information about any prepayment penalty other than its existence, if applicable. The Bureau also is changing the cross-reference for the definition of prepayment penalty from the periodic statement regulation to the definition set forth in the ATR rule.[79]

[79] *See* §1026.32(b)(6)(i). NB: Certain provisions of the ATR definition apply specifically to FHA loans.

The Bureau believes, for the reasons stated above and in the proposed rule, that information about the prepayment penalty is important for consumers to take into account when considering alternatives to an interest rate and payment increase. For this reason, the Bureau is adopting the final rule and comment 20(c)(2)(vii)-1 with the modifications set forth above.

20(c)(3) Format

Payment Change Rate Adjustment Disclosures

See the section-by-section analysis of § 1026.17(a)(1) above for a discussion of the form requirements governing § 1026.20(c). The Bureau received no comments regarding its proposed changes to § 1026.17(a)(1) regarding form requirements governing § 1026.20(c).

A consumer group representing a constituency that speaks more than 100 different dialects recommended that the Bureau require that ARM disclosures be provided in languages other than English to ensure comprehension by mortgagors with limited English proficiency. To this end, the commenter suggested requiring creditors, assignees, and servicers to send a simple, multilingual notice each month for the first three months of the ARM loan asking consumers to indicate their preferred language.

While recognizing the value to consumers of limited English proficiency of receiving communications in their native language, the Bureau is issuing the final rule without this language requirement because the Bureau believes it would be difficult and costly to implement, particularly considering the number of languages in which creditors, assignees, and servicers would be required to provide § 1026.20(c) and (d) ARM notices. The Bureau notes that Regulation Z contemplates the use of languages other than English in § 1026.27. Under this provision, disclosures may be in a language other than English, provided that the disclosures are made available in English at the consumer's request. Thus, a creditor, assignee, or servicer *may*

provide ARM disclosures in languages other than English, but the Bureau declines revising Regulation Z to *require* that they do so.

20(c)(3)(i)

All Disclosures in Tabular Form

Proposed § 1026.20(c)(3)(i) would have required that the §1026.20(c) 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 Bureau stated that 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.[80] They also had difficulty with the concepts of amortization and interest rate carryover.[81] 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 proposal explained that the Bureau's testing showed that the consumers tested more readily understood these concepts when the information was presented to them in a simple manner and in the groupings contained in the model forms. The Bureau also observed that the participants 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

[80] Macro Report, at viii.
[81] Macro Report, at viii-ix.

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 its consumer testing, the Bureau stated that it believed understanding of participants was enhanced by presenting the information in this 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 proposed that creditors, assignees, and servicers disclose the information required by § 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, the Bureau stated, participant comprehension improved with each successive iteration of the model form. As a result, the Bureau believes that displaying the information in tabular form can focus consumer attention and foster 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 the consumers tested both could understand and from which they could benefit.

Although few industry commenters recommended specific changes to the order, headings, and format of the ARM model and sample forms, a large bank and a national trade association recommended that parties subject to the rule be permitted flexibility to account for loan products and customer situations not specifically addressed by the proposed rule and forms. These two commenters pointed to certain situations, including the following, as examples of circumstances in which flexibility to customize the forms would ensure accurate and full disclosure to the consumer: consumer bankruptcies and loans originated under certain State laws

shielding consumers from personal liability; loans no longer having interest rate adjustments, such as ARMs converting to fixed-rate mortgages; creditors, assignees, and servicers choosing to send the annual § 1026.20(c) interest rate disclosure no longer required by the final rule; and payment-option and payment-rate ARMs. The national trade association stated that the proposed rule established rigid tables, configurations, substantive requirements, and order of presentation dictating the use of the sample and model forms in violation of TILA section 105(b) which, it said, specifically prohibits the Bureau from requiring use of a particular form. One commenter, a financial services compliance and risk management company, interpreted the proposed rule as mandating certain formatting requirements such as a reverse text data field and two-sided printing.

The Bureau's response to these comments is two-fold. First, the proposed rule's requirement that § 1026.20(c) disclosures be provided to consumers "in the form of the table and in the same order as, and with headings and format substantially similar to" the proposed model forms is consistent with established standards found throughout Regulation Z requiring tabular formatting as well as other conventions. For example, § 1026.6(b)(1), entitled "Form of disclosures; tabular format for open-end (not home-secured) plans," requires creditors to provide account-opening disclosures "in the form of a table with headings, content, and format substantially similar to" the tables in a particular model form. Moreover, Regulation Z's Appendices G and H—Open-End and Closed-End Model Forms and Clauses sets forth the permissible changes to model forms, including the § 1026.20(c) model forms. Thus, the proposed rule does not depart from established Regulation Z standards and does not violate TILA.

Second, the proposed language referred to by commenters was not intended to strait-jacket creditors, assignees, and servicers into language inapplicable to non-standard customer situations and loan products. The "substantially similar" language was intended to allow disclosure providers the flexibility to develop, for example, forms that may be either one- or two-sided and that may, but need not, feature reverse text data fields.

For these reasons and those articulated in the proposed rule, the Bureau is adopting § 1026.20(c)(3)(i) and (ii) and comment 20(c)(3)(i)-1. While, as stated above, the formatting conventions in the final § 1026.20(c) disclosures do not depart from standard Regulation Z format requirements, the Bureau has added comment 20(c)(3)(i)-1 clarifying that creditors, assignees, and servicers may modify the § 1026.20(c) disclosures to account for certain circumstances or transactions that may not be addressed in the final rule or forms. Also, the final rule removes § 1026.20(c) model and sample forms from the Regulation Z provision prohibiting formatting alterations. *See* Appendices G and H—Open-End and Closed-End Model Forms and Clauses.

20(c)(3)(ii)

Format of Interest Rate and Payment Table

Proposed § 1026.20(c)(3)(ii) would have required tabular format for ARM payment change notices for, among other things, interest rates, payments, and the allocation of payments for loans that are interest-only and negatively-amortizing. This table would have been located within the table proposed by § 1026.20(c)(3)(i). This table would have been substantially similar to the one tested by the Board for its 2009 Closed-End Proposal to revise § 1026.20(c). The Bureau's proposal would have required the table to follow the same order as, and have headings 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 them with the adjusted rate and new payment. Consumer testing revealed that nearly all participants were readily able to identify the table and understand the table and its content.[82] The new interest rate and payment and date the first new payment is due is key information the consumer must know to commence payment at the new rate. For these reasons, the Bureau proposed locating this information prominently in the disclosure.

The Bureau is issuing the final rule as proposed in § 1026.20(c)(3)(ii). See the section-by-section analysis of § 1026.20(c)(3)(ii) for a discussion of comments received and the Bureau's rationale for the proposed format in the interest rate and payment table and changes made in the final rule.

20(d) Initial Rate Adjustment

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 its 2009 Closed-End Proposal, the Board proposed amending the regulation that is now § 1026.20, including deleting this provision regarding substitution. 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."[83] The Board explained that when it originally adopted the provision in 1987, as footnote 45c of § 226.20(c) of Regulation Z,[84] the regulations

[82] Macro Report, at vii.
[83] 74 FR 43232, 43272 (Aug. 26, 2009).
[84] 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.

of other financial institution supervisory agencies—namely the OCC, the Federal Home Loan Bank Board (the FHLBB), and HUD—required subsequent disclosures for ARMs.[85]

The Bureau proposed removing the current content of § 1026.20(d) because it was not aware of any other Federal financial institution supervisory agency rules requiring comprehensive disclosure requirements for ARMs. The Bureau solicited comments on whether there was any reason to retain this provision, including whether the removal had implications for rights under the Alternative Mortgage Transaction Parity Act.

One non-bank servicer said that it opposed the elimination of the current content of § 1026.20(d), but did not offer a reason why. Based on the lack of reasoned opposition to the Bureau's proposal and the above-stated rationale, the Bureau is adopting the proposal, thereby removing this text from the final rule.

Legal Authority

For the reasons adduced above in the discussion of the legal authority underlying the Bureau's implementation of § 1026.20(c), the Bureau removes current § 1026.20(d) pursuant to its authority under TILA sections 105(a) and Dodd-Frank Act section 1405(b).

New Initial ARM Interest Rate Adjustment Disclosures

In place of current § 1026.20(d), the Bureau proposed to implement the initial ARM adjustment notice mandated by TILA section 128A, as added by Dodd-Frank Act section 1418. Under proposed § 1026.20(d), approximately six months before the initial adjustment of adjustable-rate mortgages, creditors, assignees, and servicers would have been required to provide consumers with key information about their ARM adjustment. The information disclosed would have included the new rate, the new payment, and options for pursuing

[85] 74 FR 43232, 43273 (*citing* 52 FR 48665, 48671 (Dec. 24, 1987)).

alternatives to their ARM. This initial ARM adjustment notice would have harmonized with proposed revisions to the § 1026.20(c) ARM payment change notice. The Bureau stated its belief that promoting consistency between the ARM disclosure provisions of § 1026.20(c) and (d) would have reduced compliance burdens on industry and minimized consumer confusion.

Creditors, assignees, and servicers. Proposed § 1026.20(d) would have applied to creditors, assignees, and servicers. Proposed comment 20(d)-1 clarified that a creditor, assignee, or servicer that no longer owned the mortgage loan or the mortgage servicing rights would not have been subject to the requirements of § 1026.20(d). This language tracked, in part, the requirements of TILA section 128A that creditors and servicers must provide the initial ARM interest rate adjustment notices, but added assignees to the list of covered persons. The Bureau stated that applying the rule to creditors, but not assignees, would have resulted in inconsistent levels of consumer protection and differing obligations for similarly-situated owners of mortgage loans.

The Bureau reasoned that it is a common practice for creditors to sell many or all of the loans they originate rather than hold them in portfolio. In those cases, without adding assignees as covered persons, assignees' obligation to provide consumers with the § 1026.20(d) notice would be unclear. Thus, the Bureau reasoned, imposing requirements only on creditors or servicers might have particularly deleterious effects on consumers whose creditors assign their mortgage loans. The Bureau reasoned 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 proposed to make assignees, along with creditors and servicers, subject to the requirements § 1026.20(d). For the same reasons, proposed § 1026.20(d) would have required, as clarified by comment 20(d)-1 that any provision

of subpart C governing § 1026.20(d) also would have applied to creditors, assignees, and servicers—even where the other provisions of subpart C referred only to creditors.

The Bureau received no comments specifically on the proposed inclusion of assignees as parties covered under § 1026.20(d), although two commenters stated that servicers, as opposed to assignees, are not subject to civil liability under TILA. The Bureau points out that the proposed rule requires creditors, assignees, and servicers to provide consumers with the disclosures required by § 1026.20(d) without referencing creditor, assignee, or servicer civil liability. Consistent with the proposal, the final rule and commentary set forth the obligation of creditors, assignees, and servicers but do not specifically address the issue of civil liability of any covered person in an action brought by a consumer. That issue is governed by TILA and the Bureau's revisions do not purport to impose requirements inconsistent with the statute. See the section-by-section analysis of § 1026.20(c) above for further discussion of civil liability.

For these reasons, and the reasons articulated in the proposal, the Bureau is adopting the rule as proposed. The Bureau is adopting comment 20(d)-1, with added language clarifying that, (1) creditors, assignees, and servicers that own either the applicable ARM or the applicable mortgage servicing rights, or both, are subject to the requirements of § 1026.20(d) and (2) although the rule applies to creditors, assignees, and servicers, those parties may decide among themselves which of them will provide the required disclosures.

The extension of the requirement to assignees is authorized, among other authorities, 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 uses its authority under Dodd-Frank Act section 1405(b) to

extend the applicability of the initial ARM adjustment notices under TILA section 128A to assignees. As discussed above, this extension serves the interest of consumers and the public interest. Application of § 1026.20(d) to assignees is consistent with current § 1026.20(c) commentary clarifying that those disclosure requirements apply to subsequent holders. Subjecting creditors, assignees, and servicers to the requirements of § 1026.20(d) also promotes consistency with final § 1026.20(c) and § 1026.41 (the periodic statement), which likewise apply to creditors, assignees, and servicers.

Loan modifications. A large bank and a national trade association recommended that the Bureau exempt loan modifications for financially-distressed consumers from the requirements of § 1026.20(d). They said that, among other reasons, requiring the notices in the context of a loan modification would delay execution of the loan modification by the 210 to 240 days advance notice required under the rule and that the § 1026.20(d) notice was not appropriate for loan modifications.

The Bureau notes that § 1026.20(c), the existing Regulation Z rule regarding post-consummation ARM disclosures, does not exempt loan modifications from its requirements. However, the Bureau agrees with this recommendation, and therefore, § 1026.20(d) limits coverage to initial interest rate adjustments pursuant to the ARM contract. Because initial interest rate adjustments occurring pursuant to a loan modification do not occur pursuant to the ARM contract, they will not be subject to this rule and thus, will not delay execution of loan modification agreements. *See* comment 20(d)-2, which the Bureau is adopting in the final rule. The Bureau believes that an initial interest rate adjustment pursuant to a loan modification agreement in a loss mitigation context does not require the consumer protections contemplated by § 1026.20(d). Such consumers have either agreed to the new interest rate prior to execution

of the loan modification or are receiving the benefit of a lower rate and thus, are not at risk of payment shock. Because the loan modification is the actual result of pursuing alternatives to the payments otherwise required under their adjustable-rate mortgages, the advance notice afforded by the rule does not benefit such consumers.

For these reasons, as adopted, § 1026.20(d) exempts from its coverage interest rate changes occurring in the context of a loan modification executed as a loss mitigation measure. Comment 20(d)-2 clarifies, however, that the requirements of § 1026.20(d) do apply to the initial interest rate adjustment that occurs subsequent to the execution of a loan modification agreement, if the interest rate adjustment occurs pursuant to the ARM contract as modified.

Form of delivery. Proposed § 1026.20(d) would have required 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 explained that to satisfy this requirement, the notices would have had to be mailed or delivered separately from any other material. The proposed comment said that, in the case of mailing the disclosure, no material in the envelope other than the ARM notice would have been permitted. If provided electronically, the notice would have had to be the only content or attachment in the email. This proposed form of delivery would have contrasted with the Bureau's proposal for § 1026.20(c), which was subject to the less stringent segregation requirements of § 1026.17(a)(1), as it would have been amended by the Bureau's proposal. The proposed comment further explained that the notice proposed by § 1026.20(d) would have been allowed to be provided to consumers in electronic form with consumer consent, pursuant to the requirements of § 1026.17(a)(1). However, in recognition of the ambiguity of the statutory language of TILA section 128A(b), the Bureau solicited comments on whether consumer protection would be compromised by providing § 1026.20(d) notices as a

separate document but in the same envelope or email correspondence with other messages from the creditor, assignee, or servicer.

Consumer groups generally applauded the Bureau for its proposed ARM disclosures and none responded to the Bureau's request for comments on this issue of delivery form. One large servicer supported the proposed interpretation of "separate and distinct from all other correspondence." On the other hand, many industry groups recommended that the Bureau permit inclusion of the ARM notice in the same envelope or email with other servicer communications. These commenters included a large bank, two national credit union trade associations, one national and one State trade association, three credit unions, and a large non-bank servicer. They stated that consumers would be more attentive to the ARM notice if it accompanied the monthly statement consumers were used to receiving from the servicer. They also noted the higher cost of mailing the notice separately.

The Bureau is mindful of the ambiguity of the statutory language. "Separate and distinct from all other correspondence" reasonably can be interpreted to require a creditor, assignee, or servicer to provide the ARM payment change notice (1) as a separate document from all other correspondence, but in the same envelope or email or (2) in an envelope or email that does not contain any other material. The former interpretation is consistent with the form requirements of revised § 1026.17(a)(1), as discussed above in that section-by-section analyses of § 1026.17(a)(1).

The Bureau does not believe that consumer protection would be compromised by providing the § 1026.20(d) notice as a separate document in the same envelope or email with other servicer communications. Consumers may be more likely to open a monthly periodic statement than a stand-alone communication from their servicer. Moreover, including the

§ 1026.20(d) initial adjustment notice as a separate document and in the particular format required under the rule, sets it apart from the other materials. The Bureau also recognizes that requiring the notice to be sent separately would generate real incremental costs for industry without any clear benefit to consumers. Thus, the Bureau is issuing the final rule and comment 20(d)-3 with the adoption of this interpretation of the statutory language. However, § 1026.17(a)(1) permits, but does not mandate, that disclosures subject to its requirements be provided to the consumer as a separate document. For this reason, the Bureau revises § 1026.17(a)(1) to require that the § 1026.20(d) initial interest rate disclosures be provided to consumers as a separate document. Thus, in the final rule, both § 1026.20(c) and (d) are subject to the requirements of § 1026.17(a)(1).

Timing. The Bureau's proposal for § 1026.20(d) generally followed the statutory requirement in TILA section 128A to provide consumers with the initial interest rate adjustment notice during the one-month period that ends six months before the interest rate in effect during the introductory period expires. Thus, the disclosure would have had to be provided six to seven months before the initial interest rate adjustment. The Bureau stated that the § 1026.20(d) disclosures were designed to avoid payment shock so as to put consumers on notice of upcoming adjustments to their adjustable-rate mortgages that may have resulted in higher payments. (The § 1026.20(c) notice, among other things, would have provided consumers with the exact amount of any payment change caused by an adjustment.) The six to seven month advance notice would have allowed sufficient time for consumers to consider their alternatives if the notice indicated there could be an increase in payment they could not have afforded. The proposal suggested refinancing as one alternative that consumers might consider. As set forth in the proposed rule, average timelines to complete a refinancing exceed 70 days.

The Bureau stated that, in the interest of consistency within Regulation Z, proposed § 1026.20(d) tied its timing requirement to the date, expressed in days rather than months, the first payment at a new level would have been due, rather than the date of the interest rate adjustment. The Bureau proposed this to maintain consistency with both current and proposed § 1026.20(c), which express time periods in days rather than months. Because interest on consumer mortgage credit generally is paid one month in arrears, for most ARMs, this would have added another approximately 30 days to the timeframe for delivery of the disclosures. Thus, the notices the Bureau proposed under § 1026.20(d) would have had to 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 would have been 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, the Bureau stated that proposed § 1026.20(d) would have been more precise, because months can vary in length, and would have maintained consistency with the timing requirements of proposed § 1026.20(c). Proposed comment 20(d)-2 explained that the timing requirements would exclude any grace period. It also clarified that the date the first payment at the adjusted level would be due is the same as the due date of the first payment calculated using the adjusted interest rate.

Also, pursuant to TILA section 128A, consumers with ARMs adjusting for the first time within six months after consummation, must receive the § 1026.20(d) initial interest rate adjustment notices at consummation. The proposed rule tied the timing of this requirement to days rather than months and to the date the new payment is due rather than the date of the adjustment to insure both internal consistency and consistency with § 1026.20(c). Thus, the proposed rule required that consumers be provided with the initial interest rate adjustment notice

at consummation if their ARMs would be adjusting for the first time within 210 days before the due date of the first adjusted payment.

A national trade association asked the Bureau to clarify whether the requirements of § 1026.20(d) are restricted to ARMs originated after the effective date of the final rule or whether they apply as well to existing ARMs that adjust for the first time after the effective date. Neither the proposal nor the final rule includes an exception or a grandfather period for ARMs originated prior to the effective date of the rule but which adjust for the first time after that date. Therefore, once the rule takes effect, it applies to all ARMs adjusting for the first time.

One large bank recommended that the § 1026.20(d) disclosures be provided to consumers 120 days, as opposed to at least 210 days, before the first payment at the adjusted level is due. Several commenters recommended limiting the notice to ARMs that adjust one, two, or more years after origination. As discussed above, the Dodd-Frank Act mandates the timeframe within which the disclosures must be provided to consumers, including specifically requiring the disclosures for ARMs adjusting soon after consummation. The Bureau believes the statutorily-required timeframe is appropriate to remind consumers of the upcoming initial interest rate adjustments and, as applicable, to potentially stave off payment shock and provide consumers with the time necessary to effectively pursue alternatives to their current mortgage. Also, the Bureau notes that, for ARMs adjusting within 180 days of consummation, providing the notice directly to consumers at consummation is less of a burden than mailing or delivering it at a later date. For the reasons set forth above, with regard to timing, the Bureau is adopting the final rule as proposed. The Bureau is adopting comment 20(d)-3, which was proposed comment 20(d)-2, with modification to clarify that "provide" means deliver or place in the mail and to clarify that the timeframe excludes any courtesy, as well as grace, periods.

Commenters recommending against adoption of proposed § 1026.20(d). A large number of industry commenters, including many small banks and national and State trade associations, recommended that the Bureau remove entirely the initial ARM interest rate notice from the final rule. In the alternative, some suggested providing a generic reminder warning consumers of the upcoming interest rate adjustment. Some commenters suggested adding to that general warning notice one or more of the following: the maximum interest rate and payment, an explanation of how the interest rate and payment is determined, and a statement encouraging consumers to direct any questions or concerns to their servicer. A large bank recommended a generic notice emphasizing and reminding consumers of the details of the adjustable-rate feature and referring them to their loan contracts for specific information. A credit union recommended eliminating the notice because, for some ARMs, it would come mere months after consummation. A few others suggested integrating the interest rate information into the periodic statement or escrow statement, although other commenters opposed this. See the discussion below of including the ARM interest rate adjustment information in the periodic statement. A research organization, a large bank, a trade association, and a credit union stated that post-implementation testing was warranted to determine if the Bureau's contention that consumers will be better informed as result of receiving the § 1026.20(d) disclosures is correct. A non-bank servicer recommended that the Bureau analyze statements and consumer responses post-implementation to ensure the relevance of all the information required to be provided to consumers.

Many of the commenters recommending against the adoption of the § 1026.20(d) requirements claimed that the cost of the § 1026.20(d) notices would outweigh its benefits. They said that reprogramming their origination and servicing systems would be expensive and time consuming. Small banks expressed concern that their systems could not accommodate certain

changes, such as distinguishing between initial and subsequent rate adjustments and maintaining different timeframes for both § 1026.20(c) and (d). Some stated that the § 1026.20(d) notice was unnecessary because consumers were informed at origination about interest rate adjustments. They also thought the § 1026.20(c) notice or the periodic statement was sufficient to warn consumers of upcoming interest rate changes. They said that those disclosure requirements or other Bureau measures, such as the qualified mortgage rule implementing TILA section 129C, would limit the amount an ARM could adjust. Other commenters said that providing the notice seven to eight months before the new payment is due is too early to have an effect on consumers. A trade association representing credit unions recommending combining the § 1026.20(c) and (d) notices and providing the unified notice between three and four months in advance of the initial interest rate adjustment.

A key concern among commenters was the use of estimates in the § 1026.20(d) notice. See immediately below, the small servicer discussion, regarding these same issues. Use of estimates, they predicted, would create confusion and lead to increased customer inquiries, inaccurate and late payments, unnecessary refinancings, and strategic defaults. A large bank stated that emphasizing that the calculation is an estimate risks diminishing the effectiveness of the notice. The large bank recommended the Bureau undertake more testing to ensure that the inclusion of estimates in § 1026.20(d) notice does not lead to consumer confusion, dissatisfaction, and frustration. One credit union said that its attempt to provide an estimated early warning disclosure resulted in customer confusion but a non-bank servicer said that its early warning notice achieved significant results and response rates. Some industry commenters also stated that estimates would be a poor predictor in a changing interest rate environment. A few commenters stated that providing estimates to consumers would create a legal risk, claiming

there was no safe harbor if the estimates turn out to be less than the actual interest rate adjustment. Many commenters said that that the volume of information, especially inclusion of data not required by the Dodd-Frank Act and the number of dynamic fields required by the notice, would unreasonably burden industry and overload consumers.

In enacting TILA section 128A, Congress made a deliberate judgment that the first time an ARM interest rate adjusts poses particular risk to consumers, such that consumers need significant advance notice of those risks in order to be prepared to handle the anticipated mortgage payment. The Bureau observes that it is not uncommon for ARMs to have one interest rate for several or more years before the first adjustment, after which adjustments may occur on an annual basis. Thus, the initial interest rate adjustment is different in kind for consumers than subsequent adjustments which consumers are more likely to anticipate. The Bureau also notes that during the years prior to the financial crisis, a significant number of ARMs were originated with the underwriting predicated only on the initial monthly payments. While the Dodd-Frank Act ability-to-repay provisions address this by requiring that ARMs be underwritten based upon the "fully-indexed rate," consumers are still subject to payment shock at the first adjustment if interest rates have risen since consummation. Thus, the Bureau concludes that the new initial interest rate disclosure can provide significant benefits for consumers. For these reasons, the Bureau rejects the suggestion that it create an exemption that would override TILA section 128A in its entirety. However, as discussed in the proposal, the Bureau has evaluated whether individual elements of the § 1026.20(d) notice further consumer protection compared to their potential burden on creditors, assignees, and servicers. In light of the comments received and further evaluation, the Bureau is modifying certain of the proposed requirements to alleviate burden, as discussed throughout the section-by-section analysis of this final rule.

With respect to the use of an estimated interest rate and payment in the § 1026.20(d) notice, the Bureau believes providing consumers with concrete amounts and an expected real-life scenario could benefit them significantly more than a generic warning that fails to give consumers an idea of what to expect when their interest rate adjusts for the first time. Consumer testing has underscored the participants tested understanding of the impact on them of a concrete amount as opposed to a generic assumption.

It is therefore appropriate to include estimates in the § 1026.20(d) disclosures. TILA section 128A(b)(3) explicitly contemplates the use of good faith estimates. The language and formatting of the § 1026.20(d) model forms clearly denote when the new payment amount and interest rate are estimates, and the disclosure informs consumers that the actual amounts will be provided to consumers two to four months before the date the first new payment is due, if the new payment will be different from the current payment. In light of the comments expressing concern about the potential to confuse or mislead consumers, the Bureau has reviewed the requirements and emphasized that those disclosures are estimates. Consumer testing confirmed that participants understood the use of estimates in the model forms. Creditors, assignees, and servicers should not expect liability resulting from consumer confusion as the use of estimates is clearly contemplated under the statute and regulation.

In addition, the Bureau believes that the goal of achieving greater consumer protection is potentially furthered by exercising its authority to modify certain aspects of the notice required by TILA section 128A. For example, the final rule does not require dynamic fields for contact information for specific homeownership counselors and counseling organizations and State housing finance authorities, as the statute mandates. The final rule also removes most of the information and all dynamic fields from the prepayment penalty disclosures. The Bureau also is

exercising its exception authority to exempt from the requirements of § 1026.20(d) consumer ARMs with terms of one year or less. Moreover, the final rule clarifies the flexibility available to creditors, assignees, and servicers using the model forms. With these changes, and others, the Bureau believes that the requirements in § 1026.20(d) can provide protections for consumers consistent with the goals of TILA section 128A while avoiding imposing requirements that may have unintended consequences with respect to the cost or availability of credit. For these reasons, the Bureau is adopting the final rule with certain adjustments to the proposed § 1026.20(d) ARM initial interest rate adjustment notices, as set forth below.

Conversions. Proposed comment 20(d)-3 explained that, in the case of an open-end account converting to a closed-end adjustable-rate mortgage, § 1026.20(d) disclosures would not be required until the implementation of the initial interest rate adjustment post-conversion. The Bureau analogized the conversion to consummation. Thus, like other ARMs subject to the requirements of proposed § 1026.20(d), disclosures for these types of converted ARMs would not have been required until the first interest rate adjustment following the conversion. The proposed rule would have been consistent with the § 1026.20(c) proposal for open-end accounts converting to closed-end adjustable-rate mortgages. The Bureau did not receive comments on the topic of open-end accounts converting to closed-end ARMs and is adopting the proposed rule and proposed comment 20(d)-3, renumbered as comment 20(d)-4, without change.

20(d)(1) Coverage

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

Scope

Adjustable-rate mortgages defined. Proposed § 1026.20(d)(1)(i) defined an adjustable-rate mortgage or ARM, for purposes of § 1026.20(d), 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 used the wording from the definitions of "adjustable-rate" and "variable-rate" mortgage in subpart C of Regulation Z to promote consistency within the regulation. Proposed comment 20(d)(1)(i)-1 explained that the definition of "ARM" meant "variable-rate mortgage" as that term is used elsewhere in subpart C of Regulation Z, except as would have been provided in proposed comment 20(d)(1)(ii)-2. Having received no comments on this issue, the Bureau is adopting the final rule and comment 20(d)(1)(i)-1 as proposed.

Proposed comment 20(d)(1)(i)-1 also clarified that the requirements of § 1026.20(d)(1)(i) would not be limited to transactions financing the initial acquisition of the consumer's principal dwelling, but 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)(1)(i). Having received no comments on this subject, the Bureau is adopting the final rule and comment 20(d)(1)(i)-1 as proposed.

Applicable to closed-end transactions. In its proposal, the Bureau stated that it believed that TILA section 128A and the implementing disclosures in proposed 1026.20(d) primarily benefited consumers with closed-end adjustable-rate mortgages. In contrast, the Bureau said, open-end credit transactions secured by a consumer's dwelling (home equity plans) with adjustable-rate features were 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 proposed to use its authority under TILA section 105(a) and (f) to exempt adjustable-rate home equity plans from the requirements of TILA section 128A and proposed § 1026.20(d).

The Bureau stated that 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.[86] The required account opening disclosures for home equity plans also must include information about any variable- or adjustable-rate features, including the circumstances under which rates may increase, limitations on the increase, and the effect of any increase.[87]

Thus, the Bureau concluded, Regulation Z already contained a comprehensive scheme for disclosing to consumers the variable- or adjustable-rate features of home equity plans. The Bureau stated 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 have been largely duplicative of the current disclosure regime and would have been confusing and unhelpful for consumers. Moreover, the Bureau reasoned, 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 have be useful because the estimate would be based on

[86] *See* § 1026.40(d)(12).
[87] *See* § 1026.6(a)(1)(ii) and (3)(vii).

the outstanding loan balance at the time the notice is given, which would change after the notice is given anytime the consumer withdraws funds.

Two other factors also supported the Bureau's use of the TILA section 105(a) exception authority to exclude home equity plans from the requirements of proposed § 1026.20(d). First, use of the term "consummation" in TILA section 128A supported 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 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."[88] Because Regulation Z uses the term "consummation" in connection with closed-end credit transactions, use of the word "consummation" in Dodd-Frank Act section 1418 supported the Bureau's proposed exemption for open-end home equity plans from the requirements of §1026.20(d). Second, the Bureau stated that Dodd-Frank Act section 1418 places TILA section 128A adjacent to the similarly numbered provision, TILA section 128, which is limited to "Consumer Credit not under Open-End Credit Plans." In its proposal, the Bureau stated that Congress's placement of the new ARM disclosure requirement in a segment of TILA that applies only to closed-end credit transactions further supported the Bureau's proposal to exempt open-end credit transactions, in this case variable- or adjustable-rate home equity plans, from the requirements of that section.

The Bureau received no comments on this issue. For the reasons discussed in the proposal, the Bureau is adopting the final rule restricting the scope of § 1026.20(d) to closed-end transactions.

[88] *Compare* § 1026.17(b) *with* § 1026.5(b)(1)(i).

Savings clause. In the proposed rule, the Bureau noted that the statute's provisions applied to hybrid ARMs, defined 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."[89] The proposal discussed the statute's "savings clause," permitting the Bureau to require the initial interest rate adjustment notices set forth in TILA 128A(b) or "other notices" for ARMs other than hybrid ARMs. The Bureau proposed to use this authority generally to extend the disclosure requirements of proposed § 1026.20(d) to ARMs that were not hybrid. The Bureau stated that it believed this approach was necessary because both hybrid ARMs and those that are not hybrid would subject consumers to the same payment shock that the advance notice of the first interest rate adjustment was designed to address. As an example, the Bureau pointed out that 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 interest rate adjusts every three years, both adjust for the first time after three years and present the same potential payment shock to consumers holding either loan. The Bureau also pointed out that the same was 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.

Many industry commenters, including large and small bank servicers and national and State trade associations, recommended against broadening the scope of § 1026.20(d) to ARMs that are not hybrid. A chief reason for their opposition was that including non-hybrid ARMs

[89] 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 commence with a rate that adjusts at set uniform intervals, such as 3/3 (adjusts every three years), 5/5 (adjusts every five years), etc.

would go beyond the scope of the statute. However, they failed to mention that TILA section 128A(c) explicitly bestows authority on the Bureau to "require the notice in 128A(b) or other notice consistent with this Act for adjustable-rate mortgage loans that are not hybrid adjustable-rate mortgage loans."

Many small bank servicers and their trade associations recommended limiting the scope of the rule to hybrid ARMs. These commenters indicated that, because they viewed the notice required by TILA section 128A as confusing and unimportant to consumers, it would be advisable to limit it to as small a set of ARMs as possible. Other reasons these commenters opposed the expansion of the scope to ARMs that are not hybrid included the burden on industry to provide additional consumers with the initial ARM adjustment notice and that hybrid ARMs are considered riskier than other ARMs and typically have extended fixed-rate periods, thereby justifying the need for heightened consumer protection.

The Bureau believes it is appropriate to apply the requirements of § 1026.20(d) to all ARMs, not just hybrid ARMs. As discussed above, the Bureau has the authority to extend the requirements to all ARMs, pursuant to the savings clause in TILA section 128A. Further, the Bureau believes that consumers of non-hybrid ARMs may benefit from the same protections afforded to consumers of hybrid ARMs. Consumers experience the same payment shock at one, three, five, seven or ten years regardless of whether the interest rate calculation classifies it as a hybrid ARM or non-hybrid ARM. Accordingly, the Bureau believes that the underlying rationale for the requirements is equally applicable to all ARMs, whether hybrid or non-hybrid, and should be extended to all ARM consumers. Commenters have not demonstrated why consumers of hybrid ARMs, as opposed to consumers of non-hybrid ARMs, should receive uniquely greater protections or why the consumer benefits for non-hybrid ARMs would not

exceed the costs of providing the notice. Nor have these commenters suggested why, once systems are put into place to provide the notice to consumers with hybrid ARMs, it would be burdensome to require the same notices for consumers with ARMs that are not hybrid. Rather, these commenters offer only general opposition to the requirements of § 1026.20(d) and, accordingly recommend a scope for the rule as prescribed and limited as possible. As set forth above, the Bureau is not persuaded by these comments and is adopting the final rule as proposed with regard to the application of § 1026.20(d) to all ARMs.

Legal Authority

For the reasons discussed above, the final rule's exemption of home equity plans from the requirements of TILA 128A and §1026.20(d) is necessary and proper under TILA section 105(a) to further the consumer protection purposes of and facilitate compliance with TILA. As discussed above, the Bureau believes that the information contained in the § 1026.20(d) notice 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 is adopting 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, such transactions are not structured in such a way as to garner benefit from the §1026.20(d) disclosures 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 § 1026.20(d) notices for open-end accounts that have adjustable-rate features would not provide a meaningful benefit to consumers.

20(d)(1)(ii) Exemptions

In General

Proposed § 1026.20(d)(1)(ii) would have exempted construction loans with terms of one year or less from the disclosure requirements of § 1026.20(d). Section 1026.20(c) proposed the same exemption. Proposed comments 20(d)(1)(ii)-1 and -2 provided clarification, including clarifying that certain loans are not ARMs if the interest rate or payment change is based on factors other than a change in the value of an index or formula.

In response to comments received from industry representatives, as discussed below, the final rule expands the construction loan exemption to all ARMs with terms of one year or less. Industry commenters requested other exemptions from § 1026.20(d) that the Bureau declines to adopt.

No Small Servicer Exemption

In its proposed rule, the Bureau considered small servicer exemptions for both § 1026.20(c) and (d) and reached the preliminary conclusion that an exemption was not appropriate. The final rule reaffirms this conclusion and thus, small servicers are subject to the requirements of both § 1026.20(c) and (d).

Before issuing its proposed rules, the Bureau considered the arguments of small servicers in favor of a small servicer exemption from both § 1026.20(c) and (d). Small community banks and credit unions expressed their views to the Bureau in the context of the Small Business Review Panel convened in advance of the issuance of the 2012 TILA Servicing Proposal. In its proposed rule, the Bureau explained that the Small Entity Representatives which participated in the Small Business Review Panel expressed opposition to the requirement to provide § 1026.20(c) and (d) disclosures altogether. Specifically, they doubted the value of disclosing certain information in the ARM notices, such as the maximum interest rate and payment and the explanation of how the interest rate and payment are determined. The Small Entity

Representatives also felt strongly that consumers would be confused by the § 1026.20(d) notices because consumers would receive the notice so far in advance that the disclosure would contain estimates, rather than the actual amounts, of the interest rate and mortgage payment.[90] The Small Entity Representatives noted that, in addition to the requirement to provide initial interest rate adjustment notices under § 1026.20(d), they would be required to provide the actual interest rate and payment in the later § 1026.20(c) notice, if the initial interest rate adjustment resulted in a payment change. They expressed concerns about the one-time development costs and on-going costs associated with providing both the initial ARM adjustment notices and the potentially recurring notices under § 1026.20(c).[91]

After considering the views of the Small Entity Representatives and the recommendation of the Small Business Review Panel, the Bureau decided not to include a small servicer exemption from these sections of its proposed rule. The Bureau reasoned that small servicers were already subject to the requirement to provide notices pursuant to § 1026.20(c), so that continuing this requirement would not add incremental cost (other than the one-time cost of development to implement the changes proposed by the Bureau). The Bureau stated that the initial interest rate adjustment notice required by § 1026.20(d) served related but distinct purposes, such that eliminating it could harm consumers. The Bureau said that the § 1026.20(d) notice was designed to provide consumers with very early warning of their interest rate adjustment, so that consumers could begin exploring other options. Receiving the § 1026.20(c) notice with the actual interest rate and payment closer to the adjustment date, the Bureau said, would be valuable to the consumer both as a second warning and as a budgeting tool.

[90] *See* Small Business Review Panel Report, at 20-21, 29-30.
[91] *See* Small Business Review Panel Report, at 20-21, 29-30.

The Bureau also considered exempting small servicers from the requirements of § 1026.20(c) for an *initial* interest rate adjustment that caused a change in payment. To this end, the Bureau considered including the information required by proposed § 1026.20(c) in the periodic statement proposed by the Bureau in § 1026.41. The Bureau concluded that this option was unworkable in light of (1) the proposed exemption for small servicers from the periodic statement requirements and (2) the increased burden of the resulting programming complexity in the periodic statement.

The Bureau also pointed out that the amount of burden reduction from a § 1026.20(c) exemption from an initial interest rate adjustment would have been extremely minimal, given that small servicers still would have had to maintain systems to generate § 1026.20(c) notices for any subsequent interest rate adjustment resulting in a corresponding payment change. Thus, the Bureau concluded, exempting small servicers from providing a § 1026.20(c) notice for the first interest rate adjustment would not have provided significant burden reduction.

The Bureau also considered whether to exempt small servicers, creditors, and assignees from the requirements of § 1026.20(d). As discussed above, the Small Entity Representatives expressed concern that consumers would be confused by receiving estimates, rather than their actual new interest rate and payment.[92] However, the Bureau stated in its proposal that it believed the best approach to address this concern was to clarify the contents of the notice, rather than to eliminate it entirely. Congress had made a specific policy judgment that the early notice would benefit consumers. Moreover, the Bureau agrees that this measure poses important potential benefits to consumers. The Bureau went on to say that creating an exemption for small creditors, assignees, and servicers could have deprived certain consumers of the benefits that

[92] *See* Small Business Review Panel Report, at 21.

Congress had intended, specifically advance notice seven to eight months before the first payment at a new level would have been due reminding consumers of the upcoming adjustment and giving them time to weigh the potential impacts of a rate change and to explore alternative actions. An exemption also would have deprived those consumers who may become financially distressed due to the upcoming interest rate change from the loss mitigation information disclosed in the § 1026.20(d) notice.

The Bureau stated that, on balance, it did not believe that the § 1026.20(d) notice would have imposed a significant burden on small entities because of its one-time occurrence. Moreover, the notice was designed to be consistent with the § 1026.20(c) notice to, among other things, reduce the burden on industry. For these reasons and those stated above regarding the consumer benefits of proposed § 1026.20(d), the Bureau's proposed rule did not exempt small servicers from its requirements. The Bureau sought comments, in addition to the comments it received through the Small Business Review Panel process, on whether the burden imposed on small entities by the ARM requirements would outweigh its consumer protection benefits.

Many industry commenters echoed the rationales offered by the Small Entity Representatives in favor of a small servicer exemption from the ARM rules. These commenters included three national and four State trade associations with small servicers as constituents and two credit unions. Non-profit servicers and State housing finance authorities also requested exemption from the proposed ARM rules. A consumer group recommended against such exemptions, stating that small servicer failures have the same effect on consumers as those of large servicers. Many industry commenters did not address this issue.

Advocates of a small servicer exemption offered general arguments in favor of their position. These commenters requested the exemption in light of the "high touch" and

personalized service business model used by small servicers. They pointed to Bureau representations that small bank servicers might be exempted from mortgage servicing rules aimed at correcting abuses in the market perpetrated by other servicers. Subjecting small servicers to the ARM rules, they predicted, would lead to the discontinuation of certain types of loans they hold in portfolio and increase the cost of credit, to the detriment of consumers in general and specifically to rural, minority, and middle class consumers. Existing rules are adequate, one commenter said, because refinancing and loan modifications have resolved the problems caused by the offending ARM products. Some commenters said that rules against unfair and abusive practices would provide adequate incentives for small servicers in place of the ARM rules.

In the final rule, for the reasons set forth above, the Bureau declines to exempt small servicers from the requirements of § 1026.20(c) and (d). In addition to the above-cited reasons, the Bureau notes that small servicers currently are subject to § 1026.20(c) and it sees no justification for scaling back existing consumer protections. Also, the Bureau is *revising* current § 1026.20(c), which is less burdensome to industry than if the Bureau was implementing a new rule. The Bureau also notes that the § 1026.20(c) notice is a limited notice, required only in the case of an interest rate adjustment causing a payment change. Moreover, the Bureau's final rule reduces industry burden by eliminating the annual notice small servicers currently are required to provide to all ARM holders whose interest rates change over the course of a year without effecting a payment change. Thus, the Bureau's final rule reduces the burden of compliance on small servicers in this respect, even absent an exemption. Also, as stated above, creditors, assignees, and servicers will have to provide the § 1026.20(c) payment change notice in any case, to inform consumers of the actual amount of their upcoming new mortgage payment. Due

to the small servicer exemption from the periodic statement, their customers will otherwise not receive this information or be informed of their new mortgage payment.

As stated above, the § 1026.20(d) notice is a one-time notice and therefore, imposes less burden on small servicers than notices that may be more frequent, such as the § 1026.20(c) payment change notice. Moreover, the Bureau's efforts to make both ARM notices consistent with one another were intended to reduce the implementation burden on servicers, as well as to ease the burden on consumers to digest two forms that differ greatly from one another. For the reasons discussed above in the proposed rule and in the immediately preceding discussion titled *Commenters recommending against adoption of proposed § 1026.20(d),* the Bureau declines to extend an exemption from § 1026.20(d) for small creditors, assignees, and servicers.

Information Required by ARM Disclosures may not be Provided Instead in the Periodic Statement

In its proposal, the Bureau also solicited comments on whether creditors, assignees, and servicers should be permitted, or even required, to provide the information required by § 1026.20(c) and (d) in the periodic statement, in lieu of providing the ARM disclosures as separate notices. A large bank servicer, a non-bank servicer, and a State trade association opposed allowing or requiring combining the ARM disclosures with the periodic statements, asserting that the ARM interest rate adjustment information was too important to merge with or attach to the information in the periodic statement. They also warned about the challenge posed by complying with the timing requirements of the periodic statement and § 1026.20(c) and (d) in one combined disclosure. A credit union trade association supported the idea but requested that the Bureau provide a model form. Two credit unions and a large non-bank servicer supported

the idea, citing decreased cost to industry and the higher likelihood of consumers reading the ARM information as reasons for their support.

The final rule does not permit integrating the ARM § 1026.20(c) and (d) notices into the periodic statement. The Dodd-Frank Act requires that the § 1026.20(d) notice be provided to consumers as a separate notice. Moreover, industry comments on the utility of combining these disclosures were sharply divided. Further, the Bureau is concerned that the volume and complexity of the information in the combined statement could overwhelm consumers and create greater programming burden on industry. Also, this measure would provide no benefit to small servicers exempt from the periodic statement. Finally, the Bureau does not believe that providing separate notices creates an appreciably greater burden on creditors, assignees, and servicers than providing them as an integrated notice, especially because the final rule permits § 1026.20(d) notices to be provided to consumers in the same envelope or email with other disclosures, pursuant to revised§ 1026.17(a)(1). See the section-by-section analysis of § 1026.17(a)(1) and § 1026.20(d) above for discussion of the form of delivery requirements for § 1026.20(d).

Accordingly, the Bureau declines to permit servicers to provide the information required by § 1026.20(c) and (d) in the periodic statement in lieu of providing the ARM disclosures. However, in the interest of ensuring that its disclosure rules and model forms are based on the best empirical data available, pursuant to its authority under Dodd-Frank Act section 1032(e), the Bureau invites interested creditors, assignees, and servicers to consider proposing a trial disclosure program to test the hypothesis that the disclosures required by § 1026.20(c) and (d) could be effectively integrated into the periodic statement without compromising consumer protections. The Bureau's proposed Policy to Encourage Trial Disclosure Programs sets forth

how the Bureau intends to exercise its authority under Dodd-Frank Act section 1032(e) to permit creditors, assignees, and servicers, among others, to test alternative disclosures designed to improve consumer understanding.[93]

Exemptions from the Rule

ARMs with terms of one year or less. For the same reasons already discussed with respect to the payment change notices required by proposed § 1026.20(c), proposed § 1026.20(d) would have included an exemption for construction ARMs with terms of one year or less (except that that timeframe within which creditors, assignees, and servicers would have had difficulty complying was 210 to 240 days before the first payment is due after the initial adjustment). *See* section-by-section analysis of § 1026.20(c)(1)(ii). On the basis of the same comments and for the same reasons set forth in the section-by-section analysis of § 1026.20(c)(1)(ii), the Bureau concluded that requiring notices under § 1026.20(d) for construction as well as other ARMs with terms of one year or less would not provide a meaningful benefit to the consumer nor would it have improved consumers' awareness and understanding of their ARMs with terms of one year or less. Thus, the Bureau is adopting the rule with an exemption for all ARMs taken out by consumers with terms of one year or less. The Bureau notes that the ARM rules apply only to consumer loans and that proposed comment 20(d)(1)(ii)-1, which the Bureau is adopting as proposed, applies the standards in current comment 19(b)-1 for determining the term of a construction loan and adds clarification regarding what other types of loans qualify for the expanded short-term ARM exemption.

Non-ARM loans. Proposed comment 20(d)(1)(ii)-2 discussed other loans to which the rule would not have applied. Proposed comments 20(c)(1)(ii)-2 and 20(d)(1)(ii)-3 were

[93] *See* 77 FR 74625 (Dec. 17, 2012), https://www.federalregister.gov/articles/2012/12/17/2012-30159/policy-to-encourage-trial-disclosure-programs-information-collection.

consistent with regard to the loans which would not have been 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 clarified that, for purposes of § 1026.20(d), the following loans, if fixed-rate transactions, would not have been considered ARMs and therefore would not have been 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 Bureau observed that the particular features of these types of loans might trigger interest rate or payment changes over the term of the loan or at the time the consumer pays off the final balance. However, the Bureau stated that these changes were based on factors other than a change in the value of an index or a formula. For example, whether or when the interest rate would adjust for the first time for a preferred-rate loan with a fixed interest rate would likely not be knowable six to seven months in advance of the adjustment. This was because the loss of the preferred rate would have been based on factors other than a formula or change in the value of an index agreed to at consummation. The Bureau received no comments on this topic and, thus, is adopting the rule and commentary 20(d)(1)(ii)-2 as proposed.

Other Requested Exemptions

A payment-option ARM is one in which consumers may select among several payments each billing period, some of which may not amortize principal or may cause negative amortization. Typically, the loan contract allows for the ARM to "recast" or to require an increase in the mortgage payment upon reaching a certain negative amortization limit. A few

commenters asked the Bureau either to exempt payment-option ARMs from the requirements of both § 1026.20(c) and (d) or to apply the 25- to 120-day advance notice requirement with regard to § 1026.20(c). One large bank asked for this exemption based on the difficulty of closely monitoring such loans to assess whether the next minimum periodic payment, which typically results in negative amortization because it does not cover all accrued interest, would cause the principal balance to exceed a contractual limit and trigger a recast of the periodic payment. That commenter indicated that it believed in certain circumstances the recast of the payment would also cause an interest rate adjustment.

The Bureau notes that payment option ARMs are subject to current § 1026.20(c) and the commenter's rationale does not justify scaling back existing consumer protections. Further, the Bureau understands from outreach with industry that the amount of unpaid principal triggers the reamortization of a payment-option loan without requiring an adjustment to the interest rate. Because there is no interest rate adjustment, § 1026.20(c) and (d) do not impose a requirement on creditors, assignees, and servicers to closely monitor such loans as presumed by the commenter. For these reasons, the payment-option ARMs are subject to the requirements of § 1026.20(c) and (d).

A number of industry commenters recommended exempting ARMs originated prior to the effective date of the rule. The Bureau believes that, for all the reasons discussed throughout the section-by-section analysis, consumers with ARMs originated prior to the effective date of the rule which adjust for the first time after that date could benefit from the consumer protections afforded by § 1026.20(d) as much as consumers with ARMs originated after the effective date. In many of these cases, the initial rate adjustment will occur a year or more after the effective date of the rule, exposing those consumers to the same risk of payment shock as those whose

ARMs originate after the effective date. Therefore, once the final rule takes effect, it applies to all ARMs which have not yet adjusted for the first time.

Finally, a national trade association representing the reverse mortgage industry recommended an exemption from the requirements of both § 1026.20(c) and (d) for reverse mortgage ARMs. The trade association stated that most, if not all, reverse mortgages with a variable rate of interest are structured as open-end credit transactions. Because current § 1026.20(c) and final § 1026.20(c) and (d) apply only to closed-end transactions, those regulations are not applicable to most reverse mortgage ARMs. However, the trade association stated, applying the new ARM rules to reverse mortgages would stifle the industry's current efforts to develop a "hybrid" ARM reverse mortgage, which could be structured as a closed-end credit transaction. They articulated the same concerns raised by other industry commenters that the 210- to 240-day advance notice required by § 1026.20(d) would require disclosure of an *estimate* that will be inaccurate by the time the rate adjusts and, thus, will result in consumer confusion. They also questioned whether § 1026.20(d) notices would be required for closed-end reverse mortgages because they do not carry regular monthly payment obligations and that such a requirement would be meaningless to consumers with closed-end variable-rate reverse mortgages.

The Bureau believes that, if the reverse mortgage industry chooses to create a closed-end adjustable-rate product, consumers with those reverse mortgages, like those with other types of ARMs, would benefit from advance warning of interest rate adjustments to help them better manage their mortgages. For the reasons set forth in the section-by-section analysis of §1026.20(d) below, the Bureau further believes that providing consumers with an estimate of their upcoming new interest rate, pursuant to § 1026.20(d), provides the important consumer

protection benefit of alerting consumers to a potential interest rate increase and to provide sufficient time to pursue other alternatives. Finally, the Bureau notes that creditors, assignees, and servicers are permitted to modify the notices required by § 1026.20(c) and (d) to accommodate credit transactions outside of the norm covered by the rule, such as reverse mortgages. For the reasons discussed above and throughout this rule, the Bureau declines providing an exemption for reverse mortgage ARMs subject to the requirement of § 1026.20(c) and (d).

Legal Authority

The Bureau uses its authority under TILA section 105(a) to exempt short-term consumer ARMs with terms of one year or less from the requirements of TILA section 128A and § 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 consumer 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 exempts these 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 consumer 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 consumer (including related financial arrangements, financial sophistication, and the importance to the consumer of the loan). Finally, the non-ARM loans listed above, because they are not ARMs, are not subject to TILA section 128A or proposed § 1026.20(d) and therefore require no disclosures under the rule.

20(d)(2) Content

Initial Rate Adjustment Disclosures

In General

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, as well as descriptions of actions the consumer must take to pursue these alternatives; (5) contact information for HUD- or State housing finance authority approved housing counselors or programs reasonably available; and (6) contact information for the State housing finance authority for the State where the consumer resides. In its proposal, the Bureau interpreted the explanation mandated by (2) above to require disclosure of any adjustment to the applicable index, including the amount of any margin and 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 of the loan caused by the interest rate adjustment.

Good faith estimate. TILA section 128A requires that § 1026.20(d) interest rate adjustment disclosures 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." In the proposed rule, the Bureau interpreted this statutory standard to require disclosure to consumers of the index rate or formula;

any adjustment to the index or formula, such as the addition of a margin or carryover interest; the loan balance; and the remaining loan term because each of these elements are used to calculate the new payment.

The proposal also reasoned that most ARM contracts base the calculation of the new interest rate and payment on an index value published far closer to the date of the interest rate adjustment than those available during the 210 to 240 days before the first payment at a new level is due after an interest rate adjustment. See the section-by-section analysis of § 1026.20(c)(2) above for the discussion in the Bureau's proposal of the timeframe it generally would have required for ascertaining the index rate used to calculate the adjusted interest rate and new payment for the proposed ARM payment change notices. The Bureau thus concluded that it was unlikely creditors, assignees, and servicers would be able to disclose the actual new interest rate and payment in the initial ARM interest rate notices. The Bureau reasoned that, consistent with the language of the statute regarding estimates, proposed § 1026.20(d)(2) would have required estimates, labeled as such, if the new interest rate or any other calculation using the new interest rate were not known as of the date of the disclosure. *See also* proposed comment 20(d)(2)(iii)(A)-1.

The Bureau also interpreted 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. The Bureau concluded that, because the notice was designed to alert consumers to upcoming changes to their mortgages 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, if it were known, would benefit consumers. The Bureau stated that, 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 the first payment at a new level was due.[94]

Proposed § 1026.20(d) also would have required that any estimate be calculated using the index figure disclosed in the source of information described in § 1026.20(d)(2)(iii)(A) within 15 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, the Bureau reasoned, would have prevented confusion as to the recency of the index value. Pursuant to the timeframe discussion above in the section-by-section analysis of § 1026.20(c)(2), the 15-day period would have allowed 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.

The Bureau received no comments on these aspects of the good faith estimate requirement and is adopting the final rule as proposed. See also the section-by-section analysis of § 1026.20(d) above for a discussion of industry opposition to the use of estimates in the § 1026.20(d) notice.

Additional content. In addition to the content explicitly required under the statute, the Bureau proposed, as discussed in more detail below, to require the ARM initial interest rate adjustment 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 was scheduled to adjust pursuant to the terms of the loan, that the adjustment might effect a change in the mortgage payment, the specific time period the current interest rate had been in effect, the dates of the upcoming and future interest rate adjustments, and any other changes to loan terms, features, or options that would take effect on the same date as the interest rate adjustment; the

[94] Macro Report, at viii.

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 amortize fully an ARM that became 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 was an estimate, a statement that another disclosure containing the actual new interest rate and payment would be provided within a specified time period if the actual interest rate adjustment resulted in a corresponding payment change; and the amount and expiration date of any prepayment penalty.

Many industry commenters recommended that the Bureau eliminate certain of the content required by the Dodd-Frank Act and refrain from including other content not statutorily-required. The Bureau directs readers to the specific content sections below for discussion of comments received and the Bureau's decisions with regard to the final rule. The Bureau notes that it is exercising its exception authority in the final rule to modify the proposed requirements regarding contact information for homeownership counselors and counseling organizations and State housing finance authorities and the prepayment penalty.

Legal Authority

As discussed above, TILA section 128A(b) expressly requires much of the content included in the initial interest rate disclosures. The Bureau is implementing these statutory requirements pursuant to its authority under TILA section 105(a). The additional content is likewise authorized under TILA section 105(a). As further discussed below, the additional content is necessary and proper to assure that consumers understand the consequences of the

upcoming ARM interest 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 additional content is further authorized under Dodd-Frank Act 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 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 Dodd-Frank Act section 1405(b), that the additional content improves consumer awareness and understanding of their residential ARM loans and is thus in the interest of consumers and in the public interest. The 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.

20(d)(2)(i)

Date of the Disclosure

Proposed § 1026.20(d)(2)(i) would have required inclusion of the date of the disclosure in the initial ARM adjustment notices. To group together all data directly related to the ARM itself, proposed § 1026.20(d)(3)(ii) would have required 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 explained that the date on the notice would have been the date the creditor, assignee, or servicer generated the notice. Proposed § 1026.20(d)(2) would have required that date to be within 15 business days after publication of the index level used to calculate the adjusted interest rate and new payment, if it was an estimated and not actual

adjusted interest rate and new payment. Because, under the proposal, consumers would have received the disclosures so far in advance, the Bureau expected estimates would have been used in most cases. As stated above, tying the date of the disclosure to the publication date of the index level, the Bureau concluded, would prevent consumer confusion as to the recency of the index value upon which the estimated interest rate and new payment was based.

The Bureau received no comment on this topic. The Bureau is adopting the final rule as proposed.

20(d)(2)(ii)

Statement Regarding Changes to Interest Rate and Payment

Proposed § 1026.20(d)(2)(ii)(A) would have required 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 current interest rate has been in effect would end on a certain date, that their interest rate might change on that date, and that any change in their interest rate might result in a change to their mortgage payment. This information, the Bureau said, is similar to the pre-consummation disclosures required by current § 1026.19(b)(2)(i) and § 1026.37(j) as proposed in the 2012 TILA-RESPA Proposal. Proposed comment 20(d)(2)(iii)(A)-1 clarified that the current interest rate was the interest rate that would be in effect on the date of the disclosure.

Proposed § 1026.20(d)(2)(ii)(B) would have required the initial ARM interest rate adjustment notices to include the dates of the impending and future interest rate adjustments. Proposed § 1026.20(d)(2)(ii)(C) also would have required disclosure 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 Bureau explained that the first ARM model form tested did not contain the 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 would adjust 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.[95] In the absence of comments regarding this provision, the Bureau is adopting the final rule as proposed.

20(d)(2)(iii)

Table with Current and New Interest Rates and Payments

Proposed § 1026.20(d)(2)(iii) would have required 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 have appeared within the larger table containing the other required disclosures, except for the date of the disclosure. Proposed comment 20(d)(iii)(A)-1 would have clarified the difference between the current and new interest rate.

This table would have followed the same order as, and had headings and format substantially similar to, those in the table in model forms H-4(D)(3) and (4) in appendix H of subpart C. The Bureau stated that it confirmed through its consumer testing that, when presented

[95] Macro Report, at vii.

with information in a logical order, participants more easily grasped the complex concepts contained in the proposed § 1026.20(d) notice. For example, the form would have begun by informing consumers of the basic purpose of the notice: their interest rate was going to adjust, when it would adjust, and the adjustment could change their mortgage payment. This introduction would have been immediately followed by a visual illustration of this information in the form of a table comparing consumers' current and new interest rates. Based on its consumer testing, the Bureau stated that it believed that the understanding of the consumers tested was 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 proposed that creditors, assignees, and servicers disclose the information in the table as set forth in model 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 were projected to increase as a result of the adjustment. All participants in all rounds of testing understood that their interest rate and payment were projected to increase and when these changes would occur.[96]

The Bureau proposed including allocation information in the table for interest-only and negatively-amortizing ARMs only. The Bureau stated it believed that providing the payment allocation information would have helped consumers better understand the risk of these products by demonstrating that their payments would not have reduced the loan principal. The Bureau also said that providing the payment allocation would have helped consumers understand the effect of the interest rate adjustment, especially in the case of a change in the ARM's features coinciding with the first interest rate adjustment, such as the expiration of an interest-only or

[96] Macro Report, at vii.

payment-option feature. Because payment allocation might change over time, the rule would have required disclosure of the expected payment allocation for the first payment period during which the adjusted interest rate would have applied.

The Bureau explained that the notice disclosing an allocation of payment for interest-only or negatively-amortizing ARMs was not tested until the third round of testing. The notice tested set forth the following scenario to consumers: the first adjustment of a 3/1 hybrid ARM—an ARM with a fixed interest rate for three years followed by annual interest rate 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 the 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. [97]

The Bureau recognized that certain Dodd-Frank Act amendments to TILA pose restrictions on the origination of non-amortizing and negatively-amortizing loans. For example, TILA section 129C requires creditors to determine that consumers have the ability to repay the mortgage loan before lending to them and that this assumes a fully-amortizing payment. The Bureau thought it possible that this law and its implementing regulations would restrict the origination of risky mortgages such as interest-only and negatively-amortizing ARMs.

The Bureau stated that other Dodd-Frank Act amendments to TILA, such as the proposed periodic statement provisions discussed below, would provide payment allocation information to

[97] Macro Report, at vii- viii. The allocation table for interest-only and negatively-amortizing ARMs was revised after the third and final round of testing and is identical in the final rule in § 1026.20(c) and (d).

consumers for each billing cycle. Thus, consumers with interest-only or negatively-amortizing loans, or those who might obtain such loans in the future, would receive information about the interest-only or negatively-amortizing features of their loans through the payment allocation information in the periodic statement. Also, as stated above, consumer testing showed that participants tested were confused by the allocation table. In view of these changes to the law and the outcome of consumer testing, the Bureau solicited comments on whether to include allocation information for interest-only and negatively-amortizing ARMs in the proposed table described above.

A trade association generally supported the tabular format, stating that consumer testing has repeatedly proven its effectiveness. A large bank recommended eliminating altogether the table with the current and new interest rates and payments because, it said, the table tested poorly with consumers and would confuse them as well as be duplicative of the proposed periodic statement. Other commenters recommended eliminating only the portion of the table disclosing allocation information for interest-only and negatively-amortizing ARMs while one large bank commended the Bureau for adding these disclosures to the § 1026.20(c) notice. Those commenters in favor of eliminating allocation information for these ARMs said the information was not fully consumer tested, would be based on projections that would confuse and distract consumers, and would require costly software upgrades. Most of these commenters recommended substituting the statement for interest-only and negatively-amortizing ARMs required by § 1026.20(d)(2)(vii) in place of the allocation information; one large bank suggested expanding the language in these statements as a substitute for the allocation information. This large bank also said the allocation information would confuse consumers because, in the case of a negatively-amortizing ARM, the portion allocated to principal would have to be expressed as a

negative number. One trade association recommended allowing estimated escrow payments for the new payment allocation table, which is what the rule proposed and the Bureau is adopting in § 1026.20(d)(2)(iii)(C).

The Bureau is adopting § 1026.20(d)(2)(iii) as proposed for the reasons set forth in the proposal and those set forth below. The table is the centerpiece of the § 1026.20(d) disclosure and contains some of the disclosure's most important information: the consumers' upcoming new interest rate and payment set forth next to their current rate and payment, such that consumers can make comparisons. This information informs consumers of the exact or estimated amount of the new mortgage payment they must pay starting in seven to eight months and the table allows easy comparison with their current charges, helping consumers decide on how best to proceed. Also, the periodic statement will provide consumers with only part of the information in the table: the date after which the interest rate will adjust and the amount of the next payment. Moreover, the periodic statement generally would provide consumers with a month warning before a payment increase, rather than the minimum 210-day advance notice required by § 1026.20(d).

Because interest-only and negatively-amortizing ARMs pose more potential risk to consumers than conventional ARMs, the Bureau believes that providing consumers with the actual or estimated payment allocations for when their interest rates adjust will provide a comprehensible snapshot of the projected consequences of the upcoming adjustments and better enable those consumers to manage their mortgages. The table itself tested well with consumers; the allocation breakdown for the new payment for interest-only and negatively-amortizing ARMs did not test as well. As discussed above, the Bureau revised the model forms to address that problem. Moreover, the periodic statement contains a similar allocation table for the

upcoming mortgage payment and testing of the periodic statement went well and raised no concerns regarding projected principal, interest, and escrow—including for payment-option loans.[98] In addition, as set forth in the periodic statement sample form in appendix H-30(C), the allocation of principal for negatively-amortizing loans is zero, and not a negative number.

Also, the proposed rule clearly set forth the bases upon which to make the projections for the allocation table for these ARMs, as well as for loan balances. See the section-by-section analysis of § 1026.20(d)(2)(vi) below regarding loan balances. For certain consumers, such as those who are delinquent, who may choose to pay ahead, or who have payment-option ARMs, the projected amount may not prove to be the actual amount. However, servicers routinely project expected payment allocations and loan balances any time they provide consumers with a future payment amount, such as in the periodic statement. The Bureau also notes that the use of allocation tables showing projected payments is an established practice in Regulation Z, as illustrated, for example, in appendices H-4(E) and (F). Also, the Bureau expects the origination of these risky loans will continue to decline in light of the qualified mortgage rules implementing TILA section 129C, thereby reducing the burden on servicers to provide the § 1026.20(d) allocation table. For these reasons and the reasons set forth in the proposed rule, the Bureau is adopting the final rule as proposed. The Bureau is adopting comment 20(d)(2)(iii)(A)-1 with the additional clarification that the new payment, if calculated from an estimated interest rate, will also be an estimate and that creditors, assignees, and servicers may round the interest rate, pursuant to the requirements of the ARM contract.

20(d)(2)(iv)

Explanation of How the Interest Rate is Determined

[98] Macro Report, at 15.

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 have required disclosure of the index and published source of the index or formula. This disclosure requirement mirrored the pre-consummation disclosure required around the time of application by current rule § 1026.19(b)(2)(iii). Section 1026.37(j), proposed in 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 any adjustment to the index, such as by the addition of a margin. Proposed § 1026.20(d)(2)(iv) would have required § 1026.20(d) notices to include an explanation of how the new interest rate would have been determined. The Bureau noted that this disclosure requirement was consistent with the pre-consummation disclosure requirements of current rule § 1026.19(b)(2)(iii). The 2012 TILA-RESPA Proposal's 1026.37(j) likewise would require disclosure prior to consummation of the amount of the margin expressed as a percentage.

Consumer testing revealed that participants generally had difficulty understanding the relationship of the index, margin, and interest rate.[99] The Bureau said this was the reason it proposed a relatively brief and simple explanation that the new interest rate would be 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 would have required disclosure of the specific amount of the margin.

[99] Macro Report, at viii.

Consumer testing indicated that the explanation helped participants better understand the relationship between the interest rate, index, and margin. As stated in the proposal, it also helped dispel the notion held by many of the consumers in the initial rounds of testing that creditors subjectively determined their new interest rate at each adjustment.[100] The Bureau stated that it believed the proposed rule and forms struck an appropriate balance between providing consumers with key information necessary to understand the basis of their ARM interest rate adjustments without overloading consumers with complex and confusing technical information.

Other than a comment regarding the application of previously unapplied carryover interest, or applied carryover interest, to the calculation of the new interest rate, which is relevant to § 1026.20(c) and not (d), the Bureau did not receive any comments on the explanation of how the interest rate is determined. In response to that comment, the Bureau modified the proposed rule to include the type and amount, rather than just the type, of any adjustment to the index and removed disclosure of the amount of any adjustment from the ensuing requirement to explain how the new payment is determined. In this way, consumers are informed of the existence and amounts of all elements used to calculate their new interest rates, rather than learning about the amount further on in the disclosure. See the section-by-section analysis of § 1026.20(c)(2)(iii) above for further discussion of this modification.

20(d)(2)(v)

Rate and Payment Limits and Unapplied Carryover Interest

Proposed rule § 1026.20(d)(2)(v) would have required the disclosure of any limits on the interest rate or payment increases at each adjustment and over the life of the loan. The Bureau stated that it believed that knowing the limitations of their ARM rates and payments would help

[100] Macro Report, at viii.

consumers understand the consequences of each interest rate adjustment and weigh the relative benefits of the alternatives that would have been disclosed under proposed § 1026.20(d)(2)(viii). The Bureau gave the example that if an adjustment caused a significant increase in the consumer's payment, knowing how much more the interest rate or payment could increase would better inform the consumer's decision on whether or not to seek alternative financing.

Proposed § 1026.20(d)(2)(v) also would have required disclosure of the extent to which the creditor, assignee, or servicer had foregone any increase in the interest rate due to a limit, called unapplied carryover interest, and the earliest date such foregone interest could be applied. Proposed comment 20(d)(2)(v)-1 would have explained that disclosure of foregone interest rate increases would apply only to transactions permitting interest rate carryover. It further would have explained that the amount of foregone interest rate increase at the initial adjustment was the amount that, subject to rate caps, could be added to future interest rate adjustments to increase, or offset decreases in, the rate determined according to the index or formula.

The Bureau reported that the consumers tested had difficulty understanding the concept of interest rate carryover when it was introduced during the third round of testing. The Bureau attributed this difficulty 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 simplified the explanation of carryover interest to address this possible confusion.[101]

In its proposed rule, the Bureau recognized that the disclosure of rate limits and unapplied carryover interest would have provided information that might help consumers better

[101] Macro Report, at viii-ix. "If not for this rate limit, your estimated rate on [date] would be [x]% higher" was replaced with "We did not include an additional [x]% interest rate increase to your new rate because a rate limit applied."

understand their ARMs. However, the Bureau stated that it was considering whether the assistance this information would have provided outweighed its potential distraction from other more key information. Also, as explained above, consumers had difficulty understanding the concept of carryover interest and the Bureau was concerned that this difficulty might diminish the effectiveness of the proposed § 1026.20(d) disclosures. The Bureau solicited comments on whether to include rate limits and unapplied carryover interest in the proposed § 1026.20(d) disclosures.

The Bureau received few comments regarding the proposed disclosure of rate limits and unapplied carryover interest. A credit union supported inclusion of the rate and payment limits in the § 1026.20(d) notice and a large bank servicer and a large non-bank servicer recommended against it. A large bank servicer commented that consumers do not need this information because they receive it at consummation and including it in the § 1026.20(d) notice would distract and confuse them. The non-bank servicer and a trade association said the unapplied carryover interest was unrelated to the interest rate adjustment and would confuse consumers. See the section-by-section analysis of § 1026.20(c)(2)(iii) and 20(c)(2)(iv) above for a discussion of unapplied interest rate increases.

In addition, a credit union and a State trade association recommended the Bureau eliminate disclosure of carryover interest altogether, asserting that it is too complex and unnecessary for consumers to understand and it would distract consumers from other information contained in the § 1026.20(d) notices. A large servicer suggested the alternative of including this information in the periodic statement instead of the § 1026.20(d) notice.

Because most ARMs covered by this rule will adjust a year or more after consummation, the Bureau disagrees that information provided at consummation suffices to adequately inform

consumers about carryover interest and rate limits. Moreover, carryover interest is an essential element in the determination of the new interest rate and payment. For these reasons and the reasons in the Bureau's proposed rule, the Bureau is adopting the final rule as proposed. The Bureau also is adopting proposed comment 20(d)(2)(v)-1, with slight modifications to clarify the definition of carryover interest.

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 have implemented this statutory provision by requiring the content discussed below. The proposed disclosure would have been consistent with the disclosures required at the time of application pursuant to current § 1026.19(b)(2)(iii). The Bureau also stated that its proposal was consistent with content proposed in § 1026.20(c) and thus would have promoted consistency in Regulation Z ARM disclosures.

Proposed § 1026.20(d)(2)(vi) would have required ARM disclosures to explain how the new payment was determined, including (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 was an estimate, a statement that another disclosure containing the actual new interest rate and new payment would be provided to the consumer between two and four months prior to the date the first new payment would be due, if the interest rate adjustment would cause a corresponding change in payment, pursuant to § 1026.20(c).

The proposal would have required 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 have required disclosure of any change in the term of the loan caused by the adjustment. As discussed in proposed § 1026.20(d)(2)(iv) above, the Bureau stated its belief that this explanation would have helped consumers better understand how these factors determine their new payment and would have dispelled the notion held by many consumers in the initial rounds of testing that, at each adjustment, the creditor subjectively determined their new interest rate, and thus the new payment. The Bureau stated that disclosure of the four key assumptions upon which the new payment would be based would have provided a succinct overview of how the interest rate adjustment works. It also would have demonstrated that factors other than the index could increase consumers' interest rates and payments. Disclosures of these factors, the Bureau said, would have provided 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. As set forth above, if an estimated new interest rate and new payment were used, consumers would have been informed by a statement in the § 1026.20(d) notice that they would receive another disclosure containing their actual new interest rate and new payment between two and four months in advance of the due date of their first new payment—if the interest rate adjustment would result in a corresponding payment change.

Two commenters voiced concern over having to project an estimate of the loan balance, as required in the proposed rule. For a discussion of the use of projections of scheduled payments for interest-only and negatively-amortizing ARMs, as well as for the loan balance, see the section-by-section analysis of § 1026.20(d)(2)(iii) above. The final rule adds emphasis regarding the use of estimates in the § 1026.20(d) model forms to further alert consumers to their

use, including that a recent index rate is used in the calculation of the new interest rate and payment and underlining of the word "estimate." The Bureau did not receive other specific comments regarding § 1026.20(d)(2)(vi) apart from one community bank recommending against the inclusion of similar information in both the explanation of how the interest rate is calculated and the explanation of how the new payment is determined. The Bureau points out that the components of the interest rate calculation are also components of how the new payment is determined and therefore, the Bureau will retain these common components in § 1026.20(d)(2)(vi). However, to avoid redundancy, the final rule does not require reiteration of the amount of the margin or any other adjustment to the index.

For these reasons and the reasons articulated in the proposed rule, the Bureau is adopting § 1026.20(d)(2)(vi) and comment 20(d)(2)(vi)-1 as proposed, except the final rule does not require disclosure of the specific amount of any adjustment to the margin, because that data is provided in the final rule under § 1026.20(d)(2)(iv).

20(d)(2)(vii)

Interest-Only and Negative-Amortization Statement and Payment

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

amortizing ARMs, the statement would have informed the consumer that the new payment would cover only part of the interest and none of the principal, and therefore the unpaid interest would add to the balance.

See the section-by-section analysis of § 1026.20(c)(2)(vi) above for a discussion of the Board's 2009 Closed-End Proposal to revise current § 1026.20(c) with regard to non-amortizing and negatively-amortizing loans and Dodd-Frank amendments to TILA that pose restrictions on the origination of non-amortizing and negatively-amortizing loans. In view of these changes to the law and the outcome of its consumer testing, the Bureau solicited comments on whether to include the payment required to amortize ARMs that would become negatively amortizing as a result of an interest rate adjustment.

Some industry commenters said that the statements regarding interest-only and negatively-amortizing ARMs should be disclosed instead of the proposed allocation information for these loans. *See* section-by-section analysis of § 1026.20(d)(2)(iii). Several consumer groups commended the Bureau for requiring the amortization statements but recommended additional warning language for negatively-amortizing ARMs, which they characterized as dangerous. The Bureau believes that the statements regarding amortization are clear and succinct and that additional warning language is not needed. Moreover, the Bureau points out that other new mortgage rules more directly address the risks posed by non-amortizing mortgage products.

The Bureau is modifying the wording of § 1026.20(d)(2)(vii) and comment 20(d)(2)(vii)-1 to clarify that § 1026.20(d) notices for "interest-only ARMs" as well as any other ARMs for which consumers are paying only interest, must include the statement discussed above regarding the amortization consequences of such payments. The Bureau also is modifying the language of

§ 1026.20(d)(2)(vii) to conform with the proposed language in comment 20(d)(2)(vii)-1 and the section-by-section analysis of the proposed rule regarding the amortization statements required for ARMs for which consumers pay only interest and for negatively-amortizing ARMs. The final rule requires § 1026.20(d) notices to disclose, for consumers whose ARM payments consist of only interest, that their payment will not be allocated to pay loan principal and will not reduce the loan balance or, for negatively-amortizing ARMs, that the new payment will not be allocated to pay loan principal and will pay only part of the interest, thereby adding to the balance of the loan. No comments were received regarding the § 1026.20(d)(2)(vii) requirement to disclose the amount necessary to amortize negatively-amortizing ARMs. For these reasons and those stated in the proposed rule, the Bureau is adopting the rule and comments 20(d)(2)(vii)-1 and -2 with the addition of the amortization language discussed above.

20(d)(2)(viii)

Prepayment Penalty

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

The Bureau reasoned that interest rate adjustments might cause payment shock or require consumers to pay their mortgage at a rate they might no longer be able to afford, prompting them to consider alternatives such as refinancing. To fully understand the implications of such actions, the Bureau stated that consumers should know whether prepayment penalties might apply. Under the proposed rule, such information would have included the maximum penalty in

dollars that might apply and the time period during which the penalty might be imposed. The Bureau stated that the dollar amount of the penalty, as opposed to a percentage, would be more meaningful to consumers.

The Bureau also proposed disclosure of any prepayment penalty in § 1026.20(c) ARM payment change 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.[102] For this reason, the Bureau proposed to clarify the circumstances giving rise to a prepayment penalty which creditors, assignees, and servicers must disclose to the consumer in the initial rate adjustment notice. The proposed forms included model language to alert consumers that a prepayment penalty might apply if they pay off their loan, refinance, or sell their home before the stated date.

See the section-by-section analysis of § 1026.20(c)(2)(vii) for a discussion of Dodd-Frank Act amendments to TILA that would significantly restrict a lender's ability to impose prepayment penalties. In view of these changes to the law, the Bureau solicited comments on whether to include information regarding prepayment penalties in § 1026.20(d). See the section-by-section analysis of § 1026.20(c)(2)(vii) for a discussion of comments received regarding the proposed prepayment penalty disclosure.

The Bureau is adopting the rule, with significant modification from the proposed rule. The final rule is renumbered as § 1026.20(d)(2)(viii). In the final rule, in place of requiring

[102] Macro Report, at vi.

disclosure of the maximum dollar amount of the penalty, the consumer is directed by the required disclosure to contact the servicer for additional information, including the maximum amount of the prepayment penalty. Comment 20(d)(2)(viii)-1 clarifies that the creditor, assignee, or servicer has the option of either deleting this field entirely from the § 1026.20(d) disclosure for consumers who do not have prepayment penalties or retaining the field and inserting a word such as "None" after the prepayment penalty heading. Thus, the final rule retains information crucial for consumers to make decisions regarding whether or not to retain their ARMs in the face of an interest rate and payment increase while reducing the burden on industry by eliminating a field that was both dynamic and particularly difficult to calculate. The Bureau believes that encouraging consumers to contact the servicer for the exact dollar amount of the maximum penalty or for other questions, rather than including that information in the disclosure, does not significantly compromise consumer protection because contacting the servicer should yield the most up-to-date information as well as encourage contact with the servicer for consumers facing financial distress. The Bureau also notes that the periodic statement required by the final rule likewise does not contain specific information about any prepayment penalty other than its existence, as applicable. The Bureau also is changing the cross-reference for the definition of prepayment penalty from the periodic statement regulation to the ATR rule.[103]

The Bureau believes, for the reasons stated above and in the proposed rule, that information about the prepayment penalty is important for consumers to take into account when considering alternatives to an interest rate and payment increase. For this reason, the Bureau is adopting the final rule and comment 20(d)(2)(viii)-1 with the modifications set forth above.

[103] *See* § 1026.30(2)(b)(6)(i). NB: Certain provisions of the ATR definition apply specifically to FHA loans.

20(d)(2)(ix)

Telephone Number of Creditor, Assignee, or Servicer

Proposed § 1026.20(d)(2)(x) would have required disclosure of the telephone number of the creditor, assignee, or servicer for consumers to call if they anticipated having problems affording the new payment. The Bureau received no comments on this topic and is issuing the final rule as proposed, renumbered as § 1026.20(d)(2)(ix).

20(d)(2)(x)

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 are refinancing, renegotiation of loan terms, payment forbearance, and pre-foreclosure sales. Proposed § 1026.20(d)(2)(viii) would have required disclosure in § 1026.20(d) initial ARM interest rate notices of the four alternatives set forth in the statute. Proposed comment § 1026.20(d)(2)(viii)-1 interpreted the rule to require simple, commonly used terms when possible in the model forms to describe the alternatives.

The proposed model forms presented the list as possibilities for consumers seeking alternatives to the projected upcoming changes to their interest rate and payment. The proposed forms also explained that the alternatives may be possible and that most of them were subject to approval by the lender. All consumers tested in the first and second rounds of testing were able to identify the list of alternatives.[104]

[104] Macro Report, at viii.

In its proposal, the Bureau said that the list of alternatives generally and concisely described the actions consumers would have to take to pursue these alternatives, such as contacting their lender or another lender. The Bureau proposed to require disclosure of this concise list of alternatives in lieu of a more detailed account of actions consumers could take to maximize the effectiveness of the disclosure without weighing it down with information that may not add significant value.

A national trade association and a non-bank servicer recommended eliminating the loss mitigation options in their entirety from the § 1026.20(d) disclosure. The trade association recommended that the Bureau exercise its exception authority to reverse the statutory mandate requiring inclusion of the loss mitigation options in the disclosure. In the alternative, the trade association recommended the Bureau remove proposed § 1026.20(d)(2)(viii) in favor of a provision encouraging consumers facing financial difficulty to contact the servicer to discuss possible loan modification and forbearance options or to permit servicers to include disclaimers about the accuracy of the required information. Chief among the reasons fueling the national trade association's opposition to including proposed § 1026.20(d)(2)(viii) in the final rule was its concern that the conditional and disclaimer language[105] of the provision would be insufficient to prevent the false impression that some or all of these loss mitigation options would be available to consumers or that they could choose among the options. Both commenters suggested the proposed language could create a moral hazard encouraging consumers to default. The trade association concluded that the provision will encourage unnecessary defaults, unfulfilled expectations, and dissatisfaction with the servicer. The non-bank servicer also stated that it

[105] The proposed § 1026.20(d) model forms stated: "the following options may be possible (most are subject to lender approval)."

would be insulting to consumers to assume that the interest rate adjustment would cause financial distress.

The Bureau declines to remove the loss mitigation options from the final rule. Disclosure of the loss mitigation options is expressly required by TILA section 128A(b)(4) and the Bureau believes presenting consumers with concrete and constructive possible responses to payment shock and financial distress, as set forth in the statute, could significantly benefit consumers. However, the Bureau believes that the proposed forms may have given unwarranted prominence to four alternatives. The Bureau believes that it is logical and may be beneficial to consumers to consolidate all of the loss mitigation information, including information about homeownership counselors and counselor organizations, State housing finance authorities, and the four alternatives, in one place in the disclosure. The Bureau is mindful that the information on alternatives will benefit only the portion of the consumers receiving the § 1026.20(d) disclosure that anticipate financial problems in the face of the higher payment that may occur with their first ARM adjustment. The Bureau also believes that the conditional and cautionary language the proposed model forms used in presenting those alternatives that require lender approval and that may not be available to consumers is sufficient and meets its goal of providing consumers with clear and succinct disclosures. The Bureau is adding emphasis to the conditional language in the final model forms by printing the word "may" in bold font.

To enhance consumer understanding, the Bureau is modifying the final rule by requiring that the alternatives be expressed in simple and clear terms. Because of this addition to the final rule, the Bureau is removing proposed comment 20(d)(2)(viii)-1 interpreting the rule to require the non-technical language in the model forms describing the alternatives.

For these reasons and the reasons articulated by the Bureau in the proposed rule, the Bureau is adopting § 1026.20(d)(2)(viii) as the final rule, with some modification and renumbered as § 1026.20(d)(2)(x). As an alternative to prominently locating the four options in the middle of the disclosure, in the § 1026.20(d) model forms, the Bureau places them at the end of the disclosure, co-located with the other loss mitigation information disclosed in the forms, *i.e.*, the homeownership counselor and State housing finance authority access information and contact information to call the servicer in case of anticipated problems paying at the estimated new rate.

20(d)(2)(xi)

Contact Information for Government Agencies and Counseling Agencies or Programs

State Housing Finance Authorities

TILA section 128A(b)(6) requires the initial interest rate adjustment notices to include the mailing and internet addresses, and telephone number of the State housing finance authority,[106] as defined in section 1301 of Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), for the State in which the consumer resides. Proposed § 1026.20(d)(2)(xi) would have implemented this statutory mandate by requiring inclusion of this information in the initial interest rate adjustment notices. 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 have required contact information for the State housing finance authority. However, those proposals would have required the contact information for the State in which the property is located rather than in which the consumer resides, because the scope of those proposed rules is not limited to a

[106] NB: The statutory language refers to "State housing finance authorities" but these entities may be named "authority" or "agency." The Bureau views these terms as interchangeable for purposes of this discussion.

consumer's principal dwelling. The Bureau sought comment on how to address any compliance difficulties posed by this inconsistency. The Bureau did not believe this inconsistency of language would be problematic because, logically, the consumer's principal dwelling would be located in the State in which the property is located.

Commenters addressing this inconsistency recommended that the Bureau provide the contact information for the State in which the property is located to maintain consistency among the Regulation Z and Regulation X mortgage rules. The Bureau agrees with this recommendation because, as stated above, TILA section 128A applies to consumer credit transactions secured by the consumer's principal residence, such that the State in which the property is located and the consumer's State of residence are the same. However, this issue of consistency is mooted by the Bureau's decision to use its exception authority to issue the final rule requiring § 1026.20(d) notices to direct consumers to a Bureau website from which they can locate contact information for the appropriate State housing finance authority, in place of including the specific contact information in the notice itself. See the Legal Authority discussion below for the bases for this modification of the rule.

Those who commented on the statutory requirement to include contact information for State housing finance authorities recommended that the Bureau issue the final rule removing this information entirely from the § 1026.20(d) notice. Alternatively, commenters recommended (1) modifying the model forms to clarify that these entities may not provide homeownership counseling or (2) directing consumers to a website where they could find contact information for the appropriate State housing finance authority.

State housing finance authorities (SHFAs) and the organizations representing them uniformly recommended against the statutory mandate to include SHFA contact information in

the § 1026.20(d) notice. While always willing to help distressed homeowners, they said, not all SHFAs provide counseling and they expressed concern that the referral might misdirect consumers away from entities more likely to provide the appropriate assistance. SHFAs voiced concern that the increase in consumer inquiries expected as a result of including their contact information in the § 1026.20(d) notices would tax their already limited resources. Industry commenters pointed out the cost burden of this dynamic field, which would require customization of the form by State and constant monitoring of changes to this information.

The Bureau believes that issuing its final rule requiring § 1026.20(d) notices to refer consumers to the Bureau website to find contact information for the appropriate SHFA, rather than including specific contact information in the disclosure itself, does not compromise consumer protection. The unanimity of SHFA commenters and their representatives favoring elimination of SHFA contact information from the notice provides sufficient proof to the Bureau that consumer protection would be better served by this modification of the proposed rule. The Bureau also notes that no consumer advocacy organizations commented on this issue and that the final rule resolves industry concerns on this topic.

Counseling Agencies or Programs

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. The 2013 HOEPA Final Rule, which implements the Dodd-Frank Act protections for "high-cost" mortgage loans, requires, among other things, that consumers get homeownership counselors and counseling organizations

prior to obtaining a high-cost mortgage.[107] It also implements other housing-counseling-related requirements unrelated to HOEPA that are included in the Dodd-Frank Act, such as requiring lenders to provide a list of homeownership counselors to applicants for federally related mortgage loans.[108]

The Bureau proposed the alternative approach, with regard to the initial ARM interest rate adjustment notices, of using its exception authority to require creditors, assignees, and servicers simply to provide the website address and telephone number to access either the Bureau list or the HUD list of homeownership counselors and counseling organizations instead of requiring contact information for a list of specific counseling agencies or programs.[109] For the reasons set forth in the proposal and below, the Bureau is adopting this proposed measure with regard to the website access to homeownership counselor resources. In addition, the Bureau is issuing the final rule modifying the proposed requirement to include both HUD and Bureau telephone numbers to access homeownership counselor information in favor of requiring disclosure only of the HUD telephone number because the Bureau believes the HUD telephone number provides adequate access to approved counseling resources.

The ARM notice required by proposed § 1026.20(d) contains, in a limited amount of space, a significant amount of important technical information about the upcoming initial interest rate adjustment of the consumer's ARM and the potential implications of that adjustment. 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

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[107] *See* § 1026.34(a)(5).

[108] The list provided to consumers pursuant to this requirement must be obtained through a Bureau website or data made available by the Bureau or HUD. *See* § 1024.20(a)(1)(i).

[109] The HUD list is available at http://www.hud.gov/offices/hsg/sfh/hcc/hcs.cfm and the HUD toll-free number is 800-569-4287. The Bureau list will be available by the effective date of this final rule at http://www.consumerfinance.gov/.

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 website would involve more programming and upkeep burden than simply listing one of the agencies' websites and the HUD telephone number.

Providing consumers with the website address for either the Bureau or HUD list of homeownership counselors and counseling organization and the HUD telephone number would streamline the disclosure and present clear and concise information for the consumer to use. Directing consumers to the actual list would allow them to choose a conveniently-located program or agency and find other programs or agencies if those contacted initially could not help the consumer. The Bureau sought comment on whether this proposal struck an appropriate balance, and on the benefits and burdens to both consumers and industry of requiring inclusion of a list of several individual homeownership counselors in the initial ARM interest rate adjustment notice.

Industry commenters uniformly supported the provision to provide information for consumers on how to access homeownership counselor information rather than requiring inclusion of the contact information for specific homeownership counselors in the § 1026.20(d) disclosure and the Bureau received no comments from other sectors. A few servicers stated that a distressed consumer's first action should be to call the servicer and, in response, the Bureau notes that the first entry in the loss mitigation portion of the model form encourages consumers to call their servicer.

The Bureau is adopting the final rule as proposed with regard to homeownership counselors and counseling organizations, except that it also is removing the requirement to

include both a HUD and Bureau telephone number to access contact information for homeownership counselors and counseling information in favor of requiring disclosure only of the HUD telephone number. The Bureau believes that its approach regarding the homeownership counselor disclosures appropriately balances consumer and industry interests.

Legal Authority

The Bureau is relying on its authority under TILA sections 105(a) and (f) and Dodd-Frank Act section 1405(b) to exempt creditors, assignees, and servicers from the requirement in TILA section 128A to include contact information for SHFAs and specific government-certified counseling agencies or programs reasonably available to the consumer in the initial ARM interest rate adjustment notice. TILA section 105(a) and Dodd-Frank Act section 1405(b) also authorize the Bureau to instead require that the initial ARM interest rate adjustment notice contain information directing consumers to the Bureau list or HUD list of homeownership counselors and counseling organizations, the HUD telephone number, and the Bureau website from which consumers can locate the appropriate State housing finance authority. For the reasons discussed above, the Bureau believes that the exemption 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 in the § 1026.20(d) notice of the contact information for SHFAs and 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 consumer (including related financial arrangements, financial

sophistication, and the importance to the consumer of the loan). Moreover, in the estimation of the Bureau, the exemptions would simplify the initial ARM adjustment notice, provide consumers with the appropriate information to locate homeownership counselors and counseling organizations, if needed, and improve the 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 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

Initial Rate Adjustment Disclosures

See the section-by-section analysis of § 1026.17(a)(1) above for a discussion of the form requirements governing § 1026.20(d). The Bureau received no comments regarding its proposed changes to § 1026.17(a)(1) regarding form requirements governing § 1026.20(d), but it did receive significant response to the proposed implementation of the "separate and distinct" standard. In the final rule, the Bureau interprets the "separate and distinct" standard as permitting the initial interest rate adjustment notices to be provided in the same envelope or email with other servicer material, but only if it is a stand-alone document. *See* further discussion in the section-by-section analysis of § 1026.20(d) above. The Bureau is issuing § 1026.17(a) with conforming changes. See the discussion in the section-by-section analysis of § 1026.17(c). See the section-by-section analysis of § 1026.20(c)(3) above for a discussion regarding ARM disclosures in languages other than English.

Legal Authority

In addition, as described below, § 1026.20(d)(3) imposes additional form requirements for initial ARM adjustment notices. For the reasons described below, these requirements are authorized under TILA section 105(a) and Dodd-Frank Act sections 1032(a) and 1405(b). As discussed in the section-by-section analysis of each of the sections of § 1026.20(d)(3), the Bureau believes, consistent with TILA section 105(a), that the 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 Dodd-Frank Act section 1032(a), that the formatting requirements ensure that the features of the ARM loans covered by § 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 Dodd-Frank Act section 1405(b), the Bureau believes that modification of the disclosure requirements of TILA section 128A(b) to require the format discussed below will 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 have required 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.

See the section-by-section analysis of § 1026.20(c)(3)(i) for a discussion of the rationale in the proposed rule for providing the § 1026.20(c) and (d) disclosures in tabular form to consumers and of the comments the Bureau received regarding the required tabular format. The Bureau's response to these comments is two-fold. First, the proposed rule's requirement that § 1026.20(d) disclosures be provided to consumers "in the form of the table and in the same order as, and with headings and format substantially similar to" the proposed model forms is consistent with established standards found throughout Regulation Z requiring tabular formatting as well as other conventions. For example, § 1026.6(b)(1), entitled "Form of disclosures; tabular format for open-end (not home-secured) plans," requires creditors to provide account-opening disclosures "in the form of a table with headings, content, and format substantially similar to" the tables in a particular model form. Moreover, Regulation Z's Appendices G and H—Open-End and Closed-End Model Forms and Clauses sets forth the permissible changes to model forms, including the § 1026.20(d) model forms. Thus, the proposed rule does not depart from established Regulation Z standards and does not violate TILA.

Second, the proposed language referred to by commenters was not intended to strait-jacket creditors, assignees, and servicers into language inapplicable to non-standard customer situations and loan products. The "substantially similar" language was intended to allow disclosure providers the flexibility to develop, for example, forms that may be either one- or two-sided and that may, but need not, feature reverse text data fields.

For these reasons and those articulated in the proposed rule, the Bureau is adopting 1026.20(d)(3)(i), (ii), and (iii) and comment 20(d)(3)(i)-1. While, as stated above, the formatting conventions in the final § 1026.20(d) disclosures do not depart from standard Regulation Z format requirements, the Bureau has added comment 20(d)(3)(i)-1 clarifying that creditors,

assignees, and servicers may modify the § 1026.20(d) disclosures to account for certain circumstances or transactions that may not be addressed in the final rule or forms. Also, the final rule removes § 1026.20(d) model and sample forms from the Regulation Z provision prohibiting formatting alterations. *See* Appendices G and H—Open-End and Closed-End Model Forms and Clauses.

20(d)(3)(ii)

Format of Date of Disclosure

Proposed § 1026.20(d)(3)(ii) would have required that the date of the disclosure appear outside of and above the table required by § 1026.20(d)(3)(i). As discussed above with respect to paragraph 20(d)(2)(i), the date would have been segregated because it is not information specific to the consumer's adjustable-rate mortgage. Having received no comments on this topic, the Bureau is adopting the rule as proposed.

20(d)(3)(iii)

Format of Interest Rate and Payment Table

Proposed § 1026.20(d)(3)(iii) would have required tabular format for initial ARM interest rate adjustment notices for, among other things, interest rates, payments, and the allocation of payments for loans that are interest-only or are negatively amortizing. This table would have been located within the table proposed by § 1026.20(d)(3)(i). This table would have been substantially similar to the one tested by the Board for its 2009 Closed-End Proposal to revise § 1026.20(c). The Bureau's proposal would have required 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 identify and understand the table and its contents.[110] The estimated or actual new interest rate and payment and date the first new payment is due is key information the consumer must know to commence payment at the new rate. For these reasons, the Bureau proposed locating this information prominently in the disclosure.

The Bureau is issuing the final rule as proposed in § 1026.20(d)(3)(iii). See the section-by-section analysis of § 1026.20(c)(iii) for a discussion of comments received and the Bureau's rationale for the proposed format in the interest rate and payment table and changes made in the final rule.

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

36(c) Servicing Practices

Section 1464 of the Dodd-Frank Act generally codified provisions in existing Regulation Z with respect to the crediting of consumer payments and providing payoff statements. The Bureau proposed to implement these statutory requirements through relatively minor changes to Regulation Z as discussed below. Pursuant to the Dodd-Frank Act and current § 1026.36(c), a servicer must promptly credit payments, must not engage in the pyramiding of late fees, and must provide a consumer with a payoff statement at the consumer's request. The Bureau proposed amending Regulation Z to implement the new statutory requirements, and to address the related issue of the handling of partial payments.

36(c)(1)(i) Periodic Payments

[110] Macro Report, at vii.

Section 1464(a) of the Dodd-Frank Act established new TILA section 129F(a), which essentially codified 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 § 1026.36(c)(1)(i) would have required a servicer to promptly credit a "full contractual payment." A full contractual payment would have been defined to mean the amount owed for 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.

In general, commenters supported the prompt crediting of full payments; however commenters expressed concerns over the definition of a full payment and requested clarification regarding the implication of this rule in certain circumstances.

Several industry commenters and one State Attorney General's office commented that a definition of "full contractual payment" that excluded late fees would encourage consumers to ignore payment of late fees, would purport to redefine the terms of the underlying security instrument, and would potentially impact the servicer's ability to collect fees to which they were contractually entitled. An industry commenter indicated that the proposed rule reflected industry practice and was not necessary, whereas another suggested that if late fees were not included in the definition of full contractual payment, there should be a message reminding consumers of their late fee obligation.

Several commenters also sought clarification regarding the implications of the requirement in certain circumstances. Specifically, a consumer advocate commenter requested clarification regarding the impact on non-payment of escrowed amounts for force-placed insurance and property taxes. Several industry commenters requested clarification regarding the application of the rule when a mortgage loan has been accelerated or is in foreclosure, and urged an exemption for such scenarios. In addition, the Bureau received one comment expressing concern about posting payments on weekends, and one comment requesting that payments only be posted on the same business day, not the same calendar day. Finally, a number of community banks, credit unions, small servicers and their trade associations requested an exemption for small servicers from all provisions of the proposed rules.

As stated in the proposal, the Bureau believes that if a consumer submits sufficient funds to cover principal, interest and escrow, those funds should be applied regardless of whether there are outstanding late fees. The rule was not intended to redefine existing contractual terms of the underlying security. While servicers must apply full payments that are sufficient to cover principal, interest and escrow, servicers may still charge and collect late fees if such payments are not timely made. The Bureau initially proposed to define the amount due in any period for principal, interest, and escrow as a "full contractual payment" to reflect the amount due in a period pursuant to the contractual obligation. However, in light of the concern that the regulation may be interpreted as redefining a consumer's contractual obligation, the Bureau is adopting instead the term "periodic payment" in place of "full contractual payment" to refer to the amount owed by the consumer for principal, interest, and escrow during any billing cycle. Thus, if a consumer submits an amount sufficient to constitute a periodic payment (that is,

enough to cover the amounts due for principal, interest, and escrow), that payment must be promptly credited to a consumer's account.

Because the definition of "periodic payment" is intended to reflect the consumer's contractual obligation, to the extent a consumer's mortgage loan has been accelerated (such that the periodic payment constitutes the total amount owed for all principal and interest), or that certain obligations for force-placed insurance or delinquent taxes have been paid through the escrow account, those amounts may be appropriately accounted for within this definition of a periodic payment. With regard to defining the periodic payment, the Bureau believes it is appropriate to include amounts owed for escrow in the periodic payment. The 2013 RESPA Servicing Final Rule imposes greater requirements on servicers with respect to advances for maintaining insurance for escrowed borrowers and the Bureau believes it is appropriate and consistent with most security instruments to include escrow in the periodic payment.

The Bureau does not believe the rule will prevent collection of late fees or impose operational challenges on servicers regarding the timing for crediting payments. Although a servicer may not delay crediting of a payment until a late fee has been paid, nothing in the rule prevents a servicer from charging and collecting a late fee where appropriate. The Bureau does not believe it is appropriate to mandate a statement to the consumer regarding the consumer's obligation to pay a late fee; however, a servicer may undertake appropriate actions, including potentially through a message on the periodic statement, to collect late fees.[111] With respect to comments regarding operational difficulties of crediting payments on a specific day, the Bureau observes that payment must be credited on the day 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

[111] *See* § 1026.41 and comment 1026.41(c)-2.

consumer reporting agency. The Bureau believes this allows servicers sufficient flexibility because, if it is operationally infeasible to post a payment on the day received, payments may be processed on a later day so long as that later posting does not result in a charge to the consumer or in the reporting of negative information to a consumer reporting agency. Accordingly, the Bureau finalizes the rule as proposed, with a minor adjustment to replace the term "full contractual payment" with the term "periodic payment." Additionally, to dispel any impression that existing comment 36(c)(1)(i)-2 is inconsistent with the final rule, the Bureau is amending the comment to clarify that it concerns the method in which payments are credited.

Small Servicers

Finally, the Bureau does not believe an exemption for small servicers from the prompt crediting requirement is appropriate. Small servicers are already required to promptly credit payments under the current requirements of Regulation Z. Outreach with small servicers indicates that such servicers are generally already in compliance with the prompt crediting requirements. Further, in the course of the Bureau's outreach efforts, small servicers told the Bureau that they do not use suspense accounts, choosing instead to credit partial payments or return the payments. These practices continue to be allowed, as clarified in comment 36(c)(1)(ii)-1.

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

Section 1464 of the Dodd-Frank Act and existing Regulation Z do not define what constitutes a "payment" for purposes of the prompt crediting requirement. Outreach to consumer and industry stakeholders revealed that partial payments are currently handled in a variety of ways: some servicers do not accept partial payments, some servicers apply partial payments, and some servicers send partial payments to a suspense or unapplied funds account. Previously,

there were no Federal regulations that governed such accounts; thus, the Bureau proposed to address partial payments in proposed § 1026.36(c)(1)(ii).

Proposed § 1026.36(c)(1)(ii) provided specific rules regarding the handling of partial payments and suspense accounts. New paragraph 36(c)(1)(ii) would have required, 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. Additionally, proposed § 1026.36(c)(1)(ii) would have provided that if a servicer were to hold 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 would have had to apply those funds to the oldest outstanding payment due.

The proposed regulation would have left 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 also would have ensured greater consistency in the handling of suspense accounts by requiring certain procedures around partial payments.

The Bureau believed this proposed approach would have clarified servicers' obligations in processing both full payments and partial payments, as well as ensured that all payments would be properly applied. The proposed disclosures would have helped consumers understand that their partial payments are being held in a suspense account rather than having been applied, as well as when those partial payments would be applied. Additionally, requiring application when a full payment accumulates would have provided protection to consumers, as well as reduced the outstanding principal balance on certain consumer loans.

The majority of commenters appreciated the rule's flexibility in handling partial payments; however, some consumer-advocate commenters felt that all payments, including partial payments, should be immediately credited to the consumer's account. Two of these commenters felt this was particularly important in the case of daily accrual loans. Comments also revealed there was some confusion about the proposed rule; in particular, there was confusion about whether the use of suspense accounts would have been *permitted* or *required*.

Consumer advocate commenters requested that the Bureau require further procedures for the handling of partial payments to avoid arbitrariness in the handling and crediting of these payments, and to ensure there is no ambiguity or uncertainty for either consumers or institutions. The Bureau also received comments directly addressing the question of whether, if payments are returned (rather than placed in a suspense account or applied), they must be returned within a specific period of time. Some commenters suggested a specific period of time, and one commenter felt that further regulation on this topic is not required. Additionally, the Bureau received one comment requesting clarification on how the periodic statement exemptions would affect the partial payments disclosure, one comment requesting confirmation that the new provisions addressing suspense accounts would not be in conflict with existing Regulation Z § 226.21, and several comments requesting an exemption from the prompt crediting provisions when a consumer is in bankruptcy.

Finally, commenters disagreed on the provision requiring application to the oldest outstanding delinquency—some agreed with this provision because they felt it would advance the date of delinquency one cycle, while other consumer advocate commenters felt it would be more consumer-friendly to mandate that servicers apply the payment to the most recent payment

due. These commenters also stated the proposed provision would conflict with certain State laws.

The Bureau is adopting as the final rule all the proposed provisions addressing partial payments, except for the clause requiring to which outstanding payment an accumulated complete periodic payment must be applied. The Bureau is clarifying in the final rule that if sufficient funds accrue in any suspense or unapplied funds account to cover a periodic payment, such funds must be treated as a periodic payment received.

The Bureau has carefully considered the comments suggesting that all payments, including partial payments and particularly partial payments for daily accrual loans, should be promptly credited. The Bureau recognizes that the statutory language does not address partial payments, but the Bureau also notes that the statute codified existing language from Regulation Z, which has been widely interpreted to allow partial payments to be sent to suspense accounts.

The Bureau also considered the burden that requiring prompt crediting of partial payments could impose on servicers. Requiring servicers to credit every payment that a consumer sends in during the month could create problems in payment processing operations. Additionally, this could create immense accounting difficulties; for example, if a consumer were to send in a few dollars the servicer would have to determine the proper allocation of those funds. Finally, this would create complications for servicers when consumers are severely delinquent. Certain State laws require a period of time between the last accepted payment and foreclosure. Constant application of partial payments could prevent servicers from being able to foreclose on property, even when such foreclosure would otherwise be appropriate. The Bureau also considered the potential benefit to consumers. While the Bureau agrees that holding payments in a suspense account rather than applying them could increase the cost of interest for

daily interest accrual loans, the Bureau notes that this cost to consumers is limited due to the requirement to apply the funds once a full payment has accrued. Thus, requiring application of partial payments would provide at best only a limited benefit to consumers. In light of the small benefit to consumers, and larger burden on servicers, the Bureau does not believe it is appropriate to require prompt application of partial payments. The Bureau notes that while the final rule *allows* servicers to place partial payments received into a suspense account, it does not *require* servicers to place partial payments in suspense accounts.[112] The Bureau believes that suspense accounts are best addressed by allowing services discretion as to whether to use such accounts but requiring that funds held in any such account be disclosed in the periodic statement, and, when sufficient funds accrue for a full payment, that they be promptly applied, as in the proposed rule. The Bureau believes many of the more detailed aspects of suspense accounts are already addressed by existing law and contracts (for example, the Bureau observes that the order of application of funds is often determined by the contract between the parties), and does not believe it is necessary to impose additional regulation on suspense accounts at this time.

In response to the request for clarification as to how the periodic statement exemptions (*see* § 1026.41(e)) affect the partial payments disclosure, the Bureau notes that, under both proposed and final § 1026.36(c)(1)(ii)(A), the disclosure is required only "if a periodic statement is required." Thus, servicers not required to send periodic statements are exempt from the provision requiring disclosure of the amount of funds held in the suspense account on the periodic statement. Further, the Bureau does not believe there would be a conflict between the provisions addressing suspense accounts and existing § 1026.21. Section 1026.21 requires the

[112] *See* comment 36(c)(1)(ii)-1: a servicer may take any of the following actions when a partial payment is received: they may credit the partial payment on receipt, they may hold the payment in a suspense or unapplied funds account, or they may return the payment.

creditor to take certain actions when a credit balance in excess of $1 is created. Because funds are only sent to a suspense account when a partial payment is received (and funds must be applied when a full payment occurs), a suspense account would not be used if there was a credit balance. Thus, the Bureau believes there is no conflict between these provisions.

The Bureau believes the prompt crediting provisions should remain in effect, even when a consumer is in a bankruptcy or trial modification scenario. While the Bureau understands the requirement that the pre-petition and post-petition accounts must be kept separate during a bankruptcy, the Bureau believes that if sufficient funds accrue in either account to make a periodic payment due, those funds should be applied. Further, the Bureau believes that consumers in the bankruptcy scenario should have full payments promptly credited. Similarly, the Bureau believes that if a consumer makes a payment sufficient to cover the principal, interest and escrow due under a trial modification plan, these funds should be applied. If a consumer were to make a payment insufficient to cover these expenses, the servicer would also have the options of returning the payment, or sending the payment to a suspense account.

The Bureau carefully considered the concerns about the requirement that a full payment must be applied to the oldest outstanding delinquency may cause conflict with certain State law requirements. This provision was intended to prevent extended delinquencies and collection of multiple late fees. However, further research has shown this problem is mitigated through other means, including the prohibition on pyramiding of late fees. Further, the Bureau has become aware that requiring application to the oldest outstanding delinquency may indeed conflict with State law. In light of these factors, the Bureau believes this provision would provide only minimal benefits; thus the Bureau is removing the language that would have required to which outstanding time period full payments would have been applied be applied. Thus,

§ 1026.36(c)(1)(ii) is adopted as proposed, except for the provision requiring to which outstanding payment an accumulated periodic payment must be applied.

Legal Authority

The required disclosures on the periodic statement are authorized under TILA section 128(f), which requires creditors, assignees, and servicers to send statements for each billing cycle that includes certain information, including "[s]uch other information as the Bureau may prescribe in regulations."

In addition, 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 requirement that partial payments held in suspense accounts be credited when a full periodic payment accumulates. Failure to credit such payments 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 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 when sufficient funds accumulate in such an account to cover a full periodic payment.

36(c)(1)(iii) Non-conforming Payments

TILA section 129F(b) codified the treatment of non-conforming payments in current § 1026.36(c)(2). The proposal did not make any substantive changes to this provision, but redesignated the section as new § 1026.36(c)(1)(iii).

The Bureau noted 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 proposal, partial payments retained in suspense or unapplied funds accounts would be treated as payments that have not been accepted and thus are not subject to § 1026.36(c)(1)(iii); as opposed to non-conforming payments that have been accepted that are subject to proposed § 1026.36(c)(1)(iii), and thus must be credited within five days of receipt.

Two commenters expressed concern about non-conforming payments, stating that prompt crediting should be contingent on consumers making payments to the servicer's proper address or through authorized channels (e.g., payment by phone, online or ACH). The Bureau agrees, but believes this concern is adequately addressed by the existing provisions on non-conforming payments, which remain unchanged. The final rule adopts the provisions on non-conforming payments as proposed.

36(c)(2) No Pyramiding of Late Fees

The proposed rule would have prohibited a servicer from assessing a late fee or delinquency charge for a payment if (1) 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 (2) the payment is otherwise a periodic payment received on the due date, or within any applicable grace period. This requirement is substantially similar to existing paragraph 36(c)(1)(ii) and the Bureau did not propose any substantive changes to the existing requirement but rather simply redesignated the requirement as new paragraph 36(c)(2). A consumer advocate commented that, in addition to prohibiting pyramiding of late fees, the regulation should prohibit assessing a late fee for nonpayment of any other fee owed. The Bureau observes that because the proposal was not

intended to enact any substantive changes to the prohibition on pyramiding late fees and the Bureau accordingly did not solicit comment on how the prohibition might be altered, the comment exceeds the scope of the rulemaking. Accordingly, the rule is finalized as proposed.

36(c)(3) Payoff Statements

Dodd-Frank Act section 1464(b) established TILA section 129G, which requires that a creditor or servicer send an accurate payoff balance 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 codified existing § 1026.36(c)(1)(iii) of Regulation Z regarding provision of payoff statements, but with four substantive changes. First, while existing Regulation Z only applies the requirement to servicers, the statute applies the requirement to both servicers and creditors. The Bureau proposed extending the requirement to assignees as well. Second, the statute applies the prompt response requirement to "home loans," rather than consumer credit transactions secured by the consumer's principal dwelling. The Bureau proposed to interpret use of the term "home loans" to expand the scope of the Regulation Z requirement from consumer credit transactions secured by *principal* dwellings to consumer credit transactions secured by *any* dwelling.[113] Third, the statute and the proposed rule limit the reasonable time for responding to a request for a payoff balance to not more than seven business days; by contrast, existing comment 36(c)(1)(iii)-1 generally created a five business day safe harbor for responding, but noted that it might be reasonable to take longer to respond in certain circumstances. Fourth, consistent with TILA section 129G, the proposed rule would have required a prompt response only to written requests for payoff amounts, while

[113] The statute requires a payoff balance be provided in response to a *borrower's* request, the Bureau interprets "borrower" (a term not used elsewhere in TILA) to have the same meaning as "consumer."

the existing regulation requires a prompt response to all such requests, including, for example, oral requests.

Comments on the proposed rule on payoff balances focused on the scope, timing and procedures for requesting a payoff balance. With respect to the scope of the proposed rule, a credit union trade association urged that the Bureau retain the limitation to loans secured by a principal dwelling because of the potential impact of the application of the rule to home equity lines of credit (HELOCs).

Numerous industry commenters indicated that the requirement that a payoff balance must be provided no more than seven business days after the request was problematic because additional time may be needed to provide payoff statements in a variety of situations, such as for reverse mortgages; loans in delinquency, bankruptcy or foreclosure; loans that have shared appreciation features; loans with payoff requests from unverified third parties; and circumstances in which an act of God makes compliance within seven business days impossible. One credit union commenter stated that the seven business day requirement is unreasonable in light of the volume of mail processed by that institution. Further, a trade association requested flexibility where the creditor, assignee or servicer relies on a payment that was later dishonored or that the consumer reversed. A number of commenters also requested clarification regarding the seven business day requirement in light of the 2012 HOEPA Proposal for a payoff statement to be provided within five business days.

Finally, commenters disagreed regarding whether a creditor, assignee or servicer should only be required to provide a payoff statement in response to a written request. Some consumer advocate commenters felt that an oral request should still be sufficient to require a payoff balance; however, an industry commenter strongly supported limiting the payoff statement

requirements to written requests. One credit union trade association commenter requested standardized requirements regarding submission of payoff balance requests and a housing finance agency commenter questioned whether the information requests provision of the 2012 RESPA Servicing Proposal could be used to submit a payoff request. Finally, three commenters asked the Bureau to consider how the payoff statement provisions would interact with timelines of State and local law.

The Bureau is adopting the proposed rule as the final rule, with modifications to the timing requirements. Specifically, the Bureau believes it is appropriate in certain scenarios to allow creditors, assignees or servicers more time than seven business days to respond to a request for a payoff balance.

The Bureau believes the requirements of the rule regarding the scope and procedures for requesting a payoff statement are necessary and appropriate to implement the statutory provisions. With respect to the scope, Congress reviewed the prior regulation, which defined the scope as "a consumer credit transaction secured by a principal dwelling."[114] Congress chose to require prompt crediting of payments only "in connection with a consumer credit transaction secured by a consumer's principal dwelling" but expanded the payoff provisions to apply to any "home loan."[115] For these reasons, the Bureau believes it is appropriate to interpret TILA section 129G to include HELOCs and other open-ended lines of credit secured by a consumer's dwelling in the payoff statement requirement.

Similarly, limitations on the requirement to provide a payoff statement only in response to written requests reflects Congress's clear change in the language from the existing regulation. Creditors, assignees or servicers are permitted, however, to continue providing payoff statements

[114] *See* existing Regulation Z § 1026.36 (c)(1)
[115] *See* TILA section 129G

in response to an oral request, even if such requests do not trigger the regulatory payoff statement request requirements.

The Bureau carefully considered the comments requesting more time in certain scenarios, and recognizes that it may not always be feasible to provide a payoff statement within seven days. Thus, the final rule includes the following exemption: when it is not feasible to provide a payoff statement because a loan is in bankruptcy or foreclosure, because the loan is a reverse mortgage or shared appreciation mortgage, or because of the occurrence of natural disasters or other similar circumstances, the payoff statement must be provided within a reasonable time. Regarding third party authorization, the Bureau believes that the seven day timeline does not begin until a request is received from a verified party. Thus, if a creditor, assignee or servicer must verify authorization for a third party, they will have seven days from when a *verified* request is received to provide the payoff statement, and the need for verification should not cause a problem with providing the payoff balance within the allotted time line.

Finally, the Bureau acknowledges there may be State or local laws addressing the timeline for payoff statements which allow 3 to 21 days; however the Bureau does not believe this will cause a direct conflict with the timeline of the final rule. The timeline for payoff statements states the maximum time within which a payoff statement must be provided, so creditors, assignees or servicers could comply with both State law timelines and this rule's timelines by providing the payoff statement within the shorter of the two timelines. The Bureau believes that State laws allowing a longer period of time do not prohibit the creditor, assignee or servicer from providing a payoff statement within seven business days. Thus, there is no direct conflict with State law on this issue, and any inconsistency with State or local laws should not present a problem.

The Bureau does not believe further regulation on procedures around payoff balances is necessary. A payoff balance request is any request from a consumer, or appropriate party acting on behalf of the consumer, which inquires into the total amount outstanding on the loan, or the amount needed to pay off the loan. While such requests are most often made when a consumer is refinancing their loan, payoff balance requests are not limited to this context. If a request is sent to the wrong address and not received by the creditor, assignee or servicer, they would not be required to respond. Upon receipt of a payoff balance request, the creditor, assignee or servicer must provide the amount required to pay off the mortgage loan; such information must be provided within seven business days. The payoff statement may be sent electronically or by fax in place of physical delivery. Finally, an issue was raised about whether a payoff statement was accurate when a payoff statement relied on a payment that was later dishonored. The Bureau is not making any changes to the requirements of the accuracy of the statement. The Bureau believes payoff statements should be issued according to the best information available at the time, and if a payment is later dishonored, recovery of that amount by adding the amount to the payoff balance should not be barred by the issuance of a payoff statement which assumed that the payment would be honored.

The Bureau received comments on interactions between the proposed rule on payoff statements and other rules on mortgage servicing. First, the Bureau considered if requests for payoff balances are subject to the oral information request obligation contained in the 2012 RESPA Servicing Proposal. Although a payoff balance request is essentially a request for information, there are subtle distinctions between the two, including that consumers may request payoff statements through a variety of channels, and servicers have been able to charge a fee for a payoff statement. The Bureau has decided to maintain a separate payoff balance request rule,

and exempt payoff balance requests from the information request provision of the 2013 RESPA Final Rule.

Second, the Bureau acknowledges that the timeline for payoff balance requests required under HOEPA is shorter than the timeline for payoff requests required under proposed § 1026.36(c)(3). However, the Bureau has decided that this difference does not warrant reducing the length of the timeline required under the final rule. Congress made a clear decision to require payoff statements under general circumstances within seven business days, as indicated by their changing the timeline from the existing regulation text when that text was codified in Dodd-Frank Act section 1464. Congress likewise made a clear decision that payoff statements for loans under HOEPA should be provided within five business days, as indicated by the language in Dodd-Frank Act section 1433(d). Additionally, the Bureau notes these different timelines are not in conflict—any creditor, assignee or servicer could comply with both by providing the payoff balance within five business days. Because of the clear intent of Congress and the lack of direct conflict between the timelines, the Bureau has decided to finalize the provision as proposed.

Although the statute requires a creditor or servicer to *send* the payoff statement, the final rule uses the term "provide" in place of "send." The Bureau believes the terms have the same meaning in this context, but "provide" conforms with existing language in Regulation Z.

The Bureau is finalizing the rule as proposed, with the addition of the following clause: when a creditor, assignee, or servicer, as applicable, is not able to provide the statement within seven business days of such a request because a loan is in bankruptcy or foreclosure, because the loan is a reverse mortgage or shared appreciation mortgage, or because of natural disasters or other similar circumstances, the payoff statement must be provided within a reasonable time.

Small Servicers

A number of community banks, credit unions, small servicers and their trade associations requested an exemption for small servicers from all the proposed provisions in the 2012 TILA Servicing Proposal. The Bureau considered if a small servicer exemption would be appropriate for the requirement on payoff statements. The Bureau noted that the final rule is very similar to the existing rule, which small servicers are already in compliance with, as evidenced by Small Entity Representative comments in the Small Business Review Panel.[116] In light of this, the Bureau does not believe a small servicer exemption to the payoff statement provision would be appropriate.

Legal Authority

The extension of the requirement to assignees is authorized, among other authorities 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 uses its authority under Dodd-Frank Act section 1405(b) to extend the applicability of the payoff statement requirements under TILA section 129G to assignees. As discussed above, this extension serves the interest of consumers and the public interest. Subjecting creditors, assignees, and servicers to the requirements of § 1026.36(c)(3) also promotes consistency with final § 1026.20(c) and § 1026.20(d) (ARMs disclosures), which likewise apply to creditors, assignees, and servicers.

The exemption to the payoff statement requirement, which allows payoff statements to be provided within a reasonable time when seven business days is not feasible due to certain

[116] *See* Small Business Review Panel Report, at 27, 32.

circumstances, is necessary and proper under TILA section 105(a) to facilitate compliance. For the reasons discussed above, under certain circumstances it would not be feasible to provide a payoff statement within seven business days. In addition, the Bureau believes, in light of the factors set forth in TILA section 105(f), that this exemption will have minimal effect on the consumer protection benefits of the payoff statement provision. Specifically, the Bureau considers that the exemption is proper irrespective of the amount of the loan, the status of the consumer (including related financial arrangements, financial sophistication, and the importance to the consumer of the loan), or whether the loan is secured by the principal residence of the consumer.

Section 1026.41 Periodic Statements for Residential Mortgage Loans

Section 1420 of the Dodd Frank Act established TILA section 128(f) requiring periodic statements for mortgage loans. The Bureau proposed implementing the requirements on periodic statements in § 1026.41. 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 homeownership counselor information), as well as such other information as the Bureau may prescribe in regulations.[117] In developing the proposed rule, the Bureau believed 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 proposed pursuant to TILA section 128(f)(1)(H) that each periodic statement also include this additional information. Additionally, the proposed regulation set forth requirements

[117] TILA section 128(f)(1).

regarding the timing and form of the periodic statement and established exemptions to the requirement to provide a periodic statement.

Under TILA section 128(f)(1), the requirement to provide a periodic statement applies to creditors, assignees, and servicers of residential mortgage loans. The Bureau interprets this to mean that the consumer must only 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. To increase readability, proposed § 1026.41 used the term "servicer" to describe the entities covered by the proposed requirement, and defined "servicer" to mean creditors, assignees, or servicers for the purposes of § 1026.41. This terminology was also used in the section-by-section analysis of proposed § 1026.41. Proposed comment 41(a)-3 clarified 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. The Bureau's 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.

The proposed periodic statement carefully balanced the need to provide consumers with sufficient information against the risk of overwhelming consumers with too much information. The proposed requirements were designed to make the statement easy to read, whether provided in a paper form or electronically. The Bureau believed that imposing a requirement that information be grouped into defined categories would present the information in a logical format, while allowing servicers flexibility in customizing the statement. Thus, the proposed regulations discussed below required 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 and information on the late fee were 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 have also included 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 homeownership 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.

41(a) In general

Proposed § 1026.41(a) stated 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.

Periodic Statements Overall

While many commenters were supportive of the periodic statements, some commenters had concerns about certain requirements, and some commenters requested the Bureau not require periodic statements at all. Such industry commenters felt that some of the information was unnecessary, and the rest of the information was available through other channels, including the original loan documents, websites with information on the loan, existing disclosures, formal information request procedures, and informal channels. These commenters also expressed concern that the Bureau was expanding the required content of the periodic statement beyond that which was specifically required in the Dodd-Frank Act, and that there was too much information on the periodic statement, resulting in a disclosure that was too busy and confusing to the consumer.

Commenters sought clarification about the periodic statement in the context of loans that have been accelerated, sent to foreclosure, or that are in the bankruptcy process. Several commenters contended that statements should not be required when loans have been accelerated or sent to foreclosure. Commenters presented opposing views about loans in bankruptcy–some consumer advocate commenters felt it was essential that statements be provided to consumers in bankruptcy to ensure they are kept informed on the status of their loan and have a record of the account, while other industry commenters insisted that providing statements for loans in bankruptcy might cause confusion or violate court orders or the Fair Debt Collection Practices Act (FDCPA). One commenter added that if statements must be provided to consumers in bankruptcy, the statement should be allowed to contain any information disclosures or messaging

required under bankruptcy rules or court orders. Finally, commenters suggested other triggers for when the periodic statement should not be required, including if the consumer has vacated the premise, if mail has been returned due to a bad address, or if the consumer has not sent any payments nor responded to the servicer's attempts to contact them in six months.

The Bureau carefully considered the concerns expressed about the periodic statement overall. Congress clearly mandated that consumers receive on a periodic basis a statement that summarizes certain key loan terms (such as the interest rate) and contact information both for servicers and homeownership counselors and counseling organizations. Congress also authorized the Bureau to require additional information. The Bureau continues to believe, for the reasons listed in the discussion of the proposed rule, as well as for the reasons set forth below, that including the information required beyond that specifically listed in the Dodd-Frank Act will allow the periodic statement to serve a variety of important purposes, including informing consumers of their payment obligations, providing information about the mortgage loan, creating a record of transactions that increase or decrease the outstanding balance, providing information needed to identify and assert errors, and providing information when consumers are delinquent. Indeed, the Bureau believes that consumers likely would be perplexed if they were to receive, on a periodic basis, statements which contained information about their loan terms and outstanding balance but did not include any information about payments. Each item of information required by the periodic statement is discussed below in the section-by-section analysis of the content of the periodic statements.

The Bureau acknowledges that some of the information on the periodic statement may be available through other channels; however, the Bureau notes that Congress clearly determined certain information should be required to be provided to consumers in a single statement on a

periodic basis. The Bureau appreciates the concern about potentially confusing the consumer or obscuring important information by providing too much on the periodic statement. The Bureau believes the periodic statement should be a snapshot of the present account, and not a recital of servicer policies. The Bureau believes that requiring certain information to be on the front page will ensure important information is highlighted. Further, the Bureau has mandated the grouping requirements discussed in § 1026.41(d) below. The Bureau believes the final periodic statement balances the need to present a significant amount of important information and documentation on the loan, with the need to present information in a format the consumer will be able to understand and process.

The Bureau also carefully considered the concerns expressed about circumstances in which periodic statements should not be required. While the Bureau acknowledges that circumstances such as acceleration could make providing a periodic statement more complicated, the Bureau notes that such circumstances are often precisely when a consumer most needs the periodic statement. The Bureau believes an important role of the periodic statement is to document fees and charges to the consumer; as long as such charges may be assessed, the consumer is entitled to receive a periodic statement. The Bureau understands the concerns about the periodic statement being provided when a consumer is in bankruptcy, and addresses these concerns in the section-by-section analysis of § 1026.41(d)(2) (Explanation of Amount Due) below.

Scope

Under TILA section 128(f), the periodic statement requirement applies to residential mortgage loans. The term "residential mortgage loan" is defined in TILA section 103(cc)(5) to generally 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 § 1026.41(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.

One industry trade association commenter suggested periodic statements should be limited to first lien loans secured by the consumer's *principal* dwelling, because consumers obtaining subordinate lien loans and loans secured by non-principal residences (such as vacation homes) are typically experienced successful homeowners, as evidenced by the fact that such consumers qualified for these loans. One commenter asked for clarification as to whether HELOCs should receive periodic statements, and one commenter sought clarity on simple interest closed-end home equity loans.

The Bureau believes that Congress clearly specified the scope of the periodic statement requirement by using the defined term "residential mortgage loans." This scope is not limited to first lien loans secured by the consumer's principal dwelling, but covers all closed-end consumer transactions secured by a dwelling. However, open-end transactions are not included in the scope of this rule. The scope of the rule is finalized as proposed.

Transmit to the Consumer

Proposed § 1026.41(a) would have required 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 must 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 clarified that joint obligors need not receive separate statements; a single statement addressed to both of them would satisfy the periodic statement requirement.

All comments on this topic were in relation to electronic statements, which are discussed in § 1026.41(c) below. The final rule uses the term "provide" in place of "transmit." The Bureau believes the terms have the same meaning in this context, but "provide" conforms with existing language in Regulation Z. This provision is otherwise adopted as proposed.

Billing Cycles

Proposed § 1026.41(a) would have required 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 under the mortgage note and any subsequent modifications. 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 realized 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, proposed § 1026.41(a) provided that, if a loan has a billing cycle shorter than a period of 31 days (for example, a bi-weekly billing cycle), a single periodic statement may be used to cover the entire month. Proposed comment 41(a)–2 clarified how such a single statement would aggregate information from multiple billing cycles. All comments on this topic were in relation to timing of the periodic statement, discussed in the section-by-section analysis of § 1026.41(b) below. The rule is otherwise adopted as proposed.

Legal Authority

Section 1026.41(a) implements 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 is using its authority under TILA section 105(a) and (f) and Dodd-Frank Act 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 a 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 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 consumer (including related financial arrangements, financial sophistication, and the importance to the consumer 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 Dodd-Frank Act section 1405(b), the exemption will prevent consumer confusion that might result from receiving multiple periodic statements in close sequence, thus furthering the consumer protection purposes of the statute.

41(b) Timing of the Periodic Statement

Proposed § 1026.41(b) provided 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 provided that four days after the close of any grace period would be considered reasonably prompt.

Initial Statement

The proposal would have required that the initial periodic statement be sent no later than 10 days before this first payment is due. This adjustment was proposed because there is no previous billing cycle from which to time the sending of the first statement.

Commenters expressed concern both about the usefulness and the feasibility of the provision, highlighting that information on the first payment is often included in the closing documents, and that it may not be possible to obtain the documents and transmit the information into the servicer's system in the proposed timeline.

The Bureau determined that the initial periodic statement would provide minimal benefit to consumers, as the initial payment information is provided at closing, and information on the

application of that payment, as well as any transaction activity, would be included in the next periodic statement. Additionally, the Bureau acknowledged the extra costs of implementation and the difficulties of providing an initial statement on the proposed timeline. Due to these factors, the Bureau has decided not to finalize the proposed requirement that an initial periodic statement be provided 10 days before the first payment is due.

Ongoing Statements

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.

Commenters emphasized that because of the tight timeframe between the close of the grace period and the due date of the next payment, sending the statements within four days was not consistent with current practices and may not be operationally feasible. Commenters suggested seven or ten days may be a more reasonable timeframe, or that statements should be allowed to be sent earlier in the month.

Multiple industry commenters also cited their current practice of "staggering" statements throughout the month–although their loans have a due date of the first of the month, batches of statements are sent out at various times during the month. Some servicers explained that it is helpful for a servicer to spread the related workload across the month, while others explained that staggered statements allowed consumers the convenience and flexibility of choosing which day of the month their payments will be due.

Many credit union commenters noted that the timing requirements would prevent servicers from providing combined statements–a common practice among credit unions of combining mortgage statements with other account statements. These commenters requested that the proposed rule be modified to allow combined statements. In contrast, a consumer advocate commenter expressly requested the Bureau prohibit the practice of combining statements on the ground that this creates confusion for consumers.

Regarding situations in which a consumer makes more than one payment during the month, commenters asked if they would be allowed to send more than one statement per month (following the "Bill and Receipt" system). Commenters also asked for clarification on billing cycles of less than one month and sought clarification about the four day period after the close of the grace period.

The Bureau acknowledges that use of the term "grace period" in the proposal may have caused unnecessary confusion. The term "grace period" is defined in relation to open-ended credit, in § 1026.5(b)(2)(ii)(B)(3), as a period within which any credit extended may be repaid without incurring a finance charge due to a periodic interest rate. The Bureau believes a periodic statement should be sent no later than four days after the close of the period of time when no late fee is imposed, a time more appropriately described as a "courtesy period" in comment 7(b)(11)-1. In light of this, the final rule replaces the term "grace period" with "courtesy period", and adds comment 41(b)-2 to provide further guidance in this regard. Further, if a mortgage loan has no courtesy period, the periodic statement must be sent no later than four days after the payment is due.

The Bureau acknowledges it may be difficult to process a large number of statements in the short period of time between the close of the courtesy period and four days later, and

understands the difficult balance between providing accurate and up-to-date information (which may require not sending a periodic statement until after the 15th of a month), and the importance of notifying the consumer in a timely manner of the amount of their upcoming payment. The Bureau notes that while the rule requires a periodic statement to be sent *no later* than four days after the close of any courtesy period, there is no restriction on sending the periodic statement earlier in the month. That is, there is no requirement in the rule that the servicer must wait until the close of the courtesy period to send the periodic statement. This gives servicers the flexibility to send statements earlier in the month. The Bureau notes this would be particularly appropriate in certain scenarios–for example, if a consumer makes a payment on the first of the month (rather than waiting until the end of the courtesy period), or a consumer has an "auto-debit" arrangement to make payments earlier in the month. The Bureau believes this flexibility will address concerns about timing difficulties for combined statements. Other concerns about combining statements are discussed below in the section-by-section analysis of paragraph 41(d) concerning layout.

To clarify the rule on timing, the Bureau notes that, if a consumer makes more than one payment during the month, servicers who have not yet sent the periodic statement for that time period may include all payments as separate transaction items in the transaction activity section. Alternatively, if a servicer has already sent the periodic statement, the subsequent payments could be reflected in the next periodic statement. Finally, if a servicer wishes to send an extra periodic statement reflecting additional payments, nothing in the regulation would prevent this practice.

If a servicer and a consumer have agreed to an alternative billing cycle from that reflected in the underlying security (for example, if a servicer arranges a bi-weekly payment plan to

correspond to a consumer's paychecks), the servicer has the option of sending either periodic statements that reflect the underlying obligation (the payment plan in the original note), or periodic statements that reflect the modified payment arrangement (the agreed-on payment plan). If this, or any payment plan, requires payments that are more frequent than on a monthly basis, the servicer has the option of combining statements and sending one aggregated statement that covers the entire month in place of multiple statements during that month. The periodic statement must be delivered or placed in the mail no later than a reasonably prompt time after the payment due date or the end of any courtesy period provided for the previous billing cycle.

Legal Authority

The Bureau interprets the requirement in TILA section 128(f) that a periodic statement be transmitted for "each billing cycle" to authorize the timing requirements in § 1026.41(b). In addition, the timing requirements are authorized under TILA section 105(a) and Dodd-Frank Act sections 1032(a) and 1405(b). For the reasons noted above, the Bureau concludes, pursuant to TILA section 105(a), that the requirements are necessary and proper to effectuate the purposes of TILA. Specifically, § 1026.41(b) promotes the meaningful disclosure of credit terms and protects consumers against inaccurate and unfair credit billing practices by ensuring that consumers receive the periodic statement at a time that is useful to them. In addition, consistent with Dodd-Frank Act section 1032(a), the Bureau believes that the 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 Dodd-Frank Act section 1405(b), the Bureau believes that the timing requirements improve consumer awareness and understanding of their residential mortgage loans by ensuring that consumers

receive the periodic statements at a meaningful time, before their next payment is due, and that the timing requirements are thus in the interest of consumers.

41(c) Form of the Periodic Statement

Proposed § 1026.41(c) provided that the periodic statement disclosures required by § 1026.41 must be made clearly and conspicuously in writing, or electronically, if the consumer agrees, and 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.

Additional Information Allowed

Proposed comment 41(c)-1 clarified the clear and conspicuous standard, stating that it generally requires that disclosures be in a reasonably understandable form, and explained 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 servicers customarily provide in their periodic statements, but is not required by the 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. Proposed comment 41(c)-2 stated that nothing in subpart C 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 other applicable law.

One commenter requested further clarification on the comment that additional information may be included so long as it does not overwhelm or obscure the required disclosures. This commenter cited concerns that this clarification would be used by consumer lawyers in frivolous litigation, and urged that the commentary include several examples.

Another commenter noted that allowing other information without requiring prescriptive content minimizes unnecessary regulatory burdens and accommodates different systems that servicers use. The Bureau believes the guidance given in the proposed commentary is sufficient, and that the clear and conspicuous standard allows an appropriate amount of flexibility. Thus, comments 41(c)-1 and 41(c)-2 are adopted as proposed.

Electronic Distribution: E-statements, Notifications and Opt-outs

TILA section 128(f)(2) provides that periodic statements "may be transmitted in writing or electronically." Consistent with this provision, proposed § 1026.41(c), as clarified by proposed comment 41(c)-3, would have allowed statements to be provided electronically, if the consumer agrees. Commenters were generally in favor of allowing electronic statements (e-statements) in place of paper statements, but expressed a few concerns about consent of the consumer and the notification process.

E-statements. Comments were generally in favor of allowing e-statements in place of paper statements, but only if the consumer has given consent. The final rule requires servicers to send a periodic statement each month to consumers. Under certain circumstances, a servicer may send e-statements in place of paper statements. No servicer is *required* to send e-statements. If a servicer prefers to send e-statements (rather than paper statements), they may do so, provided that the consumer consents. The issue of consent is discussed below. Once a consumer consents to receiving e-statements, the servicer may send statements electronically in place of paper statements. A servicer must continue to send paper statements to a consumer unless the consumer has consented to receiving e-statements.

E-Sign Act. The proposed rule would have provided that if a servicer prefers to provide statements electronically, they may do so if the consumer consents. The proposal would have

required only affirmative consent by the consumer to receive statements electronically, not full compliance with E-Sign Act verification procedures. Comments indicated some confusion about this provision. Some commenters argued that meeting the E-Sign Act requirements should be considered consent, and some commenters stated that the proposal's provision *not* requiring E-Sign verification procedures appeared to be in conflict with E-Sign Act requirements. Other commenters praised this aspect of the proposal, stating that the E-Sign verification procedures are too cumbersome and a lesser standard would be more appropriate. One commenter suggested this should be addressed by amending the E-Sign Act.

As the proposal explained, the Bureau believes the E-Sign Act's higher level of confirming consent is not mandated by the statute nor required in this situation. The E-sign Act generally provides that if information must be provided or made available in writing, such info must be provided electronically if certain verification procedures are met. The Bureau notes that TILA section 128(f) does not require a "writing"; thus, the Bureau does not believe this provision triggers the E-Sign Act.[118] The Bureau believes that only consumer consent, not the full E-Sign verification procedures are required before a servicer may provide a statement electronically in place of paper. If a servicer would like to follow the E-Sign Act procedures to obtain consumer consent, that would be allowed, but servicers may also obtain consent through a simpler process. The Bureau is adopting the comment as proposed.

Consent. Commenters also discussed what should be presumed to be "consent." Some industry commenters suggested that if a consumer has auto-debit set up to pay their mortgage automatically, they should be presumed to have consented to e-statements. Others suggested that

[118] Additionally, the Bureau notes that TILA section 128(f)(2) requires the Bureau to take into account that statements may be transmitted electronically. This further suggests the periodic statement disclosure is not a "writing" which would trigger the E-Sign Act requirements.

consumers who are currently receiving e-statements, or who have consented to electronic disclosures in the past should be deemed as having consented to receiving e-statements.

The Bureau suggested, and commenters agreed, that anyone who is currently receiving certain information electronically from their servicer shall be deemed to have consented to receiving e-statements in place of paper statements. Such consumers have demonstrated their ability and willingness to receive information electronically. This is clarified in comment 41(c)-4. The Bureau does not believe that consumers who pay their mortgage through auto-debit, but who have not consented and are not currently receiving information electronically, shall be deemed to have consented to e-statements. Such consumers must receive paper statements until the servicer obtains some form of consent from the consumer that they are willing to receive information electronically. The Bureau is adopting the rule as proposed, with the addition of comment 41(c)-4 clarifying presumed consent.

Notification. In light of information security concerns, the proposal stated the requirement to transmit a periodic statement to the consumer may be met by sending the consumer an email notification that the statement is available electronically, rather than emailing the statement itself. Two commenters expressed concern about information security.

The Bureau recognizes that, due to concerns about information security, servicers may not want to send periodic statements electronically. Thus, instead of emailing a statement, servicers may make the statement available on a website and send an email notifying the consumer that the statement is available. The Bureau notes that it is a common practice for a financial institution to contact a customer to let them know a message is available on a secure website. The Bureau also notes that notifying a consumer of a message on a secure website presents less of a risk than emailing the message, with potentially sensitive personal information,

directly to the consumer. Finally, the Bureau notes that if a servicer does not have the system to securely notify their consumers of the availability of a periodic statement on a secure website, such institution may continue to provide paper statements.

Opting-out. Commenters expressed concerns about the notification requirement. Specifically two commenters suggested the Bureau allow alternative forms of notification, such as quarterly statements or text messages. Additionally, a number of commenters suggested that consumers be allowed to opt-out of receiving these notifications, or be allowed to opt-out of periodic statements altogether. Finally, a few commenters further suggested that consumers should be required to opt-in to receiving periodic statements.

The Bureau carefully considered the comments suggesting a consumer either be able to opt-out of the periodic statement, or be required to opt-in to receiving a periodic statement. The Bureau has concerns that consumers may not be fully informed about their rights to periodic statements if they are either required to opt-in, or allowed to opt-out of statements altogether. However, the Bureau also understands that many consumers conduct their finances online and may prefer not to receive monthly reminders about their payments (either in paper or electronically). These consumers may become accustomed to disregarding information from their servicer, thus both decreasing the value of the periodic statement, and presenting the risk that these consumers may accidentally ignore other important information. The Bureau is striking a balance in the final rule, as clarified by comment 41(a)-4. A consumer may not opt-out of receiving periodic statements altogether. However, a consumer who has demonstrated the ability to access statements online may opt out of receiving notification that their statement is available. If a consumer accidentally or inadvertently opts-out of receiving such notifications, they would still be able to access their periodic statements online. These consumers would be

able to review past periodic statements to check for errors or proper payment application. However, this would allow consumers who do not feel they need a monthly reminder—for example, consumers enrolled in an auto-debit arrangement—to avoid receiving unwanted emails each month.

Sample Forms

Proposed § 1026.41(c) also stated that sample forms are provided in appendix H-28,[119] and that appropriate use of these forms will be deemed to comply with the section. The sample forms 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.

While commenters were generally in favor of the sample forms, one industry commenter expressed concerns about the sample forms—mainly that certain elements such as printing on the back, legal-sized paper, or tear-off coupons on the bottom may be difficult for servicers to replicate. Additionally, the Bureau received stylistic comments on the sample forms, suggesting the payment due date and fee information should be more prominent. Some commenters requested greater flexibility in the forms, suggesting that not all the information would fit on the front page, and that the tabular format requirements should be eliminated. Other commenters addressed the importance of a standardized form: one consumer commenter noted that his current lender provides a statement, but because it is so disorganized they are unable to understand the statement.

The Bureau considered the concerns about the sample forms, but notes that none of the details objected to are required by the regulation. For example, elements of the sample forms not

[119] The final forms are in appendix H-30.

specified in the regulation, such as the tear-off coupon and legal sized paper, are not required elements of the periodic statement. These elements are included in the sample forms to provide context, and while they show one way of demonstrating compliance, they are not required. These regulations were crafted to give servicers flexibility in designing their periodic statements. Thus the Bureau is adopting the rule as proposed.

Legal Authority

The Bureau is implementing § 1026.41(a) and the related comments, in part through the form requirements set forth in § 1026.41(c) and the related sample forms provided in appendix H-30. The form requirements are authorized under TILA section 122, which requires the disclosures under TILA be clear and conspicuous, TILA section 105(a) and Dodd-Frank Act sections 1032(a) and 1405(b). As discussed below, the Bureau concludes, pursuant to TILA section 105(a), that the form requirements are necessary and proper to effectuate the purposes of TILA. Specifically, § 1026.41(c) promotes the meaningful disclosure of credit terms and protects the consumer against inaccurate and unfair credit billing practices by ensuring that the periodic statement sent to consumers is in a form that they can understand. In addition, consistent with Dodd-Frank Act section 1032(a), the Bureau believes that the 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 Dodd-Frank Act section 1405(b), the Bureau believes that the form requirements will improve consumer awareness and understanding of their residential mortgage loans by ensuring 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.

41(d) Content and Layout of the Periodic Statement

The proposed rule required certain items to be grouped together. The specific items of content are discussed below. The goal of the grouping and form requirements is to highlight key information such as the amount due, to organize information so the statement will not be overwhelming to the consumer, and to ensure the consumer will be presented with information in an easy to read format. The commentary to § 1026.41(d), discussed below, reflects these goals.

Proposed § 1026.41(d) required 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. Proposed comment 41(d)-1 clarified 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 certain information to be located immediately next to or directly above or below certain other information, without any intervening text or graphical displays.[120]

Proposed comment 41(d)-2 provided that information that is not applicable to the loan may be omitted from the periodic statement. For example, if a loan does not have a prepayment penalty, the periodic statement may omit the prepayment penalty disclosure.

Proposed comment 41(d)-3 provided that the periodic statement may use terminology other than that found on the sample forms so long as the new terminology is commonly

[120] *See* comments 24(b)-2 and 48-3, respectively.

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.[121] 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.

In addition to addressing the specific items of information required by the periodic statement (discussed below), commenters discussed the overall layout of the periodic statement. Some industry commenters expressed concern that there was not sufficient flexibility in the requirements on the periodic statement, and that servicers should be allowed to continue using their existing statements. In contrast, some commenters praised the organization of the periodic statement. Finally, some industry commenters expressed concern that requiring all the information to be on the front page of the periodic statement would prevent combined statements.

In response to the concern about requiring too much information on the front page, the Bureau notes that not all the required content must be on the front page of the periodic statement. The amount due, explanation of amount due, past payment breakdown, and contact information must be on the front of the periodic statement. The messages and delinquency information will only be required at certain times, and may be provided as a separate disclosure at the servicer's option. An example of how all this information could fit on the front of the page is provided in

[121] Macro Report, at 12.

the sample forms. As discussed above, the Bureau believes the periodic statement balances the need for information to be presented in a structured format against the flexibility required for servicers to continue the practices that suit their needs. For these reasons, the Bureau is adopting the proposed rule.

Legal Authority

Section 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 Dodd-Frank Act sections 1032(a) and 1405(b).

More specifically, the content required by § 1026.41(d) is authorized as follows:

- *Statutorily-required content*: TILA section 128(f)(1)(a) through (g) requires the inclusion of certain items of information in the periodic statement. The final regulation generally implements 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 promulgated under this authority.

The grouping and other form requirements of the layout in § 1026.41(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 the requirement under TILA section 128(f)(2) for the Bureau to develop and prescribe a standard form for the periodic statement disclosure. The Bureau interprets the term "standard form" (a term not used elsewhere in TILA, nor in Regulation Z) to include sample forms, which are commonly used in Regulation Z. In addition, as discussed above with respect to the form requirements under § 1026.41(c) and for

the reasons explained below, the grouping and form requirements under § 1026.41(d) are authorized under TILA section 105(a) and Dodd-Frank Act sections 1032(a) and 1405(b).

41(d)(1) Amount Due

Proposed § 1026.41(d)(1) would have required 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 had to be grouped together and located at the top of the first page of the statement. The amount due would have had to be more prominent than any information on the page.

A primary purpose of the periodic statement is to alert the consumer to upcoming payment obligations. The Bureau interprets TILA section 129(f)(1)(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, the date the fees would be imposed if the payment has not been received, and 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 and expect. Because of the importance of this information, the proposed ruled would have required it to be placed in the prominent position at the top of the first page, with the total amount as 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.[122] If the consumer has a payment-option loan, the proposal would have required that each of the payment

[122] *See* Macro Report, at 6.

options must be displayed with the amount due information. An example of such a statement is included in appendix H-30(C).

Commenters were supportive of including the amount due information (amount due, due date, and late fee information) on the periodic statement, even though this amount was not specifically required by the Dodd-Frank Act. Thus, the Bureau is adopting the proposed provisions on amount due.

41(d)(2) Explanation of Amount Due

Proposed § 1026.41(d)(2) would have required periodic statements to include an explanation of the amount due, which would disclose the monthly payment amount, including the allocation of that payment to principal, interest and escrow (if applicable). Additionally, the statement would have had to provide the total fees or charges incurred since the last statement, and any amount past-due (which would include both overdue payments and overdue fees). This information would have had 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); 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 required by § 1026.41(d)(4), discussed below.

If the consumer has a payment-option loan, a breakdown of each of the payment options would have been required in the explanation of amount due. Additionally, the explanation of

amount due would have required inclusion of information about how each of the payment options will affect the outstanding loan balance. A form with such a box was used 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.[123] A sample form was provided in proposed appendix H-28(C).[124]

One credit union commenter stated that the breakdown of amount due is not necessary because consumers are only interested in knowing the full amount due, not the details. Some commenters expressed concern about difficulties in providing this payment breakdown, specifically in the context of daily simple interest loans, precomputed loans, and loans when the consumer is in bankruptcy. The Bureau also received comments asking that periodic statements continue to be sent during bankruptcy due to the importance of providing information to consumers in bankruptcy and creating a record of payment and applications. Finally, while commenters were generally supportive of the breakdown for payment option loans, two commenters suggested more information should be required.

The Bureau believes information regarding the components of the amount due is important. Including a breakdown of the amount due allows a consumer to question an improper charge before making a payment. Additionally, a consumer can compare this amount to the past payment breakdown on the next statement to ensure the payment was properly applied.

The Bureau understands the concerns about determining the breakdown for daily simple interest loans, as the breakdown would change depending on which day the consumer makes the payment. In determining the breakdown of amount due, the servicer may assume the consumer

[123] Macro Report, at 15.
[124] The final forms are in appendix H-30(C).

will make the payment on the due date. Servicers may include a note explaining this if they believe it is necessary. The Bureau considered the risk that this may cause confusion for consumers, but believes the consumer protection benefits of enabling the consumer to understand what they are being billed for, and thus to question improper charges, outweighs the risk of possible confusion. Further, the Bureau believes that if a consumer with a daily simple interest loan pays his or her loan late, the difference in the amount of the payment that goes to the principal under the amount due (shown on the earlier statement), and the amount of payment that goes to the principal under the application of payment (shown on the next statement) may highlight the additional cost of paying such loans late.

Additionally, the Bureau considered the concerns regarding the breakdown of precomputed loans. The Bureau understands that precomputed loans do not apply payments to principal or interest, but rather to the entire amount due, which consists of both principal and interest for the length of the loan. The Bureau notes there are multiple accounting systems used to determine the outstanding amount when a precomputed loan is prepaid. The Bureau is not requiring a specific system for determining the allocation to principal and interest, but rather notes that any reasonable system for determining the breakdown of principal and interest from the total amount due would be acceptable for the breakdown of amount due, as well as the breakdown of past payment application.

Similarly, the Bureau understands the concerns about the complications involved in addressing consumers in bankruptcy, (including complicated accounting and rules on communication), but believes that the complexities of this scenario necessitate the information in the periodic statement being provided to the consumer. The Bureau understands that certain laws, such as the FDCPA or the Bankruptcy Code, may prevent attempts to collect a debt from a

consumer in bankruptcy, but does not believe these laws prevent a servicer from sending a consumer a statement on the status of their loan. The final rule would allow servicers to make changes to the statement as they believe are necessary when a consumer is in bankruptcy; such servicers may include a message about the bankruptcy[125] and alternatively present the amount due to reflect the payment obligations determined by the individual bankruptcy proceeding.

Finally, the Bureau carefully considered the comments requesting additional language on the effects of non-fully-amortizing payments. While the Bureau believes information explaining the different payment options may assist a consumer making a payment decision, the Bureau also notes that there is limited space on the periodic statement and that there is a risk of providing too much information that may overwhelm the consumer. The Bureau believes the proposed rule appropriately balances these concerns. For these reasons, the Bureau is adopting the proposed rule on explanation of amount due.

41(d)(3) Past Payment Breakdown

Proposed paragraph (d)(3) would have required periodic statements to include a snapshot of how past payments have been applied. Proposed § 1026.41(d)(3)(i) would have required 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 have required 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,

[125] For example, servicers may include a statement such as: "To the extent your original obligation was discharged, or is subject to an automatic stay of bankruptcy under Title 11 of the United States Code, this statement is for compliance and /or informational purposes only and does not constitute an attempt to collect a debt or to impose personal liability for such obligation. However, Creditor retains rights under its security instrument, including the right to foreclose its lien."

escrow, fees, and charges, as well as the amount currently held in any partial payment or suspense account (if applicable). This information would have had to be grouped together in close proximity, and located on the first page of the statement.

Commenters expressed concern there may be operational difficulties in including the past payment breakdown on the periodic statement because not all servicer systems are set up to provide a breakdown of past payments, either for the past month or the year-to-date. This could be particularly difficult for daily simple interest loans, and precomputed loans. One commenter expressed concern that the year-to-date calculation could be difficult if a loan was transferred to that servicer during the course of that year.

Commenters questioned the value of the past payment breakdown, stating that consumers are not concerned with the breakdown of their past payments, and that this information could be found in the loan documents. Further, some commenters who saw value in the breakdown of payments from the past month questioned the value of the additional breakdown of all payments from the year-to-date. They stated that this information is duplicative as well as available on request, that it may be difficult to fit such information on the periodic statement, that the benefits of providing such information do not outweigh the costs, and that this information could be particularly difficult to compute if the loan is delinquent. Finally, one commenter expressed concern that the year-to-date breakdown would cause confusion if payments have been placed in a suspense account, and asked the Bureau to provide clarity that it is permissible to provide an actual suspense account balance rather than the one calculated year-to-date.

While the Bureau understands there may be some challenges in importing information on the past payment breakdown to the periodic statement, the Bureau notes that because the past payment has been applied, the servicer must have this information. The Bureau also considered

the concerns expressed about daily simple interest loans or precomputed loans; however for the reasons discussed above in the section-by-section analysis of explanation of amount due, the Bureau believes the breakdown of these loans can be disclosed on the periodic statement. The Bureau considered the concerns about calculating the year-to-date breakdown of loans which have been transferred from a previous servicer; however, the Bureau believes that all servicers should be able to accurately compute the year-to-date breakdown, and this information should transfer with the loan. Thus the Bureau does not believe that transfer of servicing will present a problem in providing the year-to-date breakdown.

Further, the Bureau believes the past payment breakdown is an important disclosure on the periodic statement. This disclosure serves several purposes, 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 § 1026.41(d)(3)(i), showing all payments made since the last statement, would allow consumers to confirm that their payments were properly applied. If the payments were not properly applied, the breakdown would provide consumers the information needed to assert an error.

Both the breakdown since the last billing cycle and the breakdown of the 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 testing participants were surprised by how much of their payment is going to interest or fees as opposed to principal. Aggregation over the year-to-date can bring this expense to a consumer's 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, as 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.

Finally, the Bureau considered the concerns about disclosing suspense account information. Proposed comment 41(d)(3)-1 would have provided 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. This comment shows the breakdown should disclose both the amount of funds that were sent to a suspense account during the time reflected by the periodic statement, as well as the total amount *currently* held in the suspense account. The Bureau believes this addresses the concerns about displaying suspense account information. Consumer testing revealed that testing participants had very little understanding about how partial payments are handled.[126] As discussed 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. For these reasons, the Bureau is finalizing the proposed provisions on the past payment breakdown.

41(d)(4) Transaction Activity

[126] Macro Report, at 11.

Proposed § 1026.41(d)(4) would have required 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 clarified that transaction activity includes any activity that credits or debits the outstanding loan balance. For example, proposed comment 41(d)(4)-1 stated 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 have provided 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. For additional clarity, the Bureau has amended the language in the final rule to state that transaction activity includes any transaction that credits or debits the *amount currently due*, and has amended comment 41(d)(4)-1 to clarify this is the amount referred to by § 1026.41(d)(1)(iii).

Proposed comment 41(d)(4)–2 clarified 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. Proposed comment 41(d)(4)–3 clarified 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 must be provided in the messages section. The messages section, discussed below, would have included an explanation of what the consumer must do to release the funds from the suspense account.

Comments on transaction activity focused on what must be disclosed, and the logistics of fitting this information on the periodic statement. Commenters had questions about what items should be included on this list, asking if a charge is entered and reversed in the same month, may it be excluded; and, if funds sent to a suspense account must be listed on the transaction activity list (and noting a potential inconsistency with the National Mortgage Settlement on this point). One commenter also stated that servicers may not know third-party fees at the time they produce the periodic statement. Commenters also addressed the listing of fees: one commenter stated it might be difficult to list all the fees that are imposed, while a consumer advocate emphasized the importance of listing all the fees that were imposed. One commenter requested that sufficient information be given in the transaction item line such that the consumer could validate the charge. Another commenter expressed concern about being able to fit the entire list of transactions on the first page of the periodic statement. Finally, a commenter sought clarification on how corrections to errors on prior statements can be displayed.

In response to the questions received, the Bureau notes that if a charge is entered and reversed in the same month, it would not affect the amount of the consumer's outstanding

balance and both line items may be left off the transaction activity. Funds sent to a suspense account must be included in the transaction activity; it is essential for the consumer to know these funds were received by the servicer. If a servicer does not know the amount of a third-party fee, it cannot bill the consumer for that fee. When the servicer bills the consumer (and thus knows the exact amount of the fee), that fee should be included in the transaction activity. While the Bureau notes it may be difficult to list all the fees that are imposed, the Bureau believes it is essential for the consumer to have an accounting of any fee that is imposed. Further, the transaction description should include sufficient information such that the consumer can determine why the charge is imposed. Servicers may use any reasonable method for correcting errors; for example, they could use a new line item which explains the correction. Finally, the Bureau notes the transaction activity is not required to be on the first page, and servicers may use additional pages if necessary. For these reasons, the Bureau is finalizing the proposed provisions on the transaction activity.

41(d)(5) Partial Payment Information

Proposed § 1026.41(d)(5) would have required 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 sought comment on what, if any, additional messages should be required.

Partial Payment Disclosure

Some commenters appreciated the clarification of suspense account information for consumers, while other commenters felt this was unnecessary and difficult to achieve. Two commenters suggested that there was not sufficient space on the periodic statement to explain the suspense account and requested the information be included in a separate letter. One commenter

suggested the consumer should receive disclosures during the life of the loan, specifically annual notices during the first three years of the loan.

While the Bureau does not believe it is appropriate to require servicers to send an annual disclosure on the suspense account procedures for the first three years, the Bureau acknowledges that information on the suspense account may be better disclosed in a separate letter. Thus, the Bureau is modifying the rule to provide that if funds are being held in a suspense account, the amount held in any suspense account must be disclosed in the past payment breakdown on the periodic statement, but the servicer may move the message about what must be done for the funds to be applied to a separate page of the statement, or may send this disclosure as a separate letter. The servicer still has the option of including this disclosure on the periodic statement itself. The final rule reflects this additional flexibility. If the servicer has the benefit of the small servicer exemption in § 1026.41(e)(4), the servicer need not send this separate letter.

Additional Messages

Some commenters expressed concerns about the logistics of including a messages box on the periodic statement. These commenters explained that dynamic information created operational difficulties for the creation of the periodic statement. Commenters had mixed responses to any additional dynamic messages that should be required. Some commenters specifically said there should be no additional messages because this might distract the consumer from other important information. Several commenters suggested the periodic statement should be required to include additional information on escrow accounts, but one commenter argued that a complete escrow breakdown is already provided annually under RESPA, and questioned if this additional information would help consumers. Commenters also suggested additional information about force-placed insurance should be included on the periodic statement. One

commenter urged the Bureau to require servicers to include force-placed insurance charges in regular invoice statements that are sent to a consumer so that a consumer is constantly reminded of how much of their payments are going toward paying for such insurance. Another consumer group submitted similar comments recommending that the Bureau require servicers to identify force-placed insurance charges specifically in proposed periodic statements so that consumers could easily recognize when force-placed insurance has been obtained. Finally, one commenter recommended a message about consumers' obligations to pay community assessments.

The Bureau carefully considered requiring additional messages, but decided that none should be required, particularly in light of the additional burden this dynamic feature would add to the periodic statement. The Bureau believes that the additional escrow information is provided through the annual escrow disclosure, and that monthly escrow information would be confusing because, although escrow accrues monthly, payments are often made at discrete times throughout the year to pay taxes and insurance premiums. Additionally, the amount paid into escrow will be shown each month. The Bureau believes that sufficient information on force-placed insurance is provided through the final rule. Charges for force-placed insurance, like any other charge, must be listed in the transaction activity section of the periodic statement. Further, detailed notification about force-placed insurance is included in the disclosures required by the force-placed insurance provisions of the 2013 RESPA Servicing Final Rule. Finally the Bureau believes the suggested message on community assessment obligations would be inappropriate due to the relatively low benefit this message would provide to consumers, and the relatively high costs to servicers of determining and tracking which consumers are members of community associations.

41(d)(6) Contact Information

Proposed § 1026.41(d)(6) would have required that the periodic statement contain contact information specifying where a consumer may obtain information regarding the mortgage. Proposed comment 41(d)(6)-2 clarified that this contact information must be the same as the contact information for asserting errors or requesting information. Proposed § 1026.41(d)(6) provided that the contact information provided must include a toll-free telephone number. Proposed comment 41(d)(6)–1 clarified that the servicer may provide additional information, such as a web address, at its option. Proposed § 1026.41(d)(6) did not require that 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 have allowed servicers to include this information with their company name and logo at the top of the page or elsewhere on the statement.

Comments on the contact information focused on concerns about disclosing the number associated with the oral error resolution procedures in the 2012 RESPA Servicing Proposal. Additionally, one commenter requested that in place of a toll-free number, servicers be allowed to provide a number where the consumer can contact the servicer at no cost.

Because the proposed oral error resolution procedures are not being finalized, proposed comment 41(d)(6)-2 has been removed from the provision requiring the contact information. The Bureau believes it is important for consumers to be able to request information or report errors without incurring a fee, and that it is consistent with standard industry practice to provide a toll-free phone number. The Bureau determined that proposed comment 41(d)(6)-1 provided minimal guidance; thus, this comment is not being finalized. The proposed rule is being adopted, subject to these modifications.

41(d)(7) Account Information

Proposed § 1026.41(d)(7) would have required that the following information about the mortgage, as required by TILA section 128(f)(1), be included on the statement: the amount of the principal obligation, the current interest rate in effect for the loan, the date on which the interest rate may next reset or adjust, the amount of any prepayment penalty, and information on homeownership counselors and counseling organizations.[127] This information may be included anywhere on the statement. This information may, but need not be, grouped together. While the sample forms display this information on the first page, the servicer is not required to include this information on the first page.

Overall, commenters focused on the disclosure of prepayment penalty information and homeownership counselor information, as discussed below. Additionally, some commenters stated that the disclosure of basic account information was unnecessary. Certain commenters objected to the inclusion of information that would also be provided in other disclosures. In particular, they stated the date on which the interest rate will next reset is already on the § 1026.20(c) and 20(d) notices (discussed above in the section-by-section analysis of § 1026.20(c)), as is the prepayment penalty disclosure, and that the outstanding balance, interest rate, and late fees are included in the loan documents.[128] Commenters pointed out that including the account information may require programing changes, and distract from other more important information on the statement.

The Bureau acknowledges that while some of this information may be available in other documents, some of these documents may not be easily accessible to the consumer. The Bureau

[127] TILA section 128(f)(1)(E) also requires a "description of any late payment fees." As noted above, the Bureau is requiring this information to be disclosed in the "amount due" section of the periodic statement. *See* § 1026.41(d)(1).

[128] One commenter objected to the disclosure of the maturity date, saying that consumers are generally not interested and that few consumers keep their loans up to the full maturity date. The Bureau notes that neither the proposed rule nor the final rule requires disclosure of the maturity date of the loan on the periodic statement.

believes that one of the purposes of the periodic statement is to serve as a dashboard for the consumer, bringing together important information into a single location. Reminding the consumer of this information on a recurring basis, including particularly the date of an interest rate reset, can help consumers plan their affairs before receiving the notice of a reset. The Bureau believes the consumer protection benefits of these disclosures outweigh the costs of potential duplication, and thus the Bureau is finalizing the proposed provisions requiring disclosure of: the date the interest rate will next reset, the outstanding balance, the current interest rate, and the prepayment penalty (modified to require the existence rather than the amount of such penalty). For these reasons, the Bureau is adopting the proposed rule on account information as final with the minor change that § 1026.41(d)(7)(iii) now requires the date *after* which the interest rate may next change,[129] and subject to the modifications to the prepayment penalty and homeownership counselor disclosures discussed below.

Prepayment penalty. Proposed § 1026.41(d)(7)(iv) would have required the periodic statement to disclose the amount of any prepayment penalty, and defined 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 was further clarified in the proposed commentary, and substantially incorporated the definitions of and guidance on prepayment penalties from other rulemakings addressing mortgages and, as necessary, reconciled their differences. The Bureau coordinated the definition of the term prepayment penalty in proposed § 1026.41(d)(7)(iv) with the definitions in other pending rulemakings relating to mortgages.

Commenters had two major concerns with the prepayment penalty provision–disclosing the amount of the penalty, and the definition of a penalty. First, a number of commenters

[129] This change is made to conform with the § 1026.20(c) and (d) ARM disclosures.

expressed concern over difficulties in calculating and providing the amount of the prepayment penalty. These commenters explained that the amount is determined by a number of dynamic factors, and is often computed by hand. Further, this information may be stored in a separate system. These commenters suggested the periodic statement disclose the *existence* of a prepayment penalty, with a note to call for the amount, rather than the *amount* of the prepayment penalty. Next, several commenters raised concerns about including in the definition of prepayment penalty FHA interest accrual amortization payments (the FHA requirement that interest be paid for a full month if the loan is paid off on the first day of the month) and closing costs reimbursed to the lender for early payoff. Finally, commenters stated that this information should not be included in the periodic statement because it would be inaccurate, it is only relevant to certain consumers, and consumers have not requested it.

The Bureau carefully considered the concerns about providing the amount of the prepayment penalty. The exact amount of the prepayment penalty provides value only to consumers considering refinancing or otherwise paying off their loan. Only a fraction of the consumers who receive the periodic statement will be considering this and will need the exact amount. Such consumers could contact their servicer and, using the information request procedures in the 2013 RESPA Servicing Final Rule, request the exact amount of the prepayment penalty. Requiring the servicer to disclose the existence of the prepayment penalty, rather than the amount, would be far less burdensome to servicers; additionally this modification would result in only a minimal decrease in consumer protection. Thus, the Bureau is making this modification to the final rule.

Additionally, the Bureau considered the definition of the prepayment penalty. The other proposals related to the Title XIV Rulemakings proposed the same definition of prepayment

penalty and received comments raising the same concerns about the definition of prepayment penalty as the comments in response to the 2012 TILA Servicing Proposal. The definition of a prepayment penalty has been coordinated across the Title XIV Rulemakings and was in the 2013 ATR Final Rule. In the interest of consistency across the Title XIV Rulemakings, the 2013 TILA Servicing Final Rule cites to the definition of prepayment penalty found in the 2013 ATR Final Rule, rather than re-define prepayment penalty or offer an alternative definition of prepayment penalty. The final rule includes this modification; accordingly, as the comments to the prepayment definition are found in the commentary to the 2013 ATR Final Rule, the duplicative commentary to § 1026.41(d)(7)(iv) has not been finalized.

Legal authority. TILA section 128(f)(1)(D) requires the periodic statement to include the amount of any prepayment penalty that may be charged. For the reasons discussed above, the Bureau is using its authority under TILA section 105(a) and (f) to exempt servicers from having to include this information in periodic statements and to instead require the periodic statement to include the existence of any prepayment penalty. This adjustment is additionally authorized under Dodd-Frank Act section 1405(b).

Homeownership Counselors and Counseling Organizations

TILA section 128(f)(1)(G) requires the periodic statement to include the name, 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 HUD 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 homeownership counselors and counseling organizations during the application process for mortgage loan. To

facilitate compliance, 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.[130] The Bureau also stated 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 homeownership counselors and counseling organizations with a minimum amount of effort.[131]

In connection with the periodic statement requirement, however, the Bureau proposed 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. Proposed § 1026.41(d)(7)(v) would have required the periodic statement to include contact information for any State housing finance authority for the State in which the property is located, and information enabling the consumer to access either the Bureau or the HUD list of homeownership counselors and counseling organizations. The Bureau suggested that this approach may appropriately balance consumer and servicer interests based on several considerations.

First, the Bureau was 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

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[130] *See* 2012 HOEPA Proposal, 77 FR 49090, 49097-99 (Aug. 15, 2012).

[131] The list provided by the lender pursuant to the 2013 HOEPA Final Rule 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* 77 FR 49090, 49098.

consultation with a homeownership 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 each billing cycle would have been significantly higher than with the one-time requirement in the HOEPA rulemaking. Space on the periodic statements is limited, and importing updated information from the Bureau website each cycle would involve more programming burden than simply listing website information in the first instance.

To address these concerns, the proposal would have required that the periodic 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 and counseling organizations.[132] Directing consumers to this information would allow them to choose a program or agency conveniently located for them, and would allow consumers to locate other programs or agencies if those contacted initially could not help them at that time.

The Bureau coordinated the homeownership counselor information requirement in § 1026.41(d)(7)(v) with the other pending rulemakings concerning mortgage loans that address homeownership counselors. The Bureau believes that, to the extent doing so is consistent with consumer protection objectives, adopting a consistent approach to providing homeownership counselor information across its various pending rulemakings will facilitate compliance.

Overall, commenters praised the Bureau's proposal on providing website information, rather than individual homeownership counselors and counseling organizations. However, commenters had remaining concerns about providing information for the relevant State housing

[132] At the time of publication, the Bureau list was not yet available and the HUD list is available at http://www.hud.gov/offices/hsg/sfh/hcc/hcs.cfm.

finance authority in addition to information on how to access the HUD list or the Bureau list. Finally, the Bureau received comments from the National Council of State Housing Agencies, expressing concern about including contact information for State housing finance authorities on the periodic statements. The Council stated that, while the State housing agencies will always be willing to assist struggling homeowners, including their contact information on the periodic statement may increase consumer confusion by misdirecting consumers away from entities more likely to be able to assist them. The Council stated that not all State housing agencies offer counseling programs and, because of limited resources, State housing agencies may not be well-equipped to handle the increased number of inquiries they would receive.

Additional comments focused on the difficulty of providing information for the individual State authority, and reconciling which state's authority should be provided. Several commenters stated that it would be difficult to have information for different State authorities appear on different statements, and asked if they could provide contact information to a location where a consumer could find a list of all the State housing finance authorities. Additionally, some commenters expressed concern about the inconsistency between the periodic statement disclosure and the § 1026.20(d) ARM initial interest rate reset disclosure. While the periodic statement would have required disclosure of the State housing finance authority for the State *in which the property is located*, the § 1026.20(d) ARM disclosure would have required the State authority for the State *in which the consumer has primary residence*. Commenters expressed concern this would create difficulties and asked that these discrepancies be reconciled or, as above, that they be allowed to provide a link to a full list of the State housing finance authorities.

The Bureau carefully considered the comments expressing concern about providing the contact information of the correct State housing finance authority, particularly the comment from

the State housing finance authority association expressing this concern. These comments were also raised in connection with the § 1026.20(d) ARM initial interest rate adjustment disclosure. As discussed above in the section-by-section analysis of § 1026.20(d), requiring the contact information for the individual State housing finance authority provides minimal benefit to the consumer (because not all State housing finance authorities provide counseling, and this information is available elsewhere), and imposes a large burden on the servicer (*i.e.*, determining which State housing finance authority's information should be included, and including dynamic information on the statement). For these reasons, the Bureau is removing the requirement to disclose contact information for the State housing finance authority for the State in which the property is located.

Legal authority. The Bureau uses its authority under TILA section 105(a) and (f) and Dodd-Frank Act 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 (i.e., State Housing Finance Authorities), and to instead require that periodic statements disclose information enabling the consumer to access either the Bureau list or HUD list of homeownership counselors and organizations. For the reasons discussed above, the Bureau believes that this exception and addition are 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 consumer (including related financial arrangements, financial sophistication, and the importance to the consumer of the loan), or whether the loan is secured by the principal residence of the consumer. Further, the Bureau believes that the exemption will simplify the periodic statement, and improve the homeownership counselor information provided to the consumer, thus furthering the consumer protection purposes of the statute. In addition, consistent with Dodd-Frank Act section 1405(b), the Bureau believes that the 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 Information

Proposed § 1026.41(d)(8) would have required 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 when the loan is delinquent. The combination of fees, partial payments being sent to suspense accounts, and application of payments to the outstanding amounts due can quickly lead to confusion. The early intervention provisions of the 2013 RESPA Servicing Final Rule require servicers to disclose information about loss mitigation or loan modification, but this information is not customized to individual consumers. The proposed delinquency notice on the periodic statement, discussed below, would have provided information that is tailored to the specific consumer. This information would have benefited the consumer in several ways.

First, this notice would have ensured that the consumer is aware of the delinquency as well as potential consequences. Second, this information would have ensured that the consumer

has the information specific to his or her loan. For example, certain loan modification programs are tied to specific timelines in delinquency. This delinquency information would ensure that consumers understand the timelines so they can benefit from the programs. Finally, the delinquency information would have created 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. The proposed rule would have required the following information:

- *Delinquency date and risks*. Proposed § 1026.41(d)(8)(i) would have required 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, a consumer 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 § 1026.41(d)(8)(ii) would have required the periodic statement to include a statement reminding the consumer of potential risks of delinquency, for example, that late fees may be assessed or, after a number of months, the consumer can be subject to foreclosure.
- *A recent account history*. Proposed § 1026.41(d)(8)(iii) would have required 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 a consumer 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 payment allocations. Although some of this information would be available from previous periodic statements, the Bureau believed that providing a separate recent account history is warranted under the circumstances.

The Bureau further believed 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 § 1026.41(d)(8)(iii) would have required 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 was 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 six 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 § 1026.41(d)(8)(iv) would have required the periodic statement to include as part of the delinquency information notice of any acceptance into a modification program, either trial or permanent, to create a record of acceptance into the modification program. For consistency with the loss mitigation provisions of the 2013 RESPA Servicing Final Rule, the final rule amends this to require notice of a loss mitigation program to which a consumer has agreed.
- *Notice if the loan has been referred to foreclosure.* Proposed § 1026.41(d)(8)(v) would have required 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. For consistency with the loss mitigation provisions of the 2013 RESPA Servicing Final Rule, the final rule amends this to require notice of the first notice or filing required by applicable law for any judicial or non-judicial foreclosure process.

- *Total amount to bring the loan current.* Proposed § 1026.41(d)(8)(vi) would have required that the total amount needed to bring the loan current be included in the delinquency information to ensure that consumers know how much money they must pay to bring the loan back to current status.
- *Homeownership counselor information reference*. Proposed § 1026.41(d)(8)(vii) would have required that the delinquency notice also contain a statement directing the consumer to the homeownership counselor information located on the statement, as proposed by § 1026.41(d)(7)(v). For example, if the homeownership 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.

The delinquency information was intended to assist consumers who have fallen behind on their mortgage payments. The proposal would not have required provision of this information until the consumer is 45 days delinquent. The Bureau recognized that not all delinquencies indicate troubled consumers; a single missed payment may be the result of other factors such as misdirected mail or inadvertence. Such consumers would likely be notified of a single missed payment by their servicer, and the missed payment 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. Thus, the delinquency information would have been required at 45 days to ensure receipt of this information by a consumer who missed two consecutive payments.

Commenters expressed concern that a number of factors would make the proposed delinquency information difficult to implement, including the volume of loan-specific information that would have to be coded, the dynamic nature of the information, the fact that such information is often stored on multiple systems, the lack of space on the periodic statement, the difficulties in determining when a consumer was accepted into a loan modification program, and, as one commenter stated, the fact that the delinquency date calculation is a "nightmare."

Commenters also stated that the information in the delinquency notice would be unnecessary, as this information is already provided in investor-required notices, required by the Early Intervention provisions proposed in § 1024.39 and other provisions of the 2012 RESPA Servicing Proposal, the delinquency date is obvious, and the information is required in state-law notices in the foreclosure process. Some commenters went further to say this information should not be provided to the consumer, as the total outstanding balance may cause confusion or depress consumers, any mention of the risk of foreclosure may be considered notice of collection or default in violation of the FDCPA or other laws, and that 45 days is too short a timeline, such that habitually late payers will often receive these messages. One commenter suggested 60 days would be a more appropriate timeline. Another commenter asked if the delinquency information must be provided once, or on each statement.

Other commenters were supportive of the delinquency notice, and even suggested that more information be included. Such commenters said the account history should extend back 12 months, rather than 6 months, there should be information on loss mitigation, there should be

more information on the delinquent payment and the effect of delinquencies, and that payment history should be provided in excel format, mirroring current bankruptcy law.

Finally, some commenters provided specific recommendations. Two commenters suggested the periodic statement note the fact that the loan is more than 45 days delinquent and request the consumer contact the servicer. Additionally, two commenters suggested this information might be better contained in a letter–one commenter suggested this should be in the breech letter or a right-to-cure, and the other suggested a payment history and explanation letter. Finally, one commenter suggested the delinquency notice be limited to past due amounts and the dates the payments were owed, and should only be provided up to the point of referral to foreclosure.

The Bureau carefully considered the difficulties of implementing the delinquency information. The Bureau recognizes the difficulties of adding dynamic boxes to the periodic statement, and so–as in the case of the partial payment disclosure discussed above–is affording servicers the flexibility to provide the delinquency information on the periodic statement, on a separate page included with the periodic statement, or in a separate letter.

The Bureau recognizes there is a large amount of loan specific data that may be included on separate systems; however, the Bureau notes the importance of bringing all this information together into one place for the consumer. The Bureau does not believe that any item of information required is unobtainable. In response to the comment that calculating the delinquency date can be a nightmare, the Bureau notes the confusion around this calculation is the very reason such a date should be included in the delinquency information. Finally, in response to concerns about determining the status of a loan modification program, the Bureau

notes the 2013 RESPA Servicing Final Rule establishes procedures relating to loss mitigation, including identifying when a borrower has agreed to a loss mitigation program.

The Bureau considered the comment that the delinquency information is unnecessary, but respectfully disagrees, in particular for the reasons expressed in the proposed rule and the supportive comments above. While the Bureau agrees that some of this information is available through other disclosures and in other locations, the Bureau believes it is important to bring this information together in a single place. In particular, while the Bureau acknowledges that delinquency information is provided in the early intervention notice required by the 2013 RESPA Servicing Final Rule, the Bureau notes that this information is generic, while the information in the periodic statement is specific to the individual loan. These two notices are designed to complement each other—for example, the early intervention notice information may discuss an option that is only available to consumers who are 60 days delinquent, and the periodic statement information would inform an individual consumer of the exact date they were considered delinquent. The Bureau considered the comment that the total amount outstanding may depress or confuse consumers, but the Bureau believes the value of transparent disclosure of information outweighs such concerns. The Bureau considered the concerns that mentioning the risks of foreclosure may violate the FDCPA, but the Bureau notes that specific language is not required by the regulation—if a servicer feels that mention of foreclosure is inappropriate when a consumer is 45 days delinquent, at that time they could warn the consumer instead of the imposition of late fees.[133] Finally, in response to the comments that 45 days is too early to require this disclosure, the Bureau notes that a 45 day delinquency corresponds to two missed payments. Delaying the delinquency notice to 60 days or more would mean a consumer would

[133] A servicer may believe foreclosure language is more appropriate later in the process when the servicer is preparing to file the first filing required for the foreclosure process.

not receive this information until they had missed three payments. The Bureau notes the delinquency notice information complements the early intervention information, and that these notices should be provided on a similar timeframe. The Bureau notes the delinquency information must be provided on, or accompanying, *each* periodic statement sent when a consumer is at least 45 days delinquent. The Bureau notes that much of the information on the delinquency notice will change as time passes, and thus a single statement will quickly become outdated.

The Bureau carefully considered the above recommendations to streamline the notice to delinquent consumers. The Bureau believes merely noting the delinquency and instructing the consumer to contact the servicer is insufficient; further this information (and more) is provided by the early intervention information required by the 2013 RESPA Servicing Final Rule. The goal of the enhanced and customized disclosures in the periodic statement is, in part, to provide delinquent consumers with additional information that might encourage them to contact their servicer. As discussed above, the Bureau believes the 45-day timeline is proper for the delinquency notice. The Bureau has adopted the proposed rule as final, with the additional flexibility of allowing such information to be contained on a separate page of the periodic statement, or in a separate letter.

41(e) Exemptions

41(e)(1) Reverse Mortgages

Proposed § 1026.41(e)(1) would have exempted reverse mortgages, as defined by § 1026.33(a), from the periodic statement requirement. The Bureau proposed 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 significant alterations to the form and regulation. The Bureau believed that it is more appropriate to address consumer protections relating to reverse mortgages in a separate comprehensive rulemaking.

The Bureau received few comments on reverse mortgages–two commenters suggested that reverse mortgages should not be exempted, a third commenter suggested that reverse mortgage with escrow accounts should be brought in, and one commenter specifically praised the reverse mortgage exemption. For the reasons expressed in the proposal, the Bureau believes the consumer protections relating to reverse mortgages would be more appropriately addressed in a separate comprehensive rulemaking. Thus, the Bureau is adopting the proposed rule exempting reverse mortgages.

Legal Authority

The Bureau uses its authority under TILA sections 105(a) and (f) and Dodd-Frank Act 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 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 consumer (including related financial arrangements, financial sophistication, and the importance to the

consumer of the loan), or whether the loan is secured by the principal residence of the consumer. Additionally, in the estimation of the Bureau, the 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. Further, consistent with Dodd-Frank Act section 1405(b), the Bureau believes that the 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) Timeshare Plans

Proposed § 1026.41(e)(2) would have clarified that timeshare plans as defined by 11 U.S.C. 101 (53D) 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 timeshare plans do not fall under this definition. Because no comments were received on the proposed timeshare plan exemption, this provision is being finalized without any changes.

41(e)(3) Coupon Book

Proposed § 1026.41(e)(3) would have implemented the statutory exemption in TILA section 128(f)(3) 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 sought 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 proposed an exemption requiring certain information in the coupon book, certain information to be made available upon request, and certain information to be provided at delinquency.

Proposed comment 41(e)(3)-1 defined "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 explained what a coupon book is.

Information in the Coupon Book

Proposed § 1026.41(e)(3)(i) would have required 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 § 1026.41(e)(3)(ii) would have required 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 penalty that may be charged, the contact information for the servicer, and homeownership counselor information. Each of these items is discussed above in the section-by-section analysis of proposed § 1026.41(d). The coupon book would also have been required to disclose information on how the consumer may obtain the

dynamic information discussed below. The information described above may be, 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 clarified that a coupon book need only include the outstanding principal balance at the beginning of that time period.

Information Made Available

Due to the static nature of the coupon book, certain dynamic information that would have been required to be included on periodic statements could not have been included in coupon books. Thus, proposed § 1026.41(e)(3)(iii) would have required that certain dynamic information be made available upon the consumer's request. The servicer could provide the information orally, in writing, in person, or electronically, if the consumer consents. Proposed § 1026.41(e)(3)(iii) would have required 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.

Many commenters praised the coupon book exemption and suggested it be finalized as proposed. Other commenters expressed concerns about requirements of the coupon book exemption, saying these requirements were too expansive. Finally commenters requested clarification as to what would trigger the requirement for servicers using coupon books to provide the information that is made available.

The Bureau carefully considered the comments received on the coupon book exemption. As an initial matter, the Bureau clarifies the information made available under § 1026.41(e)(3)(iii). Such information would have to be provided to the consumer at the consumer's request. The Bureau does not believe an excessive amount of information is required on the periodic statement, and for the reasons discussed above in the section-by-section analysis of 41(d), believes the required items of information should be disclosed to the consumer. However, in light of the difficulties of having dynamic information on a coupon book, the Bureau believes this information should be provided at the consumer's request.

Delinquency Information

Proposed § 1026.41(e)(3)(iv) would have required that to qualify for the coupon book exception, the delinquency information required by proposed § 1026.41(d)(8), discussed above, must 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. Due to the static nature of the coupon book, such information would likely have to be provided in a separate letter. Commenters expressed concern about the requirement to provide the delinquency information, saying this information would be difficult to provide, and unnecessary.

The Bureau believes the delinquency information is even more important to a consumer who is not receiving periodic statements due to the coupon book exemption. Coupon books are

generally only updated on an annual basis–a consumer who becomes delinquent during the year will not have any other guaranteed source of up-to-date information on the status of their loan of the type that those receiving periodic statements will receive under the rule. For these reasons, the Bureau is adopting the rule as proposed (subject to the modifications that have been made to the portions of § 1026.41(d) that are referenced in the coupon book exemption).[134]

Legal Authority

The Bureau uses 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 uses its TILA section 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 at the consumer's request. Additionally, the delinquency information must be provided in a separate letter when appropriate, as required by § 1026.41(e)(3)(iv). The Bureau believes this exemption is necessary and proper to facilitate compliance.

41(e)(4) Small Servicers

Proposed paragraph (e)(4) would have exempted certain small servicers from the duty to provide periodic statements. The proposal defined "small servicer" as a servicer (i) who services

[134] For example, paragraph 41(e)(3)(ii)(A) references the information required by paragraph 41(d)(7), which includes prepayment penalty information. Whereas the proposed rule required disclosure of the amount of any prepayment penalty, the final rule requires disclosure only of the existence of such a penalty. Accordingly, under final paragraph 41(e)(3)(ii)(A), a coupon book must likewise include only information regarding the existence of a prepayment penalty.

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 proposed this exemption after careful consideration of the benefits and burdens of the periodic statement requirement. The Bureau explained that it believed that the proposed periodic statement would have been helpful to consumers because it would have provided 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 believed 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 recognized 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 consumer's statement for each billing cycle. The Bureau recognized that certain 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 Small Business Review 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

Small Entity Representatives 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 explained that it believed 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-centric 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 to the customers for whom they service mortgages.[135] Because those servicers generally have a long-term relationship with the consumers, their incentives with regard to charging fees and other servicing practices may be more aligned with consumer interests. These motivations help to ensure a good relationship and incentivize good customer service—including making available information about upcoming payments, fees charged and payment history, as well as other information needed by distressed consumers. At the same time, consumers generally have easy access to these small, community-based servicers, to obtain any information they desire.

In proposing the small servicer exemption, the Bureau believed that *both* of these conditions were 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* originate the loans and retain either ownership or servicing rights. Larger

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[135] *See* Lori J. Pinto et al., Prime Alliance Loan Servicing, *Re-Thinking Loan Serving*, at 8 (Apr. 2010) ("Pinto Paper"), *available at* http://cuinsight.com/media/doc/WhitePaper_CaseStudy/wpcs_ReThinking_LoanServicing_May2010.pdf.

servicers are likely to be much more reliant on, and sophisticated users of, computer technology 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 did 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 ownership or servicing rights, without regard to size.

The proposed exemption is consistent with feedback that the Bureau received from Small Entity Representatives during the Small Business Review Panel process regarding the potentially significant burdens that would be imposed by a periodic statement requirement. Participants explained that they already provide much of the information in the proposed periodic statement through alternative means, including correspondence, more limited periodic statements, coupon books, passbooks, and telephone conversations.[136] According to the Small Entity Representatives, even where small servicers do not affirmatively provide particular items of information to consumers, they 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.[137]

The Small Entity Representatives 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

[136] Small Business Review Panel Report, at 16-19.
[137] Small Business Review Panel Report, at 16-19.

over these vendor costs.[138] 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 Small Entity Representatives stated that 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

At the time of the proposal, the Bureau had only roughly estimated the amount of burden that would be imposed by the periodic statement requirement on servicers of different sizes. However, the Bureau believed that a threshold of 1,000 loans serviced may be an appropriate approximation to limit the proposed exemption to smaller servicers in the market.

In addition to the 1,000 loan threshold, the exemption from the periodic statement would have been limited to entities that exclusively service loans that they or an affiliate own or originated. The proposed exemption was limited to these servicers because of the incentives discussed above. The proposed commentary clarified the application of the small servicer definition. Proposed comment 41(e)(4)-1 stated 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 stated that in determining whether a small servicer services 1,000 mortgage loans or less, a servicer would be 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 during a calendar year would have six months or until the beginning of the next calendar year,

[138] Small Business Review Panel Report, at 17.

whichever is later, to begin providing periodic statements. Proposed comment 41(e)(4)-2 gave examples for calculating when a servicer that crosses the 1,000 loan threshold would need to begin sending periodic statements. The purpose of this provision was to permit a servicer that crossed 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 requirements for which the servicer was previously exempt.

Proposed comments 41(e)(4)-3 clarified the circumstances in which 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 clarified that, 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 stated that permitting an exemption in such circumstances 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.

Scope of the Small Servicer Exemption

The Bureau received comments both supporting and disagreeing with the small servicer exemption. Commenters who supported the small servicer exemption agreed that, for the reasons expressed in the proposed rule, the large burden on small servicers and small decrease in consumer benefits justified the small servicer exemption to the periodic statement requirement. Many of these commenters felt the scope of the exemption should be expanded, and small servicers should be exempt from other provisions of the servicing rules. A few commenters disagreed with any small servicer exemption, because they felt all consumers should benefit from

the protection of the rules, regardless of their servicer's size. One commenter suggested that if small servicers are exempt, they should have strict liability for any errors.

The Bureau considered the comments objecting to a small servicer exemption to the periodic statement, but believes that, for the reasons discussed above, such an exemption is appropriate in the periodic statement context. The Bureau also considered if a small servicer exemption would be appropriate for other provisions of the mortgage servicing rules. A discussion of small servicers is included in the discussion above of each section of the rule. In general, the Bureau has decided not to exempt small servicers from obligations to which they are already subject (such as the requirement to provide an ARM adjustment notice or payoff statement or to promptly credit payments). The Bureau also has decided not to exempt small servicers from providing the new, initial ARM adjustment notice, as that notice is required only once in the life of any ARM and should not require large incremental expense to deliver for servicers who already are providing the annual adjustment notices. Finally, the small servicer exemption overall is discussed in more detail in the Dodd-Frank Act section 1022 analysis and Final Regulatory Flexibility Analysis below.

Size of the small servicer exemption. As discussed below in the Dodd-Frank Act section 1022 analysis, commenters almost unanimously stated that the size of the small servicer exemption was too small—most of the commenters suggested somewhere between 5,000 and 10,000 loans would be more appropriate. Some commenters also proposed alternative definitions of a small servicer. Some commenters suggested that only the nation's largest servicers should be required to provide the periodic statement. One commenter suggested that all portfolio loans should receive the benefit of the small servicer exemption. One commenter suggested this should be determined by the charged-off / delinquency ratio. One commenter

suggested that entities exempt from the Home Mortgage Disclosure Act (HMDA) reporting requirements should be considered small servicers. Two commenters suggested that only institutions under direct Bureau supervision should be required to provide periodic statements. One commenter suggested that small servicer status should be determined solely by loan count, and the second prong of the test (requiring that the servicer owns or originated the loan) should be removed. Some commenters suggested that the small servicer definition should consider the type of entity–two suggested that State housing finance authorities should be exempt, and another commenter suggested all bona fide non-profits should be exempt. Several comments suggested that all credit unions should be exempt.

The Bureau carefully considered the comments discussing the size of the small servicer exemption. The Bureau believes that, in general, loan count is the appropriate measure for a small servicer. The Bureau prefers loan count to asset threshold because the Bureau believes scale is better defined by the number of loans rather than the size of those loans. Further, these numbers will not need to be adjusted due to inflation. While the Bureau is hesitant to exempt entire classes of entities because of concerns about keeping a level playing field, the Bureau notes that certain classes of entities face special challenges when it comes to providing periodic statements, and have presented persuasive reasons why they should be exempt. In particular, the Bureau has decided to include Housing Finance Agencies in the small servicer exemption.

In light of comments received and additional analysis of the data, the Bureau has expanded the loan threshold to 5,000 loans in the final rule. See the Dodd-Frank Act section 1022 analysis below for a full discussion of the loan threshold.

The Bureau received several requests for clarification in counting the number of loans. One commenter asked if this meant 1,000 or fewer of the type of loans covered by this

requirement, or 1,000 or fewer of all types of mortgages serviced. Another commenter asked if HELOCs serviced should be included in the count. One commenter asked about interim servicing loans—loans only held for a very short period of time. The Bureau also received requests for clarifications about servicers who sell loans they originated as servicing released, and about creditors who qualify for the exemption and if they may continue to send their current periodic statements which do not meet all the requirements of the periodic statement provisions.

The loan threshold is determined by counting loans that would be subject to the periodic statement requirement, thus any HELOCs would not be included in the count (because HELOCs are not subject to the periodic statement requirement). The Bureau notes that if a servicer sells a loan servicing released, it would no longer be a servicer for that loan, and thus that loan would have no effect on the determination of small servicer status. Finally, the Bureau notes that a small servicer not subject to the periodic statement requirements of § 1026.41 would be free to continue sending periodic statements at its discretion, regardless of if those periodic statements conform to the periodic statement requirements. For these reasons, the Bureau is adopting the proposed exemption for periodic statements, but modifying the definition of small servicer in the manner discussed above.

*Housing Finance Agencie*s

Certain commenters, including the National Council of State Housing Agencies, requested that the Bureau exempt loans financed by State housing finance agencies. These commenters observed that State housing finance agencies operate as public entities in every State and that, as instrumentalities of government, they have a unique mission to provide safe and affordable financing. In addition, the commenters stated, loans financed by such agencies tend to perform better than other loans.

The Bureau agrees with the commenters that the risk of exempting loans from high-cost mortgage coverage where a State housing finance authority is the creditor should be low, given the agencies' mission to provide safe and affordable financing to consumers and the protections provided by the agencies' lending practices. The burdens placed on such agencies would take away from their mission and might render the agencies unable to originate the loans. In turn, consumers likely would turn to more expensive forms of credit, such as credit cards or unsecured debt. The Bureau notes that it recognized the special status of State housing finance agencies in the 2013 HOEPA Final Rule which exempts such agencies from the provision in § 1026.32(a)(5) prohibiting a creditor from being affiliated with a homeownership counseling entity.

Upon further consideration, the Bureau is adopting in the final rule an exemption for mortgage transactions originated by a Housing Finance Agency, as that term is defined in 24 CFR 266.5. The Bureau uses this definition to coordinate with the similar exemption in the 2013 HOEPA Final Rule. The Bureau is adopting this exemption pursuant to its authority under TILA section 105(a) to exempt all or any class of transactions where necessary or proper to effectuate the purposes of TILA, to prevent evasion, or to facilitate compliance. The Bureau believes that this exemption is necessary and proper to effectuate the purposes of TILA.

Legal authority. The Bureau exercises its authority under TILA section 105(a) and (f), and Dodd-Frank Act 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 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 consumer (including related financial arrangements, financial sophistication, and the importance to the consumer of the loan), or whether the loan is secured by the principal residence of the consumer. In addition, consistent with Dodd-Frank Act section 1405(b), for the reasons discussed above, the Bureau believes that the 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 is exercising its authority under TILA section 105(c) to issue model and sample forms for § 1026.20(c) and (d).

Appendix H-4(D) to Part 1026

The Bureau is exercising its authority under TILA section 105(c) to issue 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 have added the appendix sections that 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 which format may not be changed by creditors. It also

would have clarified that reference to creditors in the commentary would have been applicable to creditors, assignees, and servicers with regard to § 1026.20(c) and (d). The final rule is issued without this proposed revision and, thus, the comment is unchanged. Because both § 1026.20(c) and (d) explicitly state that their requirements, as well as those of other regulations in subpart C that govern § 1026.20(c) and (d), apply to creditors, assignees, and servicers, including the reference in this commentary would be redundant and unnecessary. For a discussion of the decision to remove § 1026.20(c) and (d) from the list of model and sample forms that do not permit formatting changes, see the section-by-section analysis of § 1026.20(c)(3)(i) and (d)(3)(i).

Appendix H—Closed-End Model Forms and Clauses-7

The Bureau is issuing appendix H-7 with technical changes to conform to the final rule.

Appendix H—Closed-End Model Forms and Clauses-7(i)

Proposed revisions to appendix H-7(i) would have included § 1026.20(d), as well as § 1026.20(c), as the types of models illustrated in this appendix. The proposed revision also would have added text so that the provision stated that appendix H-4(D) included 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. Having received no comments on this topic, the Bureau is adopting the commentary as proposed.

VI. Effective Date

This final rule is effective on January 10, 2014. The Bureau believes that this approach is consistent with the timeframes established in section 1400(c) of the Dodd-Frank Act and, on balance, will facilitate the implementation of the Title XIV Rulemakings' overlapping provisions, while also affording covered persons sufficient time to implement the more complex

or resource-intensive new requirements. Certain of the regulations set forth in the Final Servicing Rules are required under title XIV. Specifically, section 1420 of the Dodd-Frank Act, which requires the periodic statement, states that the Bureau "shall develop and prescribe a standard form for the disclosure required under this subsection, taking into account that the statements required may be transmitted in writing or electronically." 15 U.S.C. 1638(f)(2). Other regulations set forth in the Final Servicing Rules, while implementing amendments under title XIV of the Dodd-Frank Act, are *not* regulations required under title XIV. Pursuant to section 1400(c)(2) of the Dodd-Frank Act, the effective dates of these regulations need not be within one year of issuance.

The Bureau received approximately 60 comments from industry participants with respect to the appropriate effective date. As stated above, comments from consumer advocacy groups generally urged earlier effective dates. A number of industry trade associations, as well as a large bank and a small credit union indicated that the Bureau should provide a sufficient amount of time, but did not express an opinion regarding an appropriate timeframe. The majority of servicers, including large and small banks, non-bank servicers, and numerous credit unions, as well as their trade associations, indicated that the Bureau should establish an effective date of between 12 and 18 months after issuance.[139] Some large banks, a bank servicer, numerous trade associations, the SBA, and the GSEs stated that the Bureau should consider an implementation period of approximately 18-24 months for certain of the requirements. Further, three banks and numerous trade associations for banks and manufactured housing servicers stated that the Bureau should consider an effective date between 24 and 36 months after issuance. Each of the industry commenters generally stated that the requested time was necessary to effectively implement the

[139] In addition, a force-placed insurer stated that it would be require between 6-12 months to implement regulations relating to force-placed insurance requirements.

regulations because of the complexity of the proposed rules, the impact on systems changes and staff training, and the cumulative impact of the proposed mortgage servicing rules when combined with other requirements imposed by the Dodd-Frank Act or proposed by the Bureau. These letters provide some basis to believe that implementing the regulations within 12 months is challenging for many firms. They do not establish, however, that implementation in 12 months is impracticable.

For the reasons already discussed above, the Bureau believes that an effective date of January 10, 2014 for this final rule and most provisions of the other title XIV final rules will ensure that consumers receive the protections in these rules as soon as reasonably practicable, taking into account the timeframes established by the Dodd-Frank Act, the need for a coordinated approach to facilitate implementation of the rules' overlapping provisions, and the need to afford covered persons sufficient time to implement the more complex or resource-intensive new requirements.

VII. Dodd-Frank Act Section 1022(b)(2) Analysis

A. Overview

In developing–the final rule, the Bureau has considered potential benefits, costs, and impacts.[140] The Proposal set forth a preliminary analysis of these effects, and the Bureau requested and received comments on the topic. In addition, the Bureau has consulted, or offered to consult with, the prudential regulators, HUD, the FHFA, the Federal Trade Commission, and the Federal Emergency Management Agency, with respect to consistency with any prudential,

[140] 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.

market, or systemic objectives administered by such agencies. 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 final rule on those entities' loan programs.

In this rulemaking, the Bureau amends Regulation Z, which implements TILA, and the official interpretation to the regulation, as part of its implementation of the Dodd-Frank Act amendments to TILA's mortgage servicing rules. The amendments to Regulation Z implement Dodd-Frank Act sections 1418 (initial interest rate adjustment notice for ARMs), 1420 (periodic statements), and 1464 (prompt crediting of mortgage payments and response to requests for payoff amounts). The final rule also revises 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 2013 RESPA Servicing Final Rule that implements Dodd-Frank Act section 1463. The RESPA rule implements requirements regarding 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 an initial matter, in response to a comment, the Bureau considers whether the statute explicitly or implicitly addresses a market failure. Part II.A of the final rule ("Overview of the Mortgage Servicing Market and Market Failures") discusses the servicing market and servicer incentives. As noted in the proposed rule, a fundamental feature of the market for servicing is that borrowers generally do not choose their own servicers.[141] It is therefore difficult for

[141] *See* 77 FR 57318, 57321 (Sept. 17, 2012).

borrowers to protect themselves from shoddy service or harmful practices. A borrower may select a servicer at origination by choosing a lender that pledges to service the loans that it originates. However, relatively few lenders commit to servicing the loans that they originate, most borrowers do not choose a servicer at origination, and some borrowers who do choose a servicer at origination may find that the servicer retains a subservicer that interacts with the borrower. A borrower may refinance a mortgage loan to receive a new servicer. However, refinancing is an expensive and generally impractical way for a homeowner to obtain a new servicer, and, similar to origination, the borrower does not generally select the new servicer.

The Bureau recognizes that certain servicers have incentives to service well. Servicers that rely on a local reputation—their ability to attract new consumers depends on how well they treat current consumers—have incentives to provide high quality servicing. This describes many of the small servicers that the Bureau consulted as part of a process required under SBREFA. They described their businesses as requiring a "high touch" model of customer service, both to ensure loan performance and to maintain a strong reputation in their local communities. The vast majority of smaller servicers are community banks and credit unions, which tend to operate in narrowly defined geographic areas, depend deeply on the economies of these communities for their profitability, offer a range of products and services in both deposits and loans, are known for a "relationship" model that depends on repeat business to obtain more deposits and extend more loans, and could suffer significant harm to their business from any major failure to treat customers properly because they are particularly vulnerable to "word of mouth." These small servicers also generally service only loans they either originated or hold on portfolio.

The Bureau believes that servicers that service relatively few loans, all of which they either originated or hold on portfolio, generally have incentives to service well: foregoing the

returns to scale of a large servicing portfolio indicates that the servicer chooses not to profit from volume, and owning or having originated all of the loans serviced indicates a stake in either the performance of the loan or in an ongoing relationship with the borrower.

In general, however, mortgage servicing is influenced by the absence of avenues through which consumers can effectively reward or penalize servicers for the quality of servicing. A consumer cannot readily leave a servicer if the quality of servicing proves to be unsatisfactory, and the consumer cannot generally control the selection of the new servicer. Consumers also generally do not have other ways of imposing financial consequences on servicers for poor servicing. Markets are incomplete between consumers and servicers, and such incomplete markets are a form of market failure. This market failure leaves many servicers with only limited incentives to engage in certain activities of value to consumers.[142]

Of particular relevance to this rulemaking is the fact that servicers receive very little benefit from developing disclosures that are valuable to consumers. That is to say, the market provides servicers with limited incentives to conduct (or pay others to conduct) the research necessary to discover information that consumers find useful at different decision points and the ways to present this information to consumers. Servicers do have an incentive to provide borrowers with information and services that keep collection costs low. Thus, they have an incentive to make sure consumers know the payment due in each period, the date the payment is due, and where to send it. Servicers also have some incentive to limit customer inquiries, and so servicers may provide additional information that consumers want. The Bureau knows that certain servicers have experimented with improving their disclosures (and these instances are

[142] *See* Joseph E. Stiglitz. *Economics of the Public Sector*, at 85 ch.4 (3d ed., 2000). An alternative way to view the market failure is that servicers are both the agents of investors and, as a practical matter, monopoly providers of information to consumers about details of the loan and consumer payments. Market failures need not be mutually exclusive.

discussed below). However, this work does not appear to be widespread and the Bureau received only a small number of comments about efforts to improve disclosures. These facts are consistent with the fact that servicers receive minimal consequential feedback from consumers about the quality of servicing in general and the quality of servicing disclosures in particular. The market failure in mortgage servicing provides an economic rationale for establishing national servicing standards, including standards for disclosures, with a limited number of exceptions.

Congress included in the Dodd-Frank Act the mortgage servicing provisions described above in response to pervasive and profound consumer protection problems in mortgage servicing. The new protections in the rules promulgated under TILA and RESPA will 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.

B. Provisions to be Analyzed

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

1. Changes in the format, content, and timing of the existing interest rate adjustment disclosures for most closed-end adjustable-rate mortgages as required by revised § 1026.20(c).

2. New initial interest rate adjustment disclosures for most closed-end adjustable-rate mortgages as required by new § 1026.20(d).

3. 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 as required by revised § 1026.36(c).

4. New periodic statement disclosure requirements for most consumer credit transactions secured by a dwelling as required by new § 1026.41.

With respect to each major provision, the analysis considers the benefits and costs to consumers and covered persons, and in certain instances considers other impacts. The analysis also addresses comments the Bureau received on the proposed Dodd-Frank Act section 1022 analysis as well as certain other comments on the benefits or costs of provisions of the proposed rule when doing so is helpful to understanding the Dodd-Frank Act section 1022 analysis. Comments that mention the benefits or costs of a provision of the proposed rule in the context of commenting on the merits of that provision are addressed in the section-by-section analysis of that provision. The analysis also addresses certain alternative provisions that were considered by the Bureau in the development of the proposed rule, the final rule, or in response to comments.

C. Data and Quantification of Benefits, Costs and Impacts

Section 1022 of the Dodd-Frank Act requires that the Bureau, in adopting the rule, consider potential benefits and costs to consumers and covered persons resulting from the rule, including the potential reduction of access by consumers to consumer financial products or services resulting from the rule, as noted above; it also requires the Bureau to consider the impact of proposed rules on covered persons and the impact on consumers in rural areas. These potential benefits and costs, and these impacts, however, are not generally susceptible to particularized or definitive calculation in connection with this rule. The incidence and scope of such potential benefits and costs, and such impacts, will be influenced very substantially by economic cycles, market developments, and business and consumer choices that are substantially

independent from adoption of the rule. No commenter has advanced data or methodology that it claims would enable precise calculation of these benefits, costs, or impacts. Moreover, the potential benefits of the rule on consumers and covered persons in creating market changes anticipated to address market failures are especially hard to quantify.

In considering the relevant potential benefits, costs, and impacts, the Bureau has utilized the available data discussed in this preamble, where the Bureau has found it informative, and applied its knowledge and expertise concerning consumer financial markets, potential business and consumer choices, and economic analyses that it regards as most reliable and helpful, to consider the relevant potential benefits and costs, and relevant impacts. The data relied upon by the Bureau also include the public comment record established by the proposed rule. The Bureau recognizes that some parties may have different perspectives or consider potential benefits and costs differently.

However, the Bureau notes that for some aspects of this analysis, there are limited data available with which to quantify the potential costs, benefits, and impacts of the final rule. Regarding costs to covered persons, the Bureau would need data on the one-time and ongoing costs of modifying existing disclosures and creating new disclosures. Further, as discussed below, these costs depend on the size of the servicer, whether it prepares disclosures in-house or uses a vendor, and (if it uses a vendor) the terms of the contract with the vendor. Some of this data is proprietary and not generally available. Quantifying consumer benefits would require data on the impact of the new disclosures on housing finance decisions like refinancing and the cost savings and other benefits of these decisions.

In light of these data limitations, the analysis below generally provides a qualitative discussion of the benefits, costs, and impacts of the final rule. General economic principles,

together with the limited data that are available, provide insight into these benefits, costs, and impacts. Where possible, the Bureau has made quantitative estimates based on these principles and the data that are available. For the reasons stated in this preamble, the Bureau considers that the rule as adopted faithfully implements the purposes and objectives of Congress in the statute. Based on each and all of these considerations, the Bureau has concluded that the rule is appropriate as an implementation of the Dodd-Frank Act.[143]

D. Baseline for Analysis

The above-discussed amendments to TILA in the Dodd-Frank Act are self-effectuating, and the Dodd-Frank Act generally does not require the Bureau to adopt regulations to implement these amendments. For example, certain provisions of the final rule 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 provisions arise largely or entirely from those amendments, not from the final rule. These provisions of the final rule provide substantial benefits to servicers, compared to allowing the TILA amendments to take effect without implementing regulations, by clarifying parts of those amendments that are ambiguous. Greater clarity on these amendments, as provided by the final rule, should reduce

[143] The Bureau noted in the proposals associated with the Title XIV Rulemakings that it sought to obtain additional data to supplement its consideration of the rulemakings, including 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. Each of these data sources was not necessarily relevant to each of the rulemakings. The Bureau used the additional data from NMLS and NMLS Mortgage Call Report data to better corroborate its estimate of the contours of the non-depository segment of the mortgage market. The Bureau has received loan file extracts from three lenders, but at this point, the data from one lender is not usable and the data from the other two is not sufficiently standardized nor representative to inform consideration of the final rules. Additionally, the Bureau has thus far not yet received data from the National Mortgage Database pilot phases. The Bureau also requested that commenters submit relevant data. All probative data submitted by commenters were discussed in this document.

the compliance burdens on covered persons by, for example, reducing costs for attorneys and compliance officers as well as potential costs of over-compliance and unnecessary litigation.[144]

Dodd-Frank Act section 1022 permits the Bureau to consider the benefits, costs, and impacts of the final rule solely compared to the state of the world in which the statute takes effect without implementing regulations. 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 new initial interest rate adjustment notice and the periodic statement disclosure 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 Bureau has discretion in future rulemakings to choose the most appropriate baseline for that particular rulemaking.

The provisions of the final rule regarding prompt crediting of payments and response to requests for payoff amounts also implement self-effectuating amendments to TILA and the benefits, costs, and impacts of these provisions are also considered against a pre-statutory baseline. However, these amendments to TILA largely codify existing Regulation Z provisions in § 1026.36(c). Thus, the pre-statute and post-statute baselines are substantially the same. The final rule largely clarifies servicer[145] duties that are ambiguous under the statute and existing regulations.

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[144] In response to a comment, the Bureau notes that it is focused here on the fact that regulatory provisions that clarify ambiguous statutory provisions mitigate certain compliance costs associated with uncertainty over what the statutory provisions require. While it is possible that some clarifications would put greater burdens on servicers as compared to what the statute would ultimately be found to mandate, the Bureau believes that the rule's clarifying provisions generally mitigate burden.

[145] Reference in parts VII, VIII, and IX to "servicers" with regard to the final rule for requests for payoff amounts means creditors, assignees, and servicers.

Finally, the provisions regarding the § 1026.20(c) disclosure for adjustable-rate mortgages impose obligations on servicers[146] that are authorized, but not required, under TILA sections 105(a) and 128(f) and Dodd-Frank Act section 1405(b). Accordingly, with respect to § 1026.20(c), the Bureau considers the benefits, costs, and impacts of the provisions against the baseline provided by the current provisions of § 1026.20(c).

E. Coverage of the Final Rule

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

Size of the Small Servicer Exemption

As discussed above, the Bureau believes that servicers that service relatively few loans, all of which they either originated or hold on portfolio, generally have incentives to service well: foregoing the returns to scale of a large servicing portfolio indicates that the servicer chooses not to profit from volume, and owning or having originated all of the loans serviced indicates a stake in either the performance of the loan or in an ongoing relationship with the borrower. The vast majority of smaller servicers are community banks and credit unions, which tend to operate in narrowly defined geographic areas, depend deeply on the economies of these communities for their profitability, offer a range of products and services in both deposits and loans, are known for a "relationship" model that depends on repeat business to obtain more deposits and extend more loans, and could suffer significant harm to the business from any major failure to treat customers properly because they are particularly vulnerable to "word of mouth." These small servicers generally maintain "high-touch," customer-centric customer service models. They also generally service only loans they either originated or hold on portfolio.

[146] Reference in parts VII, VIII, and IX to "servicers" with regard to the final rules for adjustable-rate mortgages means creditors, assignees, and servicers.

Where small servicers already have incentives to provide high levels of customer contact and information, the Bureau believes that the circumstances warrant exempting those servicers from complying with certain provisions. For community banks and credit unions in particular, affirmative communications with consumers help them (and their affiliates) to ensure loan performance, market other consumer financial products and services to the customers for whom they service mortgages and have a relationship, and protect their reputations in their local communities.[147] Because these servicers generally have a long-term relationship with their customers, their incentives with regard to charging fees and other servicing practices tend to be more aligned with consumer interests. At the same time, consumers generally have easy access to these small community-based servicers to obtain any information they desire.

The Bureau believes that these two conditions are necessary to warrant a possible exemption from a provision of the rule—that is, that an exemption may be appropriate only for servicers that service a relatively small number of loans and either own or originated the loans they service. 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, compliance is likely to be somewhat easier to accomplish. Further, larger servicers also generally operate in a larger number of communities under circumstances in which the "high touch" model of customer service is not practical or service many loans in which they do not have as much a stake in the long-term performance.

In order to implement the small servicer exemption, the Bureau defines a small servicer to be any servicer that, together with any affiliates, services 5,000 or fewer mortgages loans, all

[147] *See* Pinto Paper, at 8.

of which the servicer or affiliates originated or own.[148] The definition incorporates the requirement that the servicer or affiliates originated or own the loans because, as explained above, the Bureau believes that this is a key indicator of servicers that generally have incentives to provide high levels of customer contact and information. To develop the loan count threshold, the Bureau computed loan counts for insured depository institutions using data on aggregate unpaid principal balance and a measure the Bureau derived for the average loan unpaid principal balance at insured depositories.[149] The Bureau's methodology takes into account the fact that servicers that service smaller numbers of loans also tend to service loans with smaller unpaid principal balances. For example, the Bureau finds that the average unpaid principal balance on mortgage loans at insured depositories and credit unions is about $160,000, but it is only about $80,000 at insured depositories and credit unions with under $1 billion in assets.

The Bureau believes that the 5,000 mortgage loan threshold further identifies the group of servicers that make loans only or largely in their local communities or more generally have incentives to provide high levels of customer contact and information. The Bureau also believes, in light of the available data, that no other threshold is superior in balancing potential over-inclusion and under-inclusion. With the threshold set at 5,000 loans, the Bureau estimates that over 98% of insured depositories and credit unions with under $2 billion in assets fall beneath the threshold. In contrast, only 29% of such institutions with over $2 billion in assets fall

[148] The 5,000-loan threshold reflects the purposes of the exemption that the rule establishes for these servicers and the structure of the mortgage servicing industry. The Bureau's choice of 5,000 in loans serviced for purposes of Regulation Z does not imply that a threshold of that type or of that magnitude would be an appropriate way to distinguish small firms for other purposes or in other industries.

[149] Credit Unions report the number and aggregate balance of mortgages held in portfolio on their Call Report. Using these reports the Bureau calculated the average unpaid principal balance of portfolio mortgages by State for credit unions with less than $1 billion in assets and applied the State specific figures to banks and thrifts under $10 billion in assets. For banks and thrifts with over $10 billion in assets, the Bureau relied on the OCC Mortgage Metrics Report, which showed an average unpaid principal balance estimate of $175,000. For securitized loans, the Bureau relied on the FHFA's Home Loan Performance database, which provides data by size of securitized loan book; this yielded average unpaid principal balances ranging from $141,000 to $189,000.

beneath the threshold and only 11% of such institutions with over $10 billion in assets do so. Further, over 99.5% of insured depositories and credit unions that meet the traditional threshold for a community bank—$1 billion in assets—fall beneath the threshold.[150] The Bureau estimates there are about 60 million closed-end mortgage loans overall, with about 5.7 million serviced by insured depositories and credit unions that qualify for the exemption.[151]

The Bureau believes that the insured depositories and credit unions that fall below the 5,000 loan threshold consist overwhelmingly of entities that make loans in their local communities and have incentives to provide high levels of customer contact and information. Further, while some such entities may service more than 5,000 loans, the Bureau believes that relatively few do, so expanding the loan count above 5,000 is more likely to include entities that use a different servicing model. If the loan count threshold were set at 10,000 mortgage loans, for example, over 99.5% of insured depositories and credit unions with under $2 billion in assets would fall beneath the threshold. However, 50% of insured depositories with over $2 billion in assets and 20% of those with over $10 billion in assets would fall beneath the threshold. The Bureau recognizes that some of these servicers may not qualify as small servicers because some may not own or have originated all of the loans they service. However, the Bureau believes that

[150] The Bureau notes, however, that the FDIC recently released a new set of empirical criteria for identifying community banks in which some banks with under $1 billion in assets are excluded and some banks with over $1 billion in assets are included. *See* Fed. Deposit Ins. Corp., *FDIC Community Banking Study*, at 1-5(Dec. 2012), *available at* http://www.fdic.gov/regulations/resources/cbi/study.html. The study is somewhat critical of using a $1 billion threshold to define community banks, as has been traditional. The Bureau's rule equates roughly to a $2 billion threshold to the extent that the rule covers 98% of insured depositories and credit unions with fewer assets.

[151] To obtain estimates of loan counts, the Bureau aggregated mortgage loan counts obtained or derived from the FHFA "Home Loan Performance" data described above, the Board's Flow of Funds Accounts of the United States (statistical release z.1), the data from the credit union Call Report and the bank and thrift Call Report, the CoreLogic mortgage loan servicing data set, and the BBx data set from BlackBox Logic.

these figures give a fair representation of the types of servicers that would qualify as small servicers given the respective thresholds.[152]

The Bureau concludes that the 5,000 mortgage loan threshold, coupled with the requirement to service only loans owned or originated, provides a reasonable balance between the goal of including a substantial number of servicers that make loans only or largely in their local communities or more generally have incentives to provide high levels of customer contact and information and excluding servicers that use a different, less personal business model. The Bureau further believes that it is appropriate for a definition of small servicers, for purposes of an exemption to servicing rules, to include conditions specifically associated with the incentives and business model of servicers, such as owning or originating all loans. There is no perfect way, however, to identify servicers that have chosen a business model in which an essential component is providing high levels of customer contact and information.[153]

Finally, the Bureau estimates that there are about 13.9 million closed-end mortgage loans serviced by non-depositories. The data is not available with which to accurately estimate the number of exempt non-depository servicers or the number of loans they service. However, the Bureau believes that the number of loans serviced is a small percentage of this total given the financial advantages of servicing large numbers of loans. The Bureau has therefore decided not

[152] The Bureau believes that almost all insured depositories and credit unions that service 5,000 or fewer loans own or originated those loans. Entities servicing loans they did not originate and do not own most likely view servicing as a stand-alone line of business, and they would choose to service substantially more than 5,000 loans in order to obtain a profitable return on their investment in servicing. To the extent the assumption does not hold, it is more likely not to hold for insured depositories and credit unions servicing more than 5,000 loans.

[153] The Bureau received comments from two credit unions recommending a 5,000 mortgage loan threshold. Two bank trade associations recommended a 10,000 loan threshold, one bank recommended 15,000, and the Small Business Administration recommended 5,000 to 10,000. One bank trade association recommended that a small servicer should be either any servicer that services only loans that it owns or originated, without limit, or any servicer that services 10,000 loans or fewer. For the reasons described above, the Bureau believes that the 5,000 loan count threshold coupled with the requirement that the servicer owns or originated the loans provide an appropriate definition of small servicer for purposes of the exemption.

to distinguish, in the definition of a small servicer, whether a mortgage servicer is an insured depository or credit union or has some other business form.

Size of the Small Servicer Exemption in the Proposed Rule

The Bureau proposed 1,000 mortgage loans for the threshold in the definition of a small servicer. At the time of the proposal, the Bureau understood that a significant number of servicers that maintained "high touch" customer service models would have qualified for the proposed exemption. This understanding was based in part on estimates of the number of loans serviced by banks, thrifts and credit unions derived from data on the aggregate unpaid principal balance in Call Reports and an assumed average unpaid principal balance on mortgage loans of $175,000.[154]

A number of industry commenters provided information about the unpaid principal balance on mortgage loans at their institutions and indicated that the average unpaid principal balance was much smaller. One commenter stated that the principal balance on its loans at origination was less than half the Bureau's figure; for 2011 originations the principal balance was $81,600. Another commenter stated that its average loan amount was about $56,000 and that the average mortgage in the State of Oklahoma mid-2012 was about $106,000. Yet another commenter stated that the median size of the loans on its portfolio was about $70,000. One commenter stated that the Bureau's approach penalized servicers that specialize in moderately priced homes. The Bureau seriously considered these comments. In response, the Bureau

[154] This is the average unpaid principal balance for first-lien residential mortgages at the largest national banks, which at the time of the report accounted for 63 percent of all outstanding mortgages; *See* Office of the Comptroller of the Currency, *OCC Mortgage Metrics Report, Second Quarter 2011* (Sept. 2011) ("OCC Mortgage Metrics Report"), *available at* http://www.occ.treas.gov/publications/publications-by-type/other-publications-reports/mortgage-metrics-2011/mortgage-metrics-q2-2011.pdf.

developed the methodology described above to estimate the number of loans serviced by insured depositories and credit unions.

F. Potential Benefits and Costs to Consumers and Covered Persons

1. Changes in the Format, Content, and Timing of the Regulation Z § 1026.20(c) Disclosure for Adjustable-Rate Mortgages

Under current § 1026.20(c), a notice of interest rate adjustment for variable-rate transactions subject to § 1026.19(b) must be mailed or delivered to consumers whose payments will change as a result of an interest rate adjustment 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 final rule eliminates the annual disclosure. Thus, the discussion below relates exclusively to the payment change disclosure required under § 1026.20(c).[155] The final rule also changes the minimum time for providing advance notice to consumers from 25 days to 60 days before the first payment at a new level is due, with an accommodation for ARMs with look-back periods of less than 45 days originated before January 10, 2015. The maximum time for advance notice remains the same: 120 days prior to the due date of the first payment at a new level. The revised § 1026.20(c) disclosure also contains additional content, as described in part V. The format and content of the revised § 1026.20(c) disclosure closely tracks the format and content of the initial interest rate adjustment disclosure under § 1026.20(d), discussed below.

Potential 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

[155] As discussed in part V, the Bureau believes that the annual notice is duplicative given that the periodic statement required by § 1026.41 provides much of the same information. Thus, eliminating the annual notice reduces costs for servicers with little or no loss in benefits to consumers.

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 the first payment at a new level is due would more closely reflects the time needed for consumers to refinance a loan.[156]

The benefits to consumers from the content of the revised § 1026.20(c) disclosure are measured against a baseline provided by the current § 1026.20(c) disclosure. Thus, the benefits of the rule flow entirely from changes to the disclosure; for the sake of clarity, however, the discussion mentions certain key features of the disclosure that are unchanged. For qualitative analysis, the revisions to the § 1026.20(c) disclosure may be broadly categorized as facilitating (a) the choice of an alternative to making the new payment, including refinancing; (b) the budgeting of household resources; and (c) 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 benefits of these disclosures are discussed further in part V.

The current and revised § 1026.20(c) disclosures both provide the current and upcoming interest rate and payment (not an estimate) and the date the first payment at the new rate is due. This may alert the consumer to a problem with affordability and the need to assess alternatives. However, only the revised disclosure provides notice of a prepayment penalty and explains the circumstances under which any prepayment penalty may be imposed. This notice may be useful to some consumers facing a problem with affordability and needing to assess alternatives. For

[156] A comment on timing is discussed below under costs to consumers.

example, the notice may prompt a consumer who is unclear about whether a penalty is still in effect to contact her servicer; a consumer must know if a penalty exists and (if so) the amount to properly assess alternatives that require paying off the existing loan.

In addition, the disclosure of the persistent features of the loan facilitates consumer evaluation of the longer-term benefits of the loan compared to alternatives. For instance, the revised disclosure includes an explanation of how the new interest rate and payment are determined, including the index or formula used and any adjustment to the index such as any margin added. The revised disclosure also states any limits on the interest rate or payment increase at each adjustment and over the life of the loan and the earliest date at which any foregone interest increase could be applied. In contrast, the current § 1026.20(c) disclosure provides only the index value without any explanation and does not provide information about limits on interest rate or payment increases. The additional information facilitates comparisons with alternative loans and any reevaluation of the consumer's housing finance decisions and comparisons with alternative financing options. All of this information is also useful to consumers for the budgeting of household resources.

The revised § 1026.20(c) disclosure provides additional information to consumers with interest-only or negatively-amortizing loans that addresses the accumulation of equity. For these loans, the revised disclosure states the amount of the current and new payment allocated to pay principal, interest, and taxes and insurance in escrow, as applicable, and information on how these payments will affect the balance of the loan. 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 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 discussed in part V, 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.[157] In particular, the periodic statement will provide consumers with some of the same information as that in the revised § 1026.20(c) disclosure. However, the differences in the timing of the two disclosures makes the periodic statement less useful than the revised § 1026.20(c) disclosure for facilitating comparisons between the current and new payment before the new payment is due. Similarly, while the periodic statement presents the new payment due and the amount paid the previous month, it does not compare the two as explicitly as the revised § 1026.20(c) disclosure does. Finally, since the revised § 1026.20(c) disclosure is provided only if the payment changes, the benefit to consumers from receiving important information on both disclosures is likely greater than the benefit of receiving this information only on the periodic statement disclosure.[158]

The Bureau is also prescribing formatting requirements for the § 1026.20(c) disclosure. As discussed above, these requirements benefit consumers by facilitating consumer understanding of the information in the disclosures. The final 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

[157] The Bureau received comments from industry that also made this point.

[158] Of course, a consumer who receives the prescribed § 1026.20(c) disclosure may derive little additional benefit from shortly thereafter receiving some of the same information on the periodic statement disclosure. There would, however, likely be little cost saving for servicers in not having to provide the information on the periodic statement disclosure that also appears on the § 1026.20(c) disclosure for just one or two months.

substantially similar to, certain model forms provided with the final rule. The Bureau's testing of certain information in the § 1026.20(d) notice (that is the same as certain information in the § 1026.20(c) notice) showed that the participants readily understood the information in the notice when the terms and calculations were presented in the logical order contained in the model forms. While there is no formula for producing the ideal disclosure, the Bureau believes that disclosures that satisfy the prescribed formatting requirements likely provide greater benefits to consumers than disclosures that do not satisfy these requirements. The Bureau also believes that there is some consumer benefit in harmonizing the § 1026.20(c) and (d) notices, so they present similar information in a similar format.[159]

Although the Bureau does not have the data necessary to quantify the consumer benefits of the revisions to the § 1026.20(c) disclosure required by the rule, the following hypothetical illustrates how consumers are likely to benefit from the disclosures.[160] The Bureau estimates that approximately 650,000 adjustable-rate mortgages may have an interest rate adjustment in each of the next three years. Suppose that just 5 percent of the consumers with these mortgages are sent the disclosure (this occurs only if the payment adjusts) and, because of the change in the timing from 25 days to 60 days before the first payment at a new level is due, refinance one

[159] 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*, Fed. Reserve Bull., Aug. 2011, at 1 ("Hogarth & Merry").

[160] One commenter suggested that the Bureau conduct a "breakeven" analysis, referring to OMB's Circular A-4 guidance that it issued in connection with Executive Order 12866. Section 1022(b)(2)(A) requires the Bureau to consider the potential benefits and costs to consumers and covered persons. By its terms, section 1022(b)(2)(A) does not require the Bureau to quantify the benefits and costs of the rule; limit its consideration to quantifiable benefits and costs; or determine whether the benefits outweigh the costs. Rather, the Bureau is required to "consider" the benefits and costs of the rule. The Bureau believes that there are multiple reasonable approaches for conducting the consideration called for by Dodd-Frank Act section 1022(b)(2)(A) and that the approach it has taken in this analysis is reasonable and that, particularly in light of the difficulties of reliably estimating certain benefits and costs and the Bureau's resource constraints, it has discretion to decline to undertake additional or different forms of analysis.

month sooner. If these consumers reduce their monthly payment by $50, then the annual savings to consumers would be over $1.6 million or about $2.50 per disclosure.[161]

The Bureau received comments that questioned the benefits to consumers of the proposed changes to the § 1026.20(c) notice both broadly and in respect to particular changes. The Bureau disagrees with these assessments of the value of the modifications to the § 1026.20(c) notice. The belief that the current notice is adequate may be based on the fact (explained above) that consumers cannot provide the standard market signal that a servicer is inadequate, *i.e.*, finding another service provider. Since servicers receive minimal consequential feedback from consumers about the quality of servicing disclosures, they have little incentive to incur the costs of researching and discovering the information consumers want in the payment adjustment notice and the ways to present this information that consumers find most useful. The Bureau disagrees with the assertion that the Bureau failed to cite any research supporting the proposed revisions of the § 1026.20(c) notice. On the contrary, the proposal noted that the Bureau worked closely with ICF Macro (Macro) to develop the closely related § 1026.20(d) model disclosure, conducted three rounds of consumer testing, and revised the disclosure on the basis of the test results. Based on this anecdotal evidence and the Bureau's own judgment and expertise about the marketplace and consumer needs and behavior, the Bureau believes that the benefits to the vast majority of consumers from national servicing standards for disclosures provided by the rule are substantial.

The Bureau did receive five comments from industry referring to efforts by servicers to improve consumer disclosures. One commenter discussed its general commitment to provide customers with clear, simple information about their loans. Another discussed a successful effort

[161] Although the reduction in monthly payment would last for more than one month, the benefit attributable to the change in timing of the disclosure would be the one month of savings.

to improve its interest rate adjustment disclosure in an effort to increase consumer awareness, improve loss mitigation, and facilitate early interventions where delinquency could be caused by a payment increase. This commenter said it provided simple, low-tech forms but with a longer notice period and achieved significant results and response rates. One commenter from a credit union described an effort to provide earlier rate adjustment disclosures to members so they would have more time to make decisions about obtaining a new loan or continuing with their current one. The initial attempt at this enhancement was difficult and the commenter had to add a staff member to manage the project, but after some adjustments to the timing of the disclosures the enhancement seems to have been successful. A fourth industry commenter requested permission to continue to use its "consumer-tested and appreciated" periodic billing statement. A fifth industry commenter argued against including delinquency information in the periodic statement since, in the commenter's experience, this information was more effective in collection letters.

The Bureau recognizes that certain servicers have experimented with improving their disclosures. However, this work does not appear to be widespread; as noted, the Bureau received only a small number of comments about efforts to improve disclosures. The Bureau recognizes that servicers have an incentive to keep collection costs low and therefor to make sure consumers know the payment due in each period, the date the payment is due, and where to send it. Servicers also have some incentive to limit customer inquiries, and they may therefore provide some additional information that consumers want. Some consumers receive disclosures, however, given the market failure described above, the Bureau does not believe that the aforementioned incentives are sufficient to generate better disclosures that would benefit consumers.

Potential costs to consumers. As explained further in the discussion of costs to covered persons, the cost to covered persons is expected to be about 83 cents per disclosure. This estimate takes into account both one-time additional costs (amortized over five years) and additional annual production and distribution costs.[162]

Given the small additional cost per disclosure, the Bureau believes that this cost will not be passed on to consumers in the form of increased fees or charges. Servicers may in general attempt to shift a cost increase onto others, such as creditors, who may in turn attempt to pass on such costs to consumers, so consumers may ultimately bear part of a cost increase that falls nominally on servicers. For the prescribed § 1026.20(c) disclosure, however, the costs to be shifted are very small. Thus, the disclosure is not likely to cause any material cost increase on consumers.

An industry association commented that the change in the timing of the ARM disclosure would increase the pricing of ARMs. As one industry commenter explained, committing earlier to an interest rate to provide consumers with earlier notice of the new rate and payment would increase interest rate risk. While the Bureau agrees with this point in general, the Bureau disagrees with the relevance of the point in this instance. First, as discussed in part V, the Bureau believes that the majority of ARMs already commit to an interest rate early enough to provide consumers with the earlier notice.[163] Thus, the requirement for earlier notice would not, in fact, require an earlier commitment to the interest rate for the majority of ARMs. Second, as

[162] 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. The Bureau is using five years because Section 1022(d) of the Dodd-Frank Act provides that the Bureau shall assess significant rules adopted by the Bureau within five years of the effective date of the rule.

[163] Any ARM with a 45 day (or longer) look-back period could comply with the requirement to provide earlier notice. In 2011, approximately 10% of new home-purchase loans were ARMs and most had loan contracts with 45-day look-back periods. Approximately 88% of the ARMs guaranteed by Fannie Mae and Freddie Mac have 45-day look-back periods.

also discussed in part V, the Bureau believes it is unlikely that, for the minority of ARM products with a look-back period of less than 45 days, the adjustment to a slightly longer look-back period will meaningfully impact the manner in which the product is priced. The slight increase in the period is not a sufficiently long enough time for a material change in interest rates except in the most unusual circumstances.

As noted above, the final rule adds commentary to explain that servicers have the flexibility to modify the disclosures to accommodate certain situations and consumer credit transactions not addressed by the model forms. Still, servicers must present the required information in a format substantially similar to the format of the prescribed 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 these costs are substantial. As discussed above, very few commenters described efforts to test and develop superior disclosures. Nor does the Bureau believe that servicers' current disclosures generally are superior to the prescribed disclosure, and the Bureau is unaware of general efforts by servicers to develop interest rate adjustment notices that provide the benefits to consumers of the prescribed model forms. The Bureau worked closely with Macro to develop the closely related § 1026.20(d) model disclosure, conducted three rounds of consumer testing, and revised the disclosure on the basis of the test results. Based on this anecdotal information, the comment letters, and the Bureau's own expertise in disclosure and consumer behavior, the Bureau believes that the risk of precluding servicers from using disclosures that might provide greater benefits to their customers is relatively small.

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. Servicers that handle such ARMs contractually will not be able to comply with the requirement to provide the § 1026.20(c) disclosure between 60 and 120 days before the first payment at a new level is due. Accordingly, the Bureau is grandfathering these existing ARMs, if originated before January 10, 2015. Going forward, however, ARMs must be structured to permit compliance with the prescribed 60- to 120-day timeframe.

It is possible that ARMs with look-back periods shorter than 45 days may have certain cost advantages to servicers or investors in certain interest rate environments (*e.g.*, when rates are rising quickly). In such environments, competition among servicers for servicing rights may translate the cost advantage into a benefit to originators and consumers; and, in that event, the required 60- to 120-day timeframe may impose a cost on consumers by making mortgages with such shorter look-back periods unavailable. The Bureau believes that because very few consumers have such ARMs, very few consumers would experience such costs.

Potential benefits to covered persons. The Bureau has carefully considered whether there are any significant benefits to covered persons from this provision. The Bureau has determined that there are not.

Potential costs to covered persons. The modifications to the § 1026.20(c) disclosure will result in certain compliance costs to covered persons. Based on discussions with servicers and software vendors, the Bureau believes that, in general, servicers of all sizes will incur minimal one-time costs to learn about the final rule. They will generally use vendors for one-time software and IT upgrades and for producing the disclosure. The revised disclosure provides to consumers 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 believes that under existing vendor contracts, large- and medium-sized servicers may not be charged for the upgrades but will be charged for producing and then distributing *(i.e.*, mailing or electronically providing) the disclosure. Vendors will likely pass along all of these costs to small servicers.[164] However, when most servicers simultaneously need an upgrade, the one-time cost is mitigated by the fact that the costs of a single vendor may be spread among a large number of servicers.[165]

Extrapolating from FHFA data, the Bureau estimates that approximately 639,000 adjustable-rate mortgages will have an interest rate adjustment in each of the next three years.[166] Consumers with these mortgage will receive the revised § 1026.20(c) disclosure, however, only if the interest rate *and* payment adjusts; thus, this figure is most likely an overestimate of the number of consumers that would receive the revised § 1026.20(c). The Bureau believes there are essentially no distribution costs attributable to the rule. In the absence of the rule, servicers would nonetheless be required to provide the current § 1026.20(c) payment change disclosure, and the current and revised payment change disclosures have essentially the same number of

[164] In discussions such as this of costs to covered persons, "small servicers" are servicers that meet the size standard for that business established by the Small Business Administration. Banks, thrifts, and credit unions that service mortgage loans must have $175 million or less in assets and other servicers must have $7 million or less in average annual receipts.

[165] This analysis considers the benefits, costs, and impacts of disclosures assuming that all servicers use vendors for this purpose. The Bureau believes that virtually all servicers, regardless of size, use vendors for disclosures.

[166] For these estimates, the Bureau used the Home Loan Performance data from the FHFA. Home Loan Performance is a supervisory loan-level database of all guaranteed Fannie Mae and Freddie Mac mortgages. It includes characteristics of the loans at origination and then a quarterly time-series of performance throughout the life of the loan.

recipients.[167] The remaining annual costs attributable to the rule are production costs associated with the additional content and formatting. Based on discussions with industry, the Bureau believes the annual production costs passed along to servicers would be about $128,000 (20 cents production cost per disclosure). Finally, based on discussions with industry and extrapolating from FHFA data, the Bureau estimates the one-time cost of modifying the existing § 1026.20(c) disclosure for all 12,600 servicers to be about $2 million.[168] Amortizing the one-time cost over five years and combining it with the annual cost gives an aggregate annual cost of about $528,000.[169] Thus, the cost of the modifications is $42 annually per servicer or 83 cents per disclosure.

Of the $2 million just described, about $1.65 million is the one-time costs for small servicers of revising the existing disclosure. Amortizing this cost over five years requires a payment of $41 by each small servicer in each of five years. The Bureau is not aware of any representative and reasonably obtainable data on the prevalence of ARMs in the loan portfolios of small servicers, so it is not possible to estimate the number of disclosures that small servicers would produce each year. Thus, it is not possible to quantify the total annual cost of the modifications specifically for small servicers.

The Bureau has taken a number of additional steps to mitigate the costs to covered persons, including: exempting certain types of loans where appropriate, such as ARMS with

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[167] Furthermore, by eliminating the annual § 1026.20(c) disclosure, the rule reduces certain production and distribution costs relative to the baseline.

[168] The Bureau makes the following assumptions, based on discussions with industry. All 12,600 servicers familiarize themselves with the rule for a total one-time cost of $750,000. Approximately 8,000 small servicers *(i.e.*, servicers that meet the Small Business Administration size standard) use 100 vendors, each of which spends 80 hours to revise the existing disclosure and another 80 hours validating it, all at $72 per hour. This gives an additional one-time cost of $1 million. Thirty-one very large servicers perform these tasks in-house, for an additional one-time cost of $250,000. This gives total one-time costs of $2 million. The remaining servicers have contracts with vendors under which the vendor absorbs all one-time costs of a disclosure mandated by regulation.

[169] $528,000 = ($2,000,000/5) + $128,000.

terms of one year or less; eliminating the requirement that an annual notice be sent when there is no change in rate and payment; and grandfathering loans with a look-back period of less than 45 days originated prior to January 10, 2015; and requiring disclosure of the existence of a prepayment penalty rather than the amount of any prepayment penalty. See the section-by-section analysis for § 1026.20(c).

One industry association commenter quoted a similar but less detailed analysis in the proposed rule and stated that the Bureau did not adequately identify the types of costs or the amount of those costs that servicers will incur. In response, the Bureau has provided the additional detail above.

This commenter also provided a description of the types of costs that bank servicers would incur, "as part of engaging vendors for…technology-related projects."[170] According to the commenter, a servicer undertaking this activity would incur costs for project identification and planning, vendor selection and due diligence, customized programming, adjustments prior to launch, and costs for new hardware and software. The commenter provided the example of a community bank that was changing its vendor-provided loan processing software.

While the Bureau appreciates the commenter's detailed analysis of the one-time costs associated with engaging vendors for technology-related projects, the Bureau does not believe that the revisions to the § 1026.20(c) payment change disclosure qualify as a technology-related project on the scale described by the commenter. For servicers that use vendors, changes to an existing disclosure will require software updates from the existing vendor and some monitoring by the servicer. In contrast, the commenter appears to describe the selection of a vendor to produce an *entirely new* loan processing system. While the loan processing system must

[170] U.S. Consumer Fin. Prot. Bureau, Doc ID No. 0151, *Public Comment Submission on CFPB-2012-0033*, at 9 (Oct. 9, 2012) (comment from Robert Davis, Exec. VP, American Bankers Association).

communicate accurately with the servicing system, the discussion and example have no direct connection to the costs that would be incurred by a servicer from implementing the revised § 1026.20(c) disclosures. The commenter informed the Bureau that the vendor that produces the disclosures for the community bank in the example (*i.e.*, the core provider) is different from the one providing the loan processing system which further indicates that these two activities are quite distinct.

Only two comments provided specific estimates for costs associated with revising the § 1026.20(c) disclosure. One credit union commented that it expects this disclosure to cause an additional annual expense of over $75,000. One industry association referenced a $1 million upfront cost estimate included in a comment by two unidentified large servicers on an earlier proposal by the Board. However, neither commenter provided additional information necessary for interpreting these figures, determining whether they are consistent with the Bureau's cost analysis, or using them in that analysis. Such additional information would include the number of ARMs serviced, how frequently the payments are likely to adjust, and whether the servicer uses vendors or does all work in-house.

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. 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 receives a benefit. On the other hand, if a consumer refinances from an adjustable-rate mortgage to a 15-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 consumers (or investors) if the notice helps consumers avoid delinquency.

Finally, some of the information provided in the revised § 1026.20(c) disclosure is also provided in the initial interest rate adjustment disclosure discussed below. The Bureau believes that harmonizing the two disclosures mitigates these compliance burdens for servicers and reduces the aggregate production costs to servicers.

2. New initial interest rate adjustment notice for adjustable-rate mortgages

Dodd-Frank Act section 1418 requires servicers and creditors to provide a new, one-time disclosure to consumers who have hybrid ARMs. The disclosure concerns the initial interest rate adjustment and, unlike the disclosure in § 1026.20(c), is not provided for interest rate adjustments after the first adjustment. The Dodd-Frank Act section 1418 disclosure 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 savings clause in TILA section 128A(c) confers authority on the Bureau to extend the notice requirement to non-hybrid ARMs in addition to hybrid ARMs.

The final rule implements this provision by requiring that the disclosure be provided 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, is broadening the scope of the final rule, as proposed, to include ARMs that are not hybrid. The disclosure includes the content required by the statute, with modification to the housing counselor and state housing finance authority information. The disclosure includes certain additional information not required by the statute, including notice of the existence of any prepayment penalty (but not the amount). Finally, as explained above, the Bureau conducted three rounds of consumer testing on these disclosures. The disclosure forms

were revised after each round of testing to improve their effectiveness with consumers.

Potential benefits to consumers. Decades of research shows that consumers make important decisions about housing finance at the initial interest rate adjustment. Consumers often choose to prepay at or before 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.[171]

More controversial is the question of whether payment shock at the initial interest rate adjustment causes default. One published analysis of data from the 2000s does not find a causal relationship between payment shock at the initial interest rate adjustment and default.[172] However, for consumers with certain hybrid ARMs originated in the 2000s, a substantial number experienced an increase in monthly payment of at least 5 percent 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.[173]

The information in the interest rate adjustment notice would provide a number of benefits to consumers with closed-end adjustable-rate mortgages. These benefits may be broadly categorized as facilitating (a) the choice of an alternative to making the new payment, including refinancing; (b) the budgeting of household resources; and (c) the accumulation of equity by

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[171] 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* (Fed. Reserve Bd., Staff Working Paper 2006-63, 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).
[172] Christopher Mayer et al., *The Rise in Mortgage Defaults*, 23 J. Econ. Persps. 27, 37 (2009) ("Mayer et al.").
[173] Anthony Pennington-Cross & Giang Ho, *The Termination of Subprime Hybrid and Fixed-Rate Mortgages*, 38 Real Est. Econs. 399, 420 (2010).

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 final rule requires 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 gives consumers a significant amount of time in which to pursue alternatives to making payments 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 ARMs may benefit from disclosure of any potential new interest rate and payment (or estimates of these amounts) well before the first payment at the adjusted level 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.[174] 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 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 disclosure may help the consumer who anticipates having problems making the new payment. In addition to information on the amount of the new payment, the disclosure lists alternatives to making the new payment and gives a brief explanation of each alternative. It discloses if a prepayment penalty applies, and if so provides information about when that prepayment penalty may be imposed. 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 where a consumer can access certain lists of homeownership counselors and SHFAs. All of this information benefits a consumer who anticipates having problems with making the new payment.

Finally, certain items on the 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

[174] *See* Mayer et al., at 37.

principal, interest, and escrow, as applicable.[175] The disclosure provides information about how these payments will affect the loan balance. 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 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, § 1026.20(d) includes 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 final 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 final rule. The Bureau's testing showed that the consumers who participated 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 formatting requirements are generally informed by decades of consumer testing. Based on this anecdotal evidence and the Bureau's own judgment and expertise about the marketplace and consumer needs and behavior, the Bureau believes that disclosures that satisfy the formatting requirements likely provide greater benefits to consumers than disclosures that do not satisfy these requirements.[176]

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[175] The current payment allocation would also appear on the 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.

[176] For a general discussion of disclosure formatting, disclosure testing, and consumer benefits, *see* Hogarth & Merry.

The Bureau does not have the data necessary to quantify the benefits of the initial interest rate adjustment notice to consumers. Certain consumers with ARMs 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, 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 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.

Although the Bureau does not have the data necessary to quantify the consumer benefits of the initial interest rate adjustment notice, the following hypothetical illustrates how consumers are likely to benefit from the disclosures. The Bureau estimates that approximately 280,000 adjustable-rate mortgages will have an initial interest rate adjustment in each of the next three years. If the new initial interest rate adjustment notice prompts just 1 percent of the consumers who receive the new notice to refinance six months earlier than they otherwise would, and they reduce their monthly mortgage payment by $50, then the annual savings to consumers would be

over $1.6 million per year, or about $6 per disclosure.[177] More generally, consumers may benefit whether interest rates are rising or falling if the consumer would qualify for a mortgage with better terms and the notice prompts the consumer to shop for one somewhat sooner; however, the benefits are more likely to occur when interest rates are rising since acting sooner would benefit the most consumers.

In response to the proposed rule, the Bureau received general comments asserting that existing interest rate adjustment disclosures are adequate, the new disclosures would provide no consumer benefits, or the new disclosures would produce less benefits than costs. One industry association commented that the existing system of interest rate adjustment disclosures provided "substantial notice" to consumers and no research referenced by the Bureau produced evidence that the present system needed improvement. Another industry association commenter similarly stated it was not aware of any deficiencies in the current ARM adjustment notices, and that the Bureau had not provided sufficient explanation that dictates specific information and formatting requirements. Others argued that, even if consumers with hybrid ARMs might benefit from the initial interest rate adjustment notice, consumers with non-hybrid ARMs would receive at most small benefits that did not justify the costs.

The Bureau notes that the statute specifically requires an early notice of the initial interest rate adjustment. As discussed above, the earlier notice may benefit consumers over and above the benefit of the 60 day notice because many consumers may be particularly unlikely to anticipate the very first payment adjustment. Two advance notices may catch the attention of more consumers than one.

The Bureau did receive five comments from industry referring to efforts by servicers to

[177] Although the reduction in monthly payment would likely last for more than six months, the benefit unambiguously attributable to the disclosure would be the savings in each of six months.

improve consumer disclosures. These comments, which are relevant to both proposed § 1026.20(c) and (d), and the Bureau's response, are discussed above in the section-by-section analysis of § 1026.20(c).

Potential costs to consumers. As explained further in the discussion of costs to covered persons, the cost to covered persons is expected to be about $2.67 cents per disclosure. This estimate takes into account both one-time additional costs (amortized over five years) and additional annual production and distribution costs.

Given the moderate cost per disclosure and the fact it is given just once over the life of the loan, 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 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 that event, lenders or investors may bear some of the cost. Servicers may also attempt to obtain higher compensation for servicing from creditors. Creditors 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, but not necessarily all of the costs. The relative sensitivity of supply and demand in these interrelated markets would determine the proportion of the cost increase borne by different parties, including consumers.

The final rule limits how servicers may present the required information in the initial interest rate adjustment notice. Servicers must present the required information in a format

substantially similar to the format of the prescribed 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 these costs are substantial. As discussed above, very few commenters described efforts to test and develop superior disclosures, and the Bureau is unaware of 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 prescribed model forms. In contrast, the Bureau worked closely with Macro to develop the model disclosures, conducted three rounds of consumer testing, and revised the disclosure after each round.

The Bureau received numerous comments that disclosing an estimate of the new monthly payment would confuse consumers or lead them to make poor decisions. The Bureau received similar comments from the Small Entity Representatives during the Small Business Review Panel process. 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 confusion on this point. The Bureau notes that Dodd-Frank Act section 1418 requires disclosure of a good faith estimate of the new monthly payment. In addition, servicers must provide the actual amount of the new monthly payment in the notice if it is available; and if it is not available, then consumers will be notified of the actual amount 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 prescribed § 1026.20(c) disclosure.

Potential benefits to covered persons. The Bureau has carefully considered whether there are any significant benefits to covered persons from this provision. The Bureau has determined that there are not.

Potential costs to covered persons. The initial interest rate adjustment notice will result in certain compliance costs to covered persons. Based on discussions with servicers and software vendors, the Bureau believes that, in general, servicers of all sizes will incur minimal one-time costs to learn about the final rule. They will generally use vendors for one-time software and IT upgrades and for producing the disclosure. The new disclosure provides consumers 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 believes that under existing vendor contracts, large- and medium-sized servicers may not be charged for the upgrades but will be charged for producing and then distributing *(i.e.*, mailing or electronically providing) the disclosure. Vendors will likely pass along all of these costs to small servicers.[178] However, when most servicers simultaneously need an upgrade, the one-time cost is mitigated by the fact that the costs of a single vendor may be spread among a large number of servicers.

[178] In discussions such as this of costs to covered persons, "small servicers" are servicers that meet the size standard for that business established by the Small Business Administration. Banks, thrifts, and credit unions that service mortgage loans must have $175 million or less in assets and other servicers must have $7 million or less in average annual receipts.

Extrapolating from FHFA data, the Bureau estimates that about 280,000 ARMs will adjust for the first time in each of the next three years. Based on discussions with industry, the Bureau believes the annual production and distribution costs for the disclosure is $140,000 (50 cents per disclosure). The small ongoing costs reflect the fact that there will be relatively few initial interest rate adjustments on adjustable-rate mortgages over the next few years. Using both these data sources, the Bureau estimates the one-time cost of the disclosure for the 12,600 servicers is about $3 million.[179] Amortizing the one-time cost over five years and combining it with the annual cost gives an aggregate annual cost of about $740,000.[180] Thus, the cost of new disclosure is $58 annually per servicer or $2.67 per disclosure.

Using a similar methodology, the Bureau estimates the one-time cost for small servicers of the new disclosure is about $2.7 million. Amortizing this cost over five years requires a payment of $58 by each small servicer in each of five years. The Bureau is not aware of any representative and reasonably obtainable data on the loan portfolios of small servicers, so it is not possible to estimate the number of disclosures that small servicers would produce each year. Thus, it is not possible to quantify the total annual cost of the modifications specifically for small servicers.

The Bureau attempted to reduce the burden to servicers where it could be done with minimal impact on the consumer protection purposes of the rule. The Bureau mitigates the burden of the disclosure, among other ways, by requiring the contact information for the list of

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[179] The Bureau makes the following assumptions, based on discussions with industry. 12,600 servicers familiarize themselves with the rule for a total one-time cost of $523,000. The 8,000 small servicers *(i.e.*, servicers that meet the Small Business Administration size standard) use 100 vendors, each of which spends 160 hours developing the new disclosure (double the amount of revising an existing disclosure) and another 160 hours validating it (double the amount of validating an existing disclosure), all at $72 per hour. This gives an additional one-time cost of $2.3 million. Thirty-one very large servicers perform these tasks in-house, for an additional one-time cost of $178,000. This gives total one-time costs of about $3 million. The remaining servicers have contracts with vendors under which the vendor absorbs all one-time costs of a disclosure mandated by regulation.

[180] $740,000=($3,000,000/5)+$138,500.

home ownership counselors or counseling organization in place of a list of individual counseling agencies or programs required by the statute, and by requiring disclosure of the existence of a prepayment penalty in place of the maximum amount of the prepayment penalty. Additionally, the Bureau attempted to harmonize the § 1026.20(c) and (d) disclosures both to reduce the burden on servicers, and to facilitate comprehension by consumers. In addition, relative to the statute, the Bureau has included an exemption for ARMs with a term of one year or less. Further, relative to the statute, the Bureau has drafted the rule such that rate changes occasioned by a consumer's acceptance into a loss mitigation arrangement will not trigger the requirement for the rate change notification. Finally, the Bureau has interpreted the statutory requirement that the notice be "separate and distinct from all other correspondence"[181] to mean that, while the notice must be provided as a separate document, that document may be placed in the same envelope as other communications (as opposed to requiring a separate envelope).

One industry association cited a cost analysis similar to, but less detailed than, the cost analysis presented in the proposed rule and stated that the Bureau did not adequately identify the types of costs or the amount of those costs that banks will incur. This commenter provided a description of the types of costs that bank servicers would incur, "as part of engaging vendors for…technology-related projects." In response, the Bureau has provided the additional detail above and a discussion of the comment in the consideration of the costs to covered persons of the revised § 1026.20(c) disclosure, above. Although the disclosure is new, the Bureau believes that neither this fact nor the content of the disclosure would necessitate a technology-related project on the scale described by the commenter.

[181] TILA section 128A(b).

Another industry commenter referenced the $58 cost figure for small servicers, which consists of one-time costs paid in each of five years. The commenter claimed that this figure was too low and listed a number of one-time and ongoing activities her bank would need to undertake to comply. However, the commenter did not provide an alternative cost figure or explain how the activities she listed would constitute the alternative figure. The commenter did say her bank would have to produce over 100 notices per year. The Bureau notes that $58 was an average figure for one-time costs and that with 100 notices, a better estimate of her institution's costs (consistent with the Bureau's calculations) would be $2.67 per disclosure so $267 per year.

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 receives 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. Similarly, if the notice helps consumers avoid delinquency, servicers may receive reduced fee income from delinquent consumers (or investors).

Finally, as discussed in part V, the Bureau considered but decided not to exempt small servicers from the initial interest rate adjustment notice. The Bureau is not including an exemption for small servicers because an exemption would deprive certain consumers of the seven to eight months advance notice before the first payment at a new level is due that is provided by the disclosure, as well as the information about alternatives and how to contact various sources of assistance. Additionally, the Bureau notes that small servicers are exempt

from the periodic statement requirement of final § 1026.41–one other source of information on when an interest rate might adjust that is provided to consumers. Conversely, the Bureau believes that the benefit to small entities from an exemption 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 notice is given just once to each consumer with an adjustable-rate mortgage.

3. Prompt Crediting of Payments and Response to Requests for Payoff Amounts

TILA section 129F (as added by Dodd-Frank Act section 1464(a)) generally codifies existing Regulation Z § 1026.36(c)(1)(i) on prompt crediting of payments. The final rule requires periodic payments (defined as an amount sufficient to cover principal, interest and escrow (if applicable)) to be promptly credited, and provides clarification on the handling of partial payments (*i.e.*, payments less than a periodic payment).

The final rule clarifies that servicers have the option of holding partial payments in a suspense account. If servicers hold partial payments in a suspense account, the servicer must disclose the amount on the periodic statement if a periodic statement is required. If sufficient funds accrue in any suspense or unapplied funds account to cover a periodic payment, such funds must be credited as if a periodic payment were received.

TILA section 129G (as added by Dodd-Frank Act 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.

The Bureau did not receive comments on the proposed Dodd-Frank Act section 1022(b)(2) analysis or issues closely related to that analysis in connection with the proposed provisions in § 1026.36(c). Comments on the provisions of the proposed rule are addressed in the section-by-section analysis

Potential benefits and costs to consumers. The statute largely codifies an existing regulation. While the existing regulation does not specifically address the handling of partial payments, the final rule requires practices regarding the handling of partial payments already followed by many servicers. Thus, the benefits and costs to consumers from a pre-statute baseline are likely small.

Qualitatively, the provisions on prompt crediting, coupled with the disclosure on the periodic statement of the amount of funds being held in any suspense account, should help consumers manage and reduce defaults. Consumers will better understand when their payments are being held in a suspense account rather than being applied and also when partial payments will be applied. Not including late fees in the definition of periodic payment requires servicers to credit a payment that covers principal, interest and escrow even if late fees are outstanding. Consumers who make such a payment benefit from having that payment credited. Overall, these provisions of the final rule ensure that consumers benefit from every effort that they make to pay their mortgage debt.

Potential 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 likely small. However, neither current Regulation Z nor Dodd-Frank Act section 1464(a) define what constitutes a "payment" for purposes of the crediting requirement. Thus, the final rule benefits servicers by clarifying the meaning of this term. The Bureau believes that many

servicers already credit payments as required by the final rule, and for those that do, this clarification is a benefit and is the only impact of the rule.

The Bureau engaged in outreach and believes that many servicers already comply with the final rule. However, for servicers with different crediting practices, the final rule may delay the receipt of fee income or reduce some float income. The Bureau has no data with which to determine whether this is the case but believes these losses would generally be small. The Bureau has mitigated the burden of the payoff statement provision relative to the statute by including a clause allowing additional time when providing a payoff statement within seven days would not be feasible due to certain circumstances.

4. 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[182] 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 if the consumer is given a coupon book containing substantially the same information as the statement.

The final rule requires 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 final rule provides a coupon book exemption for fixed-rate loans when the consumer is given a coupon book with certain information required by the periodic statement. The final rule also

[182] Reference in parts VII, VIII, and IX to "servicers" with regard to the final rule for the periodic statements, means creditors, assignees, and servicers.

provides exemptions for small servicers, reverse mortgages, and timeshares. The periodic statement disclosure would be provided to all consumers with a closed-end residential mortgage, unless one of the exemptions applies.

Potential 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 comply with the final rule.[183] The Bureau assumes that servicers currently provide consumers with basic billing information since servicers have an incentive to keep collection costs low. This information likely includes the amount due, the payment due date, and the amount of any late payment fee; and it may also include information that would tend to prompt the consumer to contact the servicer if it were missing, like the current interest rate and perhaps the amount of the payment going into escrow (if any). Because such information is currently being provided, its presence on the periodic statement required by final § 1026.41 likely provides no benefits or costs relative to the baseline. The benefits to consumers of these disclosures are discussed further in part V.

There is other information that typically 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. 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 consumer makes an extra payment, provides a partial payment, or misses a payment entirely.

All of the aforementioned information appears on the periodic statement required by final § 1026.41. However, on the periodic statement, the information would be accurate even if the

[183] The Bureau did receive one comment from an industry association stating that less than 10% of the members in one of its working groups regularly use coupon books as a billing method.

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 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. 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 separately to them) providing specific information about the delinquency of their loan. This is one way the servicer may catch the attention of the consumer.

Accurate information about past due charges and how fees and charges accumulate over time is especially useful to distressed or delinquent 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. For example, a consumer with past due amounts on a mortgage, a car, and a credit card would need information about the past due amounts and how the fees and charges accumulate in order to determine whether a partial or full mortgage payment is the most advantageous way of reducing total debt. This information may also be inaccurate, and disclosing it on a periodic statement may facilitate the detection and correction of errors.

The final rule includes grouping requirements for the format of the periodic statement. The grouping requirements present the information on the periodic statement 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[184] include grouping together related concepts and figures because consumers are likely to find it easier to absorb and make sense of financial disclosure 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 exemptions to the periodic statement requirement. The first, provided by statute, is an exemption for consumers with fixed-rate mortgages who receive 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 than consumers with ARMs subject to the requirements to make additional payments, partial payments or miss a payment. Therefore, the Bureau cannot estimate the extent to which such consumers may be substantially worse off than consumers with ARMs subject to the requirements.

The Bureau also provides an exemption for small servicers. A small servicer is defined as a servicer who either both (i) services 5,000 or fewer mortgage loans and (ii) only services

[184] *See* Macro Report.

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; or who is a Housing Finance Agency, as defined in 24 CFR 266.5. Such small servicers will not have to provide the periodic statement but will have to provide a coupon book and make certain other information available to the consumer on request.

As discussed above and in the section-by-section analysis of § 1026.41(e)(4), the Bureau believes that servicers that meet both conditions generally provide consumers with ready access to the information on the periodic statement required by final § 1026.41, but possibly through other channels. Servicers who only service loans for which they or an affiliate is the owner or creditor face either a reduction in the value of an asset on their portfolios or the loss of an investment in the relationship with the consumer which was established by originating the loan 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 work to effectively provide their customers with ready access to comprehensive information about their payments, amounts due and other account information. Thus, the Bureau believes that the exemption produces at most a minimal reduction in benefits to the customers of small servicers.

Using a range of data sources, the Bureau roughly estimates that approximately 52 million consumers would receive the periodic statement disclosure (taking into account the small servicer exemption).[185] To illustrate the potential benefits of the periodic statements, suppose 10

[185] The Bureau estimates there are about 60 million closed-end mortgage loans (first and subordinate liens) and about 8 million will be exempt from the periodic statement requirement. For these estimates, the Bureau aggregated mortgage loan counts obtained or derived from the FHFA "Home Loan Performance" data described above, the Board's Flow of Funds Accounts of the United States (statistical release z.1), the data from the credit union Call

percent of these consumers save 15 minutes each year because the disclosure provides them with information about their loan or payments that is not provided by their current billing statements or coupon books (*e.g.*, a past payment breakdown). These consumers might, for example, have to spend 15 minutes contacting their servicer by phone or some other means to obtain the same information. This is a savings of 1.3 million hours per year, or about $22 million at the median wage of $17 per hour.

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. The Bureau received numerous comments pointing out particular pieces of information on the periodic statement that are available to consumers on other disclosures such as IRS Form 1098; the annual escrow statement (for consumer who use escrow accounts); State mandated notices regarding referral to foreclosure, cures, and loss mitigation; bankruptcy disclosures; and notices associated with the early intervention, continuity of contact and loss mitigation provisions in the Bureau's companion proposed rulemaking on mortgage servicing, the 2013 RESPA Servicing Final Rule. Individual comments regarding disclosures on the periodic statement that are duplicative of disclosures provided in other documents are presented and discussed in part V.

While consumers may not generally benefit from duplicative disclosures, the periodic statement consolidates key information related to their mortgages, including information about their payments and the implications of non-payment that is currently provided in different documents. Regardless of whether consumers should know which of the aforementioned documents provide the information they may need in a particular situation, and regardless of

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Report and the bank and thrift Call Report, the CoreLogic mortgage loan servicing data set, and the BBx data set from BlackBox Logic.

whether consumers should retain these documents and keep them readily available, a consolidated periodic statement benefits consumers who are poorly informed about where to find the information they may need or who did not retain the relevant documents. A consolidated disclosure also provides an overview of mortgage debt and payments that some consumers may find easier to understand and more informative about the financial condition of their households than a variety of separate documents. Overall, the Bureau believes that providing a single integrated document, in addition to a number of other communications that contain fragments of this information, can be more efficient for consumers.

Potential costs to consumers. The Bureau received comments claiming that the periodic statement generally, or particular disclosures in it, could produce negative consequences for consumers. One industry commenter stated that requiring content that may be irrelevant to the consumer could detract from the actual relevant content. An industry association commenter stated that the entire periodic statement may be unwanted and could cause consumers to overlook other important information that is provided to them on a periodic basis, such as annual escrow or private mortgage insurance notices or late notices. Another argued that the periodic statement should present only a snapshot of the consumer's account and that disclosing general policies of the servicer would confuse consumers. An industry commenter argued that requiring information about any loan modification the consumer received would be confusing.

The Bureau recognizes that consumers are heterogeneous, that some will benefit more than others from a new disclosure, and that some may even experience negative, unintended consequences. However, the Bureau believes that the consolidated periodic disclosure it developed and tested provides consumer benefits. As discussed above, servicers receive minimal consequential feedback from consumers about the quality of servicing disclosures. Thus, they

have little incentive to incur the costs of researching and discovering the information consumers want in a periodic disclosure. The Bureau did receive one comment from industry referring to its "consumer tested and appreciated" periodic statement and another arguing against including delinquency information in the periodic statement since, in the commenter's experience, this information was more effective in collection letters. The Bureau is aware of other efforts by certain servicers to improve their disclosures. However, this work does not appear to be widespread, and the Bureau received only a small number of comments about efforts to improve disclosures. In contrast, the Bureau worked closely with Macro to develop the model disclosures, conducted three rounds of consumer testing, and revised the disclosure based on the results of this testing. Based on this anecdotal evidence, the comment letters, and the Bureau's expertise in disclosure design and consumer behavior, the Bureau concludes that consumers in general will benefit from the periodic statement disclosure even if certain consumers may find the disclosure confusing.

Some or all of the costs attributable to the periodic statement provisions may be passed through to consumers. As explained below, the Bureau believes that the annual cost per consumer is small. 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 new periodic statement disclosure, however, the costs to be shifted are small and so consumers would see at most a small cost increase.

As discussed above, the Bureau is adopting grouping requirements for the periodic statement disclosure. 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 these costs are substantial. As discussed above, very few commenters described efforts to test and develop superior disclosures, and the Bureau is unaware of general efforts by servicers to develop a periodic statement that meets the requirements of the Dodd-Frank Act and provides the benefits to consumers of the prescribed model forms. In contrast, the Bureau worked closely with Macro to develop the model disclosures, conducted three rounds of consumer testing, and revised the disclosure based on the results of this testing.

Potential benefits to covered persons. Providing the content in the periodic statement 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 benefit to some extent when consumers detect errors quickly, and the information in the periodic statement may facilitate this. Servicers may also have reduced costs when they manage fewer partial payments and delinquencies and can resolve delinquencies sooner.

Potential costs to covered persons. The periodic statement disclosure requirements will result in certain compliance costs to non-exempt servicers. Regarding the scope of coverage, the Bureau believes that about 380 insured depositories and credit unions will not qualify for the small servicer exemption (and about 10,800 will qualify). The insured depositories and credit unions that do not qualify for the small servicer exemption service about 40.4 million loans (those that do qualify service about 5.7 million loans).

Using data sources described in the analysis of the small servicer exemption, the Bureau estimates that there are about 13.9 million closed-end mortgage loans serviced by non-depositories. However, the Bureau does not have the data necessary to accurately estimate the number of exempt non-depository servicers or the number of loans they service. The Bureau

believes that the number of loans serviced is a small percentage of this total given the financial advantages of servicing large numbers of loans.

Regarding costs, based on discussions with servicers and software vendors, the Bureau believes that, in general, servicers of all sizes will incur minimal one-time costs to learn about the final rule. They will generally use vendors for one-time software and IT upgrades and for producing the disclosure. The revised disclosure provides to consumers 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 believes that under existing vendor contracts, large and medium sized servicers may not be charged for the upgrades but will be charged for producing and then distributing *(i.e.*, mailing or electronically communicating) the disclosure. Vendors will likely pass along all of these costs to small servicers.[186] However, when most servicers simultaneously need an upgrade, the one-time cost is mitigated by the fact that the costs of a single vendor may be spread among a large number of servicers.

A particular challenge in estimating the cost of the periodic statement disclosure requirements comes from the lack of information on the extent to which servicers currently provide consumers with coupon books, billing statements, or periodic statements.[187] This makes

[186] In discussions of costs to covered persons, "small servicers" are servicers that meet the size standard for that business established by the Small Business Administration. Banks, thrifts and credit unions that service mortgage loans must have $175 million or less in assets and other servicers must have $7 million or less in average annual receipts.

[187] A further complication comes from the use of "combined" periodic statements. The Bureau received a number of comments on this topic. Combined periodic statements may contain information about mortgage loans and open-end loans along with information about savings and checking accounts. The timing of the periodic statement may limit the ability of servicers to combine all of this information in one disclosure. Servicers who currently send a

it impossible to quantify the impact of the rule and its cost. For example, servicers who do not currently provide billing statements to consumers with adjustable rate mortgages will have new production and distribution costs for servicing those loans. In contrast, servicers who already provide billing statements will have new production costs but not new distribution costs for servicing those loans. Servicers who provide coupon books to consumers with fixed rate mortgages may not have any new production or distribution costs for servicing those loans, depending on how frequently they revise their coupon books.[188]

The lack of information on these current servicing practices makes it impossible to determine the impact of the rule on the production and distribution of disclosures. Thus, it is not possible to accurately determine the cost of the rule to covered persons. However, the Bureau received a few comments that presented costs associated with the new periodic statement disclosure:[189]

- An industry association commenter stated that for larger credit unions, the mailing costs alone may exceed $500,000.00 per year. For smaller credit unions these costs would likely be upwards of $75,000 to $100,000 per year. The commenter also reported that one credit union servicing 5,500 mortgages stated it would incur an additional $70,000 in expenses to prepare and mail the periodic statement. Initial programming and development charges could be $65,000 to more than $100,000.

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billing statement in a combined disclosure may therefore incur additional distribution costs along with additional production costs. *See* the section-by-section analysis of § 1026.41(b) for a full discussion of the timing issue and comments.

[188] However, servicers who provide coupon books to consumers with fixed rate mortgages are required to provide a delinquency notice (*see* § 1026.41(e)(3)(iv)). Since servicers already provide some kind of delinquency notice, the costs attributable to the rule are most likely small.

[189] Other comments on the costs of providing the periodic statement disclosure are discussed in the section-by-section analysis.

- A credit union servicing 11,000 mortgage loans commented it would have up-front costs of $45,000 to $65,000 and monthly production and mailing costs of $6,800.
- A multi-bank financial holding company commented that its subsidiary banks would have costs of 72 cents per statement each month, so $172,800 annually.
- A non-depository financial services company servicing 4,000 loans commented it would incur an initial cost of over $5,000 and ongoing costs of $40,000.
- An industry association commenter stated that a large credit union in North Carolina reported annual costs of $500,000 if it cannot use a combined statement; smaller credit unions reported $10,000 to $25,000 additional annual costs.

From these five comments, the Bureau can derive the following four estimates of annual costs per loan (assuming 12 disclosures per year) and three estimates of one-time costs per loan:[190]

Annual costs: $7.42, $8.64, $10.00, $12.73.

One-time costs: $1.25, $5.25, $18.18.

Regarding the annual costs, the commenters do not provide enough detail for the Bureau to know if they are accurately computing the cost of the periodic statement requirement relative to the proper baseline. For example, if commenters currently produce and mail a billing statement, then they should deduct the current production and mailing costs from those they expect to incur from the rule. For both one-time and annual costs, the Bureau would need to know whether these servicers are using vendors and (if so) the contract terms with those vendors to know if the commenters are accurately computing the cost of the rule.

[190] When a range of costs is reported, these estimates use the higher figure.

Setting aside these issues, however, the Bureau notes that the median of the total annual costs reported by the commenters (assuming a five-year amortization) is $10.25 per loan. Thus, for loans that refinance every five years, the periodic statement requirement would add about $50 to the cost of the loan. The Bureau notes that this amount could be recovered at origination with a minor fee or through a very small increase in the cost of credit to consumers. However, the Bureau believes that this figure sharply overstates the cost of the periodic statement requirement relative to the proper baseline. Many of these consumers already receive billing statements, so there would not be any additional distribution costs from the disclosure, and a cost currently incurred is not properly attributed to the rule.

Finally, the Small Business Review Panel stated that a periodic statement requirement would impose significant burdens on small servicers.[191] The panel explained that while much of the information in the 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 would be difficult for small servicers. The Small Entity Representatives 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 believed 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 would be unable to gain cost efficiencies and could not 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

[191] As in the previous discussions of costs in part VII, "small servicer" means servicers that meet the Small Business Administration size standard.

extent that small servicers currently use alternative information methods (such as coupon books for adjustable-rate mortgages, or passbooks).

The Bureau believes that the small servicer exemption in § 1026.41(e)(4) covers essentially all small insured depositories and credit unions. The Bureau has only a rough estimate of the number of small non-depository servicers covered by the exemption, but the estimate supports the view that vast majority would be exempt. Further discussion of the impact of the rule on small business is discussed in part VIII below.

The Bureau is mitigating the burden of the periodic statement requirement relative to the statute by including exemptions and relaxing certain provisions. In addition to the reverse mortgage exemption, the Bureau has expanded the small servicer exemption both by increasing the loan threshold from the proposed 1,000 loans to 5,000 loans, and by including Housing Finance Agencies in the small servicer exemption. Further, the Bureau has made modifications to the statutorily required information that must be disclosed on the periodic statement, including requiring the *existence* of any prepayment penalty (in place of the *amount*), and by requiring website information on housing counselors (in place of a list of specific housing counselors).

G. Potential Specific Impacts of the Final Rule

1. Depository Institutions and Credit Unions with $10 Billion or Less in Total Assets, As Described in Dodd-Frank Act § 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, and taking into account the expanded small servicer exemption from the periodic statement requirement, the Bureau believes that larger depositories and credit unions will incur only minimal costs from this rulemaking. The following analysis focuses on depository institutions and credit unions with

total assets between $175 million and $10 billion; the impact of the rule on depository institutions and credit unions with less than $175 million in total assets is discussed above and in the Final Regulatory Flexibility Analysis.

The initial interest rate adjustment notice is a new disclosure. The Bureau believes that depository institutions and credit unions with total assets between $175 million and $10 billion 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 percent 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 depository institutions and credit unions with total assets between $175 million and $10 billion from the revised § 1026.20(c) disclosure will also be minimal. The Bureau expects that the information collection and data processing costs will largely be absorbed by third-party vendors. The mailing costs of the revised § 1026.20(c) will be the same as the mailing costs of the current disclosure.

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 provisions for prompt crediting of payments and response to requests for payoff amounts.

Thus, most of the impact of the final rule on depository institutions and credit unions with total assets between $175 million and $10 billion comes from the periodic statement disclosure. The Bureau believes that a significant number of these institutions will qualify for the small servicer exception adopted in the final rule. Using FHFA and Call Report data, the Bureau

estimates that 92% of institutions in this range and all but one of those with assets of $175 million and below will qualify for the exception.

For those institutions with total assets between $175 million and $10 billion that do not qualify for the exception, the Bureau expects that the information collection and data processing costs will largely be absorbed by third-party vendors. Thus, the main cost factor for these institutions is the mailing (or more generally, the distribution) costs. For the reasons discussed above, the Bureau cannot accurately estimate this cost. It is reasonable to suppose, however, that there would be no new distribution costs associated with fixed rate mortgages that currently receive billing statements. There may also be no new distribution costs associated with fixed rate mortgages that currently receive coupon books; however, servicers who provide these consumers with coupon books that do not comply with the new rule would need to provide them with revised coupon books that do comply with the new rule. Similarly, it is reasonable to suppose that there would be no new distribution costs associated with adjustable rate mortgages that currently receive billing statements. There would, however, be new mailing costs for adjustable-rate mortgages that currently receive coupon books.

2. Impact of the Provisions on Consumer Access to Credit and Consumers in Rural Areas

The consideration of the cost of each provision of the final rule above found that these costs were extremely small for the § 1026.20(c) disclosure, the new initial interest rate adjustment notice, and the prompt crediting requirement. Thus, these provisions will have no significant impact on consumer access to credit. The Bureau cannot accurately estimate the cost of the periodic statement requirement, and there is a substantial difference between the Bureau's rough estimate of this cost and the higher cost figures submitted in comments. However, even

the higher cost figures should not materially reduce consumer access to credit given that such costs may be recovered at origination through a relatively minor fee.

Consumers in rural areas may experience impacts from the final 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 local banks and credit unions that service 5,000 loans or fewer and only service loans which they originated or own. For reason discussed above, these servicers likely already provide many of the benefits to consumers that the final rule is designed to provide. These servicers will benefit from the exemption to the periodic statement requirement in the final rule by not incurring the costs associated with modifying an existing disclosure or creating a new disclosure to comply with this requirement. Borrowers in turn may benefit, either as mortgagees or as customers at these insured depositories and credit unions, through continued access to a lending and servicing model they prefer.

VIII. Regulatory Flexibility Act

The Regulatory Flexibility Act (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.[192] The Bureau also is subject to certain additional procedures under the RFA involving the

[192] For purposes of assessing the impacts of the final rule on small entities, "small entities" is defined in the RFA to include small businesses, small not-for-profit organizations, and small government jurisdictions. 5 U.S.C. 601(6). A "small business" is determined by application of Small Business Administration regulations and reference to the North American Industry Classification System (NAICS) classifications and size standards. 5 U.S.C. 601(3). A "small organization" is any "not-for-profit enterprise which is independently owned and operated and is not dominant in its field." 5 U.S.C. 601(4). A "small governmental jurisdiction" is the government of a city, county, town, township, village, school district, or special district with a population of less than 50,000. 5 U.S.C. 601(5).

convening of panel to consult with small business representatives prior to proposing a rule for which an IFRA is required.[193]

An entity is considered "small" if it has $175 million or less in assets for the banks, and $7 million or less in revenue for non-bank mortgage lenders, mortgage brokers, and mortgage servicers.[194] The Bureau did not certify that the proposed rule would not have a significant economic impact on a substantial number of small entities. Thus, the Bureau convened a Small Business Review Panel to obtain advice and recommendations of representatives of the regulated small entities. The 2012 TILA Servicing Proposal preamble included detailed information on the Small Business Review Panel.[195] The Panel's advice and recommendations are found in the Small Business Review Panel Report;[196] several of these recommendations were incorporated into the proposed rule. The 2012 TILA Servicing Proposal also included a discussion of each of the panel's recommendations in the section-by-section analysis of each section.

The 2012 TILA Servicing Proposal contained an Initial Regulatory Flexibility Analysis (IRFA),[197] pursuant to section 603 of the RFA. In this IRFA the Bureau solicited comment on whether the burden imposed on small entities by the initial interest rate adjustment disclosure outweighed the consumer protection benefits it would afford as well as whether the proposed rule would have any impact on the cost of credit for small entities. Comments addressing the initial rate adjustment disclosure are addressed in the section-by-section analysis above. Comments addressing the impact on the cost of credit are discussed below. Elsewhere in the proposal, the Bureau sought comment on the small servicer exemption, specifically if "small

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[193] 5 U.S.C. 609.
[194] The current SBA size standards are found on SBA's website at http://www.sba.gov/content/table-small-business-size-standards.
[195] 77 FR 57318, 57376-77 (Sept. 17, 2012).
[196] *See* Small Business Review Panel Report.
[197] 77 FR 57318, 57376-83 (Sept. 17, 2012).

servicer" was properly defined, and if the small servicer exemption should be extended to other provisions of the proposed rules. These comments are addressed in the section-by-section analysis of each provision.

Based on the comments received, and for the reasons stated below, the Bureau is not certifying that the final rule will not have a significant economic impact on a substantial number of small entities. Accordingly, the Bureau has prepared the following final regulatory flexibility analysis pursuant to section 604 of the RFA.

1. A Statement of the Need For, and Objectives of, the Rule

The Bureau is publishing final rules to establish new regulatory protections for consumers relating to mortgage servicing. The final rule amends Regulation Z to implement amendments to TILA that were added by sections 1418, 1420, and 1464 of the Dodd-Frank Act. Congress included sections 1418, 1420, and 1464 in the Dodd-Frank Act to address consumer harms relating to mortgage servicing.

The overall objective of the disclosure requirements and the payoff statement provision is to ensure that consumers can obtain basic, accurate information about their mortgage loan obligations in a timely manner. The amendments to Regulation Z are, among other things, intended to protect consumers by ensuring that a consumer receives disclosures in advance of an interest rate adjustment with sufficient time to explore options available to the consumer, if necessary, to avoid payment shock. The Bureau also proposes to revise the content and timeframe of the Regulation Z § 1026.20(c) disclosure for interest rate adjustments that result in an accompanying payment change, from the current between 25 and 120 days before the first payment at a new level is due, to between 60 and 120 days before the first payment at a new level is due.

Further the amendments are intended to ensure that a consumer receives a monthly mortgage statement that discloses the current status of the consumer's mortgage loan obligation. The required 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 transactions to aid in error detection and resolution, and providing information to distressed or delinquent consumers.

Finally, the amendments are intended to protect consumers by imposing requirements clarifying the crediting of consumer mortgage loan payments and by requiring a servicer to provide a consumer with a payoff statement within a reasonable timeframe. The objective of the prompt crediting requirement is to ensure that consumers benefit from every effort that they make to pay their mortgage debt. The final rule clarifies the meaning of "payment" for purposes of the crediting requirement but does not require immediate crediting of partial payments.

2. Summary of Significant Issues Raised by Comments in Response to the Initial Regulatory Flexibility Analysis

In accordance with section 3(a) of the RFA, the Bureau prepared an IRFA. In the IFRA, the Bureau estimated the possible compliance costs for small entities from each major component of the rule against a pre-statute baseline.[198] The Bureau requested comments on the IRFA. An industry association submitted a comment letter that referred in passing to the Regulatory Flexibility Analysis. It did, however, raise three significant issues regarding the impact of the proposed rule on small servicers. First, the commenter stated that it would not be effective public policy to require servicers smaller than those in the top-50 to incur the costs of

[198] *See* part VII.B. for an explanation of pre-statute baseline.

complying with the proposed rule. The commenter observed that the top-50 servicers service 80 percent of outstanding mortgage loans and compliance with the rule would impose significant costs on the well over 12,000 servicers that service the remaining 20 percent. The commenter states that small servicers' costs are disproportionate to their share of the market. Second, the commenter states that neither the proposed Dodd-Frank Act section 1022 analysis nor the IRFA adequately identifies the types of costs or the amount of those costs that bank servicers will incur as a result of the servicing rulemakings. Third, the commenter states that given the servicing performance of community banks and the incentives that drive their high level of customer service, there is no demonstrated need to apply to small servicers those elements of the proposal that are not required by the Dodd-Frank Act.[199]

The Bureau has carefully considered these comments and responds as follows. First, while the Bureau agrees that it should be aware of imposing a disproportionate share of compliance costs on a particular segment of a market, it believes that doing so may be necessary under certain circumstances. The consequences of compliance costs for covered persons depend on the size of these costs relative to other costs and the ability of covered persons to absorb or shift these costs. The consequences for consumers depend on these factors as well as the improvements in products and services from compliance by servicers. These consequences are not summarized by the share of aggregate costs imposed on a particular segment. The Bureau also notes that the fact that a large number of small servicers will require new and revised

[199] The commenter does not define small servicer, but the commenter does request that the Bureau increase the loan threshold in § 1026.41(e)(4) to 10,000. The Bureau notes that about 200 insured depositories and credit unions service over 10,000 loans and others service some loans for others.

disclosures means that each vendor will likely spread the one-time costs of developing and validating disclosures over a large number of servicers.[200]

Second, the proposed Dodd-Frank Act section 1022 analysis and IRFA both briefly described the one-time and ongoing costs that bank servicers would incur as part of the servicing rulemaking. Both also provided limited quantification of the costs attributable to the rule, from a pre-statutory baseline, in light of the limited amount of data that was reasonably available. As discussed in the final Dodd-Frank Act section 1022 analysis, the Bureau does not believe that the changes required of servicers in this rulemaking would impose the types of costs that the commenter describes.[201]

Finally, the Bureau notes that it has offered good reasons for requiring all servicers to provide the revised § 1026.20(c) disclosure. The additional content, clear formatting and earlier disclosure will benefit consumers who need to refinance or move. The Bureau also notes that applying the modified § 1026.20(c) disclosure to only certain servicers may create confusion as the servicers not covered by the new rule would still be required to provide the existing notices on the existing timeframe; having servicers send very similar notices on different timeframes may be confusing for the marketplace.

The Bureau received numerous comments describing in general terms the impact of the proposed rule on small servicers and the need for exemptions for small servicers from various provisions of the proposed rule. These comments, and the Bureau's responses, are discussed in the section-by-section analysis, element 5 of this FRFA (regarding the small servicer exception to the periodic statement requirement) and element 6-1 of this FRFA.

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[200] This point was made in the proposed Dodd-Frank Act section 1022 analysis, s*ee* 77 FR 57318, 57369 (Sept. 17, 2012), and is discussed further in the final Dodd-Frank section 1022 analysis.

[201] *See* part VII.B and the consideration of costs to covered persons from the revised § 1026.20(c) notice in part VII.D.1.

3. Response to the Small Business Administration Office of Advocacy Comment

The Small Business Administration Office of Advocacy (Advocacy) provided a formal comment letter to the Bureau in response to the proposed rules on mortgage servicing. Among other things, this letter expressed concern about the following issues: inadequate notice of the proposed rules, small servicer exemptions, and the effective date of the regulation.

First, Advocacy expressed concern that small entities did not have adequate notice of the proposed rules, because although the proposed rules were posted on the Bureau website on August 10, 2012 with comments due 60 days later, the rules were not published in the **Federal Register** until September 17, 2012. Advocacy was concerned that small entities that relied on the **Federal Register** for notice of proposed rules would not have sufficient time to prepare comments in response to the proposed rule.

The Bureau believes that small entities were given adequate notice and a full opportunity to comment on the proposed rule. The rules were press released and published on the Bureau's website a full 60 days before the close of the comment period.[202] The Bureau engaged in industry outreach, including a publicity campaign around the Regulation Room project encouraging and facilitating public participation in the rulemaking process.[203] Further, the Bureau believes that, in light of the recent attention on the industry, including the National Mortgage Settlement and market changes, small entities would be aware that the Dodd Frank Act mandated changes to the servicing industry and proposed rules would be forthcoming; particularly given that trade associations have taken an active role in the rulemaking. The Bureau believes such trade associations have helped to inform small entities of the proposed

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[202] *See* CFPB Press Release on Servicing Proposal.

[203] *See e.g.*, Nat'l Ass'n of Fed. Credit Unions, *CFPB Proposes Mortgage Servicing Rule Changes* (Aug. 12, 2012) ("NAFCU Compliance Blog"), *available at* http://www.nafcu.org/News/2012_News/August/CFPB_proposes_mortgage_servicing_rule_changes/.

rulemaking.[204] In light of all this, the Bureau believes that small entities were given adequate notice of the proposed rules, as evidenced by the large number of small entities who submitted formal comments.

Second, Advocacy encouraged the Bureau to use its exception authority to exempt small servicers from as much of the proposed rule as possible, including specific requests for exemptions from the ARM disclosure and periodic statement provisions. The Advocacy letter expressed concerns that the new § 1026.20(d) initial interest rate adjustment notice would be confusing to consumers because the rate could change during the six month period between when the estimate was provided and when the rate actually changes, such that this would not provide meaningful notice to the consumer. Additionally, Advocacy encouraged the Bureau to exempt small entities from the rate change notification for non-hybrid ARMs because the changes are not required by the statute. Finally, Advocacy encouraged the Bureau to exempt all small entities from the periodic statement requirements.

The Bureau carefully considered a small servicer exemption in light of each of the proposed rules, and a complete discussion of the consideration of a small servicer exemption is found in the respective section of the section-by-section analysis. The Bureau believes the earlier notification of the initial rate change will help to ensure a consumer who would have difficulty making payments at the adjusted rate has sufficient time to pursue the alternatives suggested in the notification. As discussed above, the Bureau believes benefits of the earlier timeframe outweigh the potential confusion the estimate may cause. Further, the Bureau believes that, because both hybrid and non-hybrid ARMs are subject to the same risk of payment shock, it is appropriate to expand the scope of the rule to include non-hybrid ARMs, as

[204] *See e.g.,* NAFCU Compliance Blog.

contemplated by the savings clause in TILA section 128A(c). Finally, the Bureau is finalizing the proposed small servicer exemption for the periodic statement requirement, with an expanded threshold (5,000 loans). For the reasons discussed above in the section-by-section analysis, the Bureau believes this is the appropriate scope of the small servicer exemption.

Third, Advocacy encouraged the Bureau to provide Small Entity Representatives with a sufficient amount of time for them to comply with the requirements of the proposal, and expressed this could take 18-24 months. A complete discussion of the effective date is found in part VI above. While the Bureau understands the new rules will take time to implement, the Bureau also believes that consumers should have the benefit of the additional protections as soon as practical. In light of the comments received, the Bureau believes that 12 months is an appropriate implementation period. This time period is consistent with (1) the period requested by the vast majority of comments, (2) outreach conducted by the Bureau with vendors and systems providers regarding timeframes for updating core systems, and (3) the implementation period for other requirements imposed by the Dodd-Frank Act or regulations issued by the Bureau that may also impact creditors, assignees, and servicers. Further, the Bureau believes that an approximately 12 month implementation period appropriately balances the needs of industry to adjust operations to implement the Final Servicing Rules with the goal of providing consumers the benefit of the protections implemented by the Final Servicing Rules.

4. A Description of and An Estimate of the Number of Small Entities to which the Rule Will Apply

As discussed in the Small Business Review Panel 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.[205] A "small business" is determined by application of SBA regulations and reference to the North American Industry Classification System (NAICS) classifications and size standards.[206] Under such standards, insured depositories and credit unions 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.[207]

During the Small Business Review 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[208] (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.

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[205] 5 U.S.C. 601(6).
[206] *See* SBA Size Standards.
[207] *See* SBA Size Standards.
[208] Savings institutions include thrifts, savings banks, mutual banks, and similar institutions.

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.

The following table provides the Bureau's estimate of the number and types of entities to which the rule will apply:

Table 1: Estimated number of affected entities and small entities by NAICS code and engagement in closed-end mortgage loan servicing

Category	NAICS	Total entites	Small entities	Entities engaged in mortgage loan servicing	Small entities engaged in mortgage loan servicing
Commercial banks & savings institutions	522110, 522120	7,081	3,779	6,975	3,714
Credit unions	522130	7,040	6,079	4,889	3,951
Real estate credit	522292	5,791	5,152	1,388	800
Other activities related to credit intermediation (includes loan servicing)	522390	5,494	5,319		

For commercial banks, savings institutions, and credit unions, the number of entities and asset sizes were obtained from December 2011 Call Report data as compiled by SNL Financial.[209] 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 Licensing System and Registry (NMLS) and is current as of Q1 2011. The total equals the number of non-depositories

[209] The Bureau has updated these figures from the Initial Regulatory Flexibility Analysis, which used December 2010 Call Report data as compiled by SNL Financial.

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.

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. The Bureau has not been able to separately estimate the number of non-profits and small non-profits engaged in mortgage loan servicing. These non-profits may list loan servicing income on the IRS Form 990 Statement of Revenue, but it is not possible to search public databases on non-profit entities according to what they list on the Statement of Revenue.

The Bureau is exempting servicers that service 5,000 mortgage loans or less, all of which the servicer or an affiliate owns or originated, from the new periodic statement disclosure requirements in § 1026.41. The Bureau estimates that all but one insured depository or credit union that meets the SBA asset threshold will qualify for the exemption. The Bureau's methodology for this estimate is straightforward in the case of credit unions. The credit union Call Report presents the number of mortgages held in credit union portfolios and the amount of assets. The Bureau could readily determine which credit union small servicers (as defined by the SBA asset threshold) serviced 5,000 mortgage loans or less. In contrast, the bank and thrift Call Report does not present the number of mortgages, only the aggregate unpaid principal balance, and the amount of assets. The Bureau developed estimates of the average unpaid principal

balance at banks and thrifts of different sizes and use this with the information on aggregate unpaid principal balance to derive loan counts at each bank and thrift.[210] The Bureau could then determine which bank and thrift small servicers (as defined by the SBA asset threshold) serviced 5,000 mortgage loans or less.

It is not possible to observe whether the loans that servicers are servicing for others were originated by those servicers. However, the Bureau believes that all insured depositories and credit unions that meet both the SBA asset threshold and the loan count threshold likely qualify for the exception. In principle, these entities may not qualify for the exception because they do not meet the other conditions of the exception, *i.e.*, they service loans that they did not originate and do not own. The Bureau believes that this is extremely unlikely, however. First, most entities servicing loans they did not originate and do not own most likely view servicing as a stand-alone line of business. In this case they would most likely choose to service substantially more than 5,000 loans in order to obtain a profitable return on their investment in servicing. Additionally, the Bureau believes it is highly unlikely that insured depositories and credit unions with $175 million in assets or less choose to make this investment, preferring to use their assets to support other activities. Taking both factors into account, the Bureau believes that essentially all insured depositories and credit unions that meet the SBA threshold and the loan count condition qualify for the exception.

[210] For banks and thrifts with under $10 billion in assets, the Bureau calculated the average unpaid principal balance of portfolio mortgages by State for credit unions with less than $1 billion in assets and applied the State specific figures to these banks and thrifts. For banks and thrifts with over $10 billion in assets, the Bureau relied on the OCC Mortgage Metrics Report, which showed an average unpaid principal balance estimate of $175,000. For securitized loans, the Bureau relied on the FHFA's Home Loan Performance database, which provides data by size of securitized loan book; this yielded average unpaid principal balances ranging from $141,000 to $189,000.

The Bureau does not have the data necessary to accurately estimate the number of small entity non-depositories that would be covered by the exemption.[211] To obtain a rough estimate, the Bureau notes that $7 million in servicing revenue would be generated from an aggregate unpaid principal balance of $2 billion.[212] The Bureau estimates that all but 4 percent of insured depositories and credit unions servicing an aggregate unpaid principal balance of $2 billion or less service 5,000 loans or less. Assuming a similar relationship between servicing revenue and loan counts holds for non-depository servicers, at least for relatively small depository and non-depository servicers, all but 4 percent of non-depository servicers would service 5,000 loans or less. This estimate and the limited data available imply that 768 (all but 4 percent of 800, or 32) non-depository servicers would service 5,000 loans or less. The Bureau considers these figures to be the best available approximations to the number of non-depository servicers that would and would not qualify for the exemption.

5. Projected Reporting, Recordkeeping, and Other Compliance Requirements

The final rule does not impose new reporting or recordkeeping requirements. The final rule does, however, impose new compliance requirements on certain small entities. The

[211] In the proposed rule, the Bureau stated that it was working to gather data from the Nationwide Mortgage Licensing System and Registry (NMLS) that would be additional to the data used in Table 1. The Bureau considered that this additional data might allow the Bureau to refine its estimate of the number of small entity non-depositories that would be covered by the proposed periodic statement exemption in the proposed 2012 TILA Servicing Proposal. The Bureau did obtain additional data from the NMLS. This data, however, does not contain information directly about mortgage servicing revenue and mortgage loans serviced and it has limited information with which to derive these amounts. The Bureau has therefore not used this additional NMLS data to estimate the number of small entity non-depositories that would be covered by the exemption in this final rule. The Bureau also requested that commenters submit relevant data. All probative data submitted by commenters were discussed in this document.

[212] This calculation assumes the servicer receives 35 basis points on each dollar of unpaid principal balance. Typical annual servicing fees are 25 basis points for prime fixed-rate loans, 37.5 basis points for prime ARMs, 44 basis points for FHA loans, and 50 basis points for subprime loans ; *See* Larry Cordell *et al*., *The Incentives of Mortgage Servicers: Myths and Realities*, at 15 (Fed. Reserve Bd., Working Paper No. 2008-46, 2008). The conclusion of the analysis would be the same regardless of which figure is used.

requirements on small entities from each major component of the rule are presented below. The Bureau discusses impacts against a pre-statute baseline.

Compliance requirements. As discussed in detail in the section-by-section analysis above, the final rule imposes new compliance requirements on servicers. The final rule requires initial interest rate adjustment notifications, revised subsequent interest rate adjustment notifications, new periodic statement disclosures, and certain changes to the prompt crediting and payoff balance provisions of Regulation Z. As discussed in the Dodd-Frank Act section 1022 analysis in part VII above, the Bureau believes that small servicers will incur one-time costs to learn about the final rule and will generally use vendors for one-time software and IT upgrades. Small servicers will also generally use vendors for producing and distributing *(i.e.*, mailing or electronically communicating) the disclosures. The Bureau believes that vendors will likely pass along all of these costs to small servicers. However, the one-time cost to each small servicer will be mitigated by the fact that the costs of a single vendor will be spread among a large number of servicers. The ongoing costs of the ARM disclosures to each small servicer will be mitigated by the relatively small number of ARMs that currently exist. The one-time and ongoing costs of the periodic statement disclosure will be mitigated by the exemption for smaller servicers (as defined in § 1026.41(e)(4)).

Section 1026.20(c) generally amends the timing and content requirement for ARMs to provide a disclosure prior to each interest rate adjustment that effects a change in payment. This change will likely impose a one-time cost on small entities to update their system to comply with this provision. The Bureau reduces the burden on small entities, among other ways, by providing model forms which can be used to ease compliance, by providing exemptions for loans with a term of one year or less, by requiring similar information to that in the § 1026.20(d) notice, and

by entirely eliminating the current annual disclosure that is required when over the course of a year, no interest rate adjustment causes a payment change.

Section 1026.20(d) generally requires a new disclosure for the initial interest rate adjustment of an adjustable-rate mortgage. 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 Small Entity Representative reported the changes could take two to four days of IT support; these would be one-time costs. The Bureau reduces the burden on small entities, among other ways, by providing model forms which can be used to ease compliance, ensuring similarities between this and the § 1026.20(c) notice, and by providing exemptions for loans with a term of one year or less.

Section 1026.36(c)(1) requires prompt crediting of periodic payments, and allows that partial payments may be held in suspense accounts subject to certain requirements. Compliance with this provision should impose minimal additional costs as prompt crediting of payments is already required by existing Regulation Z. Although many small entities reported they do not use suspense accounts, small servicers who do use suspense accounts may be required to update their systems to comply with this provision.

Section 1026.36(c)(3) requires payoff balances to be provided within seven business days unless exceptional circumstances apply. Compliance with this provision should impose no significant additional cost as this essentially codifies existing Regulation Z § 1026.36(c)(1)(iii) provisions on payoff statements, except that the current provision requires payoff statements to be provided within a reasonable time and creates a safe harbor for responses provided within five business days.

Section 1026.41 generally requires servicers to provide a periodic statement. Servicers may be required to update their systems to comply with this provision. The 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 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 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 consumers 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 Bureau reduces the burden on small entities, among other ways, by providing sample forms which can be used to ease compliance with the final rule, by providing a coupon book exemption for certain fixed-rate mortgages, and by providing a small servicer exemption for certain small entities.

The Small Entity Representatives who use vendors stated that they did not know what their vendors would charge to enable them to comply with the new periodic statement requirement. The Small Entity Representatives 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.

In accordance with Dodd-Frank Act section 1420, the final rule includes 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 exemption.

Many of the Small Entity Representatives reported that they provide consumers with coupon books for ARMs. However, there is no data with which to estimate the percentage of small servicer portfolio loans that are in fixed-rate mortgages. Based on anecdotal reports, the Bureau understands that many small servicer portfolio loans are adjustable-rate mortgages.

Finally, the rule includes a small servicer exemption. In the proposed rule, the Bureau provided an exemption from the periodic statement requirement for servicers that serviced 1,000 or fewer loans, all of which they either owned or had originated. The initial regulatory flexibility analysis provided a preliminary analysis of the exemption and stated that all but 13 small insured depositories and credit unions and 65 percent of small entity non-depositories would be covered by the exemption. As was explained in the section-by-section analysis of proposed paragraph 41(e)(4), this calculation was based on the assumption that the average unpaid principal balance on the 1,000 loans was $175,000.[213] Data from the bank and thrift Call Report on total unpaid principal balance of loans serviced by each bank or thrift then allowed the Bureau to estimate the number of small insured depositories and credit unions that would be covered by the exemption. The Bureau solicited comment on all aspects of the proposed exemption and asked interested parties to provide information relating to the exemption.

Comments received. The Bureau received a number of comments from banks and thrifts regarding the average unpaid principal balance of loans they originate or service. One industry commenter stated that the average size of loans it serviced was about $55,000 and that the average mortgage in the State of Oklahoma was about $106,000. Another stated that the average size of loans in its portfolio was less than half the Bureau's figure and that at origination it would

[213]This is the average unpaid principal balance for first-lien residential mortgages at the largest national banks, which at the time of the report accounted for 63 percent of all outstanding mortgages; *See* OCC Mortgage Metrics Report.

lend only about $120,000 on the median-valued house in the zip code of its main office. Another stated that it serviced 1,800 loans with an average loan size of just under $70,000, and that the proposed threshold penalizes banks that specialize in moderately-priced homes.[214]

In response to these comments, the Bureau performed additional analysis of Call Report data from banks, thrifts and credit unions. In particular, careful examination of loan count information from the credit union Call Report allowed the Bureau to improve its estimate of the likely average unpaid principal balance of loans serviced by banks that meet the SBA threshold for a small servicer. The Bureau has concluded that the likely average unpaid principal balance of loans serviced by insured depositories and credit unions that meet the SBA threshold is closer to $70,000.[215] The Bureau also concludes that about 100 servicers meeting the threshold likely service more than 1,000 loans.

On the basis of this additional analysis, the final rule increases the loan count threshold for the exemption from 1,000 loans to 5,000 loans. The Bureau's estimate of the number of small bank and small non-bank mortgage servicers that will be exempt under the new threshold were presented in element 4 of this FRFA, above.

Estimate of the classes of small entities which will be subject to the requirement. 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,

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[214] On the other hand, one industry commenter reported holding 2,555 loans totaling $440 million, so approximately $172,000 per loan. The Bureau notes that only one of these four commenters meets the Small Business Association threshold for a small servicer.

[215] Credit Unions report the number and aggregate balance of mortgages held in portfolio on their Call Report. From these reports the Bureau calculated the average unpaid principal balance of portfolio mortgages by State for credit unions with less than $1 billion in assets and applied the State specific figures to banks and thrifts under $10 billion in assets. For securitized loans the Bureau derived the average unpaid principal balance based upon the size of the securitized loan book using the FHFA's Home Loan Performance database, which yielded balances ranging from $141,000 to $189,000.

recordkeeping, and compliance requirements of the proposed rule are the same classes of small entities that are identified above in part VIII.B.4.

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 small entities that will be affected by the rule will require continued performance of the basic functions that they perform today: generating disclosure forms, crediting partial payments from consumers either immediately or when they constitute a full payment, and responding to requests for payoff statements.

6-1. Description of the Steps the Agency Has Taken to Minimize the Significant Economic Impact on Small Entities

The Bureau understands the new provisions will impose a cost on small entities, and has attempted to mitigate the burden wherever it can be done without unduly diminishing consumer protection. The section-by-section analysis of each provision contains a complete discussion of the following steps taken to minimize the burden.

Regulation Z § 1026.20(c) Disclosure for Adjustable-Rate Mortgages

The Bureau is making changes to the existing § 1026.20(c) disclosure for ARMs. The Bureau has attempted to mitigate the burden of the changes to the § 1026.20(c) notice by modifying the final rule from the proposed requirements on prepayment penalties and housing counselors, and by increasing the flexibility in the model forms, for the same reasons discussed in the discussion of § 1026.20(d) immediately below. Additionally, the Bureau is mitigating the burden by including exemptions in the § 1026.20(c) rule for loans with terms of one year or less.

Finally, the Bureau is eliminating the annual § 1026.20(c) notice for interest rate adjustments that do not cause changes in payment. The Bureau considered but decided not to exempt small servicers, as they are currently providing this disclosure.

Regulation Z § 1026.20(d) New Initial Interest Rate Adjustment Notice for Adjustable-Rate Mortgages

Dodd-Frank Act section 1418 requires servicers to provide a new disclosure to consumers who have hybrid ARMs regarding the initial interest rate adjustment. The Bureau requires the initial interest rate adjustment notice for hybrid (1/3, 1/5, etc.) as well as ARMs that are not hybrid (1/1, 3/3, 5/5, etc.). The Bureau has attempted to mitigate the burden of the notice by modifying the final rule from the proposed requirements on prepayment penalties and housing counselors, and by increasing the flexibility in the model forms.

First, due to the nature of prepayment penalties, disclosing the amount of a prepayment penalty is significantly more burdensome than disclosing the existence of a prepayment penalty and the date it expires. Only certain consumers are interested in the amount of the prepayment penalty; such consumers can obtain this information by contacting their servicer. Thus, the final rule requires only the existence of a prepayment penalty (as well as the expiration date, and servicer contact information) in place of the amount. Second, the Bureau is amending the final rule by removing the requirement to include contact information for the State housing authority for the State where the consumer resides (as required by the proposal), or the even more burdensome requirement of providing a list of individual counselors (as required by the statute). Instead the Bureau is requiring disclosure of: (1) the HUD or Bureau website on homeownership counselors and counseling agencies, (2) the HUD toll free telephone number for the HUD list of homeownership counselors and counseling agencies, and (3) the Bureau website for locating

State housing finance authorities. Third, as discussed in the section-by-section analysis of the initial interest rate adjustment disclosure, the Bureau has included commentary highlighting the flexibility of the model forms to allow for other types of products and consumer situations. The Bureau believes these changes reduce the burden on small servicers, without greatly diminishing the consumer protection provided by this rule. Finally, the Bureau has drafted the initial ARM interest rate adjustment notice to parallel the ongoing § 1026.20(c) ARM disclosures to further reduce the implementation and compliance burden.

Additionally, the Bureau considered but decided not to adopt certain alternatives, including the following: eliminating the notice altogether, eliminating the estimate from the notice, exempting small servicers from the notice, and limiting the notice to only hybrid ARMs (rather than all ARMs). The Bureau reached this decision based on the following considerations. First, the Bureau believes the statutorily-required good-faith estimate provides important information to consumers; the Bureau believes the value of this information outweighs the potential risk of confusion. Second, the Bureau has decided it would not be appropriate to exempt small servicers from the § 1026.20(d) notice. As discussed above in the section-by-section analysis of § 1026.20(d), an exception would deprive certain consumers of advance notice seven to eight months before the first payment at a new level would be due. Without this advance notice, consumers may not have sufficient time to weigh their alternatives and pursue alternative actions. Finally, the Bureau believes it is appropriate to require the § 1026.20(d) notice for all ARMs. Both hybrid ARMs and those that are not hybrid may subject consumers to the same payment shock that the ARM disclosure was designed to address. Accordingly, the Bureau believes that the underlying rationale for the § 1026.20(d) notice is equally applicable to all ARMs, whether hybrid or non-hybrid, and should be extended to all ARMs.

Prompt Crediting and Request for Payoff Amounts

The rules on prompt crediting and payoff statements clarify the definition and crediting of payments, the handling of partial payments, the use of suspense accounts, and the time permitted for providing a payoff statement. Small servicers are generally already in compliance with these rules. For this reason, among others, the Bureau did not adopt a small servicer exemption.

The Bureau has attempted to mitigate the burden of the rules by including flexibility in the rule which allows, but does not mandate, suspense accounts and by including an exemption to the requirement to provide payoff statements within seven business days when circumstances make that timeline infeasible. First, the final rule allows, but does not require suspense accounts. This flexibility allows the variety of current business practices to continue. Servicers who currently use suspense accounts will not have to eliminate this practice. Likewise, servicers who currently credit or return partial payments will not have to incur the burden of establishing suspense accounts. Second, the Bureau included an exemption in the provision addressing payoff statements. This exemption allows payoff statements to be provided in a reasonable time when seven business days is not feasible because a loan is in bankruptcy or foreclosure, because the loan is a reverse mortgage or shared appreciation mortgage, or due to natural disasters or other similar circumstances. This exemption eases the burden of the provision addressing payoff statements. Finally, the Bureau considered but decided not to require prompt crediting of partial payments, and requiring application of an accumulated full payment in a suspense account to the oldest outstanding amount due. Instead, the final rule gives servicers the option of allowing partial payments to be sent to a suspense account. The Bureau believes this flexibility is less burdensome than requiring immediate application of partial payments.

Periodic Statements

Dodd-Frank Act section 1420 requires servicers to provide a new periodic statement to the consumer for each billing cycle. The rule would generally require the content listed in the statute, additional billing information, and payment application information. Thus, the statutory disclosure requirements would impose a smaller economic burden on small servicers than would the Bureau's regulatory disclosure requirements.

As discussed above in element four of this FRFA, the Bureau believes it has largely mitigated the burden of the periodic statement requirement on servicers that meet the size standards established by the SBA. For servicers who do not receive the benefit of this exemption, the Bureau has mitigated the burden by modifying the requirements on the disclosure of the prepayment penalty and the information on housing counselors, as discussed above. Additionally, the Bureau considered, but decided not to adopt the following alternatives: limiting the periodic statement disclosure to the DFA requirements, requiring the use of a specific form, limiting the small servicer exemption to servicers servicing 1,000 or fewer loans, and requiring alternative compliance for smaller servicers who have the advantage of the small servicer exemption.

6-2. Description of the Steps the Agency Has Taken to Minimize Any Additional 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.[216] To satisfy these statutory requirements, the Bureau provided notification to the Chief Counsel for Advocacy of the Small Business Administration on April 9, 2012 that the Bureau

[216] 5 U.S.C. 603(d).

would collect the advice and recommendations of the same Small Entity Representatives identified in consultation with the Chief Counsel through the Small Business Review 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. The Bureau sought to collect the advice and recommendations of the Small Entity Representatives during the Small Business Review Panel outreach meeting regarding these issues because, as small financial service providers, the Small Entity Representatives could provide valuable input on any such impact related to the proposed rule.

At the time the Bureau circulated the Small Business Review Panel materials to the Small Entity Representatives in advance of the Small Business Review 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.

At the Small Business Review Panel outreach meeting, the Bureau asked the Small Entity Representatives a series of questions regarding cost of business credit issues. The questions were focused on two areas. First, the Small Entity Representatives 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 Small

Entity Representatives 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 Small Entity Representatives' cost of credit.

The Small Entity Representatives 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 Small Entity Representative mentioned that at times people may use a home-secured loan to finance a business, which was corroborated by a different Small Entity Representative based on his personal experience with starting a business.

In the IRFA, the Bureau asked interested parties to provide data and other factual information regarding the use of personal home-secured credit to finance a business. The Bureau received only one comment on this issue. The commenter stated that more than 52 percent of the 27.9 million small businesses in the United States are home-based and close to 80 percent of small businesses file taxes as individuals. The commenter further stated that, according to the SBA, 73.2 percent of small businesses in the United States are sole proprietors. Thus, in some instances, an increase in the cost of consumer credit is also an increase in the cost of business credit.[217]

Regarding the impact of the rule on the cost of consumer credit, the Bureau does not believe that the frequency or content of the new initial rate adjustment notice or the changes in the frequency and content of the § 1026.20(c) disclosure create significant one-time costs or

[217] Email from Tom Sullivan, U.S. Chamber of Commerce, to Mitch Hochberg, U.S. Consumer Fin. Protection Bureau (Nov. 13, 2012) (ex-parte communication available at http://www.regulations.gov/#!documentDetail;D=CFPB-2012-0033-0183).

significant additional ongoing costs for servicers. The new initial rate adjustment disclosure is a one-time disclosure. The revised § 1026.20(c) disclosure will be given less frequently than the disclosures required by in current § 1026.20(c), much of the content of the revised disclosure is provided in the current disclosure, and the Bureau has worked to mitigate the cost of the additional content in the revised disclosure. Certain one-time and ongoing costs will likely be absorbed by vendors, as discussed above. The periodic statement disclosure is given much more frequently and the additional costs may be significantly larger than the additional costs for other disclosures. However, the Bureau is mitigating the cost of this disclosure with the exemption for almost all small servicers, as described above.

If vendors passed along all of the minimal costs associated with this rule to servicers, then the cost of servicing would rise by this amount. Servicers may attempt to collect this revenue by increasing penalties for missed payments or other charges outside of origination, in which case individuals who incur these charges may make much larger one-time payments than they do now. Over time, however, it is just as likely that servicers will seek to recover these costs at origination. All of the additional costs of servicing could be met by an origination fee or an increment to the cost of credit equal to the additional cost of servicing multiplied by the expected number of years the loan would be serviced. The Bureau believes that this cost would be minimal as well.

The impact of an increase in the cost of mortgage loan servicing on other forms of consumer credit that may be used to fund a business, and on business credit itself, would be even smaller. If a lender has made optimal (profit maximizing) decisions in one line of business, a change in the costs of another line of business would not disrupt or alter the optimal decisions in the first line of business absent some shared inputs or platforms (“economies of scope”) or other

important interdependencies that are not obvious in regards to consumer credit. This is especially clear if there is competition in the other line of business, in this case business credit lending, from firms that do not service mortgage loans and therefore did not experience a cost increase. Absent collusion, firms that did not experience an increase in the costs have the ability and the incentive to underprice any firm that attempts to pass along a cost increase.

In summary, the Bureau believes that the effect of the mortgage servicing rule on the cost of credit for small businesses is at most negligible. Furthermore, this cost is negligible whether the small business consumer is relying on a consumer mortgage loan, some other type of consumer credit, or a small business loan.

IX. Paperwork Reduction Act

The Bureau's information collection requirements contained in this rule, and identified as such, were 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). Notwithstanding any other provision of the law, 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 OMB control number for this collection is 3170-0028.

This rule amends 12 CFR part 1026 (Regulation Z). Regulation Z currently contains collections of information approved by OMB, and the Bureau's OMB control number for Regulation Z is 3170-00015. The collection title is: Truth in Lending Act (Regulation Z) 12 CFR 1026.

On September 17, 2012, notice of the proposed rule was published in the **Federal Register** (77 FR 57317). The Bureau invited comment on: (1) whether the proposed collection

of information is necessary for the proper performance of the Bureau's functions, including whether the information has practical utility; (2) the accuracy of the Bureau's estimate of the burden of the proposed information collection, including the cost of compliance; (3) ways to enhance the quality, utility, and clarity of the information to be collected; and (4) ways to minimize the burden of information collection on respondents, including through the use of automated collection techniques or other forms of information technology. The comment period for the burden analysis sections of the proposed rule expired on November 16, 2012. The Bureau did not receive any comments on the burden of the proposed information collection. However, the Bureau did receive comment on the more general consideration of certain costs in the proposed Dodd-Frank Act section 1022 analysis, this comment is addressed in the final Dodd-Frank Act section 1022 analysis above.

The title of this information collection is Mortgage Servicing Amendment (Regulation Z). The frequency of response is *on occasion*. The information collection required provides benefits for consumers and is 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 rule, the Bureau generally accounts 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 respondents), and certain non-depository servicers (the Bureau non-depository respondents). The Bureau and the Federal Trade Commission (FTC) generally both have enforcement authority over non-depository institutions

under Regulation Z. Accordingly, the Bureau has allocated to itself half of the total estimated burden from 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 changes to Regulation Z for the roughly 12,643 institutions, including Bureau respondents,[218] that are estimated to service consumer mortgages subject to the rule would be approximately 25,000 one-time burden hours and 65,000 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 making four changes to the information collection requirements in Regulation Z. First, amended § 1026.20(c) regarding adjustable-rate mortgages changes the format, content, and timing of the existing rate adjustment disclosures. The rule changes the minimum time for providing advance notice to consumers from 25 days to 60 days before the first payment at a new level is due when an interest rate adjustment causes a payment change. Servicers will be required to provide certain information that they may not currently disclose, but

[218] 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.

would no longer be required to notify consumers of a rate adjustment if the payment is unchanged. Second, as previously discussed, § 1026.20(d) regarding adjustable-rate mortgages requires creditors, assignees, or 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.

Third, § 1026.36 makes changes to the existing requirements on servicers to promptly credit payments that satisfy payment rules specified by a servicer. Amended § 1026.36 also makes changes to the existing requirements to provide an accurate payoff balance upon request. This modifies the timeline on the existing information collection of the requirement to provide accurate payoff statements.

Fourth, § 1026.41 requires 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 adjust, outstanding principal balance, etc.; and other information that may be helpful to troubled consumers. Certain small servicers (those servicing 5,000 mortgages or less and who own or originated all the loans they are servicing) are exempt from this requirement. Fixed-rate mortgages are exempt if the servicer provides the consumer with a coupon book that contains certain information, and makes other information available to the consumer.

B. Burden Analysis under the Four Information Collection Requirements[219]

1. Changes in the Regulation Z § 1026.20(c) Disclosure for Adjustable-Rate Mortgages.

All Bureau respondents will have a one-time burden under this requirement associated with reviewing the regulation. Certain Bureau respondents will 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 Bureau depository respondents and 1,050 hours and $58,000 for Bureau non-depository respondents. [220]

Regarding ongoing burden, the Bureau is requiring 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 § 1026.20(c) disclosure. The Bureau recognizes that there is content in the 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 considered a burden for purposes of PRA. The Bureau estimates the ongoing burden to be 1,250 hours for Bureau depository respondents and 180 hours and $22,000 for Bureau non-depository respondents.

2. New Initial Interest Rate Adjustment Notice for Adjustable-Rate Mortgages

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[219] Based on discussions with industry participants, 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 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.

[220] Dollar figures include estimated costs to vendors.

All Bureau respondents will have a one-time burden under this requirement associated with reviewing the regulation. Certain Bureau respondents will 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 Bureau depository respondents and 1,500 hours and $115,000 for Bureau non-depository respondents.

Certain Bureau respondents will have ongoing burden associated with the IT used in producing the disclosure. All Bureau respondents will have ongoing costs associated with distributing (*e.g.*, mailing) the disclosure. The Bureau estimates this ongoing burden to be 530 hours and $57,000 for Bureau depository respondents and 80 hours and $5,600 for Bureau non-depository respondents.

3. Prompt Crediting of Payments and Response to Requests for Payoff Amounts

All Bureau respondents will have a one-time burden under this requirement associated with reviewing the regulation. The Bureau estimates this one-time burden to be 110 hours for Bureau depository respondents and 1,375 hours for Bureau non-depository respondents.

Regarding ongoing burden, the Bureau understands that the payoff statement requirement amends the timeline of 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 Bureau depository respondents and 250 hours and $17,000 for Bureau non-depository respondents.

4. New Periodic Statements

All Bureau respondents that are not exempt will have a one-time burden under this requirement associated with reviewing the regulation. Certain Bureau respondents will have a one-time burden from creating software and IT capability to modify existing periodic disclosures or produce a new disclosure. The disclosure incorporates the usual and customarily provided 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 Bureau depository respondents and 800 hours for Bureau 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 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 periodic statement disclosure beyond what may be usual and customary to provide in existing billing statements. The Bureau estimates the ongoing burden to be 47,000 hours and $5,065,000 for Bureau depository respondents and 4,600 hours and $330,000 for Bureau non-depository respondents.

C. Summary of Burden Hours for Bureau Respondents

	Respondents	Disclosures Per Respondent	Hours burden per disclosure	Total burden hours	Total vendor costs
Ongoing:					
ARM 20(c) Notice	824	600	0.00290	1,000	22,000
ARM 20(d) Notice	824	300	0.00290	1,000	64,000
Periodic Statements	424	42,400	0.00286	52,000	5,397,000
Prompt Crediting & Payoff Statements	824	800	0.00290	2,000	195,000
One-Time:					
ARM 20(c) Notice	824	1	1.47524	1,000	58,000
ARM 20(d) Notice	824	1	2.00340	2,000	115,000
Periodic Statements	424	1	2.30357	1,000	0
Prompt Crediting & Payoff Statements	824	1	1.80340	1,000	115,000

Totals may not be exact due to rounding.

Between the proposed and final rule the Bureau improved its methodology for estimating the average unpaid principal balance of outstanding mortgages. In addition, the Bureau updated the institution counts from 2010 year-end to 2011 year-end figures.