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DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

24 CFR Part 203

[Docket No. FR 5360-P-01]
RIN 2502-AJ17]

Federal Housing Administration (FHA): Handling Prepayments: Eliminating Post-Payment Interest Charges

AGENCY: Office of the Assistant Secretary for Housing-Federal Housing Commissioner, HUD.

ACTION: Proposed rule.

SUMMARY: This rule proposes to revise FHA's regulations that allow an FHA-approved mortgagee to charge the mortgagor interest through the end of the month in which the mortgage is being paid. The proposed change would prohibit mortgagees from charging post-payment interest, allowing them instead to charge interest only through the date the mortgage is paid.

DATES: Comment Due Date: **[Insert date 60 days from the date of publication in the Federal Register]**.

ADDRESSES: Interested persons are invited to submit comments regarding this proposed rule to the Regulations Division, Office of General Counsel, Department of Housing and Urban Development, 451 7th Street, SW, Room 10276, Washington, DC 20410-0500.

Communications must refer to the above docket number and title. There are two methods for submitting public comments. All submissions must refer to the above docket number and title.

1. Submission of Comments by Mail. Comments may be submitted by mail to the Regulations Division, Office of General Counsel, Department of Housing and Urban Development, 451 7th Street, SW, Room 10276, Washington, DC 20410-0500.

2. Electronic Submission of Comments. Interested persons may submit comments electronically through the Federal eRulemaking Portal at www.regulations.gov. HUD strongly encourages commenters to submit comments electronically. Electronic submission of comments allows the commenter maximum time to prepare and submit a comment, ensures timely receipt by HUD, and enables HUD to make them immediately available to the public. Comments submitted electronically through the www.regulations.gov website can be viewed by other commenters and interested members of the public. Commenters should follow the instructions provided on that site to submit comments electronically.

Note: To receive consideration as public comments, comments must be submitted through one of the two methods specified above. Again, all submissions must refer to the docket number and title of the rule.

No Facsimile Comments. Facsimile (fax) comments are not acceptable.

Public Inspection of Public Comments. HUD will make all properly submitted comments and communications available for public inspection and copying between 8 a.m. and 5 p.m. weekdays at the above address. Due to security measures at the HUD Headquarters building, you must schedule an appointment in advance to review the public comments, by calling the Regulations Division at 202-708-3055 (this is not a toll-free number). Individuals with speech or hearing impairments may access this number via TTY by calling the toll-free Federal Relay Service at 800-877-8339. Copies of all comments submitted are available for inspection and downloading at www.regulations.gov.

FOR FURTHER INFORMATION CONTACT: Ivery Himes, Director, Office of Single Family Asset Management, Office of Housing, Department of Housing and Urban Development, 451 7th Street, SW, Room 9172, Washington, DC, 20410; telephone number 202-708-1672 (this

is not a toll-free number). Persons with hearing or speech impairments may access this number through TTY by calling the toll-free Federal Relay Service at 800-877-8339.

SUPPLEMENTARY INFORMATION

I. Background

FHA's current regulations allow FHA-approved mortgagees to charge borrowers interest due for the entire month should prepayment occur on a date other than the installment due date, subject to certain notice requirements to the mortgagor (see 24 CFR 203.558). However, current industry practices for non-FHA insured loans no longer utilize post-payment interest charges. In general, mortgagors who obtain conventional financing through banks, savings banks, or mortgage companies that finance mortgages sold through Fannie Mae, Freddie Mac, and private-label mortgage-backed securities,¹ as well as mortgagors who obtain loans from private lenders that the Department of Veterans Affairs (VA) guarantees, are not required to pay interest for the full month in which prepayment occurs.²

The final rule of the Consumer Financial Protection Bureau (CFPB) entitled "Ability-to-Repay and Qualified Mortgage Standards under the Truth and Lending Act (Regulation Z)" (CFPB final rule), was first issued on the CFPB's webpage³ and subsequently published in the Federal Register on January 30, 2013, at 78 FR 6408. The rule, which became effective January 10, 2014, broadly defines "prepayment penalty" in closed-end transactions as the "charge imposed for paying all or part of the transaction's principal before the date on which the

¹ See, e.g., Freddie Mac Single-Family Seller/Servicer Guide, Chapter 51.19: Application of payments: Mortgage paid in full, explaining that for FHA/VA and Section 502 GRH Mortgages, any notice of prepayment or entitlement to interest past the date of payment-in-full must be waived by the servicer on behalf of Freddie Mac, and Fannie Mae Single Family Servicing Guide, Part III, 102.01: Additional Principal Payments, explaining that a servicer may charge the borrower interest on the then outstanding mortgage loan balance up until the date the prepayment is applied.

² The VA currently authorizes prepayment penalties for partial prepayments made on other than an installment due date. Otherwise, the mortgagor has the right to prepay at any time, without premium or fee, the entire indebtedness or any part thereof not less than the amount of one installment, or \$100, whichever is less. See 38 CFR 36.4811.

³ See http://files.consumerfinance.gov/f/201301_cfpb_final-rule_ability-to-repay.pdf.

principal is due,” thus including charges resulting from FHA’s currently allowed monthly interest accrual amortization method (see 12 CFR 1026.32(b)(6)).⁴ In recognition of the important role that FHA-insured credit plays in the current mortgage market, the CFPB final rule provides that interest charged consistent with the monthly interest accrual amortization method is not a prepayment penalty for FHA loans consummated before January 21, 2015. However, for all FHA loans closed on or after January 21, 2015, a post-payment interest charge as a result of the monthly interest accrual amortization method will be considered a prepayment penalty, making it necessary for FHA to amend its regulations (see 12 CFR 1026.32(b)(6)(i)).

II. This Proposed Rule

This proposed rule would eliminate the option provided to FHA-approved mortgagees to charge prepaying mortgagors post-payment interest payments under FHA’s single family mortgage insurance program. The proposed regulatory change is responsive to the definition of “prepayment penalty” in the CFPB final rule. The CFPB final rule permits limited prepayment penalties for “qualified mortgages” (as that term is defined in the rule) during the first 36 months following consummation of the mortgage (see 12 CFR 1026.43(g)). Prepayment penalties are not, however, permitted for higher-priced mortgage loans, which include consumer credit

⁴ Prior to enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Public Law 111-203, approved July 21, 2010) (Dodd-Frank Act), the Federal Reserve Board (Board) had responsibility for lenders’ compliance with the Truth-in-Lending Act (TILA). (This responsibility was transferred to the CFPB in July 2011.) In a September 2009 interpretive letter to Secretary Donovan, Board staff advised that they had not addressed whether monthly interest accrual amortization is a prepayment penalty and, therefore, would not prohibit such practice without further review. (See <http://www.aba.com/Compliance/Documents/da4a00df3ffb4650b7c9154adbc1418aFedLtrtoHUD2009.pdf>) In a proposed rule published on September 24, 2010, at 75 FR 59539, the Board proposed to amend Regulation Z, which implements TILA and the Board’s accompanying staff commentary. In this proposed rule, the Board stated that based on further review and analysis the monthly interest accrual amortization method should be treated as a prepayment penalty for TILA purposes. (See 75 FR 58586.) The CFPB’s final rule on ability-to-pay continued the analysis that the Board provided in its September 24, 2010, proposed rule and categorized FHA’s monthly interest accrual amortization method as a prepayment penalty, but not for FHA loans consummated before January 21, 2015. (See 78 FR 6445.) The CFPB offers examples of the monthly interest accrual amortization method at page 78 FR 6600. In its discussion at this page, the CFPB recognized that FHA would need rulemaking to change this practice and the amount of time needed to complete the rulemaking.

transactions secured by the consumer's principal dwelling with an annual percentage rate that exceeds the average prime offer rate for a comparable transaction, as of the date the interest rate is set, by 1.5 or more percentage points for loans secured by a first lien on the dwelling or by 3.5 or more percentage points for loans secured by a subordinate lien on the dwelling (see 12 CFR 1026.43(g)(1)(i)(C)); or for loans that have an adjustable interest rate (see 12 CFR 1026.43(g)(1)(i)(A)).

While some FHA-insured single family mortgages would meet the requirements permitting limited prepayment penalties during the first 36 months following consummation of the mortgage, others would not. For mortgages for which limited prepayment penalties are permitted, the CFPB final rule also imposes an additional requirement that lenders that offer loans with prepayment penalties also offer loans without such penalties (see 12 CFR 1026.43(g)(3)). In order to maximize consistency among FHA-insured single family mortgage products, and provide the same protections for all borrowers, this proposed rule would prohibit prepayment penalties in all FHA-insured single family mortgages.

The proposed rule would revise the regulations in 24 CFR 203.558, which currently provide that, if prepayment is offered on other than an installment due date, the mortgagee may require payment of interest up to the date of the next installment due date. The proposed rule would revise this section to provide that, with respect to FHA-insured mortgages closed on or after the effective date of these proposed regulatory amendments, and notwithstanding the terms of the mortgage, the mortgagee shall accept a prepayment at any time and in any amount and shall not charge a post-payment charge. The proposed rule would require that monthly interest on the debt be calculated on the actual unpaid principal balance of the loan as of the date the prepayment is received and not as of the next installment due date.

Under the proposed rule, post-payment charges using the monthly interest accrual amortization method are not considered prepayment penalties for FHA-insured mortgages closed prior to the effective date of these proposed regulatory changes. This proposed rule retains the current provisions of § 203.558 pertaining to the handling of prepayments for such mortgages, but consolidates the provisions in a revised paragraph (b) to § 203.558 and slightly revises their wording to reflect the fact that their applicability is limited to FHA-insured mortgages closed prior to the final rule's effective date. Consistent with current regulations applicable to mortgages insured on or after August 2, 1985, the proposed rule does not permit mortgagees to require advance notice of prepayment.

In addition to the proposed amendments to § 203.558, HUD also proposes to make two technical conforming changes to the regulations in 24 CFR part 203. First, HUD proposes to amend § 203.9, which requires a mortgagee to provide written notice to the mortgagor at or before closing regarding the accrual of interest on the mortgage loan following a prepayment. Since once this rule becomes effective it will prohibit such interest accruals, the requirements of § 203.9 will not be applicable to loans closed on or after the effective date of the final rule. Second, HUD proposes to revise § 203.22(b), which currently requires that “the mortgage shall contain a provision permitting the mortgagor to prepay the mortgage in whole or in part on any installment due date....” For consistency with the proposed revision to § 203.558, this language would be amended to reference the mortgagor's ability to “prepay the mortgage in whole or in part at any time and in any amount.”

III. Findings and Certifications

Regulatory Review - Executive Orders 12866 and 13563

Under Executive Order 12866 (Regulatory Planning and Review), agencies must determine whether a regulatory action is significant and, therefore, subject to review by the Office of Management and Budget (OMB) in accordance with the requirements of the order. Executive Order 13563 (Improving Regulations and Regulatory Review) directs executive agencies to analyze regulations that are “outmoded, ineffective, insufficient, or excessively burdensome, and to modify, streamline, expand, or repeal them in accordance with what has been learned.” Executive Order 13563 also directs that, where relevant, feasible, and consistent with regulatory objectives, and to the extent permitted by law, agencies are to identify and consider regulatory approaches that reduce burdens and maintain flexibility and freedom of choice for the public. This document was determined to be a “significant regulatory action” as defined in section 3(f) of the Executive order (although not an economically significant regulatory action, as provided under section 3(f)(1) of the Executive order).

As discussed in this preamble, this rule proposes to prohibit mortgagees from charging post-payment interest and allow them to charge interest only through the date the mortgage is paid. The CFPB final rule broadly defines “prepayment penalty” in closed-end transactions as the “charge imposed for paying all or part of the transaction’s principal before the date on which the principal is due,” thus including charges from post-payment interest. HUD has prepared an economic analysis assessing costs and benefits of this proposal to eliminate post-payment interest. HUD’s full analysis can be found at www.regulations.gov. A summary of HUD’s analysis follows:

A. Transfers/Revenue Effects.

HUD’s proposal to implement its own post-payment interest rule prior to the date of the FHA loans being bound by the prepayment penalty provisions of the CFPB final rule would

result in an estimated transfer of \$13 million from those borrowers who would not prepay mid-month under the current rule to those who would. The earlier in the month that a borrower prepays, the greater the transfer under the proposed rule relative to the current one. The beneficiaries of this transfer would also pay the higher prices for FHA-insured loans, however, and, therefore, the amount of the transfer would be reduced. However, this estimate assumes that the proposed rule is made final an entire year before the January 21, 2015, deadline for FHA to implement the CFPB final rule's prepayment penalty provisions, which is an overestimation. In addition, HUD's proposal to eliminate post-payment interest entirely would result in an estimated annual transfer of \$37 million, which is a top threshold estimate. The actual annual transfer is expected to be less. See HUD's full analysis for further explanation.

B. Benefits and Costs.

Under the proposed rule, borrowers will experience costs and benefits. Borrowers who would pay post-payment interest under the current rule can expect to pay a slightly higher rate for FHA-insured financing, but they would also receive full benefit from lower interest costs when they prepay later, in most cases more than offsetting the cost of the higher rate. Borrowers who currently avoid paying post-payment interest under the current rule, however, will face the slightly higher rate for FHA-insured financing and receive no offsetting post-payment interest savings.

FHA borrowers will no longer have to delay a closing or prepayment because of the cost of prepaying at a date earlier than the next installment due date. However, a very small percentage of borrowers may be dissuaded or otherwise excluded from taking up an FHA loan. This may occur because in the borrowers' current circumstances the increase in the immediate costs of the loan (whether expressed as an increase in points and fees or an increase in the

monthly interest rate) figuratively puts the product out of reach. It may also occur because it makes another loan product more attractive.

This proposed rule will force FHA lenders to bear the entire cost of interest from the prepayment date to the end of the month. However, HUD expects that lenders will simply look elsewhere to recoup these costs, charging a higher interest rate or servicing fee differential on all FHA-insured loans than they might have otherwise charged.

Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA) (5 U.S.C. 601 et seq.) generally requires an agency to conduct a regulatory flexibility analysis 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. As noted above in this preamble, even without rulemaking by HUD, the circumstances in which a small entity could charge a prepayment penalty have been significantly limited by the CFPB final rule. The CFPB final rule implements the Dodd-Frank Act provisions that generally prohibit prepayment penalties except for certain fixed-rate, qualified mortgages where the penalties satisfy certain restrictions and the creditor has offered the consumer an alternative loan without such penalties. The CFPB final rule categorizes the post-payment interest charge resulting from FHA's monthly interest accrual amortization method as a prepayment penalty. Therefore, the use of post-payment interest charges on all FHA loans closed on or after January 21, 2015, will be considered prepayment penalties. This is true, irrespective of any economic impacts of the rule.

In any event, even if HUD were to issue a rule allowing prepayment penalties, the CFPB final rule requires that lenders that offer loans with prepayment penalties also offer loans without

such penalties (see 12 CFR 1026.43(g)(3)). As of January 21, 2015, all small lenders⁵ would have to be prepared to offer loans without prepayment penalties and, therefore, be prepared to bear, or transfer, the cost of interest (or more) from the prepayment date to the end of the month. HUD expects that, with or without this rulemaking, lenders will simply look elsewhere to recoup these costs, charging a higher interest rate or servicing fee differential on all FHA-insured loans than they might have otherwise charged.

Under the proposed rule, those borrowers who would pay post-payment interest under the current rule would be expected to pay a slightly higher rate for FHA-insured financing, but they would also receive full benefit from lower interest costs when they prepay later, in most cases more than offsetting the cost of the higher rate. Borrowers who currently avoid paying post-payment interest under the current rule, however, face the slightly higher rate for FHA-insured financing and receive no offsetting post-payment interest savings. Since HUD expects the increase in the pricing of FHA-insured loans under the proposed rule to be set to compensate lenders for the loss of post-payment interest from borrowers, the primary effect of the proposed rule is a transfer of funds from those who would not prepay mid-month under the current rule to those who would.

Accordingly, the undersigned certifies that this rule will not have a significant economic impact on a substantial number of small entities. Notwithstanding HUD's determination that this rule will not have a significant effect on a substantial number of small entities, HUD specifically invites comments regarding any less burdensome alternatives to this rule that will meet HUD's objectives as described in the preamble to this rule.

⁵ Of HUD's 1,459 supervised lenders, 598 are considered, by HUD, to be "small supervised lenders." HUD defines "small supervised lenders" as those depository institutions regulated by the Federal Reserve, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, or the National Credit Union Administration that have a depository asset base of less than \$500 million.

Environmental Impact

The proposed rule does not direct, provide for assistance or loan and mortgage insurance for, or otherwise govern or regulate, real property acquisition, disposition, leasing, rehabilitation, alteration, demolition, or new construction, or establish, revise or provide for standards for construction or construction materials, manufactured housing, or occupancy. Accordingly, under 24 CFR 50.19(c)(1), this proposed rule is categorically excluded from environmental review under the National Environmental Policy Act of 1969 (42 U.S.C. 4321).

Executive Order 13132, Federalism

Executive Order 13132 (entitled “Federalism”) prohibits an agency from publishing any rule that has federalism implications if the rule either (i) imposes substantial direct compliance costs on state and local governments and is not required by statute, or (ii) preempts state law, unless the agency meets the consultation and funding requirements of section 6 of the Executive order. This proposed rule would not have federalism implications and would not impose substantial direct compliance costs on state and local governments or preempt state law within the meaning of the Executive order.

Unfunded Mandates Reform Act

Title II of the Unfunded Mandates Reform Act of 1995 (2 U.S.C. 1531-1538) (UMRA) establishes requirements for Federal agencies to assess the effects of their regulatory actions on state, local, and tribal governments, and on the private sector. This proposed rule would not impose any Federal mandates on any state, local, or tribal governments, or on the private sector, within the meaning of the UMRA.

Catalog of Federal Domestic Assistance

The Catalog of Federal Domestic Assistance number for Mortgage Insurance-Homes is

14.117.

Paperwork Reduction Act

This proposed rule reduces information collection requirements already submitted to the Office of Management and Budget (OMB) under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501-3520). In accordance with the Paperwork Reduction Act, an agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection displays a currently valid OMB control number. The cost savings of this proposed rule, in time, are estimated to be 0.0036 burden hours.

List of Subjects in 24 CFR Part 203

Hawaiian Natives, Home improvement, Indians-lands, Loan programs-housing and community development, Mortgage insurance, Reporting and recordkeeping requirements, Solar energy.

Accordingly, for the reasons discussed in this preamble, HUD proposes to revise 24 CFR part 203 as follows:

PART 203 – SINGLE FAMILY MORTGAGE INSURANCE

1. The authority citation for 24 CFR part 203 continues to read as follows:

Authority: 12 U.S.C. 1709, 1710, 1715b, 1715z-16, 1715u, and 1717z-21; 15 U.S.C. 1639c; 42 U.S.C. 3535(d).

2. Revise the last sentence of § 203.9 to read as follows:

§ 203.9 Disclosure regarding interest due upon mortgage prepayment.

* * * This paragraph shall apply to any mortgage executed after August 22, 1991, and before [effective date of the final rule to be inserted at the final rule stage].

3. Revise § 203.22 paragraph (b) to read as follows:

§ 203.22 Payment of insurance premiums or charges; prepayment privilege.

* * * * *

(b) Prepayment privilege. The mortgage shall contain a provision permitting the mortgagor to prepay the mortgage in whole or in part at any time and in any amount. The mortgage shall not provide for the payment of any charge on account of such prepayment.

4. Revise § 203.558, to read as follows:

§ 203.558 Handling prepayments.

(a) Handling prepayments for FHA-insured mortgages closed on or after [effective date of the final rule to be inserted at the final rule stage]. With respect to FHA-insured mortgages closed on or after [effective date of the final rule to be inserted at the final rule stage], notwithstanding the terms of the mortgage, the mortgagee shall accept a prepayment at any time and in any amount. The mortgagee shall not require 30 days' advance notice of prepayment, even if the mortgage instrument purports to require such notice. Monthly interest on the debt must be calculated on the actual unpaid principal balance of the loan as of the date the prepayment is received, and not as of the next installment due date.

(b) Handling prepayment for FHA-insured mortgages closed before [effective date of the final rule to be inserted at the final rule stage]. (1) With respect to FHA mortgages insured before August 2, 1985, if a prepayment is offered on other than an installment due date, the mortgagee may refuse to accept the prepayment until the first day of the month following expiration of the 30-day notice period as provided in the mortgage, or may require payment of

interest to that date, but only if the mortgagee so advises the mortgagor, in a form approved by the Commissioner, in response to the mortgagor's inquiry, request for payoff figures, or tender of prepayment. If the installment due date (the first day of the month) falls on a nonbusiness day, the mortgagor's notice of intention to prepay or the prepayment shall be timely if received on the next business day.

(2) With respect to FHA mortgages insured on or after August 2, 1985, but closed before [effective date of the final rule to be inserted at the final rule stage], the mortgagee shall not require 30 days' advance notice of prepayment, even if the mortgage instrument purports to require such notice. If the prepayment is offered on other than an installment due date, the mortgagee may refuse to accept the prepayment until the next installment due date (the first day of the month), or may require payment of interest to that date, but only if the mortgagee so advises the mortgagor, in a form approved by the Commissioner, in response to the mortgagor's inquiry, request for payoff figures, or tender of prepayment.

(3) If the mortgagee fails to meet the full disclosure requirements of paragraphs (b)(1) and (b)(2) of this section, the mortgagee may be subject to forfeiture of that portion of the interest collected for the period beyond the date that prepayment in full was received and to such other actions as are provided in part 25 of this title.

(c) Mortgagee annual notice to mortgagors. Each mortgagee, with respect to a mortgage under this part, shall provide to each of its mortgagors not less frequently than annually a written notice, in a form approved by the Commissioner, containing a statement of the amount outstanding for prepayment of the principal amount of the mortgage. With respect to FHA-insured mortgages closed before [effective date of the final rule to be inserted at the final rule stage], the notice shall describe any requirements the mortgagor must fulfill to prevent the accrual of any interest on the principal amount after the date of any prepayment. This paragraph shall apply to any outstanding mortgage insured on or after August 22, 1991.

Dated: February 21, 2014.

Carol J. Galante,
Assistant Secretary for Housing—
Federal Housing Commissioner.

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