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DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

24 CFR Part 203

[Docket No. FR-5360-F-02]
[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: Final rule.

SUMMARY: This rule revises 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 final rule allows mortgagees to charge interest only through the date the mortgage is paid, and prohibits the charging of interest beyond that date.

DATES: Effective Date: January 21, 2015.

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—the March 13, 2014 Proposed Rule

On March 13, 2014, HUD published a proposed rule in the Federal Register, at 79 FR 14200, to eliminate post-payment interest charges to borrowers resulting from FHA's monthly interest accrual amortization method for calculating interest. This change was responsive to the

final rule of the Consumer Financial Protection Bureau (CFPB) entitled “Ability-to-Repay and Qualified Mortgage Standards under the Truth in Lending Act (Regulation Z)” (CFPB final rule)¹, which 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 resulting from FHA’s monthly interest accrual amortization method (see 12 CFR 1026.32(b)(6)).²

HUD’s March 13, 2014, rule proposed to revise the regulations in 24 CFR 203.558 to provide that, with respect to FHA-insured mortgages closed on or after the effective date of the 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 March 13, 2014, rule proposed to 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.

While the CFPB final rule permits limited prepayment penalties for “qualified mortgages” (as that term is defined in the CFPB final rule) during the first 36 months following

¹ This rule was first issued on the CFPB’s webpage at http://files.consumerfinance.gov/f/201301_cfpb_final-rule_ability-to-repay.pdf and subsequently published in the *Federal Register* on January 30, 2013, at 78 FR 6408.

² 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-repay 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.

consummation of the mortgage (see 12 CFR 1026.43(g)), such penalties are not permitted for higher-priced mortgage loans or for loans that have an adjustable interest rate.³ As a result of these restrictions, and in order to maximize consistency among FHA-insured single family mortgage products and provide the same protections for all borrowers, HUD's March 13, 2014, rule proposed to prohibit prepayment penalties in all FHA-insured single family mortgages.

In addition to amending § 203.558, the March 13, 2014, proposed rule offered two technical conforming changes to the regulations in 24 CFR part 203. See the March, 13, 2014, proposed rule for a greater discussion on the technical changes.

II. This Final Rule

This final rule follows publication of the March 13, 2014, proposed rule and adopts that proposed rule without change. The public comment period for the proposed rule closed on May 12, 2014, and HUD received four public comments. Section III of this preamble discusses the comments received on the proposed rule.

III. Discussion of Public Comments Received on the March 13, 2014, Proposed Rule

The public commenters included a mortgage company and trade associations. Commenters were over-all supportive of HUD's proposal to prohibit the charging of post-payment interest on FHA loans.

Comment: Maintain proposed implementation language and publish a final rule as soon as practicable. A commenter requested that HUD maintain the implementation language, "closed on or after [the effective date of the rule]", as opposed to using case number assignment or some other date. The commenter explained that the technological and procedural changes needed to implement this rule will require a long lead time and any change to the implementation

³ See HUD's March 13, 2014, proposed rule for additional information related to this prohibition; see also 12 CFR 1026.43(g)(1)(i)(A).

language may delay lenders' abilities to fully comply with the rule. The commenter also requested that the final rule be published as soon as practicable to provide the industry with clarity and certainty.

HUD Response: HUD appreciates the industry's support of this rule and desire for a quick implementation, and is not making any changes to the implementation language.

Comment: Concern that lenders will recoup the costs of not collecting post-payment interest by charging higher interest rates or servicing fee differential is overstated. In response to HUD's statement in the preamble to the proposed rule that HUD expects lenders will simply look elsewhere to recoup funds lost by not being able to charge interest beyond the mortgage payment date, a commenter explained that lenders continue to offer Veterans Administration (VA) and Rural Housing Service (RHS) loans, which are securitized by Ginnie Mae and, these loans do not have prepayment penalties, but offer interest rates similar to current FHA rates. The commenter also stated that FHA loans are attractive to investors, regardless of the excess interest payments, because they carry the guarantee of the federal government.

HUD Response: The commenter raises a good point, which HUD appreciates and hopes reflects how lenders will handle FHA-insured loans that now prohibit post-payment interest, and that is by continuing to offer the same interest rates that they offer now.

Comment: Publish additional information in the final rule or in a concurrent Mortgagee Letter. A commenter asked HUD to publish revised maximum mortgage calculations, for FHA refinance transactions, to include the actual amount of interest to be paid and financed. The commenter also asked that HUD consider a closing date change, and the impact on the maximum mortgage calculation, to be included in the existing policy for minor adjustments at closing.

HUD Response: HUD appreciates this concern, but believes the current policy provides

adequate flexibility in calculating the maximum mortgage eligible for FHA refinance transactions. FHA policy permits interest due on the previous mortgage to be financed into the new FHA mortgage. The amount of interest that is permitted to be financed varies based upon the refinance program. However, each program that limits the financing of interest allows for a flexibility of \$500 in determining the maximum mortgage amount. HUD expects that this flexibility provides sufficient leeway to account for changes in the interest due on the previous mortgage as a result of changes in the closing date.

Comment: Passing costs on to borrowers is not a consumer protection. One commenter raised a concern that if servicers of FHA loans continue to be obligated to pay investors charges that the servicers may no longer collect from consumers, as required by Ginnie Mae, originating lenders and servicers will need to price that charge into the cost of the loan, raising costs for FHA borrowers, which is not a consumer protection. The commenter requested that HUD, FHA, Ginnie Mae, and the CFPB coordinate actions so that the intended consumer protections can be implemented.

Another commenter explained that under current regulations, borrowers could choose to avoid paying post-payment interest by paying off the loan at the end of the month. Under the proposed rule, however, all borrowers would have to pay more, including those borrowers who would have strategically avoided paying post-payment interest under the current regulations.

HUD Response: HUD appreciates this concern, but emphasizes that any cost passed on to the consumer by the servicer, as a result of the ability for security holders to continue to collect interest through the end of the month, is expected to be minimal. In addition, not all consumers will experience additional costs. For example, consumers who would have prepaid their mortgages and would have been subject to post-payment interest charges under FHA's

regulations, prior to amendment by this rule, will no longer be subject to those charges. These consumers may end up paying slightly more in interest each month or a higher servicing fee differential, but will avoid a post-payment charge when prepaying their mortgage later on, offsetting the cost of slightly increased interest rates or servicing fee differentials.

In addition, as another commenter mentioned, lenders continue to offer VA and RHS loans, which are securitized by Ginnie Mae and permit security holders to collect interest through the end of the month, but do not allow for prepayment penalties. The interest rates on these VA and RHS loans are similar to current FHA rates, illustrating that costs are not being passed on to borrowers in the manner of higher interest rates.

Comment: Pressure placed on mortgage servicers. A commenter explains that the proposed rule would place further pressure on mortgage servicers, at a time when servicing costs continue to rise. The commenter explained that servicers will have higher direct costs, and that the rule would impact the value of FHA mortgage servicing rights.

HUD Response: HUD appreciates this concern; however, the impact on servicers is consistent with prevailing industry practice. As discussed previously, GSE, VA, and RHS loans do not require borrowers to pay post-payment interest.

Comment: FHA should work with Ginnie Mae to transition to a daily simple interest calculation structure. This structure would calculate interest daily based on outstanding principal balance, rather than as a predetermined monthly amount, and align the cash flows from the underlying loans with the payments made to investors in the mortgage-backed securities.

HUD Response: At this time, FHA declines the suggestion to work with Ginnie Mae to transition to a daily simple interest calculation structure. The simple interest calculation structure poses unnecessary risks to borrowers. For example, interest accrues daily on the unpaid

principal balance instead of monthly, so there is no grace period for payments. In addition, the loan will not fully amortize over the stated term if the borrower makes payments later than the scheduled due date.

IV. 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. At the proposed rule stage, 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). While this rule remains a significant regulatory action, HUD is adopting the proposed rule without change, and therefore further review of this rule under EO 12866 is not necessary. Additionally, the regulatory impact of this rule, specifically the costs and benefits of this rule, as presented in the preamble to the proposed rule at 79 FR 14202 through 14203 remain applicable to this rule.

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 lenders⁴ 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.

Under this final rule, those borrowers who would pay post-payment interest under the previous regulations will be expected to pay a slightly higher rate for FHA-insured financing, but they will also receive full benefit from lower interest costs when they prepay later, in most cases

⁴ 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.

more than offsetting the cost of the higher rate. Borrowers who avoided paying post-payment interest under the previous regulations, 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 this final 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.

Environmental Impact

The 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 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 rule does not have federalism implications and does 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 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 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 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 amends 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; 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 January 21, 2015.

3. Revise § 203.22(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 January 21, 2015. With respect to FHA-insured mortgages closed on or after January 21, 2015, 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 prepayments for FHA-insured mortgages closed before January 21, 2015.

(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 January 21, 2015, 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 January 21, 2015, 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: August 20, 2014

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

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