

HB

363

9-LS1299F
Cook
2/12/96

CS FOR HOUSE BILL NO. 363^(K)

IN THE LEGISLATURE OF THE STATE OF ALASKA

NINETEENTH LEGISLATURE - SECOND SESSION

BY

Offered:
Referred:

Sponsor(s): REPRESENTATIVE BUNDE

A BILL

FOR AN ACT ENTITLED

1 "An Act relating to reserve accounts held in connection with mortgage loans."

2 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

3 * Section 1. AS 06.05 is amended by adding a new section to read:

4 Sec. 06.05.285. INTEREST ON RESERVE ACCOUNTS. (a) A bank that
5 requires the payment of money by a borrower into an escrow reserve account for the
6 payment of taxes, assessments, insurance premiums, or home owner's association dues
7 in connection with a mortgage loan shall pay interest on the amount of money in the
8 account that exceeds the amount required to be held in reserve by federal law or
9 regulation. The rate of interest paid on that money shall equal three percent per year
10 and shall be computed on the average balance in the account each month.

11 (b) Interest earned under (a) of this section shall be, at the election of the
12 borrower, annually credited to the remaining principal balance on the mortgage loan
13 or paid to the borrower.

14 (c) At the end of each year, the following information regarding each escrow
15 reserve account during that year shall be delivered by the bank to the borrower:

- 1 (1) the cost to the bank of administering the account;
 - 2 ✓(2) the amount that was in the account on the last day of each month;
 - 3 (3) the amount of interest earned on the account each month;
 - 4 ✓(4) a schedule of payments made by the bank from the account.
- 5 * Sec. 2. AS 06.05.285, enacted in sec. 1 of the Act, applies to escrow reserve accounts
6 established before the effective date of this Act, as well as to accounts established on or after
7 the effective date of this Act, with interest to begin accruing on the effective date of this Act
8 on money in those accounts.

**OVERCHARGING ON MORTGAGES:
VIOLATIONS OF ESCROW ACCOUNT LIMITS
BY THE MORTGAGE LENDING INDUSTRY**

**A REPORT
BY**

THE ATTORNEYS GENERAL OF

**CALIFORNIA
FLORIDA
IOWA
MASSACHUSETTS
MINNESOTA
NEW YORK
TEXAS**

APRIL 24, 1990

**OVERCHARGING ON MORTGAGES:
VIOLATIONS OF ESCROW ACCOUNT LIMITS
BY THE MORTGAGE LENDING INDUSTRY**

Millions of homeowners throughout this country make monthly mortgage payments to banks and other mortgage lenders. The vast majority of these homeowners pay, as part of that monthly mortgage bill, a supplemental sum earmarked for what is known as a mortgage escrow or impound account. These mortgage escrow accounts are established by mortgage lenders to collect and hold money from homeowners so that the lenders can pay taxes and insurance on mortgaged properties when those payments fall due. This report, which documents the findings of a multi-state investigation into mortgage escrow practices, concludes that the mortgage lending industry has systematically violated federal law for more than a decade by extracting excessive escrow payments from the majority of mortgage-paying homeowners and presently holds several billion dollars of homeowners' money unlawfully.

I. Introduction

In 1974 Congress declared that "significant reforms in the real estate settlement process are needed to insure that consumers throughout the nation ... are protected from unnecessarily high settlement charges caused by certain abusive practices..." Based upon this finding, Congress enacted the Real Estate Settlement Procedures Act (RESPA), announcing that one of the central purposes of the new law was to achieve "a reduction in the amounts home buyers are required to place in escrow accounts established to insure the payment of real estate taxes and insurance." Sixteen years after this important federal consumer protection statute was enacted, Congress' promise to American

homeowners remains unfulfilled.

In passing RESPA, Congress sought to eliminate the prevalent practice of retaining in mortgage escrow accounts sums far in excess of the amounts actually necessary to pay tax and insurance premiums as they come due. While recognizing that a modest "cushion" in each escrow account is justified to protect lenders from having to pay the consumer's taxes or insurance out of the lender's own funds when the consumer is late in paying his or her mortgage bill, Congress was outraged that in many cases lenders were maintaining bloated escrow accounts with a year or more of excess escrow payments in them. Such exorbitant "cushions" could not be justified by the lenders' interests in not having to pay taxes and insurance out of their own funds. In response to this abusive practice, Congress enacted RESPA, which, in part, prohibits lenders and mortgage servicers from requiring consumers to maintain more than an extra two months' worth of the yearly amount necessary to pay taxes and insurance premiums. This cushion amounts to 1/6 of the total annual escrow payments.

In June 1988, after receiving consumer complaints in some states charging that mortgage lenders were requiring consumers to put into escrow considerably more money than was needed to pay taxes and insurance, the Attorneys General of the states of California, Iowa, Massachusetts, Minnesota, New York and Texas ("states") undertook a preliminary review of the mortgage escrow practices of mortgage lenders to determine if the limitations established by consumers' mortgage contracts and RESPA were followed. Florida later joined the group. As part of this process, the states analyzed individual consumer complaints, met with the Mortgage Bankers Association of America ("MBA") and

also met with and examined the escrow accounting systems of four of the largest lenders in the country.

The Attorneys General's central finding is extremely disturbing: lenders are holding in mortgage escrow accounts more funds of American homeowners than either federal law or the homeowners' mortgage contracts allow. On an industry-wide basis, mortgage lenders continually escrow excessive amounts in consumer mortgage escrow accounts in violation of the ceiling set by Congress in 1975 in RESPA. It appears that this over-escrowing affects approximately 2/3 of all home mortgages, and that each of the affected homeowners is required to maintain about \$150 more in an escrow account than RESPA permits. Nationwide, it is likely that at least several billion dollars of consumers' money is being illegally held in these accounts as a result of these over-escrowing practices. Furthermore, lenders are also ignoring the often stricter limits placed on the size of escrow accounts by their own mortgage contracts with consumers. Thus, the total dollar amount over-escrowed is likely to be even larger than the states' analysis under RESPA alone would suggest.

This report is intended to bring to public attention the widespread abuse of mortgage escrow accounts uncovered by the states' investigation. Specifically, this report explains what mortgage escrow accounts are and how they work (Part II); discusses the statutory and contractual limits on the amount which can be maintained in escrow accounts (Part III); describes the states' review of mortgage escrow practices and their findings that the mortgage industry appears to be ignoring both the statutory limits set out in RESPA and their own mortgage agreements (Part IV); describes what other actions the states have

taken to date (Part V); and concludes with recommendations for resolving this problem. Foremost is the recommendation that the Department of Housing and Urban Development ("HUD") put an end to these abuses by launching an enforcement program to ensure compliance with the RESPA limits on escrow accounts.

II. Mortgage Escrow Accounts

Most mortgage contracts for residential property are written on one of a handful of standard forms. These form mortgage contracts typically contain a clause requiring consumers to pay to the lender a supplemental monthly sum to be placed in an escrow account. Such mortgage escrow accounts are established by lenders¹ so that they can be assured that they will have received sufficient funds from consumers to pay taxes and hazard insurance on the mortgaged property when each payment is due. This protects the lenders' interest in the mortgaged property. In all but a few states, little or no interest is paid to the consumer by the lender on such escrow accounts.

A hypothetical escrow account, where all payments are made at one time in the year, would work as follows. If county taxes on a property were \$1200 per year, school taxes \$600 per year and hazard insurance \$600 per year, the lender would need to collect \$2400 per year from the consumer, or \$200 per month ($\$2400 \div 12$), in order to make these payments.

However, escrow accounts are generally more complicated than this example

¹ As used in this report, the term "lender" includes mortgage servicers, which are companies that specialize in collecting mortgage payments from consumers on loans originated or owned by some other company.

because tax and insurance payments are almost always required to be paid at different times of the year. Thus, if the lender simply required the consumer to pay \$200 per month into the escrow account, a shortage in the escrow account could result at some point during the year. For example, if there were only \$400 in the account in March and a \$1200 school tax must be paid that month, the lender would have to pay out \$800 of its own funds ($\$1200 - 400$), and the escrow account would be short by \$800.

To avoid such deficiencies in the escrow accounts, lenders perform an "escrow analysis", usually once a year, to determine if enough funds will be collected to avoid having to advance corporate funds to pay the consumer's taxes and insurance. These escrow analyses must be conducted to track yearly tax and insurance premium changes. However, most consumers are unfamiliar with these complicated escrow analyses and therefore do not check whether the lender is requiring more money to be held in these accounts than is needed to pay the taxes and insurance.

Obviously, the lenders' requirement that consumers pay funds into an escrow account for taxes and insurance combined with the substantial financial incentive lenders have to keep significantly more funds in the escrow accounts than are actually needed to pay the taxes and insurance premiums when they come due can lead to serious abuses. Indeed, as discussed below, the states estimate that the mortgage lender industry is holding several billion more dollars of homeowners' money in escrow accounts than is lawful under either state or federal law.

III. Statutory And Contractual Limits On Escrow Accounts:
RESPA And The Mortgage Contracts

In response to severe over-escrowing by some lenders --in some cases more than 12 months worth of escrow payments was maintained at all times during the year -- Congress in 1974 passed RESPA, 12 U.S.C. §2601 et seq., limiting escrow accounts to no more than a one-month surplus. This cushion was permitted because Congress recognized that consumers were sometimes a month late in paying their mortgages. A year later, in response to lenders' complaints that consumers were sometimes more than a month late in paying their mortgages, Congress amended RESPA to allow lenders to maintain up to a two-month cushion (1/6 of the annual escrow payments). 1974 U.S. Code Cong. & Ad. News 6546; 1975 U.S. Code Cong. & News 2448.

Section 10 of RESPA clearly establishes a ceiling for the so-called cushion in the escrow account. The cushion is to be "such amount as is necessary" so that one-sixth of the total escrow disbursements (two months of escrow payments) for the upcoming year will be "maintain[ed]" at all times during the year. In particular, section 10 of RESPA, 12 U.S.C. §2609(2), provides that a lender may not require a borrower:

to deposit in any such escrow account in any month beginning with the first full installment payment under the mortgage a sum [for the purpose of assuring payment of taxes, insurance premiums and charges with respect to the property] in excess of the sum of (A) one-twelfth of the total amount of estimated taxes, insurance premiums and other charges..., plus (B) such amount as is necessary to maintain an additional balance in such escrow account not to exceed one-sixth of the estimated total amount of such

taxes, insurance premiums and other charges...
(Emphasis supplied.)

Many mortgage lenders have continued to use underlying mortgage contracts that impose even more restrictive limitations on the amount which may be maintained in the escrow account than the RESPA 1/6 ceiling on escrow cushions. These mortgage contracts often provide for only a one-month cushion, or even no cushion at all. RESPA in and of itself does not authorize a 1/6 escrow cushion unless the underlying mortgage provides for such a cushion. RESPA merely imposes a ceiling, an upper amount, on any escrow cushion that may be permitted by the mortgage contract.

IV. The States' Review of Industry Escrow Practices

To determine whether and to what extent over-escrowing is taking place on an industry-wide basis, in late October, 1988 the states contacted four of the largest national mortgage lenders regarding their escrowing practices. Escrow data concerning individual homeowner mortgages was requested from each of the companies, and meetings were held with each company and with representatives of the Mortgage Bankers Association of America (MBA) in February, 1989. Based on escrow analysis data provided, the descriptions given by the companies at our meetings of how they perform escrow analyses, and the information from the MBA, the states verified that escrow administration methods that lead to excessive escrowing of consumers' funds is an industry-wide practice, although the extent of the excesses held varies from company to company.

The states found two major problems. First, there appear to be widespread violations of the RESPA two-month ceiling. The mortgage companies exceed the RESPA

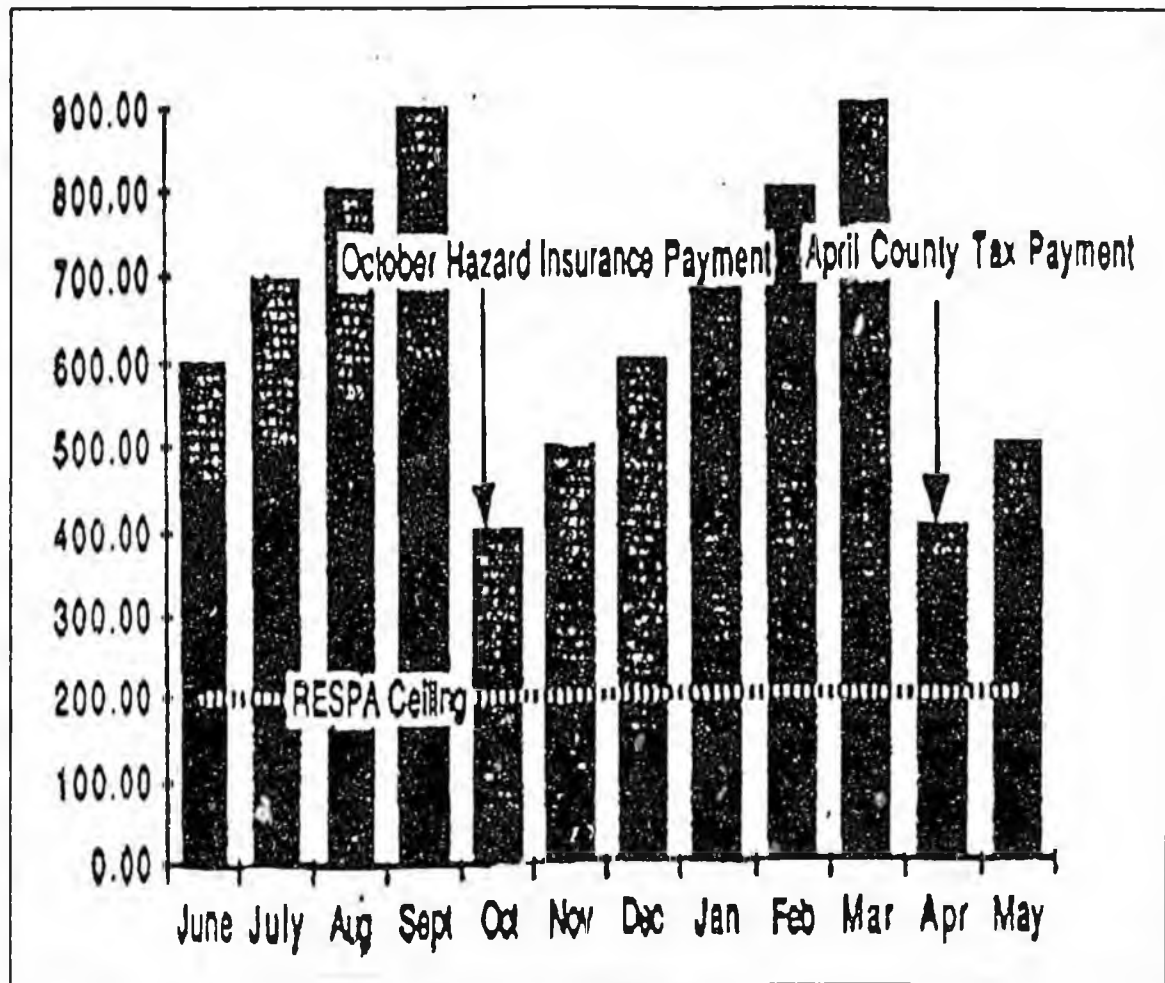
ceiling by utilizing an accounting technique called "individual item analysis." As described below, although this type of accounting analysis is permissible if properly used, it is invariably used in a manner that frequently results in unlawful escrow account balances. The problem with individual item analysis lies in the failure of the lenders to conduct checks on whether excessive balances have resulted and to take measures to restore appropriate balances as required by RESPA. Second, the states found that lenders routinely ignore the escrow account restrictions found in their underlying mortgage agreements (which typically provide for only a one month cushion or no cushion).

A. Violations of RESPA Limitation on Cushions

The Mortgage Bankers Association as well as each of the lenders we contacted readily acknowledged that the mortgage industry utilizes "individual item analysis" in establishing individual consumers' mortgage escrow accounts.

In individual item analysis, lenders, for accounting purposes, treat the single escrow account as if separate sub-accounts exist for each item which must be paid out of the escrow account. For example, each monthly escrow payment made by the consumer to the lender is apportioned to sub-accounts for such property-related expenses as school taxes, county taxes, sewage tax, and hazard insurance. Lenders then require that each of these hypothetical sub-accounts never dip below zero, regardless of how much money may be in the escrow account as a whole when each payment must be made. This method assumes, for example, that money in the school tax sub-account could not be used to pay a hazard insurance bill in a particular month. Unless lenders check and adjust for excesses, the use of individual item analysis in many cases results in three, four, or even

more months' worth of escrow payments being maintained at all times. An explanation of how individual item analysis is performed by lenders in a specific case is provided in Appendix I.



This chart illustrates a simple escrow account and shows why individual item analysis, without a subsequent check of the projected running escrow balance, fails to detect or prevent excess cushions. Two bills are paid out of the account each year, a \$600 hazard insurance payment in October and a \$600 county tax payment in April. The total annual payments to be made are therefore \$1200. The monthly escrow payment is \$100, or one-twelfth of the total of the bills. Each month, \$50 of the consumer's payment of

\$100 is allocated to hazard insurance and \$50 is allocated to the county tax. Each column represents the total amount of money that individual item analysis would require to be on hand in each month. The black area represents that portion of the required balance attributable to the hazard insurance and the grey area represents the amount attributable to the county tax. Thus, as the chart shows, the account is set up in such a way that the full \$600 necessary to pay each bill has been collected by the month prior to the month in which the bill will be paid.

The amount of cushion in this account, -- that is, the amount in excess of that necessary to pay the bills when they come due -- is \$400, or twice the amount of the RESPA ceiling, even though the cushion in each sub-account is only \$50, or half the amount of what the RESPA ceiling would be if the ceiling were based on each individual sub-account.

The reason for the discrepancy is that individual item analysis assumes that in our example the money in the county tax sub-account is not available to pay the hazard insurance bill when it comes due. There will clearly be enough money to pay the October bill if there is \$600 in the total account at the end of September. Since there are six collections of \$100 each between September and March, the month before the April bill is due, there will also be no shortage in April when it comes time to pay the second \$600 bill. Yet individual item analysis requires a balance of \$900 in the account at the end of September, far in excess of that necessary to pay either bill when due.

A review of the escrow analyses provided to us by the four lenders whose practices we examined demonstrates that, in a majority of cases, individual item analysis

has created excessive cushions that violate RESPA. Using these lenders' own analyses and assuming that their underlying mortgage contracts allowed for the full two-month cushion to be collected (which, as discussed below in IV. B. is often not the case), the states checked the amount of the cushions that resulted. Two of the companies provided detailed data and their escrow analyses for approximately 40 randomly selected mortgages during a three year period. The states found that the escrow payments collected in over two-thirds of the analyses resulted in excessive cushions. For one company, in 72% of the 41 mortgages reviewed, consumers were required to make excessive escrow payments during at least one of the three years. For the second company, 89% of 38 mortgages reviewed indicated excessive payments in at least one of the three years. In dollar terms, the average amount by which the projected cushions exceeded the RESPA ceiling was \$150 - \$115.84 for the first company and \$203.97 for the second. The material so far provided by the other two companies has not allowed for such detailed analysis, but preliminary review suggests that similar results will be found. An explanation of how these numbers were computed is found in Appendix II.

Extrapolating from the results for these lenders to the industry as a whole reveals a problem of staggering proportions. Since there are tens of millions of home mortgages in the United States which require escrow accounts, an average surplus of \$150 in 2/3 of these mortgages would add up to several billion dollars nationwide, an estimate confirmed in conversations with HUD officials.

Given the widespread use of the individual item analysis approach, it is not surprising to find so many violations, adding up to such large sums of money. Although

the division of the escrow account into individual items is certainly a simple way to ensure that there will always be sufficient money on hand to pay bills as they come due, it almost guarantees the retention of an excessive cushion. If all bills were paid at about the same time of the year, a very unusual occurrence, all of the balances in the individual sub-accounts would drop to near zero at about the same time, and the overall cushion in the account would drop to near zero as well. However, when bills are paid out of the account at different times during the year, as is the usual case, at any time when one account is near zero, even if the lender does not intentionally attempt to maintain any cushion, other sub-accounts typically have substantial funds in them. As a result, the cushion is likely never to drop to the amount permitted by RESPA, let alone to the usually smaller cushion, if any, allowed by the mortgage contract.

While RESPA does not prohibit individual item analysis per se, if the industry wants to use this kind of accounting fiction for its own convenience, it must do two things. First, it must treat all of the money in its hypothetical sub-accounts as available to meet all of the consumer's obligations. This would be consistent with RESPA's requirement that the deposit each month to the account be no more than the "sum" of all of the separate items -- various "taxes", various insurance "premiums" and other "charges" -- and would conform to Congress' intent, as reflected in the language of Section 10 of RESPA, that there be only one escrow account per mortgage, not multiple or sub-accounts.

Second, in order to avoid excessive escrow balances, mortgage companies using individual item analysis to administer their accounts must also use some means of projecting the amount of cushion that will result and, as indicated in the HUD Handbook.

Administration of Insured Home Mortgages, Doc. No. 433.01 ("HUD Handbook") p. 13, make such adjustments as are necessary to ensure that use of this method of escrow analysis does not "create excessive surpluses." The lender, for example, must perform a trial "running escrow balance" for the upcoming year to ensure that at least at some point during the upcoming year, the escrow balance will dip to no more than two months' worth of escrow payments, or whatever lesser cushion is authorized by the mortgage contract. If the escrow account does not dip to that low point sometime during the year, then under Section 10 of RESPA, an excess exists in the escrow account. See Leff v. Olympia Savings, 55 U.S.L.W. 2260 (Sept. 19, 1986, N.D. Ill.)

The legislative history of RESPA confirms that Congress, in passing and then amending RESPA, expected strict compliance from the industry, not "sophisticated" accounting methods that circumvent Section 10 requirements. The original RESPA, passed in 1974, placed the ceiling on cushions at one-twelfth of annual escrow payments. When, one year later, Congress expanded the permissible cushion to two months, it did so because it specifically found the one month cap on cushions insufficient to protect lenders forced to advance corporate funds to pay the taxes and insurance for consumers who paid their mortgages more than one month late. Yet Congress expressly limited the cushion to two months, expecting that at some time during the year the amount in the escrow account balance would drop to that amount. Certainly Congress did not intend to allow a loophole so that the industry could manipulate a two month cushion into three, four or more months of escrow funds. See 1975 U.S. Cong. & Ad. News, p. 2448.

B. Violations of Underlying Mortgage Agreements

In addition to violating the RESPA ceiling, mortgage lenders also routinely ignore the escrow limits expressly contained in their own mortgage contracts.

For example, in the FNMA (Federal National Mortgage Association) "Uniform Instrument" mortgage contract used by many lenders throughout the United States since 1983, borrowers are required to make monthly payments of

...a sum ("Funds") equal to one-twelfth of (a) yearly taxes and assessments which may attain priority over this Security Instrument; (b) yearly leasehold payments or ground rents on the Property, if any; (c) yearly hazard insurance premiums; and (d) yearly mortgage insurance premiums, if any. These items are called "escrow items." Lender may estimate the Funds due on the basis of current data and reasonable estimates of future escrow items. (emphasis supplied)

This contractual language clearly limits the lender to a monthly payment not greater than one-twelfth of the "reasonabl[y] estimate[d]" yearly taxes and premiums. Nonetheless, as a result of the individual item analysis described above, many lenders require borrowers who have FNMA contracts to maintain a cushion of more than two months' worth of escrow payments.

Lenders improperly rely on RESPA to justify maintaining a two-month payment cushion, even where the mortgage document itself permits only a one-month cushion or no cushion at all. Yet RESPA simply sets the lawful "ceiling" for escrow payments specified in a mortgage contract. It does not by its own terms authorize lenders

to maintain a two-month cushion, if a lesser amount is dictated by the mortgage instruments. In other words, if the mortgage contract provides for no cushion or a one-month cushion, then the lender is bound by that contractual limitation. If the mortgage contract calls for a cushion greater than two months, RESPA's 1/6 limitation supersedes the contractual provision.

In enacting and subsequently amending RESPA, Congress restricted the size of escrow cushions, and did not provide authority, as the industry contends, to establish a two month escrow account cushion on loans where the mortgage contract calls for a smaller cushion or no cushion at all. HUD has correctly interpreted this aspect of Section 10 of RESPA when it stated; "The mortgage instrument [not RESPA] provides the authority for the mortgagee to accumulate sufficient escrow funds with which to pay the mortgagor's tax and insurance bills..." HUD Handbook, p. 7. Section 10 of RESPA simply provides a ceiling which lenders may not exceed, notwithstanding the escrow provisions in the mortgage document.

V. State Action To Date

To address the problems identified during their investigation and review, the states have taken the following steps. In July 1988, the states contacted officials responsible for RESPA enforcement in the federal Department of Housing and Urban Development ("HUD"). Members of the multi-state group met with representatives of HUD to discuss these issues. Counsel for HUD did not dispute the states' reading of the limitations that RESPA places on the amounts that lenders may hold in mortgage escrow accounts. HUD counsel invited the states to submit a comment on the then pending

proposed regulation, 24 CFR 3500.17, dealing explicitly with the amounts which can be held in escrow accounts.

On July 20, 1988, California, Iowa, New York and Texas submitted a joint comment to HUD on its proposed rule. Massachusetts subsequently filed its own letter in support of the other states' comment. Concurring in the comments, Minnesota joined in the multi-state review of home mortgage escrow practices. The states' comment asked that HUD's proposed rule, which did little more than restate the statutory language of RESPA, be modified to clarify and make explicit how lenders should properly compute balances under RESPA so as to avoid excesses under the law. See Appendix III, comment of the states to HUD, dated July 20, 1988.

In October, 1988, HUD contacted the states and asked that we clarify our comment by providing illustrative examples. The states complied with this request by submitting clarifying language as well as examples to HUD. See Appendix IV. In April, 1989, representatives of the states met again with HUD officials to discuss our concerns on over-escrowing.

By September, 1989, more than a year after the states had submitted their comments to HUD on its proposed rule, HUD still had not even proposed a revised rule, let alone promulgated a final rule. This failure to act led the states of California, Florida, Iowa, Massachusetts, Minnesota, New York and Texas on September 19, 1989 to write to HUD Secretary Jack Kemp to urge HUD to adopt the states' proposed regulation, which would make unequivocally explicit the escrow limitations under RESPA. See Appendix V. The states have received no response from Secretary Kemp. As a result, this

important issue, involving billions of homeowners' dollars, remains in administrative limbo.

CONCLUSION

Our inquiry has revealed substantial continuing violations of law in the mortgage industry. None of the mortgage companies we contacted conforms its escrow account practices to the restrictions imposed by either RESPA or its own mortgage agreements. When we examined the individual escrow analyses of two mortgage companies in detail, we found that in 71% of the cases reviewed, lenders required homeowners to deposit excessive monthly escrow payments in violation of RESPA. In other words, in 71% of the randomly-selected files, homeowners were being required to maintain illegally large escrow balances. These illegal escrow excesses averaged at least \$150 per mortgage. From our discussions with lenders and representatives of the Mortgage Bankers Association of America, it appears that these unlawful escrow account practices are standard operating procedure within the industry. Nationwide these improper practices deprive consumers of billions of dollars.

Although individual states may take legal action against lenders doing business within their boundaries, HUD has it within its power to end these industry-wide violations once and for all by vigorously enforcing the escrow limits of RESPA and the underlying mortgage contracts. The first step in such an enforcement campaign would be the promulgation of a rule to reiterate and clarify lenders' responsibilities under RESPA with respect to mortgage escrow payments, and to explicitly prohibit lenders from using individual item analysis to retain more than a two-month escrow cushion or from retaining any other cushion not authorized by the mortgage instrument. The Attorneys General

proposed such a rule nearly two years ago. Unless HUD acts to correct these escrow practices and ensure compliance with RESPA, the protections enacted by Congress nearly 15 years ago will continue to be thwarted and millions of homeowners throughout this nation will be forced by lenders to continue paying billions of dollars in excessive escrow payments.

Dated: April 24, 1990

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APPENDIX I

Individual Item Analysis

To determine the amount of money required to fund their escrow accounts, the mortgage companies use, with variations, individual item analysis, as illustrated in the following table:

<u>Bill</u>	<u>Balance on Hand</u>	<u>Effective Date of Analysis</u>		<u>Months Since Last Payment</u>	<u>Required Balance on Hand</u>
	<u>\$438.99</u>	<u>6/84</u>	<u>Estimated Payment ÷ 12</u>		
	<u>Next Payment Date</u>	<u>Estimated Payment</u>	<u>Estimated Payment ÷ 12</u>		
Hazard Insurance	12/84	\$460.00	\$38.33	6	\$229.98
FHA Insurance	2/85	\$321.59	\$26.80	4	\$107.20
County Tax	12/84	\$329.22	\$27.43	6	\$164.58
County Tax	4/85	\$329.20	\$27.43	2	\$ 54.86
Totals		\$1440.01	\$119.99		\$556.62
Required Balance on Hand			\$556.62		
Balance on Hand			\$438.99		
Shortage			\$117.63		
Estimated Monthly Payment			\$119.99		
Shortage ÷ 12			\$ 9.80		
New Escrow Payment			\$129.79		

As this table demonstrates, under individual item analysis, companies divide their accounts into separate sub-accounts, one for each payment due in the coming year.

In this illustration, those sub-accounts are for hazard insurance, FHA insurance and two county tax payments. Lenders then divide the amount of each payment by the number of months between payments to determine the monthly contribution to the escrow account necessary to make the payment when it comes due. To determine whether a shortage or surplus will occur in the coming year, they multiply the monthly contribution required for each bill by the number of months since the time the bill was paid. Totaling these amounts for each sub-account gives the lenders an aggregate figure (here \$556.62) that they can compare to the balance on hand (here \$438.99). If, as is the case in this example, the balance on hand is smaller than the sum of the payments they "should" already have collected, the mortgage companies claim there is a shortage (here \$117.63) and require the consumer to make up the difference. If the balance on hand is larger than the sum that "should" already have been collected, the companies, in some cases, give the consumer the option of having the excess refunded or credited to the consumer's escrow account. This approach ignores RESPA limitations as well as the terms of the individual mortgage documents.

APPENDIX II

Methodology

Our method of sampling accounts was not intended to provide a statistically sound basis for predicting what the exact industry-wide incidence of excessive escrow cushions might be. However, because some of the industry's most prominent mortgage lenders and servicers provided us with escrow account data, and because we were assured by MBA that the industry generally does escrow analysis in the same way, we believe that if we were to conduct a more extensive study we would find similar levels of over-escrowing by most other companies.

To select the accounts we reviewed, we asked each company to designate the first loan to close in each calendar year from 1980 to 1987 as mortgage number one, then skipping any satisfied mortgages, to select the 30th, 40th, 50th, 60th, and 70th mortgages in the natural sequence of their own in-house numbering systems. This system provided approximately 40 mortgages per company. Since the companies generally provided three years of analyses per mortgage, we were able to review nearly 120 escrow analyses per company.

As illustrated in the table below, we calculated a running balance based upon the information contained in the analyses about the current balance, the escrow payment

Effective Date of Analysis	Beginning Balance		Required Escrow Payment	
Jun-84	438.99		129.79	
	Bill One	Bill Two	Bill Three	Bill Four
Due Date	Dec-84	Feb-85	Dec-84	Apr-85
Amount	460.00	321.59	329.22	329.20
Transaction	Date	Amount	Running Balance	
Escrow PMT	Jun-84	129.79	168.78	
Escrow PMT	Jul-84	129.79	298.57	
Escrow PMT	Aug-84	129.79	428.36	
Escrow PMT	Sep-84	129.79	558.15	
Escrow PMT	Oct-84	129.79	687.94	
Escrow PMT	Nov-84	129.79	817.73	
Escrow PMT	Dec-84	129.79	947.52	
Bill 3	Dec-84	(329.22)	618.30	
Bill 1	Dec-84	(460.00)	158.30	
Escrow PMT	Jan-85	129.79	288.09	
Escrow PMT	Feb-85	129.79	417.88	
Bill 2	Feb-85	(321.59)	96.29	
Escrow PMT	Mar-85	129.79	226.08	
Escrow PMT	Apr-85	129.79	355.87	
Bill 4	Apr-85	(329.20)	26.67	
Escrow PMT	May-85	129.79	156.46	
Total of Bills	RESPA ceiling	Projected Cushion	Excess Cushion	
1,440.01	240.00	426.67	\$186.67	

required and the bills to be paid during the analysis period. After calculating the running balance, we calculated the total of the bills to be paid during the analysis period and divided the figure by six to obtain the RESPA ceiling. We compared the lowest balance to the ceiling to identify analyses that resulted in excess cushions.



STATE OF NEW YORK
DEPARTMENT OF LAW
120 BROADWAY
NEW YORK, NY 10271

ROBERT ABRAMS
Attorney General

JOHN W. CORWIN
Assistant Attorney General in Charge
Consumer Frauds and Protection Bureau

July 20, 1988

Office of General Counsel
Attention: Grant E. Mitchell
Rules Docket Clerk, Room 10278
Department of Housing and Urban Development
451 Seventh Street, S.W.
Washington, D.C. 20410

Re: Comments of the States of California, Iowa, New York, and Texas in Docket No. P-88-1256; FR-1942, May 16, 1988, Real Estate Settlement Procedures Act; Controlled Business Provisions and Miscellaneous Changes

Dear Mr. Mitchell:

On behalf of the Attorneys General of the States of California, Iowa, New York, and Texas we are writing in response to your request for comments on a proposed rule to update Regulation X, 24 CFR Part 3500, which covers certain provisions of the Real Estate Settlement Procedures Act ("RESPA"), 26 U.S.C. 1200, et seq. While the proposed rule covers a wide array of RESPA-related issues, this letter addresses only one: the amount of money retained by lenders in mortgage escrow accounts. Any rule concerning RESPA would not be complete unless it included specific provisions to ensure that lenders do not accumulate excessive balances in mortgage escrow accounts in violation of RESPA.

Our comments are straightforward. In short, the regulation should clearly state that:

1. RESPA does not permit a lender to retain a two-month "cushion" or any other amount of cushion in the escrow account unless the mortgage instruments themselves so provide.

2. RESPA does not permit a lender, through use of individual item analysis or other clever accounting methods, to retain more than a two-month cushion in the total escrow account.

Mortgage escrow accounts are established so that lenders can be assured that they will have received sufficient funds from the consumer to be able to pay taxes and hazard insurance when each is due, thereby protecting the lenders' interest in the mortgaged property. Congress, in passing RESPA in 1974, was concerned, *inter alia*, with eliminating the practice of many lenders of retaining sums in mortgage escrow accounts far in excess of the amounts actually necessary to pay tax and insurance payments when due. Congress was outraged that in some cases lenders were maintaining escrow accounts which always had at least a year's worth of escrow payments in them. Such "cushions" served no legitimate purpose to protect lenders' interests; rather they merely provided more funds to lenders on which they could earn greater profits.

Congress responded by limiting escrow accounts to no more than is necessary to maintain a one month surplus or cushion at all times. A year later, in response to lenders' complaints that this cushion was insufficient because consumers were often somewhat late in paying their mortgages, thereby depleting the escrow account balance and forcing lenders, in essence, to lay out additional funds to pay consumers' taxes and insurance, Congress amended RESPA to allow lenders to maintain a two month cushion.

Unfortunately, since RESPA was amended in 1975, section 10 of RESPA, which established the two-month limit on the amount of cushion that could be maintained in escrow accounts, has been, to a large degree, ignored. As a result, it is not uncommon for lenders to use a method of escrow analysis by which amounts substantially in excess of those permitted by RESPA are maintained at all times. Obviously, it is in the lenders' interest to continue this practice because in most states they pay no interest at all to consumers on the balances in these accounts, and even where states require interest payments, the rate of interest to be paid to consumers is usually only 2%. Thus, the higher the average balance maintained in these accounts, the greater the profit to lenders in servicing mortgages. The lenders are thereby reaping unauthorized and illegal windfalls by these practices.

Commendably, HUD is proposing to establish a regulation, 24 CFR 3500.17, dealing explicitly with the amounts which can be held in escrow accounts. As stated in the preamble to this proposed rule, there is at present no federal regulation which provides guidance in complying with

section 10 of RESPA. Contrary to some of the comments, to which the preamble refers, there is a great need for this guidance because, as explained below, lenders generally do not abide by the requirements of RESPA, Section 10. We therefore urge HUD to adopt a regulation which specifically sets forth how Section 10 of RESPA is to be implemented.

While the proposal begins the task of clarifying how lenders should compute escrow balances, it falls short in two critical areas, and therefore should be modified in order to fully comport with the language and legislative purpose of RESPA.

1. RESPA limits the size of cushions permitted in mortgage instruments rather than expanding or creating such cushions.

First, the proposed regulation does not address a common misunderstanding or misreading of Section 10. That Section sets an upper limit or "ceiling" of two months of escrow payments that lenders may retain in federally-related mortgages. It does not require lenders to retain that much, nor does it authorize them to retain that much if the mortgage instruments themselves dictate that a lesser amount be maintained.

Thus, it is improper for lenders to rely on RESPA to justify maintaining a two-month payment cushion, where the mortgage document itself permits only a one-month cushion. HUD has correctly interpreted this aspect of Section 10 in the HUD Handbook, Administration Of Insured Home Mortgages, Doc. No. 4330.1 ("HUD Handbook"), p. 7, which states: "The mortgage instrument provides the authority for the mortgagee to accumulate sufficient escrow funds with which to pay the mortgagor's tax and insurance bills...." Nor does including in the mortgage document the boiler-plate language that it is "subject to all federal laws" rewrite the specific terms agreed to by lenders and consumers with regard to the amounts which can be maintained in escrow accounts unless those specific terms violate the ceiling found in Section 10. The point needs to be made clear in HUD's regulation, as it is in the HUD Handbook, that the source of authority for maintaining an escrow account and for determining the size of that account is the mortgage document itself. Section 10 simply provides a ceiling which lenders may not exceed.

2. RESPA does not permit more than a two-month cushion to be maintained in escrow accounts, regardless of the method of escrow analysis used.

The second point which needs to be clarified in the proposed rule concerns the use of an escrow analysis technique called individual item analysis. Use of this

accounting method without a secondary check to determine if the RESPA limits will be exceeded has resulted in lenders commonly retaining excessive escrow amounts. In many cases lenders are consistently maintaining four months or more of escrow payments, in direct contravention of the limitations established by Congress in Section 10 of RESPA. While we have no quarrel with using individual item analysis, the lender must, as indicated in the HUD Handbook, p. 13, make sure that use of this method of escrow analysis does not "create excessive surpluses." The lender can do this by running a trial "running escrow balance" for the upcoming year, and ensuring that at least at some point in the upcoming year, the escrow balance can be expected to dip down to two months' worth of escrow payments.

The point can be illustrated by a description of the current common practice in the industry and of how it needs to be corrected. Most lenders perform an annual escrow analysis. Lenders look at each tax and insurance premium which needs to be paid during the upcoming year, when each tax or premium is next due, and when the last payment on each was made. Lenders then calculate how much should be on deposit in the escrow account at the time of the escrow analysis in order for there to be sufficient funds available to pay each tax payment or premium when it becomes due. Lenders do this by assuming that each escrow item has, in essence, a "sub-account" set up for it. The sub-account for school taxes, for example, should, under the lenders' practice, have sufficient funds in it so that when a school tax is due, it can be paid, out of that sub-account, without "borrowing" from other sub-accounts set up for other escrow items such as county taxes or hazard insurance. While intuitively this methodology sounds reasonable and would not appear to result in retaining more than two months' worth of escrow payments, in fact, the technique often results, as HUD makes explicit in its Handbook, in excessive amounts being maintained at all times during the year.

The reason this is so is that when a payment is made from one sub-account, such as the school tax sub-account, the other sub-accounts are likely to contain substantial amounts, because payments from those sub-accounts will not be made for several months. As a result, the aggregate contained in all sub-accounts, i.e. the actual balance in the total escrow account, will, for most consumers, always stay well above the two-month limitation set forth in Section 10 of RESPA. Thus, if individual item analysis is used, a trial running-balance must be done as a part of the annual escrow analysis to ensure that at some point during the year the escrow balance, i.e. the aggregate of all sub-accounts, will drop to two months' worth of the escrow payments. If it does

not, then an excess exists in the escrow account, which must, under RESPA, be returned to the consumer. See Leff v. Olympic FS&L, 55 U.S.L.W. 2260, 1986 WL 10636, No. 86 C 3026 (Sept. 19, 1986, N.D. Ill.).

Certainly Congress did not intend to turn a two month cushion into a cushion of three, four or more months by a clever accounting technique. This is evidenced by the Congressional reports on RESPA in 1974 and its subsequent amendments in 1975. 1974 U.S. Code Cong. & Ad. News 6546; 1975 U.S. Code Cong. & Ad. News 2448.

We therefore urge you to modify the proposed regulation to incorporate the specific recommendations we have suggested. We believe this will serve to benefit consumers as well as to bring lenders' mortgage escrow practices into compliance with the requirements of RESPA.

Thank you for this opportunity to comment on your proposed RESPA regulations. We stand ready to assist HUD in helping to obtain compliance with the requirements of that law.

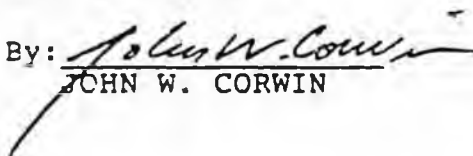
Sincerely yours,

ALBERT N. SHELDEN
Deputy Attorney General
for the State of California

RICHARD CLELAND
Assistant Attorney General
for the State of Iowa

JOHN W. CORWIN
Assistant Attorney General
for the State of New York

STEPHEN GARDNER
Assistant Attorney General
for the State of Texas

By: 
JOHN W. CORWIN



STATE OF NEW YORK
DEPARTMENT OF LAW
120 BROADWAY
NEW YORK, NY 10271

ROBERT ABRAMS
Attorney General

JOHN W. CORWIN
Assistant Attorney General in Charge
Consumer Frauds and Protection Bureau

October 24, 1988

Office of General Counsel
Attention: Grant E. Mitchell
Room 10248
Department of Housing and Urban Development
451 Seventh Street, S.W.
Washington, D.C. 20410

Re: Proposed Language
For 24 CFR §3500.17
To Implement Section
10 Of RESPA

Dear Mr. Mitchell:

Pursuant to your request, on behalf of the Attorneys General of the States of California, Iowa, Massachusetts, Minnesota, New York and Texas we are submitting the attached proposed language for a rule that would, we believe, incorporate the requirements of Section 10 of the Real Estate Settlement Procedures Act ("RESPA"), 26 U.S.C. 1200, et seq. As indicated, we will be submitting tomorrow some examples of how mortgage escrow analyses would be carried out if this rule were promulgated.

Thank you for your consideration of this proposed language. Please call Mel Goldberg if there are any questions regarding this proposal.

Sincerely yours,

JOHN VAN DE KAMP
California Attorney General
ALBERT NORMAN SHELLEN
Deputy Attorney General

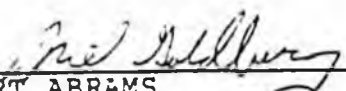
THOMAS J. MILLER
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Assistant Attorneys General

BY:


ROBERT ABRAMS
New York Attorney General
MEL GOLDBERG & SHIRLEY STARK
Assistant Attorneys General

§3500.17(b) Escrow Analysis

Regardless of the method of escrow analysis utilized or the terms of the underlying mortgage instruments, a lender shall collect and hold no more in an escrow account than is necessary to make the required tax and insurance payments when due plus, if provided for in the mortgage instrument, an amount sufficient to maintain at all times in the escrow account a cushion as provided in the mortgage instruments. In no case shall such cushion be greater than one-sixth of the annual escrow payments. For the purpose of determining whether the lender maintains an excessive escrow balance, the escrow payments by a borrower shall be treated as an aggregate amount, regardless of whether a lender establishes or maintains sub- or separate accounts for individual escrow items or payments. Accordingly, lenders, when performing an escrow analysis, must perform a trial running balance for the aggregate escrow account for the upcoming year or perform some other appropriate calculation to ensure that during the course of the upcoming year the aggregate escrow balance will fall to the level authorized in the mortgage instruments, or one-sixth of the annual escrow payments, whichever is less. If in performing such running balance or calculation, it is determined that the aggregate escrow balance during the upcoming year will not fall to that level, the lender shall: 1) notify the borrower that there is an excess in the escrow account; and 2) adjust the amount in the mortgage escrow account, by, for example, issuing a lump sum refund or reducing the monthly escrow payments, or otherwise adjusting the escrow amount pursuant to the terms of the mortgage instrument, in order to ensure that the aggregate escrow balance does fall to that level during the upcoming year.

An escrow analysis is performed in March 1989 for a mortgage which has three tax and insurance payments during the year: 1) Hazard Insurance due in June, estimated at \$240 for the upcoming year, 2) School Tax due in September, estimated at \$1200 for the upcoming year, and 3) Township Tax due February 1990 estimated at \$720 for the upcoming year. At the end of February 1989, before the escrow analysis, there was \$600 in the escrow account. The lender performs an individual item escrow analysis as follows:

Descript of Exp	Next Due	Est Amt Next Exp	Term Mos	Monthly Escrow	Months Elapse	Escrow Required
Hazard	06/89	\$240	12	\$20	9	\$180
School	09/89	\$1200	12	\$100	6	\$600
Town	02/90	\$720	12	\$60	1	\$60
Escrow Balance After 2/29/89		Escrow Required	Short- age	Total Monthly Escrow		Total Escrow Required
\$600		\$840	\$240-	\$180		\$840
Monthly Escrow Required		Shortage Amount Prorated	Monthly			New Monthly Escrow Amount
\$180		\$20				\$200

Under a typical individual item escrow analysis, the consumer would be required to pay \$200 a month to the escrow account, beginning in March, 1989. The proposed rule would require that the lender perform a trial running balance as part of its escrow analysis to ensure that at some point during the upcoming year the aggregate escrow balance drops to the surplus authorized by the mortgage instruments or 1/6 of the total amount of escrow funds estimated to be paid out in the upcoming year, whichever is less. Assuming for the purposes of this example that the mortgage instruments authorize a 1/6 cushion, the balance would have to drop to \$360 at some point in the year ($(\$240 + \$1200 + \$720) / 6 = \360). The trial running balance would look as follows:

Month	Credits	Debits	Balance
			\$600 on 2/29
March	\$200		800
April	200		1,000
May	200		1,200
June	200	240	1,160
July	200		1,360
August	200		1,560
September	200	1,200	560
October	200		760
November	200		960

December	200		1,160
January, 1990	200		1,360
February	200	720	840

Collecting \$200 monthly for the escrow account, as calculated using individual item analysis results in a minimum balance during the upcoming year of \$560, in September. This is \$200 more than RESPA permits. By September there would have been seven \$20 payments, or \$140 towards the alleged shortage of \$240. Thus, even rejecting the shortage calculation completely and keeping the monthly escrow payment at \$180, there would still be \$420 in the escrow account at the end of September, \$60 more than PFSPA allows. Thus, rather than a \$240 shortage as calculated using individual item analysis, there is in fact a \$60 excess in March 1989 when the escrow analysis is being done. Under the regulation, the lender would have to adjust the amount in the mortgage escrow account, by, for example, refunding \$60 and setting the monthly escrow payment at \$180, or reducing the monthly escrow payment below \$180, so that at the end of September the escrow balance drops to \$360.



STATE OF NEW YORK
DEPARTMENT OF LAW
120 BROADWAY
NEW YORK, N.Y. 10271

ROBERT ABRAMS
ATTORNEY GENERAL

September 19, 1989

The Honorable Jack F. Kemp
Secretary
The Department of Housing & Urban
Development
451 7th Street, S.W.
Washington, D.C. 20410

Dear Secretary Kemp:

We write to urge you to act decisively and swiftly to correct a serious problem that harms millions of homeowners in our states and throughout the nation. The problem is the widespread practice among mortgage lenders of compelling consumers to pay substantially more money into home mortgage escrow accounts than is permitted under the Real Estate Settlement Procedures Act ("RESPA"), 12 U.S.C. 2609. The corrective action needed is HUD adoption of a regulation, proposed to your office over a year ago, to make unequivocally explicit the escrow limitations under RESPA.

As you know, most mortgage contracts permit lenders to require each of their mortgagors to fund a mortgage escrow account to ensure payment of annual taxes and hazard insurance on the mortgaged property. In 1974, Congress enacted RESPA, in part to prohibit the practice of forcing homeowners to fund mortgage escrow accounts in amounts far in excess of what was actually necessary to pay tax and insurance payments when due. As originally enacted, RESPA limited this compulsory escrow account funding to the amount necessary to make tax and insurance payments when due, plus an additional "cushion" of no more than one-twelfth of the total amount of such payments. In 1975, after lenders complained that this did not provide adequate protection, Congress amended RESPA to raise the permissible cushion to one-sixth of the total annual tax and insurance payments.

Remarkably, during the course of an investigation into the escrow practices of several of the largest mortgage lenders in the country, we discovered that RESPA limitations have been largely ignored by the mortgage industry since 1975. More specifically, much of the mortgage industry uses creative accounting procedures which in many cases results in an escrow account cushion that is 50% to 100% higher than the permissible limit under RESPA. Moreover, despite the fact that RESPA merely sets a ceiling on any contractually authorized escrow account funding, many lenders have cited RESPA as authority for compelling a mortgagor to fund an escrow account up to the ceiling amount even where the mortgage contract does not authorize an escrow account or where the contract explicitly sets a lower ceiling.

As a result of these widespread practices, American homeowners collectively have been compelled to deposit several billion dollars of extra money into their escrow accounts, in violation of RESPA and the intent of Congress. In most cases, these accounts pay no interest to consumers. In those few states where interest is required to be paid on these accounts, it is almost always at submarket rates.

In formal comments to proposed regulations under section 10 of RESPA last year (copy enclosed), we urged your office to promulgate a regulation expressly reaffirming that the federal statutory limit on escrow accounts cannot be violated regardless of the creative accounting procedure used by mortgage lenders to circumvent that limit. While our proposal apparently was favorably received by your staff, and announcement in the Federal Register of a proposed regulation on the escrow account issue appeared to be near at hand in March, further progress on this issue now seems to be stalled. Because of the wide impact of the proposed regulation -- literally millions of homeowners would receive refunds or credits rightfully due them -- strong, swift action on our proposal could be an important step in building public confidence that the Department, under your leadership, will revitalize its resolve to protect the public interest.

We would be available to meet with you to more fully discuss this matter.

Sincerely,

JOHN VAN DE KAMP
Attorney General of the
State of California

ROBERT A. BUTTERWORTH
Attorney General of the
State of Florida

THOMAS J. MILLER
Attorney General of the
State of Iowa

JAMES M. SHANNON
Attorney General of the
Commonwealth of Massachusetts

HUBERT H. HUMPHREY, III
Attorney General of the
State of Minnesota

JIM MATTOX
Attorney General of the
State of Texas

BY:



ROBERT ABRAMS
Attorney General of the
State of New York

STATE INTEREST ON CROW ACCOUNT LAWS

<u>Applies To</u>	<u>Interest Rate</u>	<u>Institutions Covered</u>	<u>Exceptions-- Payment of Interest Not Required</u>	<u>Notes</u>
<hr/> CALIFORNIA <hr/>				
Loans after 1/1/77	2%	All	<ul style="list-style-type: none"> ◆ Loans made prior to effective date ◆ Moneys required by a state or regulatory authority to be placed by a lender other than a bank in a noninterest bearing demand trust fund account on loans after 1/1/80. 	<ul style="list-style-type: none"> ◆ Funds must be kept in the state. ◆ Escrow accounts on single-family, owner-occupied dwellings are optional, subject to five exceptions that protect the lender's security interest. ◆ Benefits from deposit on funds in interest bearing accounts above 2% shall accrue to lender. ◆ Applies to institutions that make or purchase loans.
<hr/> CONNECTICUT <hr/>				
Loans prior to 10/1/92	5.25%	All	<ul style="list-style-type: none"> ◆ Contract entered into before 10/1/75 and specifically disclaims interest on escrow. ◆ Violates Federal law or regulation. ◆ Servicing performed by company unaffiliated with lender, on contracts before 10/1/75, if servicer does not earn a return from investment of the escrow accounts. ◆ Loans executed between 10/1/77 and 1/1/89 and held for sale not more than 1 year by a servicer unaffiliated with purchaser; or loans executed on or after 1/1/89 and held for sale, servicing released, not more than 6 months by such servicer. 	<ul style="list-style-type: none"> ◆ If contract is prior to 10/1/77 and specifies 2%, a higher rate may not be required.
Loans 10/1/92-9/31/94	4.00%			
Loans on/after 10/1/94	5.25%			
<hr/> IOWA <hr/>				
Loans on/after 7/1/82	Passbook Savings rate	State chartered banks, savings loans, credit unions, and industrial loan companies.	◆ None	<ul style="list-style-type: none"> ◆ A lender may not require, as condition of a loan, that the borrower's funds be deposited so as to increase the yield to the lender; however, a lender may require a borrower to deposit money without interest in an escrow account to pay taxes and insurance.

<u>Applies To</u>	<u>Interest Rate</u>	<u>Institutions Covered</u>	<u>Exceptions-- Payment of Interest Not Required</u>	<u>Notes</u>
MAINE				
All loans	3%	Financial institutions & credit unions that are state or federally chartered with the principal office in the state; & supervised lenders.	<ul style="list-style-type: none"> ◆ Prohibited by Federal law or regulation. 	<ul style="list-style-type: none"> ◆ If the loan or note requires an escrow account, the mortgage deed must contain provisions for payment of interest, effective 1/1/92. ◆ May charge fee for administration of escrow account but interest can not be reduced by such service charge.
MARYLAND				
Loans after 5/31/74	Greater of passbook savings rate or 3%	Banks, savings banks, and savings and loans	<ul style="list-style-type: none"> ◆ Does not apply if loan is purchased by an out-of-state by an out-of-state lender through FNMA, GNMA, or or FHLMC and the out-of-state lender elects to service the loan. ◆ If the mortgage contract does not require the payment of interest, the purchaser of the loan does not have to pay interest. ◆ Financial institutions regulated by OTS. ◆ Mortgage and escrow account are assigned from an exempt lender that made the loan to nonexempt lender. ◆ Uses direct reduction method of applying tax and insurance payments. 	<ul style="list-style-type: none"> ◆ Applies to state chartered lending institutions doing business in the state that make mortgage loans and create, or are the assignee of, an escrow account.
MASSACHUSETTS				
Loans after 7/1/75	Determined by mortgagee annually	All	<ul style="list-style-type: none"> ◆ If lender can demonstrate a net loss from the investment of escrowed funds in its annual report, the Commissioner of Banks may grant an exemption from paying interest on escrow accounts. Exemption is good for only one year. ◆ Federally chartered thrifts with regard to loans on 2- to 4-unit residences and loans executed prior to 6/16/75. 	<ul style="list-style-type: none"> ◆ Applies only to escrow of real estate taxes.

<u>Applies To</u>	<u>Interest Rate</u>	<u>Institutions Covered</u>	<u>Exceptions-- Payment of Interest Not Required</u>	<u>Notes</u>
MINNESOTA				
All loans	5%	All	<ul style="list-style-type: none"> ◆ Escrow account is mandatory under Federal law or regulation. ◆ Conventional loan with original LTV greater than than 80%. ◆ Loans insured by HUD, VA, FmHA. 	<ul style="list-style-type: none"> ◆ Mortgagee may offer options to an escrow account. ◆ Conventional loan: under \$100,000 & is not authorized by OTS or OCC or eligible for purchase by FNMA or FHLMC. ◆ Administration fee prohibited.
NEW HAMPSHIRE				
All loans	2.5%	Banks & mortgage companies	<ul style="list-style-type: none"> ◆ None 	<ul style="list-style-type: none"> ◆ Applies to banks and to companies in the business of making loans for acquisition purposes that require, or accept monies for, an escrow account. ◆ Rate set biannually at 1% below mean interest rate paid on passbook savings accounts by state banks.
NEW YORK				
All loans	2%	All	<ul style="list-style-type: none"> ◆ Violates Federal law or regulation. ◆ Loans made prior to 4/1/74 that have an express disclaimer not to pay interest. ◆ Servicing contract before 4/1/74 does not permit company to receive return on investments from escrowed funds. 	<ul style="list-style-type: none"> ◆ Insurance drafts received as compensation for damage to a residence and deposited in escrow are included under interest requirements. ◆ Rate set annually. ◆ Administration fee prohibited.
OREGON				
All Loans	4.5%	All	<ul style="list-style-type: none"> ◆ Loan is over \$100,000. ◆ Loan or loan servicing is sold within 1 year to unaffiliated out-of-state purchaser and loan origination documents state Oregon law does not require lender to pay interest. ◆ Violates Federal law/regulation. ◆ Loans prior to 9/1/75; however, if federal law does not prohibit or is silent concerning payment of interest, then interest must be paid on all loans of federally and state chartered institutions. 	<ul style="list-style-type: none"> ◆ If loan agreement, executed between 9/1/75 & 10/1/77, is inconsistent with the statute or silent concerning an escrow account, the rate prior to 10/1/77 applies. ◆ Service charge prohibited.

<u>Applies To</u>	<u>Interest Rate</u>	<u>Institutions Covered</u>	<u>Exceptions-- Payment of Interest Not Required</u>	<u>Notes</u>
RHODE ISLAND				
All loans	4%	All	<ul style="list-style-type: none"> ◆ Loans insured by FHA, VA, FmHA or a private mortgage insurer licensed to do business in the state. 	<ul style="list-style-type: none"> ◆ Prohibits charge for ascertaining whether taxes have been paid.
UTAH				
All loans	5.25%	All	<ul style="list-style-type: none"> ◆ Account required by government insurer or guarantor. ◆ Original LTV is greater than 80%. ◆ Violates Federal law or regulation. 	<ul style="list-style-type: none"> ◆ Mortgagee may offer options to an escrow account. ◆ Service charge prohibited.
VERMONT				
All loans	5% or, for institutions that offer savings accounts, the savings account rate	All	<ul style="list-style-type: none"> ◆ If lender requires escrow account because borrower has failed within past year to pay taxes and insurance on time. ◆ Federal institutions and agencies, if not permitted by Federal law. 	<ul style="list-style-type: none"> ◆ Funds must be kept in federally insured depository institution.
WISCONSIN				
Loans or extensions to 11/1/81	5.25%	Banks, credit unions mutual savings banks	<ul style="list-style-type: none"> ◆ Funds held by third party in non-interest bearing account. ◆ FHA, VA, or FmHA loans ◆ Institutions regulated by the OTS. 	<ul style="list-style-type: none"> ◆ Parties may agree to waive all or part of interest if greater than 75% of lender's interest is sold to unaffiliated third party who holds the escrow funds.
31/83		Adds mortgage bankers, savings banks, & savings and loans.		

Historical Note

St.1972, c. 412, § 1, was approved June 8, 1972, and by section 2 made applicable "to contracts entered into on and after the effective date of this act".

Library References

Mortgages \Leftrightarrow 298(1).

C.J.S. Mortgages § 445 et seq.

RENEWAL OF MORTGAGE NOTES

Caption editorially supplied

§ 60. Interest Rate Increases

Whenever any mortgage note secured by a first lien on a dwelling house of three or fewer separate households occupied or to be occupied in whole or in part by the mortgagor provides for installment payments of principal, with or without interest, that will not amortize the outstanding principal amount in full by the maturity of such note, no increased rate of interest shall be imposed as a condition of renewing the note unless such increased rate of interest is not greater than one half of one per cent more than the rate charged on the note immediately before such maturity and the term of such renewal note is not less than five years.

Added by St.1973, c. 115.

Historical Note

St.1973, c. 115, was approved March 27, 1973.

Library References

Interest \Leftrightarrow 33.

C.J.S. Interest § 86.

REAL ESTATE TAX DEPOSITS WITH MORTGAGEE

Caption editorially supplied

§ 61. Payment of interest by mortgagee; exemption; profit or loss statement; report

A mortgagee doing business in the commonwealth and holding a first mortgage or lien on a dwelling house of four or fewer separate households occupied or to be occupied in whole or in part by the mortgagor who requires advance payments, deposits or other security

by said mortgagor for the payment of real estate taxes on mortgaged property, shall pay interest to said mortgagor on any amounts so paid or deposited in advance. Interest shall be paid at least once a year at a rate and in a manner to be determined by the mortgagee.

Mortgagees required to pay such interest shall file annually with the commissioner of banks a statement showing the amount of net profit or loss from the investment of said deposits. Mortgagees showing a net loss from these investments may file with said commissioner a request for an exemption from the requirement that interest be paid to mortgagors. The commissioner shall maintain as a public record an annual report of interest rates paid to mortgagors as required by this section during the preceding annual period. The report shall list the mortgagees granted exemptions under this section during the preceding annual period.

Added by St.1978, c. 299, § 1.

Historical Note

St.1978, c. 299, § 1, was approved May 21, 1978.

Section 2 provided: "The provisions of section sixty-one of chapter one hundred and eighty-three of the General Laws, inserted by section one of this

act, shall take effect on July first, nineteen hundred and seventy-five, and shall apply only to advance deposits for the payment of real estate taxes on mortgaged property made on or after that date."

Library References

Mortgages G-200(3).

C.J.A. Mortgages § 233.

§ 62. Payment of taxes to city or town by mortgagee; due date

Any mortgagee who requires the prepayment of taxes for real estate located in the commonwealth shall pay to the city or town wherein the property is located the full amount of taxes due on or before the date upon which said taxes become due provided that the mortgagor has paid said amount to the mortgagee. If the mortgagor has not paid the full amount of taxes due before said date, the mortgagee shall pay to the city or town wherein the property is located all amounts which have been paid to him by the mortgagor. Such mortgagee may make such payments by presenting notes issued by the city or town in anticipation of revenues, if the treasurer of the city or town has agreed to accept such notes in payment of real and personal property taxes as provided in section four B of chapter forty-four.

Added by St.1974, c. 104. Amended by St.1976, c. 4, § 30.

enforce any other obligation including the costs and expenses incurred in any enforcement authorized by law.

The provisions of this section as added by Chapter 1430 of the Statutes of 1970 shall only affect loans made on and after January 1, 1971.

The amendments to this section made at the 1975-76 Regular Session of the Legislature shall only apply to loans executed on and after January 1, 1976.

(Amended by Stats.1975, c. 794, p. 1780, § 2; Stats.1984, c. 890, § 2.)

Historical Note

1975 Amendment. Substituted 10 days for 6 days in which the borrower may cure the delinquency without a late charge, inserted "as added by Chapter 1430 of the Statutes of 1970" in the penultimate paragraph, and added last paragraph.

1984 Amendment. Substituted in the first paragraph of subd. (a) "other than a loan made pursuant to Division 9 (commencing with Section 23000), Division 10 (commencing with Section 24000), or Division 11 (commencing with Section 26000)" for "other than a loan made pursuant to Section 23464"; and inserted in subd. (a) "or her" following "his".

Law Review Commentaries

Commentaries reaches the incorrect trust deed. (1977) 32 S. Bar J. 203.

Notes of Decisions

In general 1
vol 2

1. In general

Reported settlement of class action brought by borrowers against savings and loan association was not valid insofar as

it pretended to deal with validity of clause in association's mortgage form permitting it to raise interest rates whenever its interest rates paid to depositors were increased, where such clause was outside scope of amended complaint, class representatives did not define class to include persons seeking relief from such clause and did not purport to represent such class, and where court was not informed of pendency of other action against association raising validity of said clause. *Treury v. Los Angeles Federal Sav. and Loan Ass'n* (1975) 121 Cal.Rptr. 637, 44 C.A.3d 134.

2. Estoppel

Debtor's failure to object to late charges during relief from stay proceedings and his failure to raise defense of lender's failure to send delinquency notice as required under this section did not estop debtor from raising defense, where matter of validity of late charges never became issue in relief from stay proceedings, section clearly provided that in order for lender to assess late charges lender must comply with notice requirements, and lender knew he had never sent notice and did not rely on any conduct of debtor to his injury. *In re Hiale, Breyer*, 8 D. Cal. 1966, 69 B.R. 768.

§ 2964.6. Mortgage insurance; cancellation rights; notification

(a) If private mortgage insurance or mortgage guaranty insurance, as defined in subdivision (s) of Section 12640.02 of the Insurance Code, is required as a condition of a loan secured by a deed of trust or mortgage on real property, the lender or person making or arranging the loan shall notify the borrower whether or not the borrower has the right to cancel the insurance. If the borrower has the right to cancel, then the lender or person making or arranging the loan shall notify the borrower in writing of the following:

- (1) Any identifying loan or insurance information necessary to permit the borrower to communicate with the insurer or the lender concerning the insurance.
- (2) The conditions that are required to be satisfied before the mortgage insurance may be subject to cancellation.
- (3) The procedure the borrower is required to follow to cancel the private mortgage insurance or mortgage guaranty insurance.

(b) The notice required in subdivision (a) shall be given to the borrower upon close of escrow or as soon thereafter as the lender or person making or arranging the loan knows or should know the requirements for cancellation of the private mortgage insurance or mortgage guaranty insurance. The notice shall be provided without cost to the borrower.

(c) This section shall not apply to any mortgage funded with bond proceeds issued under an act requiring mortgage insurance for the life of the loan nor to any insurance issued pursuant to Section 12640.02 (commencing with Section 51600) of Division 91 of the Health and Safety Code.

(Added by Stats.1982, c. 569, § 1.)

§ 2964.8. Impound accounts; payment of interest; restrictions; exceptions; application

(a) Every financial institution that makes loans upon the security of real property containing only a one- to four-family residence and located in this state or purchases obligations secured by such property and that receives money in advance for payment of taxes and assessments on the property,

Additional provisions in text are indicated by underlining; deletions by ~~deletions~~ * * *

for insurance, or for other purposes relating to the property, shall pay interest on the amount so held to the borrower. The interest on such amounts shall be at the rate of at least 2 percent simple interest per annum. Such interest shall be credited to the borrower's account annually or upon termination of such account, whichever is earlier.

(b) No financial institution subject to the provisions of this section shall impose any fee or charge in connection with the maintenance or disbursement of money received in advance for the payment of taxes and assessments on real property securing loans made by such financial institution, or for the payment of insurance, or for other purposes relating to such real property, that will result in an interest rate of less than 2 percent per annum being paid on the moneys so received.

(c) For the purposes of this section, "financial institution" means a bank, savings and loan association or credit union chartered under the laws of this state or the United States, or any other person or organization making loans upon the security of real property containing only a one- to four-family residence.

(d) The provisions of this section do not apply to any of the following:

(1) Loans executed prior to the effective date of this section.

(2) Moneys which are required by a state or federal regulatory authority to be placed by a financial institution other than a bank in a non-interest-bearing demand trust fund account of a bank.

The amendment of this section made by the 1979-80 Regular Session of the Legislature shall only apply to loans executed on or after January 1, 1980.

(Added by Stats.1976, c. 25, p. 40, § 1. Amended by Stats.1979, c. 808, p. 2765, § 1.)

Historical Note

1979 Amendment. Inserted in subd. (d) (2) following "moneys which are" the words "required by a state or federal regulatory authority"; and added the last paragraph.

Section 2 of Stats.1979, c. 801, p. 2763, provided:

"The provisions of this act shall become operative only if Proposition No. 2 is approved by the voters on November 4, 1979." [Proposition 2 was approved Nov. 4, 1979.]

§ 2954.9. Loans for residential property of four units or less; right to prepayment

(a) (1) Except as otherwise provided by statute, where the original principal obligation is a loan for residential property of four units or less, the borrower under any note or evidence of indebtedness secured by a deed of trust or mortgage or any other lien on real property shall be entitled to prepay the whole or any part of the balance due, together with accrued interest, at any time.

(2) Nothing in this subdivision shall prevent a borrower from obligating himself, by an agreement in writing, to pay a prepayment charge.

(3) This subdivision does not apply during any calendar year to a bona fide loan secured by a deed of trust or mortgage given back during such calendar year to the seller by the purchaser on account of the purchase price if the seller does not take back four or more such deeds of trust or mortgages during such calendar year. Nothing in this subdivision shall be construed to prohibit a borrower from making a prepayment by an agreement in writing with the lender.

(b) Except as otherwise provided in Section 10242.6 of the Business and Professions Code, the principal and accrued interest on any loan secured by a mortgage or deed of trust on owner-occupied residential real property containing only four units or less may be prepaid in whole or in part at any time but only a prepayment made within five years of the date of execution of such mortgage or deed of trust may be subject to a prepayment charge and then solely as herein set forth. An amount not exceeding 20 percent of the original principal amount may be prepaid in any 12-month period without penalty. A prepayment charge may be imposed on any amount prepaid in any 12-month period in excess of 20 percent of the original principal amount of the loan which charge shall not exceed an amount equal to the payment of six months' advance interest on the amount prepaid in excess of 20 percent of the original principal amount.

(Added by Stats.1974, c. 1069, p. 2280, § 1. Amended by Stats.1975, c. 763, p. 1775, § 2; Stats.1977, c. 579, p. 1825, § 32; Stats.1979, c. 891, p. 1458, § 1.)

Historical Note

1974 Legislation.

Section 2 of Stats.1974, c. 1069, p. 228, provides

"This act shall be applicable only to loans secured by mortgages or deeds of trust executed after January 1, 1975."

1975 Amendment. Redesignated former subd. (a) to (c) as paragraphs (1) to (3) of subd. (a), inserted "Except as

otherwise provided by statute" in subd. (a) (1), substituted "This subdivision" for "Subdivision (a) of this section" in subd. (a) (3), and added subd. (b).

Section 3 of Stats.1975, c. 763, p. 1774, provided:

"This act shall be applicable only to loans secured by mortgages or deeds of trust executed after January 1, 1976."

• Additions in text are indicated by underlines; deletions by asterisks * * *

Notes of Decisions

Savings bank investments 3

Trust company charter, acceptance of

Unclaimed accounts, interest on 2

1. Trust company charter, acceptance of

Charter of Real Estate Trust Co. may be accepted and authorization certificate issued by State Banking Department. 1937, Op. Atty. Gen. 302.

2. Unclaimed accounts, interest on

A by-law adopted with the approval of the Banking Board, permitting a savings bank to discontinue the payment of interest or dividends on "unclaimed accounts" which have re-

mained so for a period of fifteen years, and after a written report thereof has been made to the Superintendent of Banks, would appear to be consistent with provisions of this chapter. 1941, Op. Atty. Gen. 375.

2. Savings bank investments

Securities or obligations in which the Banking Board may authorize investment under subdivision 1(f) of this section and in which savings banks may invest under subdivision 19 of section 235 include the interest bearing obligations of private or municipal corporations whether or not they are of a class for which specific tests are provided in section 235. 1944, Op. Atty. Gen. 302.

§ 14-a. Power of the banking board to prescribe rate of interest

1. It is hereby declared to be the policy of the state of New York that for the period ending September first, nineteen hundred seventy-one the rate of interest provided in section 5-501 of the general obligations law shall be adjusted by the banking board in response to changed economic conditions in such manner as to insure the availability of credit at reasonable rates to the people of the state while affording a competitive return to persons extending such credit.

2. (a) For the purpose of effectuating the policy declared in subdivision one of this section, the banking board shall have power prior to September first, nineteen hundred seventy-one by a three-fifths vote of all its members:

(1) from time to time, but not more often than quarterly, to prescribe by regulation a rate of interest not less than five per centum per annum nor more than seven and one-half per centum per annum as the maximum rate of interest to be charged, taken or received, upon a loan or forbearance of any money, goods or things in action, except as otherwise provided by law, and

(2) to adopt such other regulations as it shall deem necessary or proper to implement the provisions of this section.

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(b) The rate of interest prescribed by the banking board pursuant to paragraph (a) of this subdivision shall be based on prevailing economic conditions including, in particular, yields on conventional home mortgages throughout the United States and on corporate interest-bearing securities of high quality, and shall include as interest any and all amounts paid or payable, directly or indirectly, by any person, to or for the account of the lender in consideration for making the loan or forbearance as defined by the banking board pursuant to subparagraph two of paragraph (a) of this subdivision.

(c) No rate of interest prescribed by the banking board pursuant to paragraph (a) of this subdivision shall remain in effect after September first, nineteen hundred seventy-one, except that any loan or forbearance made on or before such date at a rate of interest not in excess of the rate of interest authorized by law at the time such loan or forbearance was made shall continue to be enforceable in accordance with its terms and the provisions of section 5-501 of the general obligations law.

3. The banking board shall provide reasonable notice to the public of any change in the rate of interest, of the effective date of each such change, which shall be not less than seven days following the adoption of such change by the banking board, and of any rule or regulation adopted pursuant to paragraph (a) of subdivision two of this section. Such notice shall be provided by publication in the state bulletin, the weekly bulletin of the banking department, and in newspapers of general circulation promptly following the adoption of such change, and by such other means as the banking board shall deem necessary or proper. The banking board shall also make available to the public copies of all regulations adopted pursuant to this section.

Added L.1968, c. 849, § 3, eff. May 15, 1968.

Historical Note

Effective date and expiration of L. 1968, c. 348. Section 13 of L.1968, c. 349 provided: "This act [adding this section and amending sections 108, 178, 202, 235-b, 283-a, 330-a, 454, 510-a, 577 and General Obligations Law §§ 5-501, 524.] shall take effect May fifteenth, nineteen hundred sixty-eight and shall apply in accord-

ance with its terms only to a loan or forbearance made on or before September first, nineteen hundred seventy-one, on which date the authority granted to the banking board by this act to prescribe the maximum rate of interest to be charged, taken or received upon a loan or forbearance shall expire."

Cross References

Criminal usury, see Penal Law § 190.60.

Interest and usury generally, see General Obligations Law § 5-501 et seq.

Possession of usurious loan records, see Penal Law § 190.68.

Notes of Decisions

Computation of interest rate 4

Constitutionality 1

Judgments 2

Mechanics' liens 3

The legal interest rate of six per cent or such other rate as may be established by the banking board is applicable when the county clerk calculates interest on default judgments. *Op. State Compt. 88-690.*

1. Constitutionality

This section giving banking board, for limited period of time, power to adjust maximum and minimum rates of interest within prescribed limits, as if deemed a delegation of legislative power, was not invalid. *Woodhouse, Drake and Cray Limited v. Anderson, 1979, 61 Misc.2d 851, 307 N.Y.S.2d 118.*

Action of legislature in conferring power on Banking Board, and regulations of Banking Board pursuant thereto, fixing maximum rates of interest for specified period of time were not unconstitutional as an improper delegation of power. *Id.*

2. Judgments

Interest payable from time of judgment against defaulting obligor is at legal rate prevailing at time of judgment regardless of whether rate has changed between default and judgment. *Jamaica Sav. Bank v. Giacomantonio, 1969, 59 Misc.2d 704, 300 N.Y.S.2d 218.*

Rate of interest prescribed by banking board is the "legal rate of interest" as that term is used in CPLR 5004 providing that interest on judgment shall be at the legal rate; rates of interest prescribed by banking board constitute "legal rate" of interest on money judgments. *Id.*

3. Mechanics' liens

The legal interest rate of six per cent or such other rate as may be established by the banking board is applicable when the county clerk passes on the sufficiency of cash bonds substituted for mechanics' liens. *Op. State Compt. 88-690.*

4. Computation of interest rate

Increases in legal rate of interest, as established by bank board pursuant to law, control to fix rate of interest recoverable upon a past-due demand from effective dates of increases in rate. *Hachlin & Co. v. Tra-Mar, Inc., 1979, 33 A.D.2d 870, 308 N.Y.S.2d 153.*

After maturity of an obligation, whether occasioned by due date or by default or other act on part of obligor that permits acceleration of maturity, rate of interest is to be computed from date of maturity or date of default resulting in maturity of obligation at rate then prescribed by statute. *Dime Sav. Bank of Brooklyn v. Carlonzo, 1969, 53 Misc.2d 821, 298 N.Y.S.2d 808.*

On and after date on which statutory interest rate was established at 7½ per cent per annum, interest on unpaid principal of note in default should have been computed at that rate. *Id.*

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§ 15. Deputies, clerks, examiners, special agents and other employees; appointment; compensation; oath of office; bonds; powers of deputies

1. The superintendent may appoint five deputies, and shall employ from time to time such clerks, examiners, special agents and other employees, under such titles as he may assign to them, as he may need to discharge in the proper manner the duties imposed upon him by law. They shall perform such duties as the superintendent shall assign to them. The superintendent shall fix their compensation.

2. Every deputy, within fifteen days after notice of his appointment, shall take and subscribe the constitutional oath of office, and file such oath in the department of state. Every examiner, before entering upon his duties as such examiner, shall take and subscribe such oath and file it in the office of the clerk of the county in which he resides.

3. The superintendent may require from deputies, examiners, agents and other employees such bonds and undertakings as he may deem necessary. Premiums charged by corporations approved by him as surety upon such bonds and undertakings shall be a general expense of the department.

4. If any deputy who, prior to appointment as deputy, has served as examiner for a period of three years or more, is removed by the superintendent from such position as deputy he must be restored to the position of examiner and as such shall be entitled to the same rights and privileges to which he would have been entitled had he continued as examiner and shall receive full credit for his service as deputy and be entitled to receive a salary at least equal to that paid to him as deputy, upon the audit and warrant of the comptroller as provided in section seventeen of this article, if he shall have served as deputy continuously for more than one year or, if he shall have served as deputy for one year or less, at least equal to that paid to him as examiner immediately preceding his appointment as deputy. The superintendent may, in his discretion, appoint as an examiner for a term of not more than six months any person who shall have served in such capacity for at least three years, and shall have left the department voluntarily and in good standing.

5. Any action which the superintendent is required or authorized hereinafter by this chapter to take may be taken by a dep-

§ 5-531

Note 10

Where no action to recover usurious payment had been commenced by intestate prior to her death, action commenced by her administrator more than one year after making of payment was untimely. *Elias v. Schwartz*, 1960, 22 Misc.2d 129, 201 N.Y.S.2d 223.

GENERAL OBLIGATIONS LAW

Art. 5

An action against a broker for deducting interest in excess of 6 per cent must be brought within one year. *Lavers v. Hutton*, 1924, 122 Misc. 516, 203 N.Y.S. 235.

TITLE 6. INTEREST ON CERTAIN DEPOSITS**Section**

5-601. Interest on deposits in escrow with mortgage investing institutions.

5-602. Interest on insurance draft deposits in escrow with mortgage investing institutions.

New York Codes, Rules and Regulations

Payment of interest on mortgage escrow accounts, see § NYCRR Part 10.

United States Code Annotated

Real estate settlement procedures, see section 2601 et seq. of Title 12, Banks and Banking.

WESTLAW Electronic Research

WESTLAW supplements McKinney's Consolidated Laws of New York and is useful for additional research. Enter a citation in Insta-Cite for display of any parallel citations and case history. Enter a statute citation in a case-law database for cases of interest.

Example query for Insta-Cite: IC 403 N.Y.S.2d 123

Example query for New York Constitution: N.Y.Const. Const. Constitution /s 6 VI +3 3

Example queries for statute: "General Obligations" G.O.L. Gen.Obl /s 5-703 /5 2

Also, see the WESTLAW Electronic Research Guide following the Explanation.

§ 5-601. Interest on deposits in escrow with mortgage investing institutions

Any mortgage investing institution which maintains an escrow account pursuant to any agreement executed in connection with a mortgage on any one to six family residence occupied by the owner or on any property owned by a cooperative apartment corporation, as defined in subdivision twelve of section three hundred sixty of the tax law, (as such subdivision was in effect on December thirti-

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INTEREST ON CERTAIN DEPOSITS

§ 5-602

Title 6

eth, nineteen hundred sixty), and located in this state shall, for each quarterly period in which such escrow account is established, credit the same with dividends or interest at a rate of not less than two per centum per year based on the average of the sums so paid for the average length of time on deposit or a rate prescribed by the banking board pursuant to section fourteen-b of the banking law and pursuant to the terms and conditions set forth in that section whichever is higher. The banking board shall prescribe by regulation the method or basis of computing any minimum rate of interest required by this section and any such minimum rate shall be a net rate over and above any service charge that may be imposed by any mortgage lending institution for maintaining an escrow account. No mortgage investing institution shall impose a service charge in connection with the maintenance of an escrow account unless provision therefor was expressly made in a loan contract executed prior to the effective date of this section.

(Added L.1974, c. 119, § 2; amended L.1979, c. 32, § 2; L.1987, c. 267, § 2.)

Historical Note

1987 Amendment. L.1987, c. 267, § 2, eff. July 20, 1987, inserted parenthetical reference to section 360, subd. 12 of the Tax Law as was in effect on Dec. 30, 1960.

"Any mortgage" inserted "or on any property owned by a cooperative apartment corporation as defined in subdivision twelve of section three hundred sixty of the tax law".

1979 Amendment. L.1979, c. 32, § 2, eff. Mar. 30, 1979, in sentence beginning

Effective Date. Section effective July 1, 1974, pursuant to L.1974, c. 119, § 7.

Library References

American Digest System

Deposits; rights and liabilities of parties, see Deposits and Escrows ¶4.

Encyclopedia

Depositaries; rights and liabilities of parties, see C.J.S. Depositaries § 5.

Notes of Decisions

I. Agreement of parties

Issue whether corporate mortgagor was entitled to interest received by institutional mortgagee on payments made to an account of real estate taxes on mortgaged premises depended, not upon categorical concepts suggested by such labels as "trust," "agency," "escrow," "debtor-

creditor," but upon rights and obligations parties intended to create as manifested by words they used in their written agreement, with parol evidence admissible to clarify ambiguities, if any under recognized canons of construction. *Surrey Strathmore Corp. v. Dollar Sav. Bank of New York*, 1975, 36 N.Y.2d 173, 366 N.Y.S.2d 107, 325 N.E.2d 527.

§ 5-602. Interest on insurance draft deposits in escrow with mortgage investing institutions

Any mortgage investing institution which maintains an escrow account pursuant to any agreement executed in connection with a

or labor, in order to determine whether or not there has been usury. *Root v. Pinney* (1860) 11 Wis. 84.

29. Sale of goods

If there be a sale of goods at an unfair price, made as a condition of the loan, the court will determine the fair value of the goods in order to determine whether there has been usury. *Root v. Pinney* (1860) 11 Wis. 84.

30. Sale of promissory notes

Sale of interest-bearing note at discount will not be deemed usurious unless its transfer, viewed in light of all surrounding facts and circumstances, is found to be cloak or cover for what is in reality usurious loan. *Val Zimmermann Corp. v. Jeffingwell*, (1982) 318 N.W.2d 781, 107 Wis.2d 86.

Contingent nature of indorser's liability to indorsee precluded mere fact that unmatured, interest-bearing note was indorsed and transferred from establishing that there was understanding between parties that amount due on the note was repayable absolutely by indorser, and thus contract of indorsement, by which the note was transferred for less than its face value, was sale of the note, with recourse, and was not loan subject to usury statutes. *Id.*

Payee, by indorsing promissory note "with recourse," expressly intended and provided that, upon default and notice of dishonor, he would repay note according to its tenor at time of his indorsement, and thus indorsement and transfer of the note for amount less than balance due at time of transfer was not sale without recourse or conditional sale such as would limit indorser's liability to his transferee to adjusted purchase price. *Id.*

31. Reservation of property use

Where plaintiff, by the agreement in each transaction, reserved the equal undivided one-third of the land for the use of his money advanced to secure the same together with the right to the repayment of the full amount so advanced within a year, and, if not then paid, the repayment of the amount, with interest at 8 per cent. thereafter, such reservation, so far as it exceeded the rate of interest allowed by law,

was illegal. *Scheiber v. LoClaire* (1886) 29 N.W. 570, 66 Wis. 579.

32. Partnerships

Where an agreement was made that a party was to receive, as his share of a business, \$250 every six months, in consideration of \$2,000 advanced to the concern, without any reference to the fact whether the business produced any profit or not, and also that if there was danger that the party would lose the \$2,000, he might immediately enter a judgment, and collect the amount upon execution, such an agreement does not constitute a partnership between the parties thereto, but it is a usurious transaction. *Cooper v. Tappan* (1859) 9 Wis. 361.

33. Third-party payments

The rule that usury laws being for the protection of the borrower, the lender may receive an excess over the legal interest voluntarily paid by a third person, applied in a case where one agreed to pay \$2,500 cash for a farm if he could borrow the money, but the lender asking \$30 in excess of the legal rate, and the borrower refusing to pay it, the owner agreed to pay the lender the \$30, and the borrower paid the owner \$2,470, and gave the lender a note and mortgage for \$2,500. *McArthur v. Schenck* (1873) 31 Wis. 673, 11 Am.Rep. 643.

34. Admissibility of evidence

Although real estate installment sales contracts did not on their face appear to provide a usurious rate of interest, parol evidence was admissible to show that usurious interest was actually charged. *First Nat. Bank of Wisconsin Rapids v. Dickinson* (App.1981) 308 N.W.2d 910, 103 Wis.2d 428.

35. Infraction

Retailer's one and one-half percent monthly charge on declining unpaid balance of its revolving charge account, in violation of usury statute, constituted a "public nuisance" which would be enjoined at instance of the state. *State v. J. C. Penney Co.* (1970) 179 N.W.2d 641, 48 Wis.2d 125.

138.051. Residential mortgage loans

(1) In this section:

(a) "Contract rate" means the initial rate contracted to be paid on the principal of a loan from time to time.

(b) "Loan" means a loan, other than a loan made by a federally chartered or state-chartered savings and loan association, secured by a first lien real estate mortgage on, or an equivalent security interest in, a one- to 4-family

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MONEY AND RATES OF INTEREST

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dwelling which the borrower uses as his or her principal place of residence and which is:

1. Made on or after April 6, 1980 and prior to November 1, 1981;
2. Refinanced, renewed, extended or modified on or after April 6, 1980 and prior to November 1, 1981; or
3. Made within 2 years after November 1, 1981, pursuant to a loan commitment made on or after April 6, 1980 and prior to November 1, 1981.

(2) A loan may be prepaid by the borrower at any time in whole or in part without premium or penalty. Upon prepayment of a loan in full by cash, renewal or refinancing, the borrower is entitled to a refund of unearned interest charged determined as follows:

(a) On a loan which is repayable in substantially equal, successive instalments at approximately equal intervals of time and the face amount of which includes predetermined interest charges, the amount of such refund shall be as great a proportion of the total interest charged as the sum of the balances scheduled to be outstanding during the full instalment periods commencing with the instalment date nearest the date of prepayment bears to the sum of the balances scheduled to be outstanding for all instalment periods of the loan.

(b) On any other loan, the amount of the refund shall not be less than the difference between the interest charged and interest, at the rate contracted for, computed upon the unpaid principal balance of the loan from time to time outstanding prior to prepayment in full.

(3) For purposes of computing a refund under sub. (2), interest does not include:

(a) Identifiable and separately itemized charges for services incident to the loan if they are bona fide and paid to 3rd parties unrelated to the lender;

(b) Fees, discounts or other sums actually imposed by government national mortgage association, federal national mortgage association, federal home loan mortgage corporation or any other governmentally sponsored or private secondary mortgage market purchaser of a loan from the original lender; and

(c) A loan administration fee charged by a lender, not to exceed 2% of the principal amount of any construction loan and one percent of the principal amount of any other loan.

(4) For the purpose of calculating the rate of interest on a loan scheduled to be paid in instalments under sub. (2), the parties may agree that any instalment paid within 30 days prior to or after the scheduled due date will be considered to have been paid on the due date.

(5) A bank, credit union or mutual savings bank which originates a loan and which requires an escrow to assure the payment of taxes or insurance shall pay interest on the outstanding principal balance of the escrow of not less than 5.25% per year. This subsection applies to any refinancing, renewal, extension or modification of the loan on or after November 1, 1981.

(6) Delinquency charges on a loan shall not exceed an amount determined by application of the contract rate to the unpaid amount, including interest accrued and unpaid, until paid or maturity of the obligation, whether by acceleration or otherwise, whichever first occurs. Interest imposed after maturity may not exceed the contract rate applied to the amount due on the date of maturity.

(7) This section does not apply to a loan insured, or committed to be insured, or secured by mortgage or trust deed insured by the U.S. secretary of housing and urban development, insured, guaranteed or committed to be insured or guaranteed under 38 USC 1801 to 1827 or insured or committed to be insured under 7 USC 1921 to 1995.

(8) The contract rate is not subject to rate limitations imposed under this chapter or s. 218.01 or 422.201.

Historical Note

Source:

L.1979, c. 168, § 3, eff. April 6, 1980.
L.1981, c. 45, §§ 5, 6, eff. Nov. 1, 1981.
Laws 1979, c. 168, § 20 provides:

"This act is not the adoption of a law limiting the amount or rate of interest under P.L. 96-161 or a successor thereto."

Cross References

Effect of usury and penalties, see § 138.06.
Precomputed loan law, see § 138.09.
Primary mortgage loan program not subject to this section, see § 45.79.

Law Review Commentaries

A description of the modification of Wisconsin's Usury Laws. James L. Brown and Robert A. Patrick. 65 Marquette L.Rev. 309 (1982).

Library References

Mortgages ¶122.
WESTLAW Topic No. 266.
C.J.S. Mortgages § 179.

138.052. Residential mortgage loans

(1) In this section:

(a) "Contract rate" means the rate contracted to be paid from time to time on the principal of a loan.

(b) "Loan" means a loan secured by a first lien real estate mortgage on, or an equivalent security interest in, a one- to 4-family dwelling which the borrower uses as his or her principal place of residence and which is made, refinanced, renewed, extended or modified on or after November 1, 1981, but does not include a mobile home transaction as defined in s. 138.056(1)(c).

(c) "Loan administration" means a lender's processing of a loan and includes review, underwriting and evaluation of the loan application, document processing and preparation and administration of the loan closing, but does not include appraisals, inspections, surveys, credit reports or other activities

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MONEY AND RATES OF INTEREST

138.052

Incidental to loan origination and normally taking place outside the office of the lender or performed by 3rd persons.

(d) "Person related to" has the meaning given under s. 421.301(32) and (33).

(2)(a) 1. A loan may be prepaid by the borrower at any time in whole or in part.

2. The parties may agree that if a prepayment is made within 5 years of the date of the loan, then the lender shall receive an amount not exceeding 60 days' interest at the contract rate on the amount by which the aggregate principal prepayments for a 12-month period exceeds 20% of the original amount of the loan.

3. If a prepayment is made 5 or more years from the date the loan is made, no premium or penalty may be received by the lender. This subdivision applies notwithstanding any refinancing, renewal, extension or modification of the loan.

(b) Upon prepayment of a loan in full by cash, renewal or refinancing, the borrower is entitled to a refund of unearned interest paid. Unearned interest is that portion of any prepaid charge, excluding amounts permitted under sub. (3), multiplied by the number of unexpired payment periods as of the date of prepayment and divided by the total number of payment periods, plus, at the option of the lender, either:

1. The portion of interest which is allocable to all unexpired payment periods as scheduled. Except as otherwise agreed by the parties under sub. (4), a payment period is unexpired if prepayment is made within 15 days after the payment's due date. The unearned interest is the interest which, assuming all payments are made as scheduled, would be earned for each unexpired payment period by applying to unpaid balances of principal, according to the actuarial method, the contract rate on the date of prepayment. The creditor may decrease the annual interest rate to the next multiple of 0.25%.

2. The total interest charge less all prepaid interest charges and the amount determined by applying the contract rate, according to the actuarial method, to the unpaid balances for the actual time those balances were unpaid up to the date of prepayment.

(3) For purposes of computing a refund under sub. (2)(b), interest does not include any of the following:

(a) Identifiable and separately itemized charges for services incident to the loan if they are bona fide and paid to 3rd parties.

(b) Fees, discounts or other sums actually imposed by the government national mortgage association, the federal national mortgage association, the federal home loan mortgage corporation or other governmentally sponsored secondary mortgage market purchaser of the loan or any private secondary mortgage market purchaser of the loan who is not a person related to the original lender.

(c) A loan administration fee charged by a lender, including fees paid to 3rd parties for loan administration services, not exceeding 2% of the principal amount of any construction loan and 2% of the principal amount of any other loan.

(d) The amount of any prepayment charge authorized under sub. (2)(a) 2 and received.

(e) Loan commitment fees.

(f) Amounts paid to the lender by any person other than the borrower.

(4) For the purpose of calculating the rate of interest under sub. (2)(b), the parties may agree that any installment paid within 30 days prior to or after the scheduled due date is paid on the due date.

(5)(a) Except as provided in par. (b), a bank, credit union, savings bank, savings and loan association or mortgage banker which originates a loan after January 31, 1983, and which requires an escrow to assure the payment of taxes or insurance shall pay interest on the outstanding principal balance of the escrow of not less than 5.25% per year, unless the escrow funds are held by a 3rd party in a noninterest-bearing account.

(b) The parties may agree to waive payment of all or part of the interest required under par. (a) if more than 75% of the lender's interest in the loan is sold to a 3rd party who is not a person related to the lender and the escrow funds are held by the 3rd party.

(5m)(a) In this subsection, "escrow agent" means a person who receives escrow payments on behalf of itself or another person.

(b) 1. Except as provided in par. (e), if an escrow is required to assure the payment of property taxes, a bank, credit union, savings bank, savings and loan association or mortgage banker which originates a loan on or after July 1, 1988, shall, before the loan closing, provide the borrower with a written notice clearly stating that the borrower may require the escrow agent to make payments in any manner specified in subd. 3 from the amount escrowed to pay property taxes and the responsibilities of the borrower and escrow agent as provided in subds. 4 and 5.

2. Except as provided in par. (e), if an escrow is required to assure the payment of property taxes for a loan originated before July 1, 1988, the escrow agent shall send, by November 15, 1988, written notice to the borrower clearly stating that the borrower may require the escrow agent to make payments in any manner specified in subd. 3 from the amount escrowed to pay property taxes and the responsibilities of the borrower and escrow agent as provided in subds. 4 and 5.

3. Except as provided in par. (e), a borrower may require an escrow agent who receives escrow payments to assure the payment of the borrower's property taxes to do any of the following, if the borrower notifies the escrow agent as provided in subd. 4 and if the borrower is current in his or her loan payments:

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a. By December 18, send to the borrower a check in the amount of the funds held in escrow for the payment of property taxes, made payable to the borrower and the town, city or village treasurer authorized to collect the tax.

b. Pay the property taxes by December 31, if the escrow agent has received a tax statement for that property by December 20.

c. Pay the property taxes when due.

4. To require the escrow agent to make payments in any of the manners specified in subd. 3, the borrower shall send, by December 1, written notice to the escrow agent specifying the manner, from the 3 choices under subd. 3, that the borrower wants the escrow agent to make payments. Except as provided in subd. 5. b, once notified, the escrow agent shall annually make payments in that manner unless the borrower is not current in his or her loan payments or unless otherwise notified in writing by the borrower by December 1.

5. a. If the borrower chooses to receive payments as provided in subd. 3. a, the borrower shall annually, by March 31, send to the person to whom the borrower makes his or her loan payments a copy of the receipt for paid property taxes.

b. If the borrower fails to comply with subd. 5. a, the borrower loses the option of receiving payments that year in the manner specified in subd. 3. a. During the next year, the borrower may again receive payments under subd. 3. a if the borrower renotifies the escrow agent by sending written notice to the escrow agent by December 1 of the next year and if the borrower is current in his or her loan payments.

6. If the borrower sends the check received under subd. 3. a to the town, city or village treasurer after the county has assumed responsibility for collecting property taxes, the town, city or village treasurer shall accept the check and pay over to the county treasurer the amount of the check. If the amount of the check sent by the borrower to the town, city or village treasurer exceeds the amount of property taxes owed by the borrower, the town, city or village treasurer shall refund the excess amount to the borrower and, if the county has assumed responsibility for collecting property taxes, pay over to the county treasurer the remaining amount of the check.

(c) A borrower may establish an escrow account required for the payment of taxes and insurance in a financial institution, as defined in s. 710.05(1)(c), of the borrower's choice if the escrow agent fails to comply with par. (b) 3, unless the lender or person to whom the loan is sold or released demonstrates that the financial institution is incapable of servicing the escrow account.

(d) If a borrower establishes an escrow account under par. (c), the borrower shall annually, by March 31, send to the person to whom the borrower makes his or her loan payments verification of the amounts which the borrower deposited in the escrow account during the previous 12 months and copies of receipts for taxes and insurance paid during the previous 12 months.



REPRESENTATIVE CON BUNDE
CO-CHAIR HEALTH, EDUCATION
& SOCIAL SERVICES
VICE-CHAIR RULES

**Alaska State Legislature
House of Representatives**

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SPONSOR STATEMENT

HOUSE BILL 363

“An Act requiring banks to pay interest on money in reserve accounts held in connection with mortgage loans.”

In 1974 Congress found that many lenders were maintaining bloated escrow accounts with a year or more of excess escrow payments in them. Lenders called this excessive amount a “cushion”, but were unable to justify the need for such excess. In response, Congress enacted the Real Estate Settlement Procedures Act (RESPA) which prohibits lenders and mortgage servicers from requiring consumers to maintain more than an extra two months’ worth of the yearly amount necessary to pay taxes and insurance premiums. Some escrow accounts do not have more than two months’ payments available. However, the accounting system used by the institution holding the escrow account may cause the account to be seriously over the two month ceiling set by RESPA.

Lenders often invest escrow funds for the short term and use the profits as their institution sees fit. The consumer that pays into the escrow account gives the use of their money to the bank and gains nothing. Therefore the institutions that hold escrow accounts have an incentive to ignore RESPA and bloat their accounts in order to maximize profits.

HB 363 requires banks (lending institutions) to pay interest on money in escrow reserve accounts. The interest paid shall be credited to the principal balance of a mortgage or paid directly to the borrower.

It is time for lending institutions to give consumers a better deal. I urge the committee to recommend the passage of this legislation.

FISCAL NOTE

STATE OF ALASKA
1996 LEGISLATIVE SESSION

BILL NO. HB 363

Revision Date: _____
Title: Interest on Mortgage Escrow Accounts

Department: Commerce and Economic Development
BRU: Banking, Securities and Corporations
Component: Banking, Securities and Corporations

Sponsor: Representative Bunde
Requestor: Representative James

COMPONENT SERIAL NO. 1233

Expenditures/Revenues	(Thousands of Dollars)					
OPERATING EXPENDITURES	FY 97	FY 98	FY 99	FY 00	FY 01	FY 02
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0
CAPITAL EXPENDITURES	0.0	0.0	0.0	0.0	0.0	0.0
CHANGE IN REVENUES	0.0	0.0	0.0	0.0	0.0	0.0

FUND SOURCE	(Thousands of Dollars)					
1002 Federal Receipts						
1003 GF Match						
1004 General Fund						
1005 GF/Program Receipts						
1006 GF/MHTIA						
Other						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY 96) cost: \$ 0.0

POSITIONS						
FULL-TIME						
PART-TIME						
TEMPORARY						

ANALYSIS: (Attach a separate page if necessary)

Prepared by: Willis F. Kirkpatrick, Director Phone: 465-2521
 Division: Banking, Securities and Corporations Date: 1-12-96
 Approved by Commissioner: William L. Hensley Date: 1-12-96
 Agency: Commerce and Economic Development

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15646 Southpark Loop
Anchorage, Ak. 99516
Jan. 3, 1996

To: Rep. Con Bunde
Fax 4653871
Re: Escrow Account Interest

Dear Mr. Bunde:

After reading the following article, (Bottom Line, Volume 17, Number 1; Jan. 1, 1996) I wondered if this issue is one that might involve legislative action. As I have not called any lender other than our own (City Mortgage) I don't know if this policy differs among the Alaskan lenders. At any rate, I cannot understand why any lender is entitled to earn interest on this money.

I wish you a successful legislative session.

Sincerely,

Carol C. Lewis

Carol C. Lewis

• Get refunds and reduced payments from your escrow/impound account. This is a separate account held by the mortgage lender that you pay into each month for the property taxes and hazard insurance the lender pays for you. It is called an "impound account" in California and the West. New federal rules introduced in 1995 say that lenders...

...cannot require more than two months' payments as a cushion. Some

now require cushions of four months or more, which is illegal.

... must send you a statement early in the year projecting how much escrow payments could increase. A year-end statement will compare projected and actual payments.

... must consider money already in the account when calculating the monthly payment for the coming year—resulting in lower payments for most home owners.

Strategy: Find out how much is in your escrow account by checking your monthly statement or calling your lender. If the lowest balance during the year is more than twice your monthly payment—principal, interest, taxes and insurance—complain to the lender.

• Make sure you're receiving legally mandated interest. Millions of consumers don't receive interest on their escrow accounts, though they should.

Important: Financial institutions in California, Connecticut, Iowa, Maine, Maryland, Massachusetts, Minnesota, New Hampshire, New York, Oregon, Rhode Island, Utah, Vermont and Wisconsin are now required to make interest payments. The rates range from 1.6% to 5.25%, and payments are usually made annually.

On an average balance of \$2,000, 5% interest comes to \$100 a year—*for the*