HB 735

Department of Legislative Services

Maryland General Assembly
2014 Session

FISCAL AND POLICY NOTE

House Bill 735 (Delegate Olszewski)
Economic Matters Finance

Financial Institutions - Interest Payable on Escrow Accounts and Specific Purpose Savings Accounts

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This bill alters the method used to calculate the amount of interest paid by (1) a lending institution on an escrow account created in connection with a loan secured by a first mortgage or first deed of trust on residential real property and (2) a banking institution on each interest-bearing account that is instituted for a specific purpose for a period of one year or less. The bill requires the amount of interest to be an annual interest rate not less than the weekly average yield on U.S. Treasury securities adjusted to a constant maturity of one year as published by the Federal Reserve in "Selected Interest Rates (Daily) – H.15," as of the first business day of the calendar year.

The bill takes effect June 1, 2014, and applies retroactively to escrow accounts and savings accounts in existence on or after January 1, 2014.

Fiscal Summary

State Effect: The bill does not directly affect governmental operations or finances.

Local Effect: The bill does not directly affect local governmental operations or finances.

Small Business Effect: Potential meaningful.

Analysis

Current Law:

Escrow Accounts: If a specified lending institution creates, or is the assignee of, an escrow account in connection with a loan secured by a first mortgage or first deed of trust on any interest in residential real property, the lending institution must pay interest to the borrower on the funds in the escrow account at an annual rate not less than the six-month average dealer bid rate on nationally traded certificates of deposits, as published by the Federal Reserve in "Selected Interest Rates (Daily) – H.15," as of the first business day of the calendar year. The amount of interest must be adjusted, if applicable, as of the first day of each calendar year to reflect the rate to be paid during that year. The lending institution must provide the borrower with an escrow account statement each year and pay annual interest, computed on the account's average monthly balance, by crediting the escrow account with the amount due.

Maryland's requirements to pay a specified amount of interest and provide a statement for an escrow account created for a loan secured by a first mortgage or first deed of trust on any interest in residential real property do not apply if the loan is purchased by an out-of-state lender through the Federal National Mortgage Association, the Government National Mortgage Association, or the Federal Home Loan Mortgage Corporation and the out-of-state lender, as a condition of purchase, elects to service the loan. However, they do apply if the out-of-state lender sells the loan to a Maryland lender or places the loan with a Maryland lender for servicing.

If the purpose of the escrow account is to pay taxes, insurance premiums, and ground rents, the account funds may not be used to reduce principal or pay interest or other loan charges, except in a foreclosure, release, or situation in which the escrow account balance exceeds the amount provided for in the note, loan agreement, or security instrument. If the balance does periodically exceed the amount provided for in the note, loan agreement, or security instrument, the lending institution must give the borrower the option of (1) receiving a refund of the excess amount; (2) applying the excess amount to the payment of principal and interest; or (3) leaving the excess amount in the escrow account. Any refund of an excess amount must be made within 60 days after the receipt by the lender of the borrower's request for a refund. However, if the borrower has not yet notified the lender of the option chosen, the lender must refund any excess amount within 60 days after the date the lender mailed notice of the excess amount to the borrower.

Specific Purpose Accounts: A banking institution must pay interest on each interest-bearing account that is instituted for a specific purpose, including "Christmas" or "vacation" accounts, for a period of one year or less at an annual rate not less than the

six-month average dealer bid rate on nationally traded certificates of deposits, as published by the Federal Reserve in "Selected Interest Rates (Daily) – H.15," as of the first business day of the calendar year.

Background: A financial institution may require borrowers of loans secured by mortgaged property to place funds into an escrow account. The funds maintained in the escrow account are then used to pay annual taxes and insurance on the mortgaged property. While the financial institution generally determines whether the borrower must maintain an escrow account, a financial institution is required to establish escrow accounts for some federal programs, including any Federal Housing Administration-insured loans. The federal Real Estate Settlement Procedures Act (RESPA) allows a financial institution to collect escrow payments one-sixth greater than the estimated year-end tax and insurance amounts. However, if state law or mortgage documents allow for a lesser amount, the financial institution may only collect the lesser amount. RESPA further requires the financial institution to perform an annual escrow account analysis and provide the borrower with initial and annual escrow account statements. If the annual escrow account analysis reveals a shortage or a deficiency, RESPA provides a loan servicer with several options in order to collect repayment from a borrower.

Tracking of the previous published interest rate used to determine minimum interest rates, the six-month average dealer bid rate on certificates of deposit, was discontinued in 2013 by the Federal Reserve Board. The U.S. Treasury's yield curve rates, commonly referred to as "Constant Maturity Treasury" rates or "CMTs," are based on yields that are interpolated by the U.S. Treasury from the daily yield curve. This curve, which relates the yield on a security to its time to maturity, is based on the closing market bid yields on actively traded U.S. Treasury securities in the over-the-counter market. These market yields are calculated from composites of quotations obtained by the Federal Reserve Bank of New York. The yield values are read from the yield curve at fixed maturities, currently 1, 3, and 6 months and 1, 2, 3, 5, 7, 10, 20, and 30 years.

As shown in **Exhibit 1**, the U.S. Treasury's yield curve rates for one year, as of the first business day of the year, have ranged, over the past 10 years, from as high as 5% in 2007 to as low as 0.12% in 2012.

Exhibit 1
Six-month Average Dealer Bid Rate on Certificates of Deposit and One-year Average Yield Rate on U.S. Treasury Securities 2005-2014

Year	Six-month Average Dealer Bid Rate	One-year Average Yield Rate
2014	ND*	0.13%
2013	0.30%	0.15%
2012	0.25%	0.12%
2011	0.14%	0.29%
2010	0.43%	0.45%
2009	4.59%	0.40%
2008	5.30%	3.17%
2007	4.36%	5.00%
2006	2.33%	4.38%
2005	1.06%	2.79%

*The Federal Reserve Board discontinued tracking the six-month average dealer bid rate on certificates of deposit beginning in the second half of 2013.

Source: Federal Reserve Board

Small Business Effect: The bill has a potentially meaningful effect on in-state financial institutions, some of which are small businesses. Under current law, a financial institution must pay interest at an annual rate not less than the six-month average dealer bid rate on nationally traded certificates of deposits. Under the bill, if the average weekly yield rate on U.S. Treasury securities adjusted to a constant maturity of one year remains at its current level, financial institutions could realize meaningful savings. The magnitude of savings would depend on the number of accounts, the amount of funds in each account, and the length of time the funds are held in the account.

It should be noted, however, that despite the potential savings for financial institutions due to recent low U.S. Treasury securities yield rates, in the future, lending institutions may be required to return an amount of interest greater than the current requirement to the extent that the U.S. Treasury securities yield rates exceed rates on certificates of deposit.

Additional Information

Prior Introductions: None.

Cross File: SB 583 (Senators Kelley and Middleton) - Finance.

Information Source(s): Department of Housing and Community Development; Judiciary (Administrative Office of the Courts); Department of Labor, Licensing, and Regulation; Department of Legislative Services

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Analysis by: Joshua A. Lowery

Direct Inquiries to:
(410) 946-5510
(301) 970-5510