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Handbook: **Examination**
Subject: **Truth in Lending Act**

This rescission does not change the applicability of the conveyed document. To determine the applicability of the conveyed document, refer to the original issuer of the document.



Section: 1305

Truth in Lending Act

Summary: This bulletin transmits revised Examination Handbook Section 1305, Truth in Lending Act. The revisions incorporate changes to the examination procedures as a result of amendments to Regulation Z that prohibit unfair, abusive or deceptive mortgage lending and servicing practices. The revised handbook section replaces the existing Examination Handbook Section 1305.

For Further Information Contact: Your Office of Thrift Supervision (OTS) Regional Office or Rhonda L. Daniels in the Compliance and Consumer Protection Division of OTS, Washington D.C. at (202) 906-7158. You may access this bulletin and the Examination Handbook at our web site: www.ots.treas.gov.

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SUMMARY OF CHANGES

OTS is issuing revised Examination Handbook Section 1305, Truth in Lending Act, to address changes to the Regulation Z lending and servicing requirements for mortgage loans. Change bars in the margins of the handbook section indicate revisions to content. We provide a summary of changes below.

1305 Truth in Lending Act

The Truth in Lending Act (TILA) requires creditors to provide consumers with information about the cost of credit that they can use to make choices in the marketplace. As a result of revisions to Regulation Z, TILA's implementing regulation, OTS has updated its examination procedures.

Regulation Z now includes key protections for a newly defined category of "higher-priced mortgage loans" secured by a consumer's principal dwelling. "Higher-priced mortgage loans" are defined as loans with an annual percentage rate that exceeds the average prime offer rate by 1.5 percentage points for first lien loans, or by 3.5 or more percentage points for subordinate lien loans. These loans are subject to requirements concerning repayment ability, income verification, prepayment penalties, escrows, and evasion.¹

In addition, Regulation Z includes new protections for all closed-end mortgages secured by a consumer's principal dwelling, including a prohibition on abusive servicing practices. Regulatory revisions also establish additional advertising standards for all mortgage loans and prohibit deceptive or misleading advertising practices.

This set of revisions to the TILA examination procedures incorporates these changes to Regulation Z.

¹ Only higher priced loans secured by a first lien on a principal dwelling are subject to the escrow requirement.

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Under the revised procedures, examiners will be required to evaluate whether savings associations meet the following requirements.

1. Protection for “Higher-Priced” Mortgage Loans and HOEPA Loans

- A savings association is prohibited from making a higher-priced mortgage loan or HOEPA loan without regard to a borrower’s ability to repay the loan from income and assets other than the home’s value. Prior to the relevant revisions to Regulation Z, a lender was prohibited from engaging in a “pattern or practice” of extending HOEPA loans without regard to the consumer’s ability to repay. The “pattern or practice” qualification has been removed.
- A savings association is required to verify the income and assets it relies upon and the consumer’s current obligations to determine repayment ability for higher-priced mortgage loans and HOEPA loans. Prior to the relevant revisions to Regulation Z, there was a rebuttable presumption of a violation when a lender engaged in a “pattern or practice” of making HOEPA loans without verifying repayment ability. The “pattern or practice” requirement has been removed.
- For higher-priced mortgage loans and HOEPA loans in which the payment can change in the first four years of the loan, a savings association is prohibited from imposing a prepayment penalty. For higher-priced mortgage loans and HOEPA loans in which the payment may not change for four years after consummation, a prepayment penalty period cannot last for more than two years after consummation. Prepayment penalties for HOEPA loans are also prohibited if: 1) the borrower’s debt-to-income ratio exceeds 50 percent; 2) there is a refinancing by the same creditor or affiliate; or 3) applicable law prohibits such a penalty. A higher-priced mortgage loan or HOEPA loan with a prepayment penalty that does not conform to these prepayment penalty limitations is generally subject to a three-year right of rescission.
- For higher-priced mortgage loans secured by a first lien on a principal dwelling, a savings association must establish an escrow account for the payment of property taxes and homeowner’s insurance. A savings association is permitted to allow borrowers to cancel escrows 365 days after loan consummation. The escrow requirement is effective as of April 1, 2010 for site-built homes and October 1, 2010 for manufactured homes.
- Savings associations are prohibited from structuring closed-end loans as open end lines of credit for the purpose of evading these requirements.

2. Prohibited Acts or Practices

For all closed-end mortgages secured by a consumer’s principal dwelling, a savings association is prohibited from: 1) failing to credit payment to a consumer’s account as of the date the payment is received; 2) failing to provide a payoff statement within a reasonable period of time; and 3) pyramiding late fees. In addition, for all closed-end mortgages secured by a consumer’s principal dwelling, a savings association is prohibited from coercing a real estate appraiser to misstate a home’s value.

3. Advertising Practices

For both open-end and closed-end mortgage loans, advertising must contain additional information about rates, monthly payments, and other loan features. In addition, the following seven deceptive or misleading practices are prohibited in advertisements for closed-end loans:

- Advertisements that state that a rate or payment is fixed when it can change.
- Advertisements that compare an actual or hypothetical rate or payment obligation to the rates or payments that would apply if the consumer obtains the advertised product unless the advertisement states the rates or payments that will apply over the full term of the loan.
- Advertisements that characterize the product as a “government loan program” or “government sponsored loans” even though the program is not government supported or sponsored loans.
- Advertisements that display the name of the consumer’s current mortgage lender unless the advertisement also prominently discloses that the advertisement is from a mortgage lender not affiliated with the consumer’s current lender.
- Advertisements that make claims of debt elimination if the product advertised would merely replace one debt obligation with another.
- Advertisements that create a false impression that the mortgage broker or lender is a “counselor” for the consumer.
- Foreign-language advertisements in which certain information is provided in a foreign language while required disclosures are provided only in English.

The examination procedures have been revised to reflect these changes.



—*Timothy T. Ward*

Deputy Director

Examinations, Supervision, and Consumer Protection

Truth in Lending Act

Background and Summary

The Truth in Lending Act (TILA), 15 USC 1601 et seq., was enacted on May 29, 1968, as title I of the Consumer Credit Protection Act (Pub. L. 90-321). The TILA, implemented by Regulation Z (12 CFR 226), became effective July 1, 1969.

The TILA was first amended in 1970 to prohibit unsolicited credit cards. Additional major amendments to the TILA and Regulation Z were made by the Fair Credit Billing Act of 1974, the Consumer Leasing Act of 1976, the Truth in Lending Simplification and Reform Act of 1980, the Fair Credit and Charge Card Disclosure Act of 1988, and the Home Equity Loan Consumer Protection Act of 1988.

L I N K S

[Program](#)

[Appendix A](#)

Regulation Z also was amended to implement section 1204 of the Competitive Equality Banking Act of 1987 and, in 1988, to include adjustable rate mortgage loan disclosure requirements. All consumer leasing provisions were deleted from Regulation Z in 1981 and transferred to Regulation M (12 CFR 213).

The Home Ownership and Equity Protection Act of 1994 amended TILA. The law imposed new disclosure requirements and substantive limitations on certain closed-end mortgage loans bearing rates or fees above a certain percentage or amount. The law also included new disclosure requirements to assist consumers in comparing the costs and other material considerations involved in a reverse mortgage transaction and authorized the Federal Reserve Board to prohibit specific acts and practices in connection with mortgage transactions. Regulation Z was amended¹ to implement these legislative changes to TILA.

The TILA amendments of 1995 dealt primarily with tolerances for real estate secured credit. Regulation Z was amended on September 14, 1996 to incorporate changes to the TILA. Specifically, the revisions limit lenders' liability for disclosure errors in real estate secured loans consummated after September 30, 1995. The Economic Growth and Regulatory Paperwork Reduction Act of 1996 further amended

TILA. The amendments were made to simplify and improve disclosures related to credit transactions.



Approved – FFIEC

¹ 60 FR 15463, March 24, 1995 and 66 FR 65604, December 20, 2001.

The Electronic Signatures in Global and National Commerce Act (the E-Sign Act), 15 USC 7001 et seq., was enacted in 2000 and did not require implementing regulations. On November 9, 2007, Regulation Z and the official staff commentary were issued to simplify the regulation and provide guidance on the electronic delivery of disclosures consistent with the E-Sign Act.²

In July 2008, Regulation Z was amended to protect consumers in the mortgage market from unfair, abusive, or deceptive lending and servicing practices. Specifically, the change applied protections to a newly defined category of “higher priced mortgages” that includes virtually all closed-end subprime loans secured by a consumer’s principal dwelling. The revisions also applied new protections to mortgage loans secured by a dwelling, regardless of loan price, and required the delivery of early disclosures for more types of transactions. The revisions also banned several advertising practices deemed deceptive or misleading. The Mortgage Disclosure and Improvement Act of 2008 (MDIA) broadened and added to the requirements of the Board’s July 2008 final rule by requiring early truth-in-lending disclosures for more types of transactions and by adding a waiting period between the time when disclosures are given and consummation of the transaction.

In December 2008, the Board adopted two final rules pertaining to open-end (not home-secured) credit. The first rule involved Regulation Z revisions and made comprehensive changes applicable to several disclosures required for: applications and solicitations, new accounts, periodic statements, change in terms notifications, and advertisements. The second was a rule published under the Federal Trade Commission (FTC) Act and was issued jointly with the Office of Thrift Supervision and the National Credit Union Administration. It sought to protect consumers from unfair acts or practices with respect to consumer credit card accounts. Before these rules became effective, however, the Credit Card Accountability Responsibility and Disclosure Act of 2009 (Credit Card Act) amended TILA and established a number of new requirements for open-end consumer credit plans. Several provisions of the Credit Card Act are similar to provisions in the Board’s December 2008 TILA revisions and the joint FTC Act rule, but other portions of the Credit Card Act address practices or mandate disclosures that were not addressed in these rules. The Credit Card Act provisions are effective in three stages. The first group of provisions require creditors to increase the amount of notice consumers receive before the rate on a credit card account is increased or a significant change is made to the account’s terms. These amendments also allow consumers to reject such increases and changes by informing the creditor before the increase or change goes into effect. The next set of provisions involve rules regarding interest rate increases, over-the-limit transactions, and student cards. Finally, the third group of provisions address the reasonableness and proportionality of penalty fees and charges and re-evaluation of rate increases.

² 72 FR 63462, November 9, 2007. These amendments took effect December 10, 2007, with a mandatory compliance date of October 1, 2008. Further technical amendments were issued December 14, 2007, with a January 14, 2008 effective date and an October 1, 2008 mandatory compliance date (72 FR 71058).

Format of Regulation Z

The disclosure rules creditors must follow differ depending on whether the creditor is offering open-end credit, such as credit cards or home-equity lines, or closed-end credit, such as car loans or mortgages.

Subpart A (§§ 226.1 through 226.4) of the regulation provides general information that applies to open-end and closed-end credit transactions. It sets forth definitions and stipulates which transactions are covered and which are exempt from the regulation. It also contains the rules for determining which fees are finance charges.

Subpart B (§§ 226.5 through 226.16) of the regulation contains rules for disclosures for home-equity loans, credit and charge card accounts, and other open-end credit.

Subpart B also covers rules for resolving billing errors, calculating annual percentage rates, credit balances, and advertising open-end credit. Special rules apply to credit card transactions only, such as certain prohibitions on the issuance of credit cards and restrictions on the right to offset a cardholder's indebtedness. Additional special rules apply to home-equity lines of credit, such as certain prohibitions against closing accounts or changing account terms.

Subpart C (§§ 226.17 through 226.24) includes provisions for closed-end credit. Residential mortgage transactions, demand loans, and installment credit contracts, including direct loans by banks and purchased dealer paper, are included in the closed-end credit category. Subpart C also contains disclosure rules for regular and variable rate loans, refinancings and assumptions, credit balances, calculating annual percentage rates, and advertising closed-end credit.

Subpart D (§§ 226.25 through 226.30), which applies to both open-end and closed-end credit, sets forth the duty of creditors to retain evidence of compliance with the regulation. It also clarifies the relationship between the regulation and state law, and requires creditors to set a cap for variable rate transactions secured by a consumer's dwelling.

Subpart E (§§ 226.31 through 226.36) contains special requirements for mortgages that fit the criteria in § 226.32(a) ("high cost mortgages"), § 226.33 (a) ("reverse mortgages") and § 226.35(a) ("higher-priced mortgage loans"), as well as loans secured by a consumer's principal dwelling.

The appendices to the regulation set forth model forms and clauses that creditors may use when providing open-end and closed-end disclosures. The appendices contain detailed rules for calculating the annual percentage rate (APR) for open-end credit (appendix F) and closed-end credit (appendixes D and J). The last two appendixes (appendixes K and L) provide total annual loan cost rate computations and assumed loan periods for reverse mortgage transactions.

Official staff interpretations of the regulation are published in a commentary that is normally updated annually in March. Good faith compliance with the commentary protects creditors from civil liability under the Act. In addition, the commentary includes mandates, which are not necessarily explicit in

Regulation Z, on disclosures or other actions required of creditors. It is virtually impossible to comply with Regulation Z without reference to and reliance on the commentary. The following narrative does not discuss all the sections of Regulation Z, but rather highlights certain sections of the regulation and the Truth in Lending Act.

SUBPART A - GENERAL

Purpose of the TILA and Regulation Z

The Truth in Lending Act is intended to ensure that credit terms are disclosed in a meaningful way so consumers can compare credit terms more readily and knowledgeably. Before its enactment, consumers were faced with a bewildering array of credit terms and rates. It was difficult to compare loans because they were seldom presented in the same format. Now, all creditors must use the same credit terminology and expressions of rates. In addition to providing a uniform system for disclosures, the Act:

- Protects consumers against inaccurate and unfair credit billing and credit card practices;
- Provides consumers with rescission rights;
- Provides for rate caps on certain dwelling-secured loans;
- Impose limitations on home equity lines of credit and certain closed-end home mortgages; and
- Delineates and prohibits unfair or deceptive mortgage lending practices.

The TILA and Regulation Z do not, however, tell financial institutions how much interest they may charge or whether they must grant a consumer a loan.

Summary of Coverage Considerations § 226.1 & § 226.2

Lenders must carefully consider several factors when deciding whether a loan requires Truth in Lending disclosures or is subject to other Regulation Z requirements. The coverage considerations under Regulation Z are addressed in more detail in the commentary to Regulation Z. For example, broad coverage considerations are included under § 226.1(c) of the regulation and relevant definitions appear in § 226.2.

Exempt Transactions § 226.3

The following transactions are exempt from Regulation Z:

- Credit extended primarily for a business, commercial, or agricultural purpose;³
- Credit extended to other than a natural person (including credit to government agencies or instrumentalities);
- Credit in excess of \$25,000 and not secured by real or personal property used as the principal dwelling of the consumer;
- Public utility credit;
- Credit extended by a broker-dealer registered with the Securities and Exchange Commission (SEC) or the Commodity Futures Trading Commission (CFTC), involving securities or commodities accounts;
- Home fuel budget plans; and
- Certain student loan programs.

When determining whether credit is for consumer purposes, the creditor must evaluate all of the following:

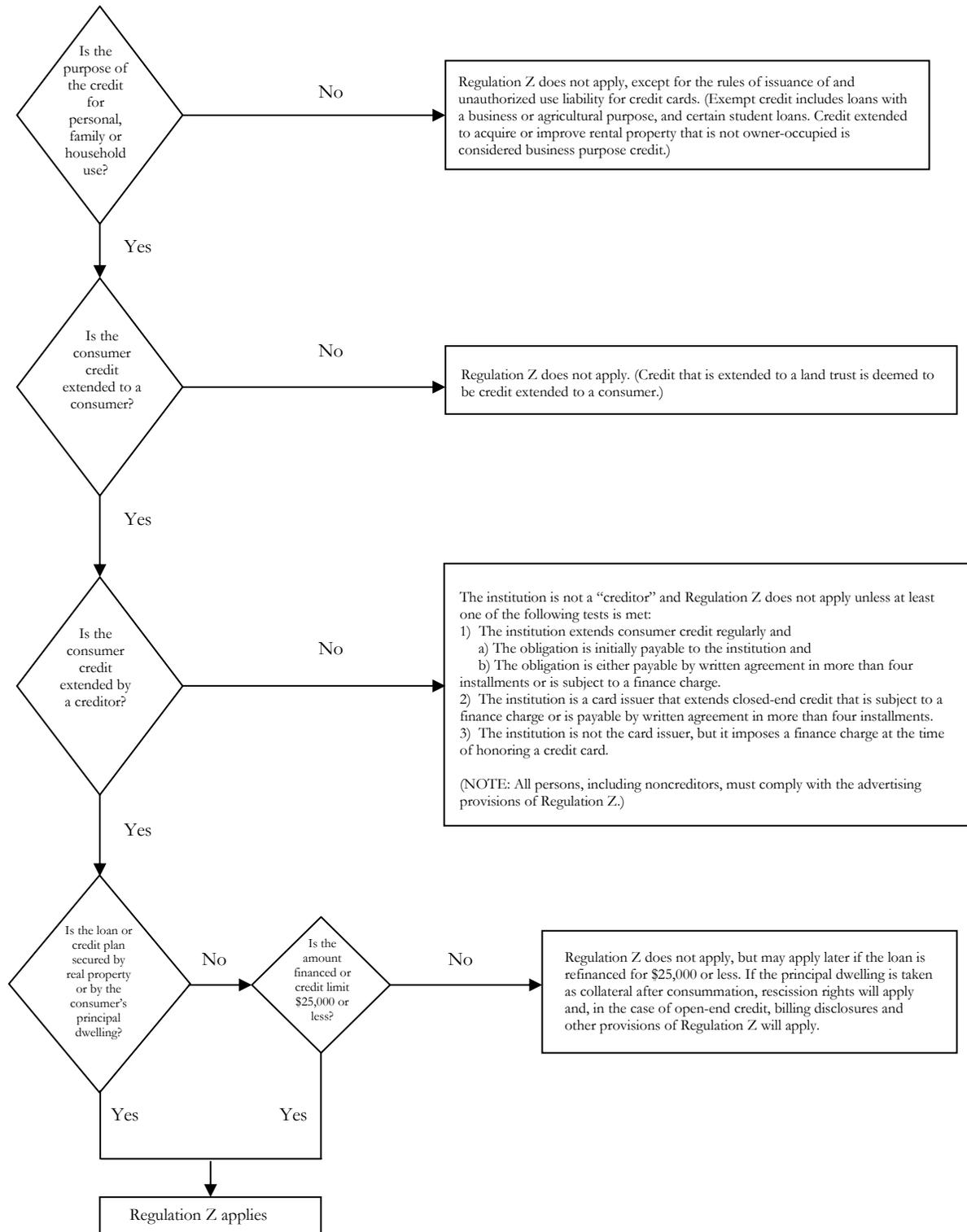
- Any statement obtained from the consumer describing the purpose of the proceeds.
 - For example, a statement that the proceeds will be used for a vacation trip would indicate a consumer purpose.
 - If the loan has a mixed-purpose (e.g., proceeds will be used to buy a car that will be used for personal and business purposes), the lender must look to the primary purpose of the loan to decide whether disclosures are necessary. A statement of purpose from the consumer will help the lender make that decision.
 - A checked box indicating that the loan is for a business purpose, absent any documentation showing the intended use of the proceeds, could be insufficient evidence that the loan did not have a consumer purpose.

³ If a credit card is involved, generally exempt credit (e.g., business or agricultural purpose credit) is still subject to requirements that govern the issuance of credit cards and liability for their unauthorized use. Credit cards must not be issued on an unsolicited basis and, if a credit card is lost or stolen, the cardholder must not be held liable for more than \$50 for the unauthorized use of the card.

- The consumer's primary occupation and how it relates to the use of the proceeds. The higher the correlation between the consumer's occupation and the property purchased from the loan proceeds, the greater the likelihood that the loan has a business purpose. For example, proceeds used to purchase dental supplies for a dentist would indicate a business purpose.
- Personal management of the assets purchased from proceeds. The lower the degree of the borrower's personal involvement in the management of the investment or enterprise purchased by the loan proceeds, the less likely the loan will have a business purpose. For example, money borrowed to purchase stock in an automobile company by an individual who does not work for that company would indicate a personal investment and a consumer purpose.
- The size of the transaction. The larger the size of the transaction, the more likely the loan will have a business purpose. For example, if the loan is for a \$5,000,000 real estate transaction, that might indicate a business purpose.
- The amount of income derived from the property acquired by the loan proceeds relative to the borrower's total income. The lesser the income derived from the acquired property, the more likely the loan will have a consumer purpose. For example, if the borrower has an annual salary of \$100,000 and receives about \$500 in annual dividends from the acquired property, that would indicate a consumer purpose.

All five factors must be evaluated before the lender can conclude that disclosures are not necessary. Normally, no one factor, by itself, is sufficient reason to determine the applicability of Regulation Z. In any event, the financial institution may routinely furnish disclosures to the consumer. Disclosure under such circumstances does not control whether the transaction is covered, but can assure protection to the financial institution and compliance with the law.

Coverage Considerations under Regulation Z



DETERMINATION OF FINANCE CHARGE AND APR

Finance Charge (Open-End and Closed-End Credit) § 226.4

The finance charge is a measure of the cost of consumer credit represented in dollars and cents. Along with APR disclosures, the disclosure of the finance charge is central to the uniform credit cost disclosure envisioned by the TILA.

The finance charge does not include any charge of a type payable in a comparable cash transaction. Examples of charges payable in a comparable cash transaction may include taxes, title, license fees, or registration fees paid in connection with an automobile purchase.

Finance charges include any charges or fees payable directly or indirectly by the consumer and imposed directly or indirectly by the financial institution either as an incident to or as a condition of an extension of consumer credit. The finance charge on a loan always includes any interest charges and often, other charges. Regulation Z includes examples, applicable both to open-end and closed-end credit transactions, of what must, must not, or need not be included in the disclosed finance charge (§ 226.4(b)).

Accuracy Tolerances (Closed-End Credit) §§ 226.18(d) & 226.23(h)

Regulation Z provides finance charge tolerances for legal accuracy that should not be confused with those provided in the TILA for reimbursement under regulatory agency orders. As with disclosed APRs, if a disclosed finance charge were legally accurate, it would not be subject to reimbursement.

Under TILA and Regulation Z, finance charge disclosures for open-end credit must be accurate since there is no tolerance for finance charge errors. However, both TILA and Regulation Z permit various finance charge accuracy tolerances for closed-end credit.

Tolerances for the finance charge in a closed-end transaction are generally \$5 if the amount financed is less than or equal to \$1,000 and \$10 if the amount financed exceeds \$1,000. Tolerances for certain transactions consummated on or after September 30, 1995 are noted below.

- Credit secured by real property or a dwelling (**closed-end credit only**):
 - The disclosed finance charge is considered accurate if it does not vary from the actual finance charge by more than \$100.
 - Overstatements are not violations.
- Rescission rights after the three-business-day rescission period (**closed-end credit only**):
 - The disclosed finance charge is considered accurate if it does not vary from the actual finance charge by more than one-half of 1 percent of the credit extended.

- The disclosed finance charge is considered accurate if it does not vary from the actual finance charge by more than 1 percent of the credit extended for the initial and subsequent refinancings of residential mortgage transactions when the new loan is made at a different financial institution. (This excludes high cost mortgage loans subject to § 226.32, transactions in which there are new advances, and new consolidations.)
- Rescission rights in foreclosure:
 - The disclosed finance charge is considered accurate if it does not vary from the actual finance charge by more than \$35.
 - Overstatements are not considered violations.
 - The consumer can rescind if a mortgage broker fee is not included as a finance charge.

Note: Normally, the finance charge tolerance for a rescindable transaction is either 0.5 percent of the credit transaction or, for certain refinancings, 1 percent of the credit transaction. However, in the event of a foreclosure, the consumer may exercise the right of rescission if the disclosed finance charge is understated by more than \$35.

See the Finance Charge Tolerances charts within this handbook section for help in determining appropriate finance charge tolerances.

Calculating the Finance Charge (Closed-End Credit)

One of the more complex tasks under Regulation Z is determining whether a charge associated with an extension of credit must be included in, or excluded from, the disclosed finance charge. The finance charge initially includes any charge that is, or will be, connected with a specific loan. Charges imposed by third parties are finance charges if the financial institution requires use of the third party. Charges imposed by settlement or closing agents are finance charges if the bank requires the specific service that gave rise to the charge and the charge is not otherwise excluded. The Finance Charge Tolerances charts within this document briefly summarize the rules that must be considered.

Prepaid Finance Charges § 226.18(b)

A prepaid finance charge is any finance charge paid separately to the financial institution or to a third party, in cash or by check before or at closing, settlement, or consummation of a transaction, or withheld from the proceeds of the credit at any time.

Prepaid finance charges effectively reduce the amount of funds available for the consumer's use, usually before or at the time the transaction is consummated.

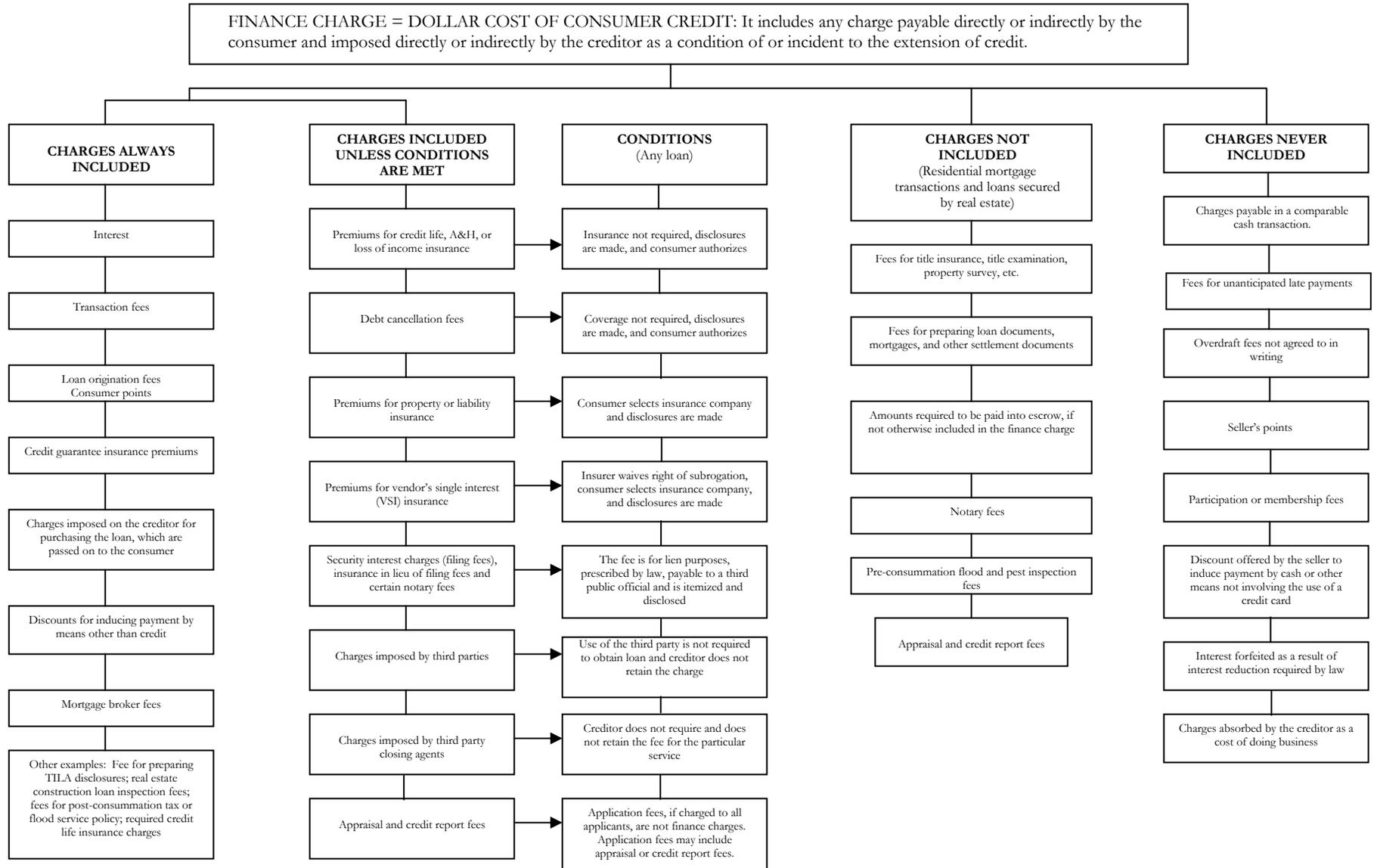
Examples of finance charges frequently prepaid by consumers are borrower's points, loan origination fees, real estate construction inspection fees, odd days' interest (interest attributable to part of the first

payment period when that period is longer than a regular payment period), mortgage guarantee insurance fees paid to the Federal Housing Administration, private mortgage insurance (PMI) paid to such companies as the Mortgage Guaranty Insurance Company (MGIC), and, in non-real-estate transactions, credit report fees.

Precomputed Finance Charges

A precomputed finance charge includes, for example, interest added to the note amount that is computed by the add-on, discount, or simple interest methods. If reflected in the face amount of the debt instrument as part of the consumer's obligation, finance charges that are not viewed as prepaid finance charges are treated as precomputed finance charges that are earned over the life of the loan.

Finance Charge Chart



Instructions for the Finance Charge Chart

The finance charge initially includes any charge that is, or will be, connected with a specific loan. Charges imposed by third parties are finance charges if the creditor requires use of the third party. Charges imposed on the consumer by a settlement agent are finance charges only if the creditor requires the particular services for which the **settlement agent** is charging the borrower and the charge is not otherwise excluded from the finance charge.

Immediately below the finance charge definition, the chart presents five captions applicable to determining whether a loan related charge is a finance charge.

The first caption is **charges always included**. This category focuses on specific charges given in the regulation or commentary as examples of finance charges.

The second caption, **charges included unless conditions are met**, focuses on charges that must be included in the finance charge unless the creditor meets specific disclosure or other conditions to exclude the charges from the finance charge.

The third caption, **conditions**, focuses on the conditions that need to be met if the charges identified to the left of the conditions are permitted to be excluded from the finance charge. Although most charges under the second caption may be included in the finance charge at the creditor's option, third party charges and application fees (listed last under the third caption) must be excluded from the finance charge if the relevant conditions are met. However, inclusion of appraisal and credit report charges as part of the application fee is optional.

The fourth caption, **charges not included**, identifies fees or charges that are not included in the finance charge under conditions identified by the caption. If the credit transaction is secured by real property or the loan is a residential mortgage transaction, the charges identified in the column, if they are bona fide and reasonable in amount, must be excluded from the finance charge. For example, if a consumer loan is secured by a vacant lot or commercial real estate, any appraisal fees connected with the loan must not be included in the finance charge.

The fifth caption, **charges never included**, lists specific charges provided by the regulation as examples of those that automatically are not finance charges (e.g., fees for unanticipated late payments).

Annual Percentage Rate Definition (Closed-End Credit) § 226.22

Credit costs may vary depending on the interest rate, the amount of the loan and other charges, the timing and amounts of advances, and the repayment schedule. The APR, which must be disclosed in nearly all consumer credit transactions, is designed to take into account all relevant factors and to provide a uniform measure for comparing the cost of various credit transactions.

The APR is a measure of the cost of credit, expressed as a nominal yearly rate. It relates the amount and timing of value received by the consumer to the amount and timing of payments made. The disclosure of the APR is central to the uniform credit cost disclosure envisioned by the TILA.

The value of a closed-end credit APR must be disclosed as a single rate only, whether the loan has a single interest rate, a variable interest rate, a discounted variable interest rate, or graduated payments based on separate interest rates (step rates), and it must appear with the segregated disclosures. Segregated disclosures are grouped together and do not contain any information not directly related to the disclosures required under § 226.18.

Since an APR measures the total cost of credit, including costs such as transaction charges or premiums for credit guarantee insurance, it is not an “interest” rate, as that term is generally used. APR calculations do not rely on definitions of interest in state law and often include charges, such as a commitment fee paid by the consumer, that are not viewed by some state usury statutes as interest. Conversely, an APR might not include a charge, such as a credit report fee in a real property transaction, which some state laws might view as interest for usury purposes. Furthermore, measuring the timing of value received and of payments made, which is essential if APR calculations are to be accurate, must be consistent with parameters under Regulation Z.

The APR is often considered to be the finance charge expressed as a percentage. However, two loans could require the same finance charge and still have different APRs because of differing values of the amount financed or of payment schedules. For example, the APR is 12 percent on a loan with an amount financed of \$5,000 and 36 equal monthly payments of \$166.07 each. It is 13.26 percent on a loan with an amount financed of \$4,500 and 35 equal monthly payments of \$152.18 each and final payment of \$152.22. In both cases the finance charge is \$978.52. The APRs on these example loans are not the same because an APR does not only reflect the finance charge. It relates the amount and timing of value received by the consumer to the amount and timing of payments made.

The APR is a function of:

- The amount financed, which is not necessarily equivalent to the loan amount. For example:
 - if the consumer must pay at closing a separate 1 percent loan origination fee (prepaid finance charge) on a \$100,000 residential mortgage loan, the loan amount is \$100,000, but the amount financed would be \$100,000 less the \$1,000 loan fee, or \$99,000.
- The finance charge, which is not necessarily equivalent to the total interest amount (interest is not defined by Regulation Z, but rather is defined by state or other federal law). For example:
 - If the consumer must pay a \$25 credit report fee for an auto loan, the fee must be included in the finance charge. The finance charge in that case is the sum of the interest on the loan (i.e., interest generated by the application of a percentage rate against the loan amount) plus the \$25 credit report fee.

- If the consumer must pay a \$25 credit report fee for a home improvement loan secured by real property, the credit report fee must be excluded from the finance charge. The finance charge in that case would be only the interest on the loan.
- The payment schedule, which does not necessarily include only principal and interest (P + I) payments. For example:
 - If the consumer borrows \$2,500 for a vacation trip at 14 percent simple interest per annum and repays that amount with 25 equal monthly payments beginning one month from consummation of the transaction, the monthly P + I payment will be \$115.87, if all months are considered equal, and the amount financed would be \$2,500. If the consumer's payments are increased by \$2.00 a month to pay a non-financed \$50 loan fee during the life of the loan, the amount financed would remain at \$2,500 but the payment schedule would be increased to \$117.87 a month, the finance charge would increase by \$50, and there would be a corresponding increase in the APR. This would be the case whether or not state law defines the \$50 loan fee as interest.
 - If the loan above has 55 days to the first payment and the consumer prepays interest at consummation (\$24.31 to cover the first 25 days), the amount financed would be \$2,500 - \$24.31, or \$2,475.69. Although the amount financed has been reduced to reflect the consumer's reduced use of available funds at consummation, the time interval during which the consumer has use of the \$2,475.69, 55 days to the first payment, has not changed. Since the first payment period exceeds the limitations of the regulation's minor irregularities provisions (see § 226.17(c)(4)), it may not be treated as regular. In calculating the APR, the first payment period must not be reduced by 25 days (i.e., the first payment period may not be treated as one month).

Financial institutions may, if permitted by state or other law, precompute interest by applying a rate against a loan balance using a simple interest, add-on, discount or some other method, and may earn interest using a simple interest accrual system, the Rule of 78's (if permitted by law) or some other method. Unless the financial institution's internal interest earnings and accrual methods involve a simple interest rate based on a 360-day year that is applied over actual days (even that is important only for determining the accuracy of the payment schedule), it is not relevant in calculating an APR, since an APR is not an interest rate (as that term is commonly used under state or other law). Since the APR normally need not rely on the internal accrual systems of a bank, it always may be computed after the loan terms have been agreed upon (as long as it is disclosed before actual consummation of the transaction).

Special Requirements for Calculating the Finance Charge and APR

Proper calculation of the finance charge and APR are of primary importance. The regulation requires that the terms "finance charge" and "annual percentage rate" be disclosed more conspicuously than any other required disclosure. The finance charge and APR, more than any other disclosures, enable

consumers to understand the cost of the credit and to comparison shop for credit. A creditor's failure to disclose those values accurately can result in significant monetary damages to the creditor, either from a class action lawsuit or from a regulatory agency's order to reimburse consumers for violations of law.

Footnote 45d: If an APR or finance charge is disclosed incorrectly, the error is not, in itself, a violation of the regulation if:

- The error resulted from a corresponding error in a calculation tool **used in good faith** by the financial institution.
- Upon discovery of the error, the financial institution promptly discontinues use of that calculation tool for disclosure purposes.
- The financial institution notifies the Federal Reserve Board in writing of the error in the calculation tool.

When a financial institution claims a calculation tool was used in good faith, the financial institution assumes a reasonable degree of responsibility for ensuring that the tool in question provides the accuracy required by the regulation. For example, the financial institution might verify the results obtained using the tool by comparing those results to the figures obtained by using another calculation tool. The financial institution might also verify that the tool, if it is designed to operate under the actuarial method, produces figures similar to those provided by the examples in appendix J to the regulation. The calculation tool should be checked for accuracy before it is first used and periodically thereafter.

SUBPART B - OPEN-END CREDIT

The following is not a complete discussion of the open-end credit requirements in the Truth in Lending Act. Instead, the information provided below is offered to clarify otherwise potentially confusing terms and requirements. Refer to §§ 226.5 through 226.16 and related commentary for a more thorough understanding of the Act.

Time of Disclosures (Open-End Credit) § 226.5(b)

A creditor is prohibited from treating a payment as late or imposing finance charges as a result of the loss of a grace period unless the creditor has provided a reasonable amount of time for consumers to make a payment. A reasonable amount of time is 21 days between the date on which the statement is mailed or delivered to the consumer and the date on which the consumer's payment must be received by the creditor to avoid incurring a finance charge or a late fee. Although the rule does not establish an absolute requirement that periodic statements be mailed 21 days in advance of the payment due date, the rule does require creditors to adopt "reasonable procedures designed to ensure" that statements are mailed or delivered at least 21 days before the payment due date and the expiration of the grace period.

The “grace period” is defined as a period within which any credit extended may be repaid without incurring a finance charge due to a periodic interest rate.

For example, if a creditor has adopted reasonable procedures designed to ensure that periodic statements are mailed or delivered to consumers no later than three days after the closing date of the billing cycle, the payment due date and the date on which any grace period expires must be no less than 24 days after the closing date of the billing cycle.

This provision applies to all open-end consumer credit plans rather than just credit card accounts.

Subsequent Disclosures (Open-End Credit) § 226.9

Creditors are required to provide consumers with 45 days’ advance written notice of rate increases and other significant changes to the terms of their credit card account agreements. The list of “significant changes” includes most fees and other terms that a consumer should be aware of before use of the account. Examples of such fees and terms include:

- Penalty fees.
- Transaction fees.
- Fees imposed for the issuance or availability of the open-end plan.
- Grace period.
- Balance computation method.

Changes that do not require advance notice include:

- Reducing finance charges.
- Increasing the minimum payment.
- Terminating account privileges resulting from an agreement involving a court proceeding.
- Suspending account privileges or terminating an account when a borrower’s creditworthiness deteriorates.
- Increasing an APR upon expiration of a specified period of time previously disclosed in writing.
- Increasing a variable APR that changes according to an index.

- Increasing a rate due to the completion of, or failure of a consumer to comply with, the terms of a workout or temporary hardship agreement.

A creditor may lower the credit limit without notice, but may not impose an over limit fee or penalty rate as a result of exceeding the new credit limit without a 45-day advance notice of the reduced credit limit.

For significant changes in terms (with the exception of an increase in the minimum payment), a creditor must also provide consumers the right to reject the change, unless the consumer fails to make a required minimum periodic payment within 60 days after the due date. If the consumer does reject the change prior to the effective date, the creditor may not apply the increase or change to the existing account balance (§ 226.9(h)(2)(i)). However, the creditor may apply the change to transactions that occur more than 14 days after it sends its notice (§ 226.9(h)(3)(ii)).

Note: Although not required by Regulation Z, OTS recommends that institutions voluntarily include in the notice a statement indicating that whether the consumer accepts or rejects a change or increase, it will apply to transactions that occur after a date specified in the notice; this date must be more than 14 days after the notice has been provided. Including such a statement may help avoid consumer confusion about the effect on future transactions of exercising the right to reject changes or increases.

In addition, when a consumer rejects a change or increase, the creditor must not:

- Impose a fee or charge or treat the account as in default solely as a result of the rejection; or
- Require repayment of the balance on the account using a method that is less beneficial to the consumer than one of the following methods: (1) the method of repayment prior to the rejection; (2) an amortization period of not less than five year from the date of rejection; or (3) a minimum periodic payment that includes a percentage of the balance that is not more than twice the percentage included prior to the date of rejection.

Finance Charge (Open-End Credit) § 226.6(a)

Each finance charge imposed must be individually itemized. The aggregate total amount of the finance charge need not be disclosed.

Determining the Balance and Computing the Finance Charge

The examiner must know how to compute the balance to which the periodic rate is applied. Common methods used are the previous balance method, the daily balance method, and the average daily balance method, which are described as follows:

- Previous balance method – The balance on which the periodic finance charge is computed is based on the balance outstanding at the start of the billing cycle. The periodic rate is multiplied by this balance to compute the finance charge.
- Daily balance method – A daily periodic rate is applied to either the balance on each day in the cycle or the sum of the balances on each of the days in the cycle. If a daily periodic rate is multiplied by the balance on each day in the billing cycle, the finance charge is the sum of the products. If the daily periodic rate is multiplied by the sum of all the daily balances, the result is the finance charge.
- Average daily balance method – The average daily balance is the sum of the daily balances (either including or excluding current transactions) divided by the number of days in the billing cycle. A periodic rate is then multiplied by the average daily balance to determine the finance charge. If the periodic rate is a daily one, the product of the rate multiplied by the average balance is multiplied by the number of days in the cycle.

In addition to those common methods, financial institutions have other ways of calculating the balance to which the periodic rate is applied. By reading the financial institution's explanation, the examiner should be able to calculate the balance to which the periodic rate was applied. In some cases, the examiner may need to obtain additional information from the financial institution to verify the explanation disclosed. Any inability to understand the disclosed explanation should be discussed with management, who should be reminded of Regulation Z's requirement that disclosures be clear and conspicuous.

When a balance is determined without first deducting all credits and payments made during the billing cycle, that fact and the amount of the credits and payments must be disclosed.

If the financial institution uses the daily balance method and applies a single daily periodic rate, disclosure of the balance to which the rate was applied may be stated as any of the following:

- A balance for each day in the billing cycle. The daily periodic rate is multiplied by the balance on each day and the sum of the products is the finance charge.
- A balance for each day in the billing cycle on which the balance in the account changes. The finance charge is figured by the same method as discussed previously, but the statement shows the balance only for those days on which the balance changed.
- The sum of the daily balances during the billing cycle. The balance on which the finance charge is computed is the sum of all the daily balances in the billing cycle. The daily periodic rate is multiplied by that balance to determine the finance charge.
- The average daily balance during the billing cycle. If this is stated, however, the financial institution must explain somewhere on the periodic statement or in an accompanying document

that the finance charge is or may be determined by multiplying the average daily balance by the number of days in the billing cycle, rather than by multiplying the product by the daily periodic rate.

If the financial institution uses the daily balance method, but applies two or more daily periodic rates, the sum of the daily balances may not be used. Acceptable ways of disclosing the balances include any of the following:

- A balance for each day in the billing cycle.
- A balance for each day in the billing cycle on which the balance in the account changes.
- Two or more average daily balances. If the average daily balances are stated, the financial institution shall indicate on the periodic statement or in an accompanying document that the finance charge is or may be determined by multiplying each of the average daily balances by the number of days in the billing cycle (or if the daily rate varies, by multiplying the number of days that the applicable rate was in effect), multiplying each of the results by the applicable daily periodic rate, and adding the products together.

In explaining the method used to find the balance on which the finance charge is computed, the financial institution need not reveal how it allocates payments or credits. That information may be disclosed as additional information, but all required information must be clear and conspicuous.

Finance Charge Resulting from Two or More Periodic Rates

Some financial institutions use more than one periodic rate in computing the finance charge. For example, one rate may apply to balances up to a certain amount and another rate to balances more than that amount. If two or more periodic rates apply, the financial institution must disclose all rates and conditions. The range of balances to which each rate applies also must be disclosed. It is not necessary, however, to break the finance charge into separate components based on the different rates.

Annual Percentage Rate (Open-End Credit)

Accuracy Tolerance § 226.14

The disclosed APR on an open-end credit account is accurate if it is within one-eighth of 1 percentage point of the APR calculated under Regulation Z.

Determination of APR

The regulation states two basic methods for determining the APR in open-end credit transactions. The first involves multiplying each periodic rate by the number of periods in a year. This method is used for disclosing all of the following:

- The corresponding APR in the initial disclosures.
- The corresponding APR on periodic statements.
- The APR in early disclosures for credit card accounts.
- The APR in early disclosures for home-equity plans.
- The APR in advertising.
- The APR in oral disclosures.

The corresponding APR is prospective. In other words, it does not involve any particular finance charge or periodic balance.

The second method is the quotient method, used in computing the APR for periodic statements. The quotient method reflects the annualized equivalent of the rate that was actually applied during a cycle. This rate, also known as the historical rate, will differ from the corresponding APR if the creditor applies minimum, fixed, or transaction charges to the account during the cycle.

If the finance charge is determined by applying one or more periodic rates to a balance, and does not include any of the charges just mentioned, the financial institution may compute the historical rate using the quotient method. In that method, the financial institution divides the total finance charge for the cycle by the sum of the balances to which the periodic rates were applied and multiplies the quotient (expressed as a percentage) by the number of cycles in a year.

Alternatively, the financial institution may use the method for computing the corresponding APR. In that method, the financial institution multiplies each periodic rate by the number of periods in one year. If the finance charge includes a minimum, fixed, or transaction charge, the financial institution must use the appropriate variation of the quotient method. When transaction charges are imposed, the financial institution should refer to appendix F of this handbook for computational examples.

The regulation also contains a computation rule for small finance charges. If the finance charge includes a minimum, fixed, or transaction charge, and the total finance charge for the cycle does not exceed 50 cents, the financial institution may multiply each applicable periodic rate by the number of periods in a year to compute the APR.

Optional calculation methods also are provided for accounts involving daily periodic rates (§ 226.14(d)).

Brief Outline for Open-End Credit APR Calculations on Periodic Statements

Note: Assume monthly billing cycles for each of the following calculations.

I. APR when finance charge is determined solely by applying one or more periodic rates:

A. Monthly periodic rates:

1. Monthly rate x 12 = APR

or

2. (Total finance charge / applicable balance x 12 = APR⁴)

This calculation may be used when different rates apply to different balances.

A. Daily periodic rates:

1. Daily rate x 365 = APR

or

2. (Total finance charge / average daily balance) x 12 = APR

or

3. (Total finance charge / sum of balances) x 365 = APR

II. APR when finance charge includes a minimum, fixed, or other charge that is not calculated using a periodic rate (and does not include charges related to a specific transaction, such as a cash advance fees):

A. Monthly periodic rates:

1. (Total finance charge / amount of applicable balance⁵) x 12 = APR⁶

B. Daily periodic rates

1. (Total finance charge / amount of applicable balance) X 365 = APR^{7,8}

⁴ If zero, no APR can be determined. The amount of applicable balance is the balance calculation method and may include the average daily balance, adjusted balance, or previous balance method.

⁵ See footnote 4.

⁶ Loan fees, points, or similar finance charges that relate to the opening of the account must not be included in the calculation of the APR.

⁷ See footnote 4.

⁸ See footnote 6.

2. The following may be used if at least a portion of the finance charge is determined by the application of a daily periodic rate. If not, use the formula above.
 - a. $(\text{Total finance charge} / \text{average daily balance}) \times 12 = \text{APR}^9$
 - or
 - b. $(\text{Total finance charge} / \text{sum of balances}) \times 365 = \text{APR}^{10}$

C. Monthly and daily periodic rates

1. If the finance charge imposed during the billing cycle does not exceed \$.50 for a monthly or longer billing cycles (or pro rata part of \$.50 for a billing cycle shorter than monthly), the APR may be calculated by multiplying the monthly rate by 12 or the daily rate by 365.

III. If the total finance charge included a charge related to a specific transaction (such as a cash advance fee), even if the total finance charge also included any other minimum, fixed, or other charge not calculated using a periodic rate, then the monthly and daily APRs are calculated as follows: $(\text{total finance charge} / \text{the greater of: the transaction amounts that created the transaction fees or the sum of the balances and other amounts on which a finance charge was imposed during the billing cycle}^{11}) \times \text{number of billing cycles in a year (12)} = \text{APR}^{12}$

SUBPART C - CLOSED-END CREDIT

The following is not a complete discussion of the closed-end credit requirements in the Truth in Lending Act. Instead, the information provided below is offered to clarify otherwise potentially confusing terms and requirements. Refer to §§ 226.17 through 226.24 and related commentary for a more thorough understanding of the Act.

Finance Charge (Closed-End Credit) § 226.17(a)

The aggregate total amount of the finance charge must be disclosed. Each finance charge imposed need not be individually itemized and must not be itemized with the segregated disclosures.

⁹ See footnote 4.

¹⁰ See footnote 4.

¹¹ The sum of the balance may include amounts computed by either the average daily balance, adjusted balance, or previous balance method. When a portion of the finance charge is determined by application of one or more daily periodic rates, the sum of the balances also means the average of daily balances.

¹² If the product is less than the highest periodic rate applied, expressed as an APR, the higher figure must be disclosed as the APR.

Annual Percentage Rate (Closed-End Credit) § 226.22

Accuracy Tolerances

The disclosed APR on a closed-end transaction is accurate for:

- Regular transactions (which include any single advance transaction with equal payments and equal payment periods, or an irregular first payment period and/or a first or last irregular payment), if it is within one-eighth of 1 percentage point of the APR calculated under Regulation Z (§ 226.22(a)(2)).
- Irregular transactions (which include multiple advance transactions and other transactions not considered regular), if it is within one-quarter of 1 percentage point of the APR calculated under Regulation Z (§ 226.22(a)(3)).
- Mortgage transactions if:
 - The APR is within one-eighth of 1 percentage point for regular transactions or one-quarter of 1 percentage point for irregular transactions;
 - The rate results from the disclosed finance charge and the disclosed finance charge is considered accurate under § 226.18(d)(1) or 226.23(g) or (h) (§ 226.22(a)(4)); or
 - The disclosed finance charge is calculated incorrectly but is considered accurate under §§ 226.18(d)(1) or 226.23(g) or (h) and either:
 - ♦ (A) the finance charge is understated and the disclosed APR is also understated but is closer to the actual APR than the APR that would be considered accurate under § 226.22(a)(4) or
 - ♦ (B) the disclosed finance charge is overstated and the disclosed APR is also overstated but is closer to the actual APR than the APR that would be considered accurate under § 226.22(a)(4).

For example, in an irregular transaction subject to a tolerance of 1/4th of 1 percentage point, if the actual APR is 9.00% and a \$75 omission from the finance charge corresponds to a rate of 8.50% that is considered accurate under § 226.22(a)(4), a disclosed APR of 8.65% is considered accurate under § 226.22(a)(5). However, a disclosed APR below 8.50% or above 9.25% would not be considered accurate.

Construction Loans § 226.17(c)(6) and Appendix D

Construction and certain other multiple advance loans pose special problems in computing the finance charge and APR. In many instances, the amount and dates of advances are not predictable with

certainty since they depend on the progress of the work. Regulation Z provides that the APR and finance charge for such loans may be estimated for disclosure.

At its option, the financial institution may rely on the representations of other parties to acquire necessary information (for example, it might look to the consumer for the dates of advances). In addition, if either the amounts or dates of advances are unknown (even if some of them are known), the financial institution may, at its option, use Appendix D to the regulation to make calculations and disclosures. The finance charge and payment schedule obtained through Appendix D may be used with volume one of the Federal Reserve Board's APR tables or with any other appropriate computation tool to determine the APR. If the financial institution elects not to use Appendix D, or if Appendix D cannot be applied to a loan (e.g., Appendix D does not apply to a combined construction-permanent loan if the payments for the permanent loan begin during the construction period), the financial institution must make its estimates under § 226.17(c)(2) and calculate the APR using multiple advance formulas.

On loans involving a series of advances under an agreement to extend credit up to a certain amount, a financial institution may treat all of the advances as a single transaction or disclose each advance as a separate transaction. If advances are disclosed separately, disclosures must be provided before each advance occurs, with the disclosures for the first advance provided before consummation.

In a transaction that finances the construction of a dwelling that may or will be permanently financed by the same financial institution, the construction-permanent financing phases may be disclosed in one of three ways listed below.

- As a single transaction, with one disclosure combining both phases.
- As two separate transactions, with one disclosure for each phase.
- As more than two transactions, with one disclosure for each advance and one for the permanent financing phase.

If two or more disclosures are furnished, buyer's points or similar amounts imposed on the consumer may be allocated among the transactions in any manner the financial institution chooses, as long as the charges are not applied more than once. In addition, if the financial institution chooses to give two sets of disclosures and the consumer is obligated for both construction and permanent phases at the outset, both sets of disclosures must be given to the consumer initially, before consummation of each transaction occurs.

If the creditor requires interest reserves for construction loans, special Appendix D rules apply that can make the disclosure calculations quite complicated. The amount of interest reserves included in the commitment amount must not be treated as a prepaid finance charge.

If the lender uses Appendix D for construction-only loans with required interest reserves, the lender must estimate construction interest using the interest reserve formula in Appendix D. The lender's own interest reserve values must be completely disregarded for disclosure purposes.

If the lender uses Appendix D for combination construction-permanent loans, the calculations can be much more complex. Appendix D is used to estimate the construction interest, which is then measured against the lender's contractual interest reserves.

If the interest reserve portion of the lender's contractual commitment amount exceeds the amount of construction interest estimated under Appendix D, the excess value is considered part of the amount financed if the lender has contracted to disburse those amounts whether they ultimately are needed to pay for accrued construction interest. If the lender will not disburse the excess amount if it is not needed to pay for accrued construction interest, the excess amount must be ignored for disclosure purposes.

Calculating the Annual Percentage Rate § 226.22

The APR must be determined under one of the following:

- The actuarial method, which is defined by Regulation Z and explained in appendix J to the regulation.
- The U.S. Rule, which is permitted by Regulation Z and briefly explained in appendix J to the regulation. The U.S. Rule is an accrual method that seems to have first surfaced officially in an early nineteenth century United States Supreme Court case, *Story v. Livingston* (38 U.S. 359).

Whichever method is used by the financial institution, the rate calculated will be accurate if it is able to "amortize" the amount financed while it generates the finance charge under the accrual method selected. Financial institutions also may rely on minor irregularities and accuracy tolerances in the regulation, both of which effectively permit somewhat imprecise, but still legal, APRs to be disclosed.

360-Day and 365-Day Years § 226.17(c)(3)

Confusion often arises over whether to use the 360-day or 365-day year in computing interest, particularly when the finance charge is computed by applying a daily rate to an unpaid balance. Many single payment loans or loans payable on demand are in this category. There are also loans in this category that call for periodic installment payments.

Regulation Z does not require the use of one method of interest computation in preference to another (although state law may). It does, however, permit financial institutions to disregard the fact that months have different numbers of days when calculating and making disclosures. This means financial institutions may base their disclosures on calculation tools that assume all months have an equal number of days, even if their practice is to take account of the variations in months to collect interest.

For example, a financial institution may calculate disclosures using a financial calculator based on a 360-day year with 30-day months, when, in fact, it collects interest by applying a factor of 1/365 of the annual interest rate to actual days.

Disclosure violations may occur, however, when a financial institution applies a daily interest factor based on a 360-day year to the actual number of days between payments. In those situations, the financial institution must disclose the higher values of the finance charge, the APR, and the payment schedule resulting from this practice.

For example, a 12 percent simple interest rate divided by 360 days results in a daily rate of .033333 percent. If no charges are imposed except interest, and the amount financed is the same as the loan amount, applying the daily rate on a daily basis for a 365-day year on a \$10,000 one year, single payment, unsecured loan results in an APR of 12.17 percent ($.033333\% \times 365 = 12.17\%$), and a finance charge of \$1,216.67. There would be a violation if the APR were disclosed as 12 percent or if the finance charge were disclosed as \$1,200 ($12\% \times \$10,000$).

However, if there are no other charges except interest, the application of a 360-day year daily rate over 365 days on a regular loan would not result in an APR in excess of the one eighth of one percentage point APR tolerance unless the nominal interest rate is greater than 9 percent. For irregular loans, with one-quarter of 1 percentage point APR tolerance, the nominal interest rate would have to be greater than 18 percent to exceed the tolerance.

Variable Rate Information § 226.18(f)

If the terms of the legal obligation allow the financial institution, after consummation of the transaction, to increase the APR, the financial institution must furnish the consumer with certain information on variable rates. Graduated payment mortgages and step-rate transactions without a variable rate feature are not considered variable rate transactions. In addition, variable rate disclosures are not applicable to rate increases resulting from delinquency, default, assumption, acceleration, or transfer of the collateral.

Some of the more important transaction-specific variable rate disclosure requirements under § 226.18 follow.

- Disclosures for variable rate loans must be given for the full term of the transaction and must be based on the terms in effect at the time of consummation.
- If the variable rate transaction includes either a seller buydown that is reflected in a contract or a consumer buydown, the disclosed APR should be a composite rate based on the lower rate for the buydown period and the rate that is the basis for the variable rate feature for the remainder of the term.
- If the initial rate is not determined by the index or formula used to make later interest rate adjustments, as in a discounted variable rate transaction, the disclosed APR must reflect a

composite rate based on the initial rate for as long as it is applied and, for the remainder of the term, the rate that would have been applied using the index or formula at the time of consummation (i.e., the fully indexed rate).

- If a loan contains a rate or payment cap that would prevent the initial rate or payment, at the time of the adjustment, from changing to the fully indexed rate, the effect of that rate or payment cap needs to be reflected in the disclosures.
- The index at consummation need not be used if the contract provides a delay in the implementation of changes in an index value (e.g., the contract indicates that future rate changes are based on the index value in effect for some specified period, like 45 days before the change date). Instead, the financial institution may use any rate from the date of consummation back to the beginning of the specified period (e.g., during the previous 45-day period).
- If the initial interest rate is set according to the index or formula used for later adjustments, but is set at a value as of a date before consummation, disclosures should be based on the initial interest rate, even though the index may have changed by the consummation date.

For variable-rate loans that are not secured by the consumer's principal dwelling or that are secured by the consumer's principal dwelling but have a term of one year or less, creditors must disclose the circumstances under which the rate may increase, any limitations on the increase, the effect of an increase, and an example of the payment terms that would result from an increase (§ 226.18(f)(1)).

For variable-rate consumer loans secured by the consumer's principal dwelling and having a maturity of more than one year, creditors must state that the loan has a variable-rate feature and that disclosures were previously given (§ 226.18(f)(2)). Extensive disclosures about the loan program are provided when consumers apply for such a loan (§ 226.19(b)), and throughout the loan term when the rate or payment amount is changed (§ 226.20(c)).

Payment Schedule § 226.18(g)

The disclosed payment schedule must reflect all components of the finance charge. It includes all payments scheduled to repay loan principal, interest on the loan, and any other finance charge payable by the consumer after consummation of the transaction.

However, any finance charge paid separately before or at consummation (e.g., odd days' interest) is not part of the payment schedule. It is a prepaid finance charge that must be reflected as a reduction in the value of the amount financed.

At the creditor's option, the payment schedule may include amounts beyond the amount financed and finance charge (e.g., certain insurance premiums or real estate escrow amounts such as taxes added to payments). However, when calculating the APR, the creditor must disregard such amounts.

If the obligation is a renewable balloon payment instrument that unconditionally obligates the financial institution to renew the short-term loan at the consumer's option or to renew the loan subject to conditions within the consumer's control, the payment schedule must be disclosed using the longer term of the renewal period or periods. The long-term loan must be disclosed with a variable rate feature.

If there are no renewal conditions or if the financial institution guarantees to renew the obligation in a refinancing, the payment schedule must be disclosed using the shorter balloon payment term. The short-term loan must be disclosed as a fixed rate loan, unless it contains a variable rate feature during the initial loan term.

Amount Financed § 226.18(b)

Definition

The amount financed is the net amount of credit extended for the consumer's use. It should not be assumed that the amount financed under the regulation is equivalent to the note amount, proceeds, or principal amount of the loan. The amount financed normally equals the total of payments less the finance charge.

To calculate the amount financed, all amounts and charges connected with the transaction, either paid separately or included in the note amount, must first be identified. Any prepaid, precomputed, or other finance charge must then be determined.

The amount financed must not include any finance charges. If finance charges have been included in the obligation (either prepaid or precomputed), they must be subtracted from the face amount of the obligation when determining the amount financed. The resulting value must be reduced further by an amount equal to any prepaid finance charge paid separately. The final resulting value is the amount financed.

When calculating the amount financed, finance charges (whether in the note amount or paid separately) should not be subtracted more than once from the total amount of an obligation. Charges not in the note amount and not included in the finance charge (e.g., an appraisal fee paid separately in cash on a real estate loan) are not required to be disclosed under Regulation Z and must not be included in the amount financed.

In a multiple advance construction loan, proceeds placed in a temporary escrow account and awaiting disbursement in draws to the developer are not considered part of the amount financed until actually disbursed. Thus, if the entire commitment amount is disbursed into the lender's escrow account, the lender must not base disclosures on the assumption that all funds were disbursed immediately, even if the lender pays interest on the escrowed funds.

Required Deposit § 226.18(r)

A required deposit, with certain exceptions, is one that the financial institution requires the consumer to maintain as a condition of the specific credit transaction. It can include a compensating balance or a deposit balance that secures the loan. The effect of a required deposit is not reflected in the APR. Also, a required deposit is not a finance charge since it is eventually released to the consumer. A deposit that earns at least 5 percent per year need not be considered a required deposit.

Calculating the Amount Financed

A consumer signs a note secured by real property in the amount of \$5,435. The note amount includes \$5,000 in proceeds disbursed to the consumer, \$400 in precomputed interest, \$25 paid to a credit reporting agency for a credit report, and a \$10 service charge. Additionally, the consumer pays a \$50 loan fee separately in cash at consummation. The consumer has no other debt with the financial institution. The amount financed is \$4,975.

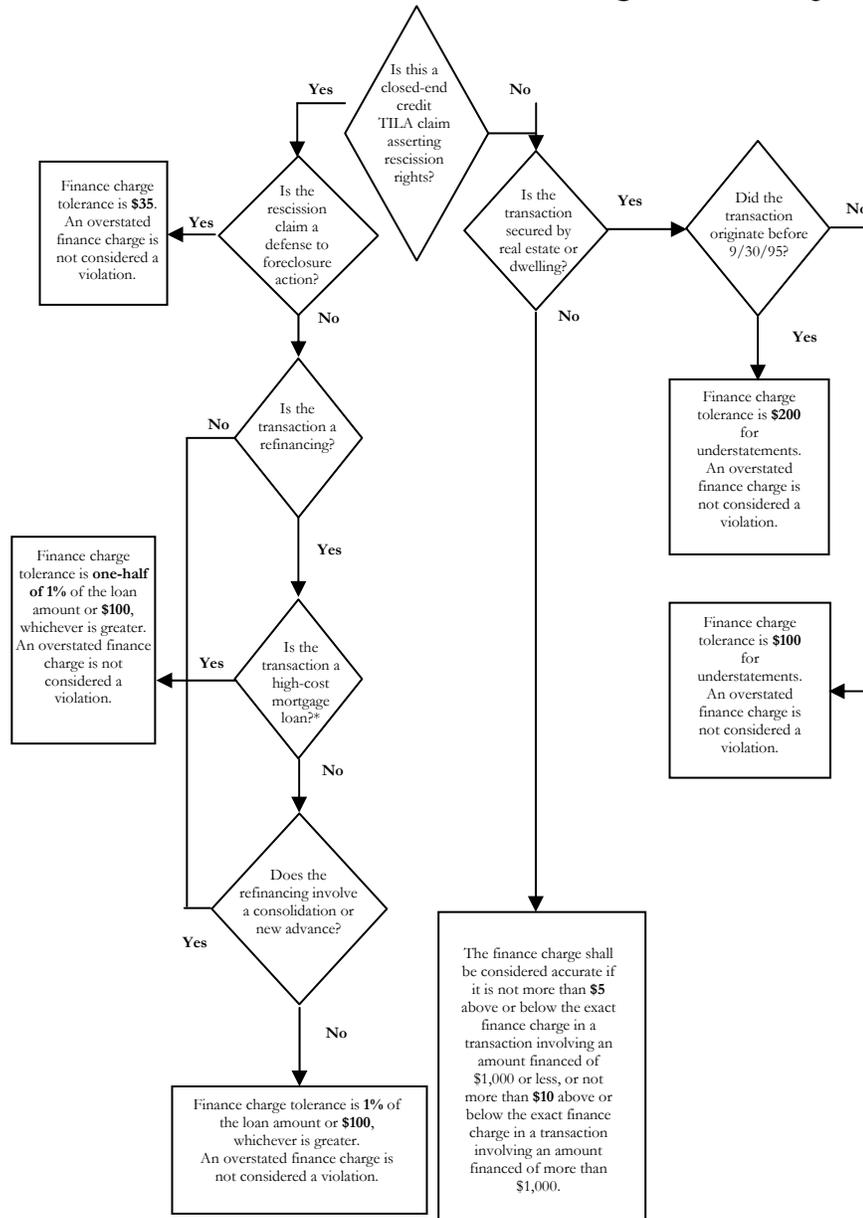
The amount financed may be calculated by first subtracting all finance charges included in the note amount ($\$5,435 - \$400 - \$10 = \$5,025$). The \$25 credit report fee is not a finance charge because the loan is secured by real property. The \$5,025 is further reduced by the amount of prepaid finance charges paid separately, for an amount financed of $\$5,025 - \$50 = \$4,975$. The answer is the same whether finance charges included in the obligation are considered prepaid or precomputed finance charges.

The financial institution may treat the \$10 service charge as an addition to the loan amount and not as a prepaid finance charge. If it does, the loan principal would be \$5,000. The \$5,000 loan principal does not include either the \$400 or the \$10 precomputed finance charge in the note. The loan principal is increased by other amounts that are financed which are not part of the finance charge (the \$25 credit report fee) and reduced by any prepaid finance charges (the \$50 loan fee, not the \$10 service charge) to arrive at the amount financed of $\$5,000 + \$25 - \$50 = \$4,975$.

Other Calculations

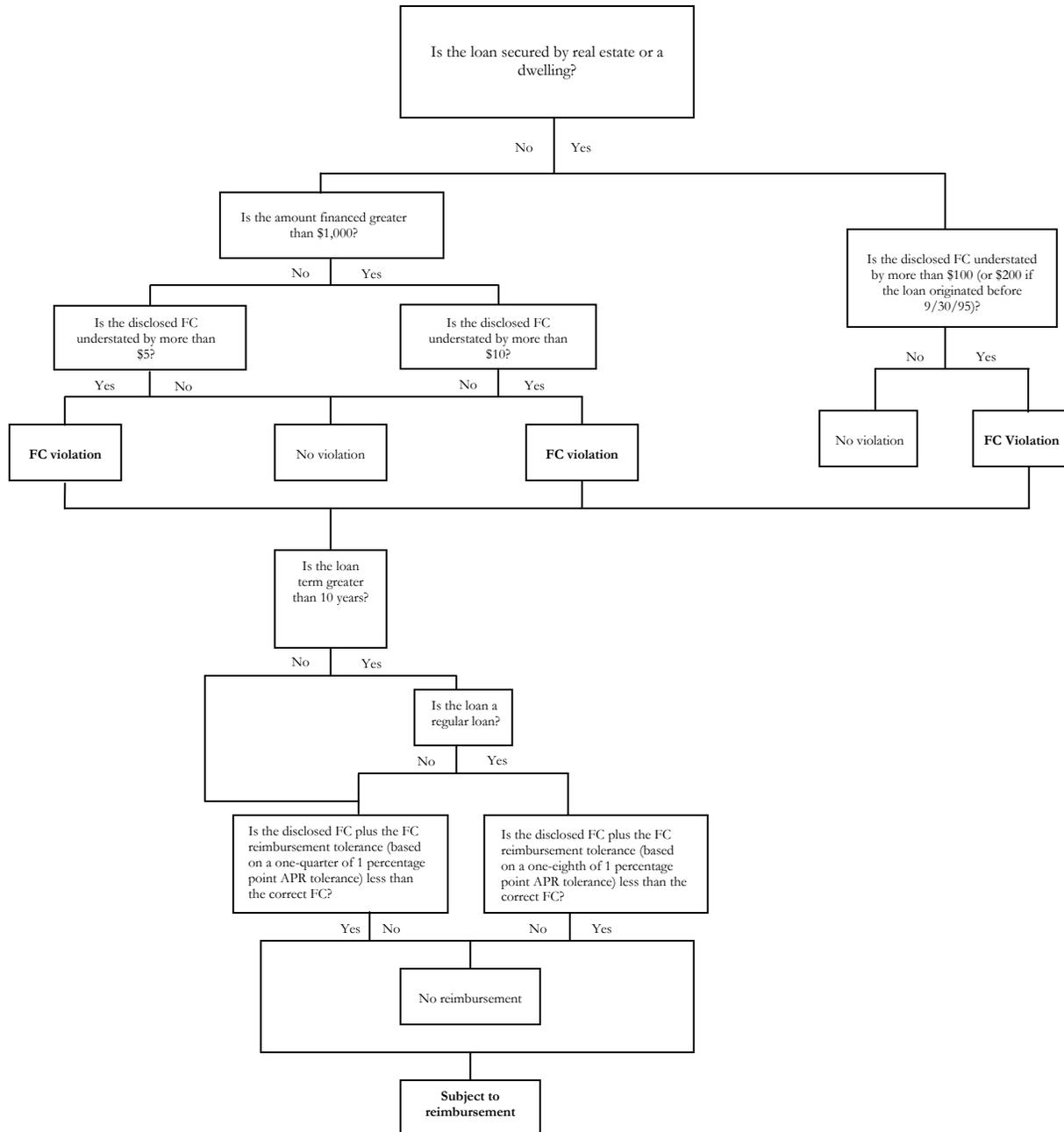
The financial institution may treat the \$10 service charge as a prepaid finance charge. If it does, the loan principal would be \$5,010. The \$5,010 loan principal does not include the \$400 precomputed finance charge. The loan principal is increased by other amounts that are financed which are not part of the finance charge (the \$25 credit report fee) and reduced by any prepaid finance charges (the \$50 loan fee and the \$10 service charge withheld from loan proceeds) to arrive at the same amount financed of $\$5,010 + \$25 - \$50 - \$10 = \$4,975$.

Closed-End Credit: Finance Charge Accuracy Tolerances

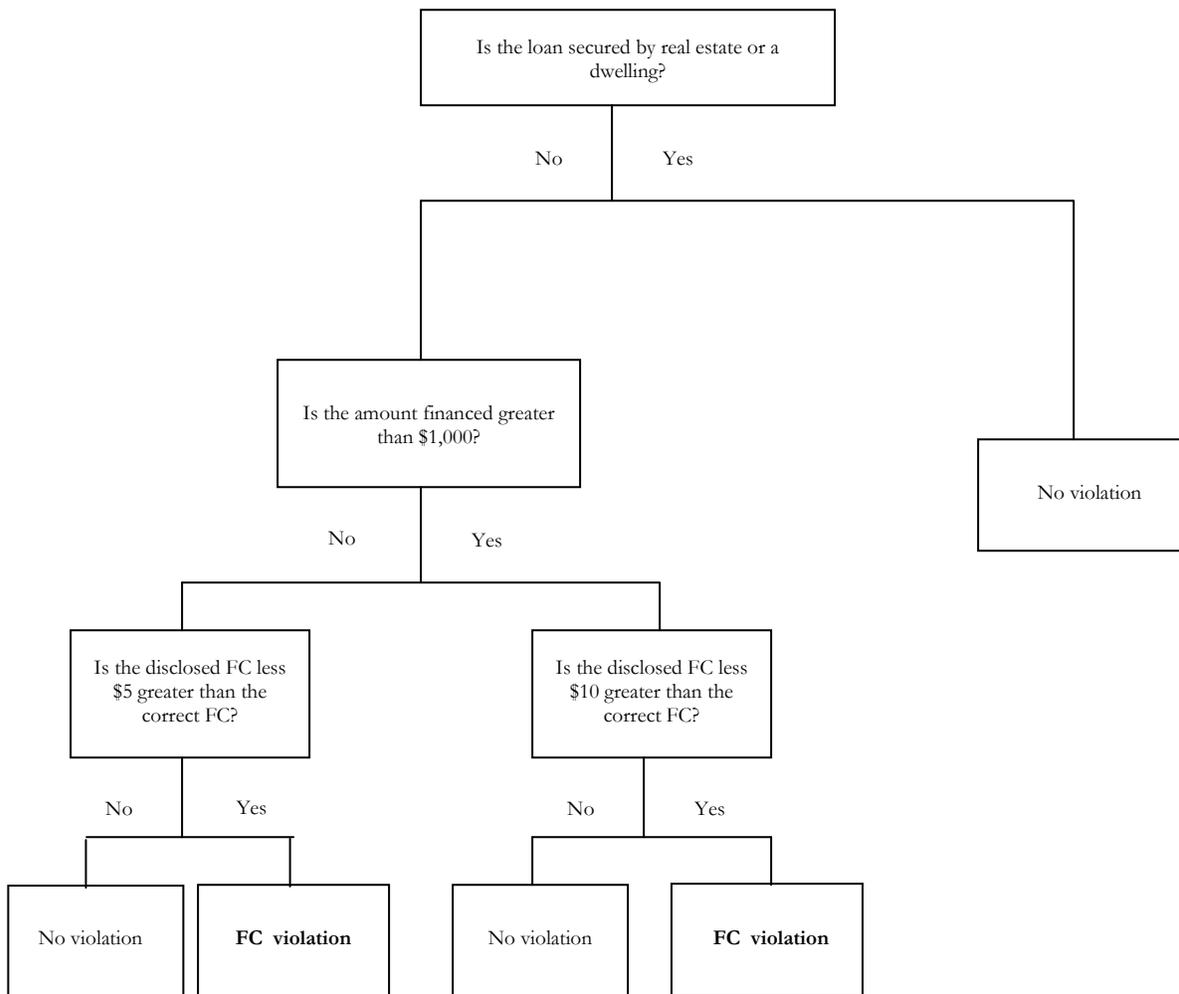


* See 15 USC 160 (aa) and 12 CFR 226.32

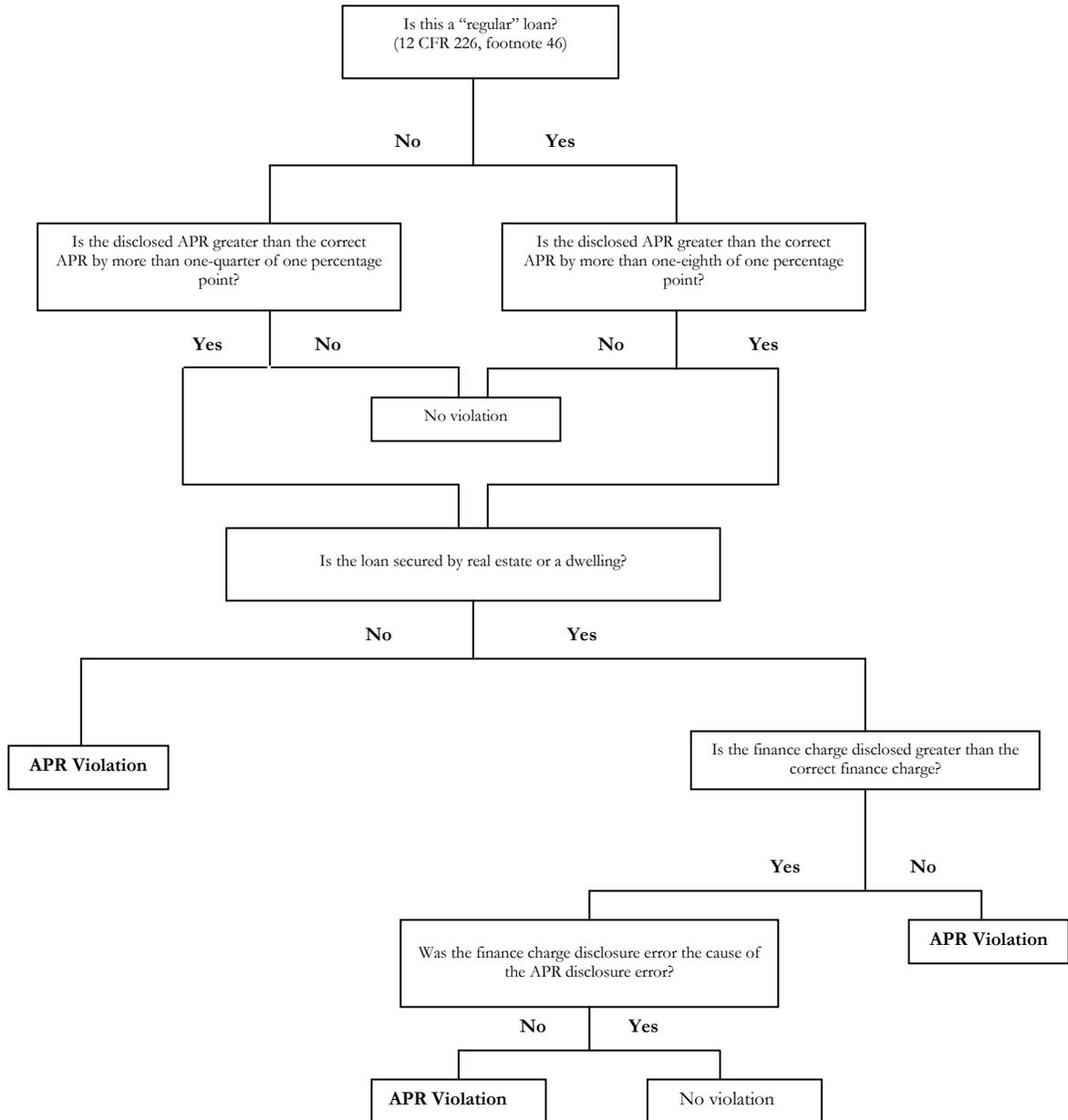
Closed-End Credit: Accuracy and Reimbursement Tolerances for **UNDERSTATED FINANCE CHARGES**



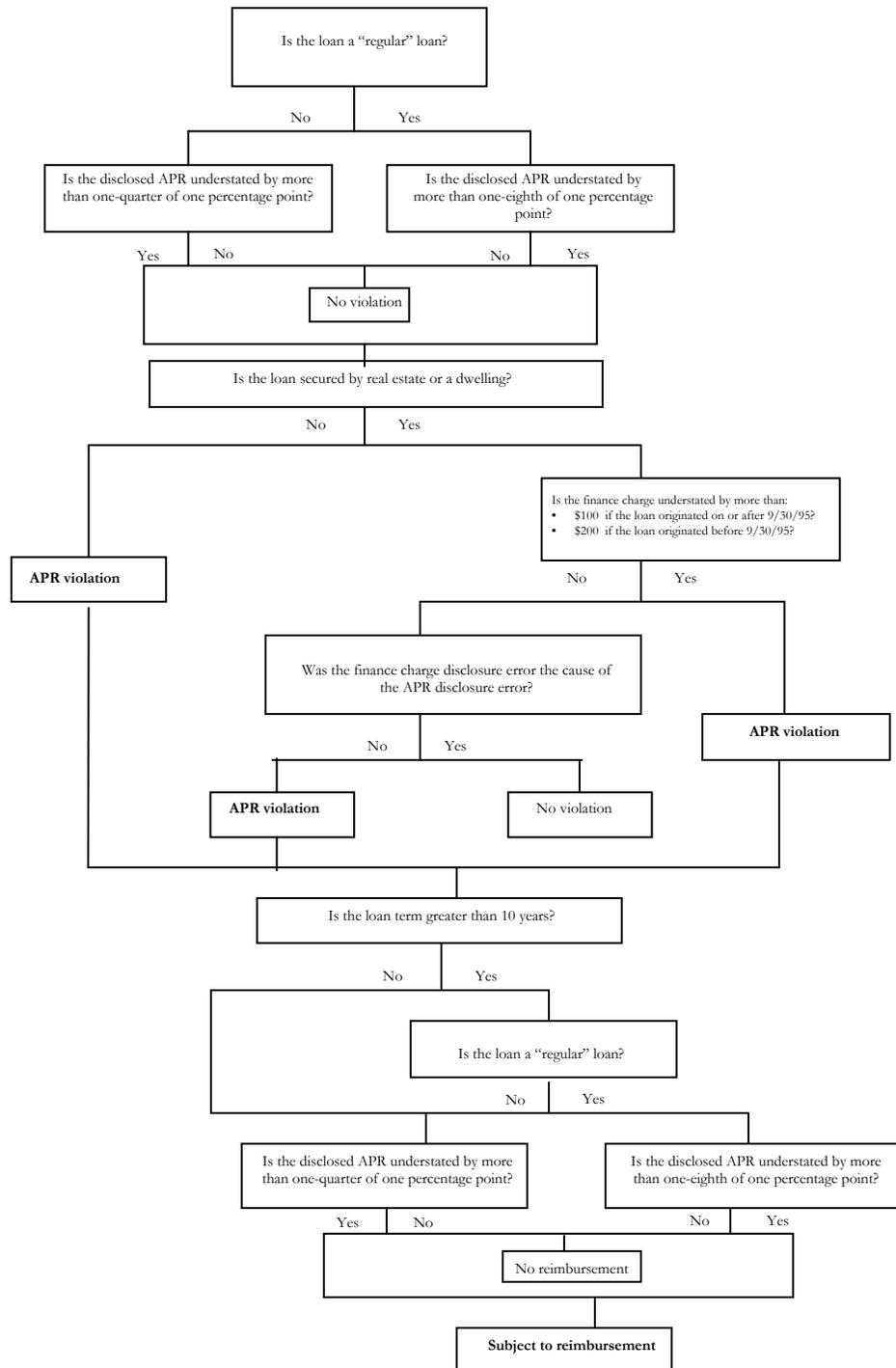
Closed-End Credit: Accuracy Tolerances for
OVERSTATED FINANCE CHARGES



Closed-End Credit: Accuracy Tolerances for
OVERSTATED APRs



Closed-End Credit: Accuracy and Reimbursement Tolerances For
UNDERSTATED APRs



Refinancings § 226.20

When an obligation is satisfied and replaced by a new obligation to the original financial institution (or a holder or servicer of the original obligation) and is undertaken by the same consumer, it must be treated as a refinancing for which a complete set of new disclosures must be furnished. A refinancing may involve the consolidation of several existing obligations, disbursement of new money to the consumer, or the rescheduling of payments under an existing obligation. In any form, the new obligation must completely replace the earlier one to be considered a refinancing under the regulation. The finance charge on the new disclosure must include any unearned portion of the old finance charge that is not credited to the existing obligation (§ 226.20(a)).

The following transactions are not considered refinancings even if the existing obligation is satisfied and replaced by a new obligation undertaken by the same consumer:

- A renewal of an obligation with a single payment of principal and interest or with periodic interest payments and a final payment of principal with no change in the original terms.
- An APR reduction with a corresponding change in the payment schedule.
- An agreement involving a court proceeding.
- Changes in credit terms arising from the consumer's default or delinquency.
- The renewal of optional insurance purchased by the consumer and added to an existing transaction, if required disclosures were provided for the initial purchase of the insurance.

However, even if it is not accomplished by the cancellation of the old obligation and substitution of a new one, a new transaction subject to new disclosures results if the financial institution:

- Increases the rate based on a variable rate feature that was not previously disclosed; or
- Adds a variable rate feature to the obligation.

If, at the time a loan is renewed, the rate is increased, the increase is not considered a variable rate feature. It is the cost of renewal, similar to a flat fee, as long as the new rate remains fixed during the remaining life of the loan. If the original debt is not canceled in connection with such a renewal, the regulation does not require new disclosures. Also, changing the index of a variable rate transaction to a comparable index is not considered adding a variable rate feature to the obligation.

Advertising § 226.16 and § 226.24

The regulation requires that advertisements for mortgage loans provide accurate and balanced information, in a clear and conspicuous manner, about rates, monthly payments, and other loan features. The advertising rules ban several deceptive or misleading advertising practices, including representations that a rate or payment is “fixed” when in fact it can change.

Advertising Rules for Open-End Plans § 226.16

If an advertisement for credit states specific credit terms, it must state only those terms that actually are or will be arranged or offered by the creditor. If any of the terms required to be disclosed under the open-end initial disclosure requirements are set forth in an advertisement, the advertisement must also clearly and conspicuously state the following:

- Any minimum, fixed, transaction, activity or similar charge that could be imposed;
- Any periodic rate that may be applied expressed as an APR as determined under § 226.14(b). If the plan provides for a variable periodic rate, that fact must be disclosed; and
- Any membership or participation fee that could be imposed.

If any finance charges or other charge or payment terms are set forth, affirmatively or negatively, in an advertisement for a home-equity plan subject to the requirements of § 226.5b, the advertisement also must clearly and conspicuously set forth the following:

- Any loan fee that is a percentage of the credit limit under the plan and an estimate of any other fees imposed for opening the plan, stated as a single dollar amount or a reasonable range;
- Any periodic rate used to compute the finance charge, expressed as an APR as determined under § 226.14(b); and
- The maximum APR that may be imposed in a variable-rate plan.

Regulation Z’s open-end home-equity plan advertising rules include a clear and conspicuous standard for home-equity plan advertisements, consistent with the approach taken in the advertising rules for consumer leases under Regulation M. Commentary provisions clarify how the clear and conspicuous standard applies to advertisements of home-equity plans with promotional rates or payments, and to Internet, television, and oral advertisements of home-equity plans. The regulation allows alternative disclosures for television and radio advertisements for home-equity plans. The regulation also requires that advertisements adequately disclose not only promotional plan terms, but also the rates or payments that will apply over the term of the plan.

Regulation Z also contains provisions implementing the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, which requires disclosure of the tax implications of certain home-equity plans.

Closed-End Advertising § 226.24

If an advertisement for credit states specific credit terms, it must state only those terms that actually are or will be arranged or offered by the creditor.

Disclosures required by this section must be made “clearly and conspicuously.” To meet this standard in general, credit terms need not be printed in a certain type size nor appear in any particular place in the advertisement. For advertisements for credit secured by a dwelling, a clear and conspicuous disclosure means that the required information is disclosed with equal prominence and in close proximity to the advertised rates or payments triggering the required disclosures.

If an advertisement states a rate of finance charge, it must state the rate as an “annual percentage rate,” using that term. If the APR may be increased after consummation, the advertisement must state that fact.

If an advertisement is for credit *not* secured by a dwelling, the advertisement must not state any other rate, except that a simple annual rate or periodic rate that is applied to an unpaid balance may be stated in conjunction with, but not more conspicuously than, the APR.

If an advertisement is for credit secured by a dwelling, the advertisement must not state any other rate, except that a simple annual rate that is applied to an unpaid balance may be stated in conjunction with, but not more conspicuously than, the APR. That is, an advertisement for credit secured by a dwelling may not state a periodic rate, other than a simple annual rate, that is applied to an unpaid balance.

“Triggering terms” - The following are triggering terms that require additional disclosures:

- The amount or percentage of any down payment;
- The number of payments or period of repayment;
- The amount of any payment; and
- The amount of any finance charge.

An advertisement stating a triggering term must also state the following terms as applicable:

- The amount or percentage of any down payment;
- The terms of repayment, which reflect the repayment obligations over the full term of the loan, including any balloon payment; and
- The “annual percentage rate,” using that term, and, if the rate may be increased after consummation, that fact.

For any advertisement secured by a dwelling that states a simple annual rate of interest and more than one simple annual rate of interest will apply over the term of the advertised loan, the advertisement must state in a clear and conspicuous manner:

- Each simple rate of interest that may apply. In variable-rate transactions, a rate determined by adding an index and margin must be disclosed based on a reasonably current index and margin.
- The period of time during which each simple annual rate of interest will apply.
- The APR for the loan.

The regulation prohibits the following seven deceptive or misleading practices in advertisements for closed-end mortgage loans:

- Stating that “fixed” rates or payments for loans whose rates or payments can vary are “fixed” without adequately disclosing that the interest rate or payment amounts are “fixed” only for a limited period of time, rather than for the full term of the loan;
- Making comparisons between credit payments or rates and any payment or rate available under the advertised product that are not available for the full term of the loan, with certain exceptions for advertisements for variable rate products;
- Characterizing the products offered as “government loan programs,” “government-supported loans,” or otherwise endorsed or sponsored by a federal or state government entity when the advertised products are not government-supported or -sponsored loans;
- Displaying the name of the consumer’s current mortgage lender, unless the advertisement also prominently discloses that the advertisement is from a mortgage lender not affiliated with the consumer’s current lender;
- Making claims of debt elimination if the product advertised would merely replace one debt obligation with another;
- Creating a false impression that the mortgage broker or lender is a “counselor” for the consumer; and
- In foreign-language advertisements, providing certain information, such as a low introductory “teaser” rate, in a foreign language, while providing required disclosures only in English.

SUBPART D - MISCELLANEOUS

Civil Liability (TILA §§ 130 and 131)

If a creditor fails to comply with any requirements of the TILA, other than with the advertising provisions of chapter 3, it may be held liable to the consumer for:

- Actual damage, and
- The cost of any legal action together with reasonable attorney's fees in a successful action.

If it violates certain requirements of the TILA, the creditor also may be held liable for either of the following:

- In an individual action, twice the amount of the finance charge involved, but not less than \$100 or more than \$1,000. However, in an individual action relating to a closed-end credit transaction secured by real property or a dwelling, twice the amount of the finance charge involved, but not less than \$200 or more than \$2,000.
- In a class action, such amount as the court may allow. The total amount of recovery, however, cannot be more than \$500,000 or 1 percent of the creditor's net worth, whichever is less.

Civil actions that may be brought against a creditor also may be maintained against any assignee of the creditor if the violation is apparent on the face of the disclosure statement or other documents assigned, except where the assignment was involuntary.

A creditor that fails to comply with TILA's requirements for loans that meet the criteria in § 226.32 (a) ("high-cost mortgage loans") or § 226.35(a) ("higher priced mortgage loans") may be held liable to the consumer for all finance charges and fees paid to the creditor. For high-cost mortgage loans (under § 226.32(a)) any subsequent assignee is subject to all claims and defenses that the consumer could assert against the creditor, unless the assignee demonstrates that it could not reasonably have determined that the loan was subject to § 226.32.

Criminal Liability (TILA § 112)

Anyone who willingly and knowingly fails to comply with any requirement of the TILA will be fined not more than \$5,000 or imprisoned not more than one year, or both.

Administrative Actions (TILA § 108)

The TILA authorizes federal regulatory agencies to require financial institutions to make monetary and other adjustments to the consumers' accounts when the true finance charge or APR exceeds the disclosed finance charge or APR by more than a specified accuracy tolerance. That authorization

extends to unintentional errors, including isolated violations (e.g., an error that occurred only once or errors, often without a common cause, that occurred infrequently and randomly).

Under certain circumstances, the TILA requires federal regulatory agencies to order financial institutions to reimburse consumers when understatement of the APR or finance charge involves:

- Patterns or practices of violations (e.g., errors that occurred, often with a common cause, consistently or frequently, reflecting a pattern with a specific type or types of consumer credit).
- Gross negligence.
- Willful noncompliance intended to mislead the person to whom the credit was extended.

Any proceeding that may be brought by a regulatory agency against a creditor may be maintained against any assignee of the creditor if the violation is apparent on the face of the disclosure statement or other documents assigned, except where the assignment was involuntary (§131).

Relationship to State Law (TILA §111)

State laws providing rights, responsibilities, or procedures for consumers or financial institutions for consumer credit contracts may be:

- Preempted by federal law;
- Not preempted by federal law; or
- Substituted in lieu of TILA and Regulation Z requirements.

State law provisions are preempted to the extent that they contradict the requirements in the following chapters of the TILA and the implementing sections of Regulation Z:

- Chapter 1, “General Provisions,” which contains definitions and acceptable methods for determining finance charges and annual percentage rates.
- Chapter 2, “Credit Transactions,” which contains disclosure requirements, rescission rights, and certain credit card provisions.
- Chapter 3, “Credit Advertising,” which contains consumer credit advertising rules and annual percentage rate oral disclosure requirements.

For example, a state law would be preempted if it required a bank to use the terms “nominal annual interest rate” in lieu of “annual percentage rate.”

Conversely, state law provisions may be appropriate and are not preempted under federal law if they call for, without contradicting chapters 1, 2, or 3 of the TILA or the implementing sections of Regulation Z, either of the following:

- Disclosure of information not otherwise required. A state law that requires disclosure of the minimum periodic payment for open-end credit, for example, would not be preempted because it does not contradict federal law.
- Disclosures more detailed than those required. A state law that requires itemization of the amount financed, for example, would not be preempted, unless it contradicts federal law by requiring the itemization to appear with the disclosure of the amount financed in the segregated closed-end credit disclosures.

The relationship between state law and chapter 4 of the TILA (“Credit Billing”) involves two parts. The first part is concerned with sections 161 (correction of billing errors) and 162 (regulation of credit reports) of the Act; the second part addresses the remaining sections of chapter 4.

State law provisions are preempted if they differ from the rights, responsibilities, or procedures contained in sections 161 or 162. An exception is made, however, for state law that allows a consumer to inquire about an account and requires the bank to respond to such inquiry beyond the time limits provided by federal law. Such a state law would not be preempted for the extra time period.

State law provisions are preempted if they result in violations of sections 163 through 171 of chapter 4. For example, a state law that allows the card issuer to offset the consumer’s credit-card indebtedness against funds held by the card issuer would be preempted, since it would violate 12 CFR 226.12(d). Conversely, a state law that requires periodic statements to be sent more than 14 days before the end of a free-ride period would not be preempted, since no violation of federal law is involved.

A bank, state, or other interested party may ask the Federal Reserve Board to determine whether state law contradicts chapters 1 through 3 of the TILA or Regulation Z. They also may ask if the state law is different from, or would result in violations of, chapter 4 of the TILA and the implementing provisions of Regulation Z. If the board determines that a disclosure required by state law (other than a requirement relating to the finance charge, (APR) or the disclosures required under § 226.32) is substantially the same in meaning as a disclosure required under the Act or Regulation Z, generally creditors in that state may make the state disclosure in lieu of the federal disclosure.

SUBPART E - SPECIAL RULES FOR CERTAIN HOME MORTGAGE TRANSACTIONS

General Rules § 226.31

The requirements and limitations of this subpart are in addition to and not in lieu of those contained in other subparts of Regulation Z. The disclosures for high cost and reverse mortgage transactions must be made clearly and conspicuously in writing, in a form that the consumer may keep.

Credit Subject to § 226.32

The requirements of this section apply to a consumer credit transaction secured by the consumer's principal dwelling, in which either:

- The APR at consummation will exceed by more than 8 percentage points for first-lien mortgage loans, or by more than 10 percentage points for subordinate-lien mortgage loans, the yield on Treasury securities having comparable periods of maturity to the loan's maturity (as of the 15th day of the month immediately preceding the month in which the application for the extension of credit is received by the creditor); or
- The total points and fees (see definition below) payable by the consumer at or before loan closing will exceed the greater of eight percent of the total loan amount or \$583 for the calendar year 2009. (This dollar amount is adjusted annually based on changes in the Consumer Price Index. See staff commentary to 32(a)(1)(ii) for a historical list of dollar amount adjustments.) (§ 226.32(a)(1))

Exemptions:

- Residential mortgage transactions (generally purchase money mortgages),
- Reverse mortgage transactions subject to § 226.33, or
- Open-end credit plans subject to Subpart B of Regulation Z.

Points and Fees include the following:

- All items required to be disclosed under § 226.4(a) and (b), except interest or the time-price differential;
- All compensation paid to mortgage brokers; and
- All items listed in § 226.4(c)(7), other than amounts held for future taxes, unless all of the following conditions are met:

- The charge is reasonable;
- The creditor receives no direct or indirect compensation in connection with the charge;
- The charge is not paid to an affiliate of the creditor; and
- Premiums or other charges, paid at or before closing whether paid in cash or financed, for optional credit life, accident, health, or loss-of-income insurance, and other debt-protection or debt cancellation products written in connection with the credit transaction (§ 226.32(b)(1)).

Prohibited Acts or Practices in Connection with Credit Subject to § 226.32

Among other requirements, a creditor extending mortgage credit subject to § 226.32 (“high-cost” mortgage loans) must not make such loans based on the value of the consumer’s collateral without regard to the consumer’s repayment ability as of consummation, including *mortgage-related obligations*.

- Mortgage-related obligations are expected property taxes, premiums for mortgage-related insurance required by the creditor, and similar expenses.
- A creditor must also verify amounts of income or assets that it relies on to determine repayment ability using tax returns, payroll receipts, financial institution records, or other third party documents that provide reasonably reliable evidence of the consumer’s income or assets. A creditor must also verify the consumer’s current obligations.

A presumption of compliance is available for some transactions, but only if the creditor:

- Verifies the consumer’s repayment ability as required;
- Determines the consumer’s repayment ability using the largest payment of principal and interest scheduled in the first seven years following consummation and taking into account current obligations and mortgage-related obligations; and
- Assesses the consumer’s repayment ability taking into account either the ratio of total debts to income or the income the consumer will have after paying debt obligations.

For high-cost mortgage loans, the regulation prohibits the imposition of prepayment penalties under certain circumstances, and in no case may a penalty be imposed after two years following consummation (five years following consummation for loans for which an application was received before October 1, 2009).

The regulation prohibits prepayment penalties **at any time** for high-cost mortgage if:

- Other applicable law (e.g., state law) prohibits such penalty;
- The penalty applies where the source of the prepayment funds is a refinancing by the same mortgage lender or an affiliate;
- The consumer's mortgage payment can change during the first four years of the loan term (*applicable only to loans for which an application was received on or after October 1, 2009*); or
- The consumer's total monthly debt payments (at consummation), including amounts owed under the mortgage, exceed 50 percent of the consumer's monthly gross income.

The regulation prohibits creditors from structuring a home-secured loan as an open-end plan to evade these requirements.

Reverse Mortgages § 226.33

A reverse mortgage is a non-recourse transaction secured by the consumer's principal dwelling which ties repayment (other than upon default) to the homeowner's death or permanent move from, or transfer of the title of, the home.

Higher-Priced Mortgage Loans § 226.35

A mortgage loan subject to § 226.35 ("*higher-priced*" mortgage loan) is a consumer credit transaction secured by the consumer's principal dwelling with an APR that exceeds the *average prime offer rate* for a comparable transaction as of the date the interest rate is set by:

- 1.5 or more percentage points for loans secured by a first lien on a dwelling; or
- 3.5 or more percentage points for loans secured by a subordinate lien on a dwelling.

Average prime offer rate means an APR that is derived from average interest rates, points, and other loan pricing terms currently offered to consumers by a representative sample of creditors for mortgage transactions that have low-risk pricing characteristics. The Federal Reserve Board publishes average prime offer rates for a broad range of types of transactions in a table updated at least weekly, as well as the methodology it uses to derive these rates. These rates are available on the website of the Federal Financial Institutions Examination Council.

A higher-priced mortgage loan does not include:

- A transaction to finance the initial construction of a dwelling;

- A temporary “bridge” loan with a term of twelve months or less;
- A reverse mortgage subject to § 226.33; or
- A home equity line of credit subject to § 226.5(b).

The regulation prohibits prepayment penalties **at any time** for higher-priced mortgage loans for which an application was received on or after October 1, 2009 if:

- Other applicable law (e.g., state law) prohibits such penalty;
- The penalty will apply after the two-year period following consummation;
- The source of the prepayment funds is a refinancing by the same mortgage lender or an affiliate;
or
- The consumer’s mortgage payment can change during the first four years of the loan term.

The regulation prohibits creditors from structuring a home-secured loan as an open-end plan to evade these requirements.

With few exceptions, a creditor may not extend a higher-priced mortgage loan secured by a first lien on a principal dwelling unless an escrow account is established before consummation for payment of property taxes and premiums for mortgage-related insurance required by the creditor. The exceptions involve loans secured by shares in a cooperative or condominium units where the condominium association has an obligation to maintain a master insurance policy. A creditor may allow a consumer to cancel the escrow account one year after consummation if a consumer’s written cancellation request is received no earlier than 365 days after consummation. (The provisions regarding escrows apply to loans where applications were received on or after April 1, 2010 or, for manufactured homes, on or after October 1, 2010.

Prohibited Acts or Practices in Connection with Credit Secured by a Consumer’s Principal Dwelling § 226.36

Coercion of Appraiser

Creditors and mortgage brokers are prohibited from coercing a real estate appraiser to misstate a home’s value. Examples of actions that violate that prohibition include telling an appraiser what minimum value is necessary to approve the loan or failing to compensate when values do not meet minimum requirements. Examples of actions that do not violate this section include asking an appraiser to consider additional information for the basis of valuation or requesting the appraiser to correct factual inaccuracies in the appraisal.

Loan Servicing Practices

Companies that service mortgage loans are prohibited from engaging in certain practices, such as pyramiding late fees. In addition, servicers are required to credit consumers' loan payments as of the date of receipt and provide a payoff statement within a reasonable time of request.

Specifically, for a consumer credit transaction secured by a consumer's principal dwelling, a loan servicer cannot:

- Fail, with limited exception, to credit a payment to the consumer's loan account as of the date of receipt;
- Impose on the consumer any late fee or delinquency charge in connection with a timely payment made in full, when the only delinquency is attributable to late fees or delinquency charges assessed on an earlier payment; or
- Fail to provide, within a reasonable time after receiving a request from the consumer or person acting on behalf of the consumer, an accurate statement of the total outstanding balance that would be required to satisfy the consumer's obligations in full as of a specific date.

Specific Defenses (TILA § 108)

Defense Against Civil, Criminal, and Administrative Actions

A financial institution in violation of TILA may avoid liability by:

- Discovering the error before an action is brought against the financial institution, or before the consumer notifies the financial institution, in writing, of the error.
- Notifying the consumer of the error within 60 days of discovery.
- Making the necessary adjustments to the consumer's account, also within 60 days of discovery. (The consumer will pay no more than the lesser of the finance charge actually disclosed or the dollar equivalent of the APR actually disclosed.)

The above three actions also may allow the financial institution to avoid a regulatory order to reimburse the customer.

An error is "discovered" if it is:

- Discussed in a final, written report of examination.
- Identified through the financial institution's own procedures.

- An inaccurately disclosed APR or finance charge included in a regulatory agency notification to the financial institution.

When a disclosure error occurs, the financial institution is not required to re-disclose after a loan has been consummated or an account has been opened. If the financial institution corrects a disclosure error by merely re-disclosing required information accurately, without adjusting the consumer's account, the financial institution may still be subject to civil liability and an order to reimburse from its regulator.

The circumstances under which a financial institution may avoid liability under the TILA do not apply to violations of the Fair Credit Billing Act (chapter 4 of the TILA).

Additional Defenses Against Civil Actions

The financial institution may avoid liability in a civil action if it shows by a preponderance of evidence that the violation was not intentional and resulted from a bona fide error that occurred despite the maintenance of procedures to avoid the error.

A bona fide error may include a clerical, calculation, computer malfunction, programming, or printing error. It does not include an error of legal judgment.

Showing that a violation occurred unintentionally could be difficult if the financial institution is unable to produce evidence that explicitly indicates it has an internal controls program designed to ensure compliance. The financial institution's demonstrated commitment to compliance and its adoption of policies and procedures to detect errors before disclosures are furnished to consumers could strengthen its defense.

Statute of Limitations (TILA §§ 108 and 130)

Civil actions may be brought within one year after the violation occurred. After that time, and if allowed by state law, the consumer may still assert the violation as a defense if a financial institution were to bring an action to collect the consumer's debt.

Criminal actions are not subject to the TILA one-year statute of limitations.

Regulatory administrative enforcement actions also are not subject to the one-year statute of limitations. However, enforcement actions under the policy guide involving erroneously disclosed APRs and finance charges are subject to time limitations by the TILA. Those limitations range from the date of the last regulatory examination of the financial institution, to as far back as 1969, depending on when loans were made, when violations were identified, whether the violations were repeat violations, and other factors.

There is no time limitation on willful violations intended to mislead the consumer. A summary of the various time limitations follows.

- For open-end credit, reimbursement applies to violations not older than two years.
- For closed-end credit, reimbursement is generally directed for loans with violations occurring since the immediately preceding examination.

Notification or Sale or Transfer of Mortgage Loans (TILA § 131)

Notice of new creditor – No later than 30 days after the date on which a mortgage loan is sold or otherwise transferred or assigned to a third party, the creditor that is the new owner or assignee of the debt shall notify the borrower in writing of such transfer and include the following:

- The identity, address, and telephone number of the new creditor.
- The date of the transfer.
- How to reach an agent or party having authority to act on behalf of the new creditor.
- The location of the place where the transfer of ownership of the debt is recorded.
- Any other relevant information regarding the new creditor.

This notice of sale or transfer must be provided for any consumer credit transaction that is secured by the principal dwelling of a consumer. This notification is required even if the loan servicer remains the same.

Rescission Rights (Open-End and Closed-End Credit) § 226.15 and § 226.23

TILA provides that for certain transactions secured by the consumer's principal dwelling, a consumer has three business days after becoming obligated on the debt to rescind the transaction. The right of rescission allows consumer(s) time to reexamine their credit agreements and cost disclosures and to reconsider whether they want to place their homes at risk by offering it as security for the credit. A higher-priced mortgage loan (whether or not it is a Home Ownership and Equity Protection Act (HOEPA) loan) having a prepayment penalty that does not conform to the prepayment penalty limitations (§ 226.32 (c) and (d) and § 226.35(b)(2) is also subject to a three-year right of rescission. Transactions exempt from the right of rescission include residential mortgage transactions (§ 226.2(a)(24)) and refinancings or consolidations with the original creditor where no "new money" is advanced.

If a transaction is rescindable, consumers must be given a notice explaining that the creditor has a security interest in the consumer's home, that the consumer may rescind, how the consumer may rescind, the effects of rescission, and the date the rescission period expires.

To rescind a transaction, a consumer must notify the creditor in writing by midnight of the third business day after the latest of three events: consummation of the transaction, delivery of material TILA disclosures, or receipt¹³ of the required notice of the right to rescind. For purposes of rescission, business day means every calendar day except Sundays and the legal public holidays (§ 226.2(a)(6)). The term “material disclosures” is defined in § 226.23(a)(3) to mean the required disclosures of the APR, the finance charge, the amount financed, the total of payments, the payment schedule, and the disclosures and limitations referred to in § 226.32(c) and (d).

The creditor may not disburse any monies (except into an escrow account) and may not provide services or materials until the three-day rescission period has elapsed and the creditor is reasonably satisfied that the consumer has not rescinded. If the consumer rescinds the transaction, the creditor must refund all amounts paid by the consumer (even amounts disbursed to third parties) and terminate its security interest in the consumer’s home.

A consumer may waive the three-day rescission period and receive immediate access to loan proceeds if the consumer has a “bona fide personal financial emergency.” The consumer must give the creditor a signed and dated waiver statement that describes the emergency, specifically waives the right, and bears the signatures of all consumers entitled to rescind the transaction. The consumer provides the explanation for the bona fide personal financial emergency, but the creditor decides the sufficiency of the emergency.

If the required rescission notice or material TILA disclosures are not delivered or if they are inaccurate, the consumer’s right to rescind may be extended from three days after becoming obligated on a loan to up to three years.

REFERENCES

Laws

15 USC 1601 et seq.	Truth in Lending Act (TILA)
15 USC 1666 et seq.	Fair Credit Billing Act
15 USC 7001 et seq.	Electronic Signatures in Global and National Commerce Act

¹³ 12 CFR 226.15(b) and 226.23(b)(1) were amended to include the electronic delivery of the notice of the right to rescind. If a paper notice of the right to rescind is used, a creditor must deliver two copies of the notice to each consumer entitled to rescind. However, under the final rule on electronic delivery of the disclosures if the notice is in electronic form, in accordance with the consumer consent and other applicable provisions of the E-Sign Act, only one copy to each customer is required.

Regulations

Federal Reserve Board Regulations (12 CFR)

Part 226 Truth in Lending Regulation

Final Rules

73 FR 44522 Final Rule Implementing Home Ownership and Equity Protection Act (HOEPA) (July 30, 2008)

74 FR 5244 Final Rule; Truth in Lending (January 29, 2009)

74 FR 23289 Final Rule Implementing the Mortgage Disclosure Improvement Act (MDIA) (May 19, 2009)

74 FR 36077 Interim Final Rule on Credit Cards (July 22, 2009)

74 FR 41194 Final Rule Implementing the Higher Education Opportunity Act (HEOA) adding disclosure and timing requirements for creditors making private education loans (August 14, 2009)

74 FR 40477 Final Rule amending the Staff Commentary Re: Annual Fee-based Trigger for High-Cost Mortgage Disclosures (August 12, 2009)

OTS CEO Memoranda

No. 275 Illustrations of Consumer Information for Hybrid Adjustable Rate Mortgage Products

No. 276 HELOC Account Management Guidance

No. 308 Credit CARD Act of 2009: Effective Dates

No. 312 Credit CARD Act: Interest Rate Increases and Rules on Unfair Practices

Truth in Lending Program

EXAMINATION OBJECTIVES

To appraise the quality of the financial institution's compliance management system for the Truth in Lending Act and Regulation Z.

To determine the reliance that can be placed on the financial institution's compliance management system, including internal controls and procedures performed by the person(s) responsible for monitoring the financial institution's compliance review function for the Truth in Lending Act and Regulation Z.

To determine the financial institution's compliance with the Truth in Lending Act and Regulation Z.

To initiate corrective action when policies or internal controls are deficient, or when violations of law or regulation are identified.

To determine whether the institution will be required to make adjustments to consumer accounts under the restitution provisions of the Act.

GENERAL PROCEDURES

WKP. REF.

1. Obtain information pertinent to the area of examination from the financial institution's compliance management system program (historical examination findings, complaint information, and significant findings from compliance review and audit).
-
2. Through discussions with management and review of the following documents, determine whether the financial institution's internal controls are adequate to ensure compliance in the area under review. Identify procedures used daily to detect errors/violations promptly. Also, review the procedures used to ensure compliance when changes occur (e.g., changes in interest rates, service charges, computation methods, and software programs).
 - Organizational charts.
 - Process flowcharts.
 - Policies and procedures.
 - Loan documentation and disclosures.

Exam Date:	
Prepared By:	
Reviewed By:	
Docket #:	

Truth in Lending Program

WKP. REF.

- Checklists/worksheets and review documents.
 - Computer programs.
-

3. Review compliance review and audit work papers and determine whether:
- a. The procedures used address all regulatory provisions (see Transactional Testing section).
 - b. Steps are taken to follow up on previously identified deficiencies.
 - c. The procedures used include samples that cover all product types and decision centers.
 - d. The work performed is accurate (through a review of some transactions).
 - e. Significant deficiencies, and the root cause of the deficiencies, are included in reports to management/board.
 - f. Corrective actions are timely and appropriate.
 - g. The area is reviewed at an appropriate interval.
-

Disclosure Forms

4. Determine if the financial institution has changed any TILA disclosure forms or if there are forms that have not been previously reviewed for accuracy. If so:

Verify the accuracy of each disclosure by reviewing the following:

- Note and/or contract forms (including those furnished to dealers).
- Standard closed-end credit disclosures (§§ 226.17(a) and 226.18).
- ARM disclosures (§ 226.19(b)).
- High cost mortgage disclosures (§ 226.32(c)).
- Initial disclosures (§ 226.6(a)-(d)) and, if applicable, additional HELOC disclosures (§ 226.6(e)).
- Credit card application/solicitation disclosures (§ 226.5a(b)-(e)).

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- HELOC disclosures (§ 226.5b(d) and (e)).
- Statement of billing rights and change in terms notice (§ 226.9(a)).
- Reverse mortgage disclosures (§ 226.33(b)).
- Notice of Right to Rescind (§§ 226.15(b) and 226.23(b)(1)).

Closed-End Credit Forms Review Procedures

- a. Determine the disclosures are clear, conspicuous, grouped, and segregated. The terms Finance Charge and APR should be more conspicuous than other terms (§ 226.17(a)).
- b. Determine if the disclosures include the following as applicable (§ 226.18).
 1. Identity of the creditor
 2. Brief description of the finance charge
 3. Brief description of the APR
 4. Variable rate verbiage (§ 226.18(f)(1) or (2))
 5. Payment schedule
 6. Brief description of the total of payments
 7. Demand feature
 8. Description of total sales price in a credit sale
 9. Prepayment penalties or rebates
 10. Late payment amount or percentage
 11. Description for security interest
 12. Various insurance verbiage (§226.4(d))
 13. Statement referring to the contract
 14. Statement regarding assumption of the note
 15. Statement regarding required deposits.
- c. Determine all variable rate loans with a maturity greater than one year secured by a principal dwelling are given the following disclosures at the time of application (§ 226.19).

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1. Consumer handbook on adjustable rate mortgages or substitute
 2. Statement that interest rate payments and or terms can change
 3. The index/formula and a source of information
 4. Explanation of the interest rate/payment determination and margin
 5. Statement that the consumer should ask for the current interest rate and margin
 6. Statement that the interest rate is discounted, if applicable
 7. Frequency of interest rate and payment changes
 8. Rules relating to all changes
 9. Either a historical example based on 15 years, or the initial rate and payment with a statement that the periodic payment may substantially increase or decrease together with a maximum interest rate and payment
 10. Explanation of how to compute the loan payment, giving an example
 11. Demand feature, if applicable
 12. Statement of content and timing of adjustment notices
 13. Statement that other variable rate loan program disclosures are available, if applicable.
- d. Determine that the disclosures required for high-cost mortgage transactions (§ 226.32), clearly and conspicuously include the items below (§ 226.32(c), see Form H-16 in Appendix H).
1. The required statement “you are not required to complete this agreement merely because you have received these disclosures or have signed a loan application. If you obtain this loan, the lender will have a mortgage on your home. You could lose your home, and any money you have put into it, if you do not meet your obligations under the loan.”
 2. Annual percentage rate.
 3. Amount of the regular monthly (or other periodic) payment and the amount of any balloon payment. The regular payment should include amounts for voluntary items, such as credit life insurance or debt-cancellation coverage, only if the consumer has previously agreed to the amount. (See staff commentary to 32(c)(3).)

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4. Statement that the interest rate may increase, and the amount of the single maximum monthly payment, based on the maximum interest rate allowed under the contract, if applicable.
5. For a mortgage refinancing, the total amount borrowed, as reflected by the face amount of the note; and where the amount borrowed includes premiums or other charges for optional credit insurance or debt-cancellation coverage, that fact shall be stated (grouped together with the amount borrowed).

Open-End Credit Forms Review Procedures

- a. Determine the initial disclosure statement is provided before the first transaction under the account and ensure the disclosure includes the items below as applicable (§ 226.6).
 1. Statement of when the finance charge is to accrue and if a grace period exists
 2. Statement of periodic rates used and the corresponding APR
 3. Explanation of the method of determining the balance on which the finance charge may be computed
 4. Explanation of how the finance charge would be determined
 5. Statement of the amount of any other charges
 6. Statement of creditor's security interest in the property
 7. Statement of billing rights (§§ 226.12 and 226.13)
 8. Certain home equity plan information if not provided with the application in a form the consumer could keep (§ 226.6(e)(7)).
- b. Determine the following credit card disclosures were made clearly and conspicuously on or with a solicitation or an application. Disclosures in 12-point type are deemed to comply with the requirements. See staff comment 5a(a)(2)-1. The APR for purchases (other than an introductory rate that is lower than the rate that will apply after the introductory rate expires) must be in at least 18-point type (§ 226.5a).
 1. APR for purchases, cash advances, and balance transfers, including penalty rates that may apply. If the rate is variable, the index or formula, and margin must be identified.

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2. Fee for issuance of the card.
3. Minimum finance charge.
4. Transaction fees.
5. Length of the “grace period.”
6. Balance computation method.
7. Statement that charges incurred by use of the charge card are due when the periodic statement is received.

Note: The above items must be provided in a prominent location in the form of a table. The remaining items may be included in the same table or clearly and conspicuously elsewhere on the same document. An explanation of specific events that may result in the imposition of a penalty rate must be placed outside the table with an asterisk inside the table (or other means) directing the consumer to the additional information.

8. Cash advance fees.
 9. Late payment fees.
 10. Fees for exceeding the credit limit.
- c. Determine that disclosure of items 1-7 in “b” above are made orally for creditor-initiated telephone applications and pre-approved solicitations. Also, determine for applications or solicitations made to the general public that the card issuer makes one of the optional disclosures (§ 226.5a(d) and (e)).
- d. Determine the following home equity disclosures were made clearly and conspicuously, at the time of application (§ 226.5b).
1. Home equity brochure
 2. Statement that the consumer should retain a copy of the disclosure
 3. Statement of the time the specific terms are available
 4. Statement that terms are subject to change before the plan opens
 5. Statement that the consumer may receive a full refund of all fees
 6. Statement that the consumer’s dwelling secures the credit
 7. Statement that the consumer could lose the dwelling
 8. Creditors right to change, freeze, or terminate the account

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9. Statement that information about conditions for adverse action are available upon request
10. Payment terms including the length of the draw and repayment periods, how the minimum payment is determined, the timing of payments, and an example based on \$10,000 and a recent APR
11. A recent APR imposed under the plan and a statement that the rate does not include costs other than interest (fixed rate plans only)
12. Itemization of all fees paid to creditor
13. Estimate of any fees payable to third parties to open the account and a statement that the consumer may receive a good faith itemization of third party fees
14. Statement regarding negative amortization, as applicable
15. Transaction requirements
16. Statement that the consumer should consult a tax advisor regarding the deductibility of interest and charges under the plan
17. For variable rate home equity plans, disclose the following:
 - i. That the APR, payment, or term may change
 - ii. The APR excludes costs other than interest
 - iii. Identify the index and its source
 - iv. How the rate will be determined
 - v. Statement that the consumer should request information on the current index value, margin, discount, premium, or APR
 - vi. Statement that the initial rate is discounted and the duration of the discount, if applicable
 - vii. Frequency of APR changes
 - viii. Rules relating to changes in the index, APR, and payment amount
 - ix. Lifetime rate cap and any annual caps, or a statement that there is no annual limitation
 - x. The minimum payment requirement, using the maximum APR, and when the maximum APR may be imposed

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- xi. A table, based on a \$10,000 balance, reflecting all significant plan terms
 - xii. Statement that rate information will be provided on or with each periodic statement.
- e. Determine when the last statement of billing rights was furnished to customers and whether the institution used the short form notice with each periodic statement (§ 226.9(a)).
- f. Determine that the written notice of any significant changes in account terms (listed below) or increase in the required minimum payment was provided 45 days prior to the effective date of the change (§ 226.9(c)(2)). This notice applies to the following changes:
- 1. APR increase, including each periodic rate that may be used to compute the finance charge on outstanding balances for purchases, a cash advance, or a balance transfer (such rates may include any discounted initial rate, premium initial rate, or penalty rate that may be applied to the account);
 - 2. Fees for issuance or availability, including any fee based upon account activity or inactivity;
 - 3. Fixed finance charge or minimum interest charge, if it exceeds \$1.00;
 - 4. Transaction charge for purchases;
 - 5. Grace period;
 - 6. Balance computation method;
 - 7. Cash advance fee;
 - 8. Late payment fee;
 - 9. Over-the-limit fee;
 - 10. Balance transfer fee;
 - 11. Returned payment fee; and
 - 12. Required insurance, debt cancellation, or debt suspension coverage.
- g. Ensure that the written change-in-terms notice contains the following disclosures:
- 1. A description of the change or any increase in the required minimum payment;
 - 2. A statement that changes are being made to the account;

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3. The date the changes will become effective;
4. Except in the case of an increase in the required minimum periodic payment:
 - i. A statement that the consumer has the right to reject the change or changes prior to the effective date of the changes, unless the consumer fails to make a required minimum periodic payment within 60 days after the due date for payment;
 - ii. Instructions for rejecting the change or changes, and a toll-free telephone number that the consumer may use to notify the creditor of the rejection; and
 - iii. If applicable, a statement that if the consumer rejects the change or changes, the consumer's ability to use the account for further advances will be terminated or suspended.

A 45-day advanced written notice is not required when the change involves:

1. Charges for documentary evidence;
2. A reduction of any component of a finance or other charge;
3. Suspension of future credit privileges (see exceptions discussed below) or termination of an account;
4. Change resulting from an agreement involving a court proceeding;
5. An increase in APR upon the expiration of a specified period of time, provided that:
 - a. Prior to commencement of that period, the creditor disclosed in writing to the consumer, in a clear and conspicuous manner, the length of the period and the annual percentage rate that would apply after expiration of the period; and
 - b. The APR that applies after that period does not exceed the previously disclosed rate.
6. When the change is an increase in a variable APR in accordance with a credit card agreement that provides for changes in the rate according to operation of an index that is not under the control of the creditor and is available to the general public; or

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7. When the changes is an increase in the APR due to the completion of a workout or temporary hardship arrangement by the consumer, provided that:
 - a. The APR applicable to a category of transactions following any such increase does not exceed the rate that applied to the category of transactions prior to commencement of the arrangement, or, if the rate that applied was a variable rate, the rate following any such increase is a variable rate determined by the same formula (index and margin) that applied to the category of transactions prior to commencement of the workout or temporary hardship arrangement, and
 - b. The creditor has provided the consumer, prior to the beginning of the workout, a clear and conspicuous written disclosure of the terms of the arrangement (including any increases due to such completion).
- h. If a creditor increases any component of a charge on a credit card account or introduces a new charge that is not listed in (f) above, determine that the creditor either:
 1. Complied with the 45-day notice requirement, or
 2. Provided notice of the amount of the charge before the consumer agrees to or becomes obligated to pay the charge, at a time or in a manner that a consumer would be likely to notice the disclosure of the charge, either in writing or orally (§ 226.9(c)).
- i. Reduction in the credit limit; imposition of over-the-limit fee – Determine that a notice of a decrease in the credit limit was provided in writing or orally 45 days before an over-the-limit fee is imposed as a result of a consumer exceeding the newly decreased credit limit (§ 226.9(c)).
- j. Decrease in the credit limit; imposition of the penalty rate – Determine that a written notice was provided 45 days in advance of imposing a penalty rate as a result of a consumer obtaining an extension of credit that exceeds the credit limit. The notice should include:
 1. A statement that the credit limit on the account has been or will be decreased;
 2. A statement indicating the date on which the penalty rate will apply, if the outstanding balance exceeds the credit limit as of that date;

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3. A statement that the penalty rate will not be imposed on the date set forth in the notice if the outstanding balance does not exceed the credit limit as of that date;
4. The circumstances under which the penalty rate, if applied, will cease to apply to the account, or that the penalty rate, if applied, will remain in effect for a potentially indefinite time period;
- k. Determine further that the creditor did not increase the rate applicable to the consumer's account to the penalty rate if the outstanding balance did not exceed the credit limit on the date the penalty rate will be imposed as set forth in the notice (§ 226.9(g)).
- l. Determine that the 45-day written notice was provided prior to an increase in the rate due to delinquency, default or as a penalty for a specified event, like late payment or an extension of credit in excess of the credit limit, and that the notice was provided after the occurrence of the triggering event. Ensure that the written notice includes:
 1. A statement that the delinquency or default rate or penalty rate, as applicable, has been triggered;
 2. Date upon which the delinquency or default rate will apply;
 3. Circumstances under which the delinquency or default rate, as applicable, will cease to apply, or if it will remain in effect indefinitely;
 4. A statement that the consumer has the right to reject the increase in the APR prior to the effective date of that increase, unless the consumer fails to make a required minimum payment within 60 days after the due date for that payment;
 5. Instructions for rejecting the change, including a toll-free number; and
 6. If applicable, a statement that if the consumer rejects the change or changes, that the consumer's ability to use the account for further advances will be terminated or suspended.

Note that the advance written notice required above is not required if the applicable rate increased as a result of the consumer's failure to comply with the terms of a workout or temporary hardship arrangement, provided that:

1. The rate following any such increase does not exceed the rate that applied prior to the beginning of the workout or temporary hardship arrangement, or if a variable rate, is determined by the same formula (index and margin)

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that applied to the category of transactions prior to the beginning of the workout period; and

2. The creditor provided the consumer, prior to the commencement of such arrangement, with a clear and conspicuous disclosure of the terms of the arrangement (including any increase due to such failure) (§ 226.9(g)).
- m. Determine further that the creditor did not increase the rate applicable to the consumer's account to the penalty rate if the outstanding balance did not exceed the credit limit on the date the penalty rate will be imposed as set forth in the notice (§ 226.9(g)).
- n. When the consumer is given the right to reject a significant change to an account term or other increase in an APR in the notices provided under (g) or (j) above, determine whether the consumer was given the option to reject the change or increase by notifying the creditor of the rejection before the effective date of the change or increase.
- o. If the creditor was notified of the rejection of a significant change to an account term or an increase in the APR, determine that the creditor did not:
 1. Apply the charge or increase to the account;
 2. Impose a fee or charge or treat the account as in default solely as a result of the rejection; or
 3. Require repayment of the balance on the account using a method that is LESS beneficial to the consumer than one of the following methods:
 - i. The method of repayment for the account on the date on which the creditor was notified of the rejection;
 - ii. An amortization period of not less than five years, beginning no earlier than the date on which the creditor was notified of the rejection; or
 - iii. A required minimum periodic payment that includes a percentage of the balance that is equal to no more than twice the percentage required on the date on which the creditor was notified of the rejection.

Note that these requirements do not apply:

1. When the creditor has not received the consumer's required minimum periodic payment within 60 days after the due date for that payment; or
2. To transactions that occur more than 14 days after provision of the written notices (§ 226.9(h)).

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- p. Determine that disclosure of items 1-7 in “b” above are provided if the account is renewed. Additionally, the disclosure provided upon renewal must disclose how and when the cardholder may terminate the credit to avoid paying the renewal fee (§ 226.9(e)).
- q. Determine that a statement of the maximum interest rate that may be imposed during the term of the obligation is made for any loan in which the APR may increase during the plan (§ 226.30(b)).

Reverse Mortgage Forms Review Procedures (Both open and closed-end)

- a. Determine that the disclosures required for reverse mortgage transactions are substantially similar to the model form in Appendix K and include the items below.
 - 1. A statement that the consumer is not obligated to complete the reverse mortgage transaction merely because he or she has received the disclosures or signed an application.
 - 2. A good faith projection of the total cost of the credit expressed as a table of “total annual loan cost rates” including payments to the consumer, additional creditor compensation, limitations on consumer liability, assumed annual appreciation, and the assumed loan period.
 - 3. An itemization of loan terms, charges, the age of the youngest borrower, and the appraised property value.
 - 4. An explanation of the table of total annual loan costs rates.

Note: Forms that include or involve current transactions, such as change in terms notices, periodic billing statements, rescission notices, and billing error communications, are verified for accuracy when the file review worksheets are completed.

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Timing of Disclosures

5. Review financial institution policies, procedures, and systems to determine, either separately, or when completing the actual file review, whether the applicable disclosures listed below are furnished when required by Regulation Z. Take into account products that have different features, such as closed-end loans or credit card accounts that are fixed or variable rate.
 - a. Credit card application and solicitation disclosures - On or with the application (§ 226.5a(b)).
 - b. HELOC disclosures – At the time the application is provided or within three business days under certain circumstances (§ 226.5b(b)).
 - c. Open-end credit initial disclosures – Before the first transaction is made under the plan (§ 226.5(b)(1)).
 - d. Periodic statement disclosures for open-end credit under § 226.7 – Required if at the end of a billing cycle the account has a debit or credit balance of \$1 or more or if a finance charge has been imposed (§226.5(b)(2)(i)). Also, the creditor must adopt reasonable procedures designed to ensure that periodic statements are mailed or delivered at least 21 days prior to the payment due date and the date on which any grace period expires (§ 226.5(b)(2)(ii)).
 - e. Statement of billing rights – At least once per year (§ 226.9(a)).
 - f. Supplemental credit devices – Before the first transaction under the plan (§ 226.9(b)).
 - g. Open-end credit change in terms – 15 days prior to the effective change date (§ 226.9(c)).
 - h. Finance charge imposed at time of transaction – Prior to imposing any fee (§ 226.9(d)).
 - i. Disclosures upon renewal of credit or charge card – 30 days or one billing cycle, whichever is less before the delivery of the periodic statement on which the renewal fee is charged. Alternatively, notice may be delayed until the mailing or delivery of the periodic statement on which the renewal fee is charged to the accounts if the notice meets certain requirements (§ 226.9(e)).
 - j. Change in credit account insurance provider – Certain information 30 days before the change in provider occurs and certain information 30 days after the change in provider occurs. The institution may provide a combined disclosure 30

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- days before the change in provider occurs (§ 226.9(f)).
- k. Closed-end credit disclosures – Before consummation (§ 226.17(b)).
 - l. For disclosures for dwelling-secured transactions subject to RESPA (other than open-end), multiple timing requirements apply. Determine whether the creditor provides early disclosures within three business days after receiving the consumer's written application. The creditor is required to deliver or mail the early disclosures no later than three business days after receiving the consumer's application and at least seven business days before consummation (§ 226.19(a)(1)(i) and § 226.19(a)(2)(i)). If the APR stated in the early disclosures is not considered accurate under § 226.22 when compared to the APR at consummation, determine whether the creditor provided corrected disclosures of all changed terms, including the APR, that the consumer received no later than the third business day before consummation (§ 226.19(a)(2)(ii)).
 - m. Disclosures for transactions subject to § 226.32 – Three business days prior to consummation. If such disclosures become inaccurate due to a change by the creditor, ensure the creditor provided new, accurate disclosures no later than three business days prior to consummation (§ 226.31(c)(1)).
 - n. Disclosures for reverse mortgages – Three days prior to consummation of a closed-end credit transaction or prior to the first transaction under an open-end credit plan (§ 226.31(c)(2)).
 - o. Disclosures for adjustable-rate mortgages – At least once each year during which an interest rate adjustment is implemented without an accompanying payment change, and at least 25, but no more than 120 calendar days before a new payment amount is due, or in accordance with other variable-rate subsequent-disclosure regulations issued by a supervisory agency (§ 226.20(c)).
 - p. Notice of new creditor- For any mortgage loan (credit transaction that is secured by the principal dwelling of a consumer) that was sold or otherwise transferred or assigned to the creditor, determine that the creditor (as the new owner or assignee of the debt) notifies the borrower in writing of such transfer, including:
 - 1. The identity, address, telephone number of the new creditor;
 - 2. The date of the transfer;
 - 3. How to reach an agent or party having authority to act on behalf of the new creditor;

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4. The location of the place where the transfer of ownership of the debt is recorded; and
 5. Any other relevant information regarding the new creditor.
-

Electronic Disclosures

Note: Disclosures may be provided to the consumer in electronic form, subject to compliance with the consumer consent and other applicable provisions of the Electronic Signatures in Global and National Commerce Act (E-Sign Act) (15 USC 7001 et seq.) The E-Sign Act does not mandate that an institution or consumer use or accept electronic records or signature. It permits institutions to satisfy any statutory or regulatory requirements by providing the information electronically after obtaining the consumer's affirmative consent. Before consent can be given, consumers must be provided with all of the following information:

- Any right to have the information provided in paper.
- The right to withdraw the consent to receive information electronically and the consequences of doing so.
- The scope of the consent.
- The procedures to withdraw consent and to update information needed to contact the consumer electronically.
- The ways in which a consumer can obtain, after consent and upon request, a paper copy and whether any fee will be charged.
- The hardware and software requirements for access to and retention of the electronic information.

The consumer must consent electronically or confirm consent electronically in a manner that "reasonably demonstrates that the consumer can access information in the electronic form that will be used to provide the information that is the subject of the consent." After the consent, if an institution changes the hardware or software requirements such that a consumer may be prevented from accessing and retaining information electronically, the institution must notify the consumer of the new requirements and must allow the consumer to withdraw consent without charge.

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6. If the financial institution makes its disclosures available to consumers in electronic form, determine that the forms comply with the appropriate sections – 226.5(a)(1); 226.5a(a)(2)(v); 226.5b(a)(3); 226.15(b); 226.16(c); 226.17(a)(1); 226.17(g); 226.23(b)(1); 226.24(d) and 226.31(b).
-

Record Retention

7. Review the financial institution's record retention practices to determine whether evidence of compliance (for other than the advertising requirements) is retained for at least two years after the disclosures were required to be made or other action was required to be taken (§ 226.25).
-

Advertising (Open and Closed End)

8. For open- and closed-end loans, sample advertising copy, including any electronic advertising, since the previous examination and verify that the terms of credit are accurate, clear, balanced and conspicuous. If triggering terms are used, determine the required disclosures are made (§§ 226.16 and 226.24).

For advertisements for closed-end credit,

- If a rate of finance charge was stated, determine that it was stated as an APR
 - If an APR will increase after consummation, a statement to that fact is made
 - Determine whether there are deceptive or misleading statements or practices.
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TRANSACTIONAL TESTING

Note: When verifying APR accuracies, use the OCC's APR calculation model or other calculation tool acceptable to your regulatory agency.

Closed-End Credit

9. For each type of closed-end loan being tested, determine the accuracy of the disclosures by comparing the disclosures to the contract and other financial institution documents (§ 226.17).
-
10. Determine whether the required disclosures were made before consummation of the transaction and ensure the presence and accuracy of the items below, as applicable (§ 226.18):
 - a. Amount financed
 - b. Itemization of the amount financed (RESPA GFE may substitute)
 - c. Finance charge
 - d. APR
 - e. Variable rate verbiage as follows for loans not secured by a principal dwelling or with terms of one year or less:
 1. Circumstances which permit rate increase
 2. Limitations on the increase (periodic or lifetime)
 3. Effects of the increase
 4. Hypothetical example of new payment terms
 - f. Payment schedule including amount, timing and number of payments.
 - g. Total of payments.
 - h. Total sales price (credit sale)
 - i. Description of security interest
 - j. Credit life insurance premium included in the finance charge unless:

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- Insurance is not required;
 - Premium for the initial term is disclosed; and
 - Consumer signs or initials an affirmative written request for the insurance.
- k. Property insurance available from the creditor excluded from the finance charge if the premium for the initial term of the insurance is disclosed
- l. Required deposit.
-

11. Determine for adjustable rate mortgage loans secured by the borrower's principal dwelling with maturities of more than one year that the required early and subsequent disclosures are complete, accurate, and timely. Early disclosures required by § 226.19(a) are verified during the closed-end credit forms review. Subsequent disclosures should include the items below, as applicable (§ 226.20(c));
- a. Current and prior interest rates
 - b. Index values used to determine current and prior interest rates
 - c. Extent to which the creditor has foregone an increase in the interest rate
 - d. Contractual effects of the adjustment (new payment and loan balance)
 - e. Payment required to avoid negative amortization.

Note: The accuracy of the adjusted interest rates and indexes should be verified by comparing them with the contract and early disclosures. Refer to the Additional Variable Rate Testing section of these examination procedures.

12. Determine, for each type of closed-end rescindable loan being tested, the appropriate number of copies of the rescission notice are provided to each person whose ownership interest is or will be subject to the security interest. The rescission notice must disclose the items below (§ 226.23(b));
- a. Security interest taken in the consumer's principal dwelling
 - b. Consumer's right to rescind the transaction

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- c. How to exercise the right to rescind, with a form for that purpose, designating the address of the creditor's place of business
 - d. Effects of rescission
 - e. Date the rescission period expires.
-

13. Ensure funding was delayed until the rescission period expired (§ 226.23(c)).

14. Determine if the institution has waived the three-day right to rescind since the previous examination. If applicable, test rescission waivers (§ 226.23(e)).

15. Determine whether the maximum interest rate in the contract is disclosed for any adjustable rate consumer credit contract secured by a dwelling (§ 226.30(a)).

Open-End Credit

16. For each open-end credit product tested, determine the accuracy of the disclosures by comparing the disclosure with the contract and other financial institution documents (§ 226.5(c)).

17. Review the financial institution's policies, procedures, and practices to determine whether it provides appropriate disclosures for creditor-initiated direct mail applications and solicitations to open charge card accounts, telephone applications and solicitations to open charge card accounts, and applications and solicitations made available to the general public to open charge card accounts (§ 226.5a(b), (c), and (d)).

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18. Determine for all home equity plans with a variable rate that the APR is based on an independent index. Further, ensure home equity plans are terminated or terms changed only if certain conditions exist (§ 226.5b(f)).

19. Determine that, if any consumer rejected a home equity plan because a disclosed term changed before the plan was opened, all fees were refunded. Verify that non-refundable fees were not imposed until three business days after the consumer received the required disclosures and brochure (§ 226.5b(g) and (h)).

20. Review consecutive periodic billing statements for each major type of open-end credit activity offered (overdraft and home-equity lines of credit, credit card programs, etc.). Determine whether disclosures were calculated accurately and are consistent with the initial disclosure statement furnished in connection with the accounts (or any subsequent change in terms notice) and the underlying contractual terms governing the plan(s). The periodic statement must disclose the items below, as applicable (§ 226.7):

- a. Previous balance
- b. Identification of transactions
- c. Dates and amounts of any credits
- d. Periodic rates and corresponding APRs, if variable rate plan, must disclose that the periodic rates may vary
- e. Balance on which the finance charge is computed and an explanation of how the balance is determined
- f. Amount of finance charge with an itemization of each of the components of the finance charge
- g. Annual percentage rate
- h. Itemization of other charges
- i. Closing date and balance

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- j. Payment date, if there is a “free ride” period
 - k. Address for notice of billing errors.
-

21. Verify the institution credits a payment to the open-end account as of the date of receipt (§ 226.10).

22. Determine institution’s treatment of credit balances. Specifically, if the account’s credit balance is in excess of \$1, the institution must disclose all of the items below (§ 226.11);

- a. Credit the amount to the consumer’s account.
 - b. Refund any part of the remaining credit balance within seven business days from receiving a written request from the consumer.
 - c. Make a good faith effort to refund the amount of the credit to a deposit account of the consumer if the credit remains for more than six months.
-

23. Review a sample of billing error resolution files and a sample of consumers who have asserted a claim or defense against the financial institution for a credit card dispute regarding property or services. Verify the following (§§ 226.12 and 226.13);

- a. Credit cards are issued only upon request
 - b. Liability for unauthorized credit card use is limited to \$50
 - c. Disputed amounts are not reported delinquent unless remaining unpaid after the dispute has been settled
 - d. Offsetting credit card indebtedness is prohibited
 - e. Errors are resolved within two complete billing cycles.
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24. Determine, for each type of open-end rescindable loan being tested, the appropriate number of copies of the rescission notice are provided to each person whose ownership interest is or will be subject to the security interest and perform items 4, 5, and 6 under the Closed-End Credit section (§ 226.15(b), (c) and (e)).
-

Additional Variable Rate Testing

25. Verify that when accounts were opened or loans were consummated that loan contract terms were recorded correctly in the financial institution's calculation systems (e.g., its computer). Determine the accuracy of the following recorded information:
- a. Index value
 - b. Margin and method of calculating rate changes
 - c. Rounding method,
 - d. Adjustment caps (periodic and lifetime).
-
26. Using a sample of periodic disclosures for open-end variable rate accounts (e.g., home equity accounts) and closed-end rate change notices for adjustable rate mortgage loans:
- a. Compare the rate-change date and rate on the credit obligation to the actual rate-change date and rate imposed.
 - b. Determine that the index disclosed and imposed is based on the terms of the contract (example: the weekly average of one-year Treasury constant maturities, taken as of 45 days before the change date) (§§ 226.7(g) and 226.20(c)(2)).
 - c. Determine that the new interest rate is correctly disclosed by adding the correct index value with the margin stated in the note, plus or minus any contractual fractional adjustment (§§ 226.7(g) and 226.20 (c)(1)).

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- d. Determine that the new payment disclosed (§ 226.20(c)(4)) was based on an interest rate and loan balance in effect at least 25 days before the payment change date (consistent with the contract) (§ 226.20(c)).
-

Certain Home Mortgage Transactions Subject to Subpart E

27. Determine whether the financial institution originates consumer credit transactions subject to Subpart E of Regulation Z; specifically, certain closed-end home mortgages (high-cost mortgages (§ 226.32), reverse mortgages (§ 226.33) and “higher priced mortgage loans” (§ 226.35)).
-
28. You may use the worksheet in [Appendix A](#) of this Handbook Section as an aid for identifying and reviewing high-cost mortgages.
-
29. In addition to reviewing high-cost mortgages and reverse mortgages for compliance with requirements in other subparts of Regulation Z (for example, disclosure timing requirements under § 226.19(a), review such mortgages to ensure the following:
 - a. Required disclosures are provided to consumers in addition to, not in lieu of, the disclosures contained in other subparts of Regulation Z (§ 226.31(a)).
 - b. Disclosures are clear and conspicuous, in writing, and in a form that the consumer may keep (§ 226.31(b)).
 - c. Disclosures are furnished at least three business days prior to consummation of a mortgage transaction covered by § 226.32 or a closed-end reverse mortgage transaction (or at least three business days prior to the first transaction under an open-end reverse mortgage) (§ 226.31(c)).
 - d. Disclosures reflect the terms of the legal obligation between the parties (§ 226.31(d)).

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- e. If the transaction involves more than one creditor, that only one creditor provided the disclosures. Where the obligation involves multiple consumers, ensure that the disclosures were provided to any consumer who is primarily liable on the obligation. Further, for rescindable transactions, verify that the disclosures were provided to each consumer who has the right to rescind (§ 226.31(e)).
- f. The APR is accurately calculated and disclosed in accordance with the requirements and within the tolerances allowed in § 226.22 (§ 226.31(g)).

30. For high-cost mortgages (§ 226.32), ensure that:

- a. In addition to other required disclosures, the creditor discloses the following at least three business days prior to consummation: [See model disclosure at App. H-16]
 - 1. Notice containing the prescribed language (§ 226.32(c)(1)).
 - 2. Annual percentage rate (§ 226.32(c)(2)).
 - 3. Amount of regular loan payment and the amount of any balloon payment. The disclosed regular payment should be treated as accurate if it is based on an amount borrowed that is deemed accurate under § 226.32(c)(5) (§ 226.32(c)(3)).
 - 4. For variable rate loans, a statement that the interest rate and monthly payment may increase, and the amount of the single maximum monthly payment allowed under the contract (§ 226.32(c)(4)).
 - 5. For a mortgage refinancing, the total amount the consumer will borrow (the face amount) and if this amount includes premiums or other charges for optional credit insurance or debt-cancellation coverage, that fact is stated. This disclosure should be treated as accurate if within \$100 of the actual amount borrowed (§ 226.32(c)(5)).
 - 6. A new disclosure is required if, subsequent to providing the additional disclosure but prior to consummation, there are changes in any terms that make the disclosures inaccurate. For example, if a consumer purchases optional credit insurance and, as a result, the monthly payment differs from the payment previously disclosed, redisclosure is required and a new three-day waiting period applies (§ 226.31(c)(1)(i)).

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7. If a creditor provides new disclosures by telephone when the consumer initiates a change in terms, then at consummation (§ 226.31(c)(1)(ii)).
 - The creditor must provide new written disclosures and both parties must sign a statement that these new disclosures were provided by telephone at least three days prior to consummation.
 8. If a consumer waives the right to a three-day waiting period to meet a bona fide personal financial emergency, the consumer's waiver must be a dated written statement (not a pre-printed form) describing the emergency and bearing the signature of all entitled to the waiting period (a consumer can waive only after receiving the required disclosures and prior to consummation) (§ 226.31(c)(1)(iii)).
- b. High-cost mortgage transactions (§ 226.32) do not provide for any of the following loan terms:
1. Balloon payment (if term is less than 5 years, with exceptions) (§ 226.32(d)(1)(i) and (ii)).
 2. Negative amortization (§ 226.32(d)(2)).
 3. Advance payments from the proceeds of more than 2 periodic payments (§ 226.32(d)(3)).
 4. Increased interest rate after default (§ 226.32(d)(4)). A rebate of interest, arising from a loan acceleration due to default, calculated by a method less favorable than the actuarial method (§ 226.32(d)(5)).
 5. Prepayment penalty, unless:
 - i. it will not apply after the two-year period following consummation;
 - ii. it will not apply if the source of prepayment funds is a refinancing by the creditor or an affiliate of the creditor;
 - iii. the consumer's total monthly debt payments (including amounts owed under mortgage), at consummation, is 50 percent or less of the consumer's monthly gross income (as verified in accordance with § 226.34(a)(4)(ii)); and,
 - iv. the amount of the periodic payment of principal or interest or both may not change during the four-year period following consummation) (§§ 226.32(d)(6) and 226.32(d)(7)).

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6. A due-on-demand clause permitting the creditor to terminate the loan in advance of maturity and accelerate the balance, with certain exceptions (§ 226.32(d)(8)).
- c. The creditor is not engaged in the following acts and practices for high-cost mortgages:
 1. Home improvement contracts – paying a contractor under a home improvement contract from the proceeds of a mortgage unless certain conditions are met (§ 226.34(a)(1)).
 2. Notice to assignee – selling or otherwise assigning a high-cost mortgage without furnishing the required statement to the purchaser or assignee (§ 226.34(a)(2)).
 3. Refinancing within one year of extending credit – within one year of making a high-cost mortgage loan (§ 226.32), a creditor may not refinance any high-cost mortgage to the same borrower into another high-cost mortgage that is not in the borrower’s interest. This also applies to assignees that hold or service the high-cost mortgage. Commentary to 34(a)(3) has examples applying the refinancing prohibition and addressing “borrower’s interest” (§ 226.34(a)(3)).

-
31. For higher-priced mortgage loans (§ 226.35), ensure that:
 - a. Loan terms do not provide for a prepayment penalty, unless:
 1. the penalty is otherwise permitted by law, including § 226.32(d)(6);
 2. the penalty will not apply after the two-year period following consummation;
 3. the source of prepayment funds is a refinancing by the creditor or an affiliate of the creditor; and
 4. the amount of the periodic payment of principal or interest or both may not change during the four-year period following consummation (§ 226.35(b)).
 - b. For loans secured by a first lien on a principal dwelling escrow accounts are established before consummation for property taxes and premiums for mortgage-related insurance required by the creditor.

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32. For **both** high-cost (§ 226.32) and higher priced mortgages (§ 226.35) review for the following:
- a. Consumers' ability to repay – Ensure these loans are **not** being extended based on the consumer's collateral without regard to repayment ability, including the consumer's current and expected income, current obligations, mortgage related obligations, assets other than collateral, and employment.
 - 1. Review underwriting standards to ensure the creditor bases its determination of repayment ability on current or reasonably expected income from employment or other sources, on assets other than the collateral, or both.
 - 2. Determine that a creditor verifies amounts of income or assets that it relies on to determine repayment ability, including expected income or assets, by the consumer's Internal Revenue Service Form W-2, tax returns, payroll receipts, financial institution records, or other third party documents that provide reasonably reliable evidence of the consumer's income or assets.
 - 3. To establish whether a presumption of compliance applies, determine whether a creditor verifies the consumer's current obligations by:
 - i. verifying repayment ability as described above;
 - ii. determining the consumer's repayment ability by using the largest payment of principal and interest in the first seven years following consummation;
 - iii. taking into account current and mortgage-related obligations; and
 - iv. assessing the consumer's repayment ability taking into account at least one of the following: the ratio of total debt obligations to income, or the income the consumer will have after paying debt obligations.
 - b. Evasion of requirements – Ensure that the creditor does not structure a high-cost or higher-priced mortgage loan as an open-end plan ("spurious open-end credit") to evade the requirements of Regulation Z. See staff commentary to 34(b) for factors to be considered (§ 226.34(b)).

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Prohibited Acts or Practices in Connection with Credit Secured by a Consumer's Principal Dwelling (§ 226.36)

33. Coercion of Appraiser – For consumer credit secured by a consumer's principal dwelling, review files (and specific consumer complaints not reflected in files) to determine if there is misrepresentation of the value of the consumer's principal dwelling. Specifically, ensure that the creditor or mortgage broker, or affiliate of a creditor or mortgage broker, has not directly or indirectly coerced, influenced or otherwise encouraged an appraiser to misstate or misrepresent the value of a consumer's principal dwelling.
-
34. Determine if the creditor knew, at or before loan consummation, of a violation of the appraiser coercion prohibition. If so, verify that the creditor acted with reasonable diligence to determine that the appraisal in question does not materially misstate or misrepresent the value of the consumer's principal dwelling.
-
35. Loan Servicing Practices – For a consumer credit transaction secured by a consumer's principal dwelling, determine if loan servicer:
- Failed to credit a conforming payment to the consumer's loan account as of the date of receipt, where the delay in crediting resulted in a charge to the consumer or in the reporting of negative information to a credit reporting agency;
 - Imposed on the consumer any late fee or delinquency charge in connection with a payment, when the only delinquency was attributable to late fees or delinquency charges assessed on an earlier payment, and the payment is otherwise a full payment for the applicable period and is paid on its due date or within any applicable grace period; or

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- c. Failed to provide, within a reasonable time after receiving a request from the consumer or person acting on behalf of the consumer, an accurate statement of the total outstanding balance that would be required to satisfy the consumer's obligations in full as of a specific date. A reasonable time under most circumstances would be to provide the statement within five business days, unless refinance application volume is unusually high.
-

Administrative Enforcement

- 36. If there is noncompliance involving understated finance charges or understated APRs subject to reimbursement under the FFIEC Policy Guide on Reimbursement (policy guide), continue with step 32 of the polciy guide.
-

- 37. Document the date on which the administrative enforcement of the TILA policy statement would apply for reimbursement purposes by determining the date of the preceding examination.
-

- 38. If the noncompliance involves indirect (third-party paper) disclosure errors and affected consumers have not been reimbursed:
 - a. Prepare comments, discussing the need for improved internal controls to be included in the report of examination.
 - b. Notify your supervisory office for follow up with the regulator that has primary responsibility for the original creditor.

If the noncompliance involves direct credit:

- c. Make an initial determination whether the violation is a pattern or practice.
- d. Calculate the reimbursement for the loans or accounts in an expanded sample of the identified population.
- e. Estimate the total impact on the population based on the expanded sample.

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- f. Inform management that reimbursement may be necessary under the law and the policy guide, and discuss all substantive facts including the sample loans and calculations.
 - g. Inform management of the financial institution's options under section 130 of the TILA for avoiding civil liability and of its option under the policy guide and section 108 (e)(6) of the TILA for avoiding a regulatory agency's order to reimburse affected borrowers.
-

PROGRAM CONCLUSIONS

1. Summarize the findings, supervisory concerns and regulatory violations.

2. For the violations noted, determine the root cause by identifying weaknesses in internal controls, audit and compliance reviews, training, management oversight, or other factors. Determine whether the violation(s) are repetitive or systemic.

3. Identify action needed to correct violations and weaknesses in the institution's compliance system.

4. Discuss findings with the institution's management and, if necessary, obtain a commitment for corrective action.

5. Record violations according to agency policy in the EDS/ROE system to facilitate analysis and reporting.

EXAMINER'S SUMMARY, RECOMMENDATIONS, AND COMMENTS

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HIGH-COST MORTGAGE (§226.32) WORKSHEET

Borrower's Name	Loan Number:
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COVERAGE		
	Yes	No
Is the loan secured by the consumer's principal dwelling? [§226.2(a)(19), §226.32(a)(1)]		
If the answer is No, STOP HERE		
Is the loan for the following purpose?		
1. Residential Mortgage Transaction – [§226.2(a)(24)]		
2. Reverse Mortgage Transaction – [§226.33]		
3. Open-End Credit Plan – Subpart B [note prohibition against structuring loans as open-end plans to evade §226.32 – [§226.34(b)]		
If the answer is Yes to Box 1, 2, or 3, STOP HERE. If No, continue to Test 1.		

TEST 1 – CALCULATION OF APR		
A. Disclosed APR		
B. Treasury Security Yield of Comparable Maturity		
<p>Obtain the Treasury Constant Maturities Yield from the FRB’s Statistical Release, H-15 – Selected Interest Rates (the “Business” links will display daily yields). Use the yield that has the most comparable maturity to the loan term and is from the 15th day of the month that immediately precedes the month of the application. If the 15th is not a business day, use the yield for the business day immediately preceding the 15th. If the loan term is exactly halfway between two published security maturities, use the lower of the two yields.) Note: Creditors may use the FRB’s Selected Interest Rates or the actual auction results. See Staff Commentary to Regulation Z for further details.</p> <p>[§226.32(a)(1)(i)]</p> <p>http://www.federalreserve.gov/releases/H15/data.htm</p>		
C. Treasury Security Yield of Comparable Maturity (Box B)		
<p><u>Plus:</u> 8 percentage points for first-lien loan; or 10 percentage points for subordinate-lien loan</p>		
	Yes	No
D. Is Box A greater than Box C?		
If Yes, the transaction is a High-Cost Mortgage. If No, continue to Test 2, Points and Fees.		

HIGH-COST MORTGAGE (§226.32) WORKSHEET

TEST 2 - CALCULATION OF POINTS AND FEES

STEP 1: Identify all Charges Paid by the Consumer at or before Loan Closing

A. Finance Charges – §226.4(a) and (b) (Interest, including per-diem interest, and time price differential are excluded from these amounts.)

	Fee	Subtotals
Loan Points		
Mortgage Broker Fee		
Loan Service Fees		
Required Closing Agent/3 rd Party Fees		
Required Credit Insurance		
Private Mortgage Insurance		
Life of Loan Charges (flood, taxes, etc.)		
Any Other Fees Considered Finance Charges		
Subtotal		

B. Certain Non-Finance Charges Under §226.4(c)(7) – Include fees paid by consumers only if the amount of the fee is unreasonable or if the creditor receives direct or indirect compensation from the charge or the charge is paid to an affiliate of the bank. (See the example in §226.32(b)(1)(ii) of the commentary for further explanation.)

Title Examination		
Title Insurance		
Property Survey		
Document Preparation Charge		
Credit Report		
Appraisal		
Fee for “Initial” Flood Hazard Determination		
Pest Inspection		
Any Other Fees Not Considered Finance Charges		
Subtotal		

C. Premiums or Other Charges for Optional Credit Life, Accident, Health, or Loss-of-Income Insurance, or Debt-Cancellation Coverage

D. Total Points & Fees: Add Subtotals for A, B, C

HIGH-COST MORTGAGE (§226.32) WORKSHEET

TEST 2 – CALCULATION OF POINTS AND FEES (continued)

STEP 2: Determine the Total Loan Amount for Cost Calculation [226.32(a)(1)(ii)]

A. Determine the Amount Financed [§226.18(b)]

Principal Loan Amount

Plus: Other Amounts Financed by the Lender (*not already included in the principal and not part of the finance charge*)

Less: Prepaid Finance Charges [§226.2(a)(23)]

Equals: Amount Financed

B. Deduct costs included in the points and fees under §226.32(b)(1)(iii) and (iv) (Step 1, Box B and Box C) that are financed by the creditor

C. Total Loan Amount (Step 2, Box A minus Box B)

TEST 2 – CALCULATION OF POINTS AND FEES (continued)

STEP 3: Perform High-Fee Cost Calculation

A. Eight Percent of the Total Loan Amount (Step 2, Box C)

B. Annual Adjustment Amount – [§226.32(a)(1)(ii)]
1999: \$441; 2000: \$451; 2001: \$465; 2002: \$480
(use the dollar amount corresponding to the year of the loan's origination)

C. Total Points & Fees (Step 1, Box D)

Yes

No

In Step 3, does Box C exceed the greater of Box A or Box B?

If Yes, the transaction is a High-Cost Mortgage. If No, the transaction is not a High-Cost Mortgage under Test 2, Points and Fees.