

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.

NOTE: The following narrative does not encompass all the sections of Regulation Z, but rather highlights areas that have caused the most problems with the calculation of the finance charge and the calculation of the annual percentage rate.

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 is designed to:

- Protect consumers against inaccurate and unfair credit billing and credit card practices;
- Provide consumers with rescission rights;
- Provide for rate caps on certain dwelling-secured loans; and
- Impose limitations on home equity lines of credit and certain closed-end home mortgages.

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;
- Credit extended to other than a natural person (including credit to government agencies or instrumentalities);
- Credit in excess of \$25 thousand 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.

NOTE: If a credit card is involved, generally exempt credit (e.g., business or agricultural purpose credit) is still subject to requirements that govern 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 card holder must not be held liable for more than \$50.00 for the unauthorized use of the card.

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.
- 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.

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 these examination procedures for help in determining appropriate finance charge tolerances.