TRUTH IN LENDING REIMBURSEMENT

OVERVIEW

This Appendix provides information relating to the identification of reimbursable Truth in Lending violations, reimbursement calculations, and for the determination of appropriate corrective action.

Objective(s)

The objectives of these procedures are to provide:

- General guidance for identifying and calculating reimbursable violations
- Proper treatment of these violations in the Report of Examination

IN THIS APPENDIX

REIMBURSEMENT GUIDELINES

In dealing with Truth in Lending reimbursement, the examiner needs to be familiar with the following guidance:

- Truth in Lending Act
- "Administrative Enforcement of the Truth in Lending Act **Restitution,"** FFIEC Joint Statement of Policy (Revised September 1998)
- FFIEC's Questions and Answers on Truth in Lending Reimbursement (Q&A) (Revised July 1999)

REIMBURSEMENT GUIDELINES (cont'd)

Regulatory Actions

Section 108(e)(2) of the Truth in Lending Act (Act) directs that the FDIC shall require "adjustments" (monetary reimbursement) to consumers for understatements of annual percentage rates (APR) or finance charges (FC). Unless other statutory or regulatory exemptions are met, the FDIC is required to seek reimbursement and may not waive or grant relief from reimbursement. If an institution does not voluntarily comply with the law and make reimbursement, Section 108(e)(4) of the Act authorizes the FDIC to order institutions to make monetary adjustments to the accounts of consumers where an APR or FC was understated.

In 1980, the FFIEC adopted a Joint Statement of Policy entitled "Administrative Enforcement of the Truth in Lending Act – Restitution" (Policy Guide) that summarizes and explains the restitution provision of the Act. The Policy Guide was revised in September 1998 to incorporate changes to the statute in 1996 and 1997. The Policy Guide is reproduced in FDIC's looseleaf Rules and Regulations service under the "FDIC Statements of Policy" tab.

The Policy Guide states that, in general, the FDIC must require (and may order) restitution when understatement of the cost of borrowing results from ***a clear and consistent pattern or practice of violations, gross neglect, or a willful violation*** intended to mislead the consumer. This parallels the reimbursement requirements of Section 108(e)(2) of the Act. In such instances, a file search may be requested to detect loans containing specific problems requiring reimbursement. The request is made by the Regional Office or, if permitted by Regional policy, may be made by the Examiner-in-Charge (EIC).

While the Act and Policy Guide set the definitive general principles as to when reimbursement is required, the FFIEC's interpretive Questions and Answers on Truth in Lending Reimbursement (Q&A) regarding the Policy Guide provide guidance as to applying the principles to given situations. The Q&A are included in this Appendix. The Q&A were originally issued in 1980 and were revised in 1999 to reflect the 1998 revisions to the Policy Guide.

Requests for Relief from Reimbursement

Historically, the FDIC has treated a request made by non-member banks seeking relief from making reimbursement under the Truth in Lending Act, 15 U.S.C. §1601 et seq. (TILA), as an application under its regulations. The Board has delegated authority to the Director of the Division of Compliance and Consumer Affairs (DCA) to grant or deny these requests. The Director has further delegated this authority to the Regional Directors (DCA), but only to deny requests where the amount of reimbursement totals less than $25,000.

REIMBURSEMENT GUIDELINES (cont'd)

Requests for Relief from Reimbursement (cont'd)

The TILA grants the enforcement agencies very little discretion to grant relief from reimbursement for violations. Because of this limited discretion, the FDIC has not been able to grant relief in many instances. From 1991 through 1996, a total of 63 requests were reviewed at the Washington level and only one of these requests was granted. In that one instance, it was determined that the cited violation was, in fact, not a violation of Regulation Z.

Should a nonmember bank wish to pursue a request for relief, even though there is a strong likelihood that a request will not be granted, the request will be processed within established time frames:

- Requests that can be processed under delegated authority by the Regional Director and Regional Counsel must be completed within 60 days after receipt unless the institution has agreed in writing to an extension of time to make the determination.

- Requests requiring action by the Washington Office will be referred by the Regional Office to the Washington Office within 45 days of receipt. A decision will be made within 45 days of receipt in Washington.

Legal Background

Section 108(e) of the TILA,[1] which governs enforcement of TILA, provides a very specific framework for requiring agency action on restitution. Once the FDIC determines that a disclosure error involving an inaccurate APR or finance charge has occurred, and that the error has resulted from "gross negligence," or a "clear and consistent pattern or practice of violations," the agency **shall require** an adjustment unless one of four stated exceptions applies, in which case the agency **need not require** an adjustment.[2] If the exceptions apply, or in cases of similar disclosure errors, an agency **may require** an adjustment.

The use of the terms "shall require an adjustment," "need not require an adjustment" and "may require an adjustment" within the same section of the statute suggests that Congress intended the term "shall require" to be mandatory. The Congress used the word **must**, indicating the compulsory nature of its direction that an agency enforce the TILA with regard to the specific kinds of violations enumerated, as contrasted with the agency's discretion to order restitution in other situations:

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[1] Consumer Credit Protection Act, tit. 1,§108(e), Pub. L. No. 90-321, 82 Stat. 150 (1968), as amended by the Truth in Lending Simplification Act, Pub. L. No. 96-221, tit. VI, §608, 94 Stat. 132 (1980)(codified at 15 U.S.C. §1607(e)).

[2] 15 U.S.C. §1607(e)(2). Where there is a "willful violation which was intended to mislead the person to whom credit was extended" the exceptions do not apply.

REIMBURSEMENT GUIDELINES (cont'd)

Requests for Relief from Reimbursement (cont'd)

> "Where the violation resulted from a pattern or practice of violations, gross negligence, or a willful violation intended to mislead, an agency must, subject to the restrictions discussed below, order restitution to the consumer designed to assure that the consumer pays no more than the lower of the finance charge or annual percentage rate actually disclosed...In the case of violations not falling under any of the above criteria, each agency may in its discretion order restitution."
> Id. at 12; accord verbatim, S. Rep. No. 368, 96th Cong., 1st Sess. 26 (1979).

There are four instances where the FDIC has discretion to waive reimbursement. Three of these exceptions are straightforward and are fact specific. It would be unusual to find a bank which could successfully assert one of these exceptions as a defense, since it is unlikely that restitution would have been ordered in the first place as FDIC examiners carefully evaluate whether any of the exceptions exist before requesting that a bank make restitution.

The first three exceptions are where:

1. The error involves a fee or charge that would otherwise be excludable in computing the finance charge.

2. The error involved a disclosed amount which was 10 percent or less of the amount that should have been disclosed and either the annual percentage rate (APR) or finance charge was disclosed correctly; or

3. The error involved a total failure to disclose either the APR or finance charge.[3]

The fourth exception is the one most frequently cited by an institution in requesting relief. It is the one that is most difficult to meet since it contains four elements, **all four of which must be met** for the exception to apply. The conditions are that:

- the error resulted from a unique circumstance
- the disclosure violations are clearly technical and non-substantive
- the disclosure violations do not adversely affect information provided to the consumer; and
- the disclosure violations have not misled or otherwise deceived the consumer.[4]

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[3] 15 U.S.C. §1607(e)(2)(A)-(C).

[4] 15 U.S.C. §1607(e)(2)(D).

REIMBURSEMENT GUIDELINES (cont'd)

Requests for Relief from Reimbursement (cont'd)

The legislative history of TILA does not define the term "unique circumstance"; however, the FDIC considers the term "unique" to have the traditional meaning, including "unusual," "atypical," and "infrequent." Where violations involving the finance charge and APR are concerned, the requirement that the error be "clearly technical and nonsubstantive" generally cannot be met. Technical and nonsubstantive violations do not include those which could affect the outcome of a borrower's decision in credit shopping. See S. Rep. No. 368, 96th Cong., 1st Sess. 16-17 (1979). Congress intended the "technical and non-substantive" exception to be construed very narrowly for use in such situations as clerical or computer errors.[5]

Similarly, where there is an understatement of the finance charge or APR, it is **unlikely** that there will be "no adverse effect on information provided to the consumer" and that the error **would not have** "misled or otherwise deceived the consumer." Thus, it is extremely rare that the conditions contained in the fourth exception are ever met. For example, some recent requests by institutions seeking relief from having to make reimbursement have included some of the following reasons as a defense that the FDIC determined to be unacceptable:

- Consumers did not pay any additional amount because of inaccurate disclosures
- Impact on the institution's reputation in its community
- Size of the institution
- Consumers signed the credit life insurance application, but did not affirmatively indicate a desire to purchase the insurance
- Provider of form/software purchased by institution gave erroneous advice
- Consumers were given new disclosures, but were not provided monetary reimbursement
- Examiners did not cite violation at previous examination

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5 Many violations involve credit life insurance disclosures. Such errors were considered important enough to Congress to form the basis of amendments made to the original version of TILA. See S. Rep. No. 368, 96th Cong., 1st Sess. (1979).

REIMBURSEMENT GUIDELINES (cont'd)

Requests for Relief from Reimbursement (cont'd)

Procedures for Making a Request

If an institution decides to make a request for relief from reimbursement, it should do so within 60 days of receipt of the report of examination containing the request to conduct a file search and make restitution to affected customers. The request should be directed to the attention of the Regional Director (DCA) and must address the statutory factors contained in Section 108(e) of the TILA. The Regional Director will notify the institution of the receipt of the request and that pending a final determination, the institution is not required to complete corrective action on the restitution request.

When restitution must be made, the FDIC expects the institution to carry out the reimbursement to the customer expeditiously according to the Joint Statement of Policy on Restitution adopted on July 11, 1980. When lump sum payments to consumers are required to be made, they must be provided to the consumer either by official check or a deposit into an existing unrestricted consumer asset account, such as an unrestricted savings, checking or NOW account. If, however, the loan is delinquent, in default, or has been charged off, the creditor may apply all or part of the reimbursement to the amount past due, if permissible under law.

There have been instances where institution personnel have inappropriately requested consumers to return reimbursement checks to the institution. This, and any like practice, is not permissible, and the FDIC views any such attempts to prevent unrestricted access by the consumer to reimbursement proceeds as a serious breach of fiduciary duty as well as a violation of law and regulation. These violations will be subject to enforcement actions, including but not limited to, assessment of civil money penalties, orders to cease and desist, and possible removal/prohibition orders.

Required Corrective Action

Under provisions of the Act, a financial institution will generally have no civil liability (Section 130(b)) or regulatory liability (Section 108(e)(6)) if it takes two affirmative corrective actions. Within 60 days of "discovering" an error (but before institution of a civil action or receipt of a written notice of error from a consumer), the financial institution must both:

- Notify the consumer of the error, *and*
- Reimburse the consumer for overcharges

An error is "discovered" if the institution either identifies the error through its own procedures or if it is disclosed in a written examination report.

If the financial institution attempts to correct a disclosure error by merely redisclosing the required information accurately, without reimbursing the Consumer, correction has not been effected. Consumer reimbursement is an inseparable part of the correction action.

REIMBURSEMENT GUIDELINES (cont'd)

Required Corrective Action (cont'd)

The FFIEC Questions and Answers indicate that the institution must make a cash payment or a deposit into an existing unrestricted consumer asset account, such as an unrestricted savings or NOW account in cases involving closed-end credit. In cases involving open-end credit, the agencies (on a case by case basis) may permit creditors to apply the reimbursement to the outstanding balance of an account. However, for both open-end and closed end credit, if the loan is delinquent, in default, or has been charged off, the creditor may apply all or part of the reimbursement to the amount past due, if permissible under law.

Corrective Action Period

Open-end credit transactions will be subject to an adjustment if the violation occurred within the two-year period preceding the date of the current examination, regardless of whether there were intervening examinations during that time period.

Closed-end transactions will be subject to an adjustment if the violation resulted from a clear and consistent pattern or practice or gross negligence where:

- There is an understated APR or understated FC, and the practice giving rise to the violation is identified during a current examination. Loans containing the violation which were consummated since the date of the immediately preceding examination are subject to an adjustment

- There is an understated APR or understated FC, the practice giving rise to the violation was identified during a prior examination and is not corrected by the date of the current examination. Loans containing the violation which were consummated since the financial institution was first notified in writing of the violation are subject to an adjustment. (Prior examinations include any examinations conducted since July 1, 1969.)

Immediately Preceding Examination **-**The agencies now interpret the phrase, "immediately preceding examination" to mean an examination of any type conducted for any purpose by a federal regulatory agency with designated administrative enforcement responsibility under the TILA. However, supervisory visitations, inspections, or other field reviews that are not considered examinations by the agencies are not considered examinations for purposes of applying this definition. An examination of an affiliated entity, such as an operating subsidiary or an institution's holding company is not considered when determining the corrective action time period.

Sometimes several different types of examinations begin on the same day (commonly referred to as concurrent examinations). These examinations may begin in succession, and sometimes they begin several weeks or months apart but within the same examination cycle, based on factors such as the availability of working space for the examination teams, or the express preferences of management.

REIMBURSEMENT GUIDELINES (cont'd)

Corrective Action Period (cont'd)

For purposes of applying the policy change regarding the corrective action time period, the agencies consider a concurrent examination to be one event. Assume, for example, the situation where a safety and soundness examination begins on Monday, a trust examination begins on Tuesday, and the compliance examination starts on Wednesday. Assuming further that the compliance team identifies a pattern or practice of violations triggering the restitution provisions of the TILA. The agencies will consider the immediately preceding examination to be the last completed examination, not the trust examination that began on Tuesday, or the safety and soundness examination that began on Monday.

Similarly, consider an example where an institution's management asks for "concurrent" examinations to be conducted in succession, meaning that the compliance examination should begin after the safety and soundness and/or trust examination field work is completed, or wrapping-up, which could be several months after the start date. The agencies will consider those concurrent examinations to be part of the same examination cycle and will not limit the corrective action time period in such circumstances to the starting date of the safety and soundness or trust examination. Y2K examinations conducted on-site will be considered an examination for purposes of applying the policy of an immediately preceding examination.

Variable-rate transactions consummated after September 30, 1984 where the initial rate is discounted from the index rate used for later adjustments and results in a clear and consistent pattern or practice or gross negligence involving an understated APR or understated FC will be subject to an adjustment.

Each closed-end credit transaction containing a willful violation intended to mislead the consumer consummated since July 1, 1969 is subject to an adjustment.

For terminated loans not previously identified as having an understated APR or FC, an adjustment will not be ordered if the violation occurred in a transaction consummated more than two years prior to the date of the current examination.

Tolerances and Calculation of Reimbursement

Illustrated below are the tolerances to be applied in calculating the amount of the adjustment to a consumer's account.

- For loans involving a willful violation and containing understated APR violations, a tolerance of 1/8% applies

- For loans granted April 1, 1982 or later which contain understated APR violations which did not result from a willful violation:

REIMBURSEMENT GUIDELINES (cont'd)

Tolerances and Calculation of Reimbursement (cont'd)

	Amortized 10 Years or Less	Amortized Over 10 Year
Regular Loans	1/4	1/8
Irregular Loans	1/4	1/4

Nondisclosure of the APR or FC

Nondisclosure of the APR or FC
1. If the APR was not disclosed, use the contract rate.
2. If the contract rate was not disclosed, use the actual APR (calculated by the examiner) less one percent. For first lien mortgage loans, use the actual APR less **percent.**
3. No adjustment will be ordered where a FC was not disclosed.

Improper Disclosure of Insurance

CREDIT LIFE, ACCIDENT, HEALTH, OR LOSS OF INCOME INSURANCE
In general, treatment of credit insurance premiums is covered by Sections 106(b) and (c) of the Act and by Section 226.4 (d) (1) of Regulation Z. It is also covered in Paragraph 4(d) of the Federal Reserve's Official Staff Commentary to Regulation Z.

Required Insurance Coverage

Credit insurance coverage required by the institution as a precedent to obtaining the loan is a cost of credit and must be included in calculations for the APR and FC. Failure to do so may lead to an understated APR and FC.

REIMBURSEMENT GUIDELINES (cont'd)

When credit insurance coverage is not required by the financial institution as a precedent to obtaining a loan, the cost of the insurance premiums are not a cost of credit. They may be excluded from APR and FC calculations only if full credit insurance disclosures are properly made. Failure to do so may lead to an understated APR and FC.

Optional Insurance Coverage

Credit insurance disclosures must be made in writing. Verbal disclosures are not acceptable. *All* three elements of the disclosures must be present:

1. A statement that the insurance coverage is optional and is not required by the financial institution, and

2. The cost of the premium for the initial term of the insurance coverage, and

   Cost

   - In most closed-end loans, insurance must be disclosed as a total dollar amount. However, insurance may be disclosed on a unit-cost basis (for example, $1 per $1,000 of the amount financed):

     -- Where the insurance plan limits the total amount of indebtedness subject to coverage, or

     -- Involving mail or phone transactions without face-to-face or direct telephone solicitation

     See Paragraph 4(d)(4) of Regulation Z's Official Staff Commentary.

   - In open-end credit, insurance is disclosed on a unit-cost basis

   Term

   - If the term of the insurance is less than that of the transaction, the term of the insurance coverage must also be shown

   - If the term is unclear, such as when premiums are paid periodically and the consumer is under no obligation to continue making the payments, premiums may be disclosed on the basis of a one-year period, but the one-year period must be clearly labeled

   Refer to Paragraph 4(d)(11) of Regulation Z's Official Staff Commentary.

3. The customer's signature or initials signifying an affirmative desire for the optional insurance coverage.

REIMBURSEMENT GUIDELINES (cont'd)

Grouping of Insurance Disclosures

Separated disclosures are acceptable. The three required credit insurance disclosures are not required to be located in the "Federal Box" or even on the primary Truth in Lending disclosure form. In addition, they do not need to be grouped together, or even appear on the same page. *Refer* to Footnote 38 to Regulation Z.

Unacceptable Alternatives

Substitute disclosures do not satisfy Truth in Lending requirements. For instance, a consumer's signature at the bottom of the Truth in Lending disclosure form, acknowledging receipt of the form, is not an acceptable substitute for a separate signature or initial specifically affirming a desire for the optional insurance coverage. In a similar manner, coverage of the insurance premiums in the itemization of the finance charge does not substitute for the requirement to state separately the cost of the insurance within the credit insurance disclosure. Likewise, disclosure of separate elements of the disclosures on other forms, such as itemization of the premiums on a HUD-1 form for mortgages, or signing an insurance company's application form, do not satisfy the credit insurance disclosure requirements of Truth in Lending.

Credit Insurance Legal Opinion

In a series of related opinions dated January 29, February 8, and September 5, 1985, the Legal Division indicated that understated APR's and FC's stemming from faulty credit insurance disclosures were reimbursable violations that, by statute, required reimbursement. The opinions indicated that such violations were substantive, and not merely technical, violations. The opinions further stated that, except for the statutory exemptions in Section 108 of the Act, the FDIC must mandatorily require the financial institution to reimburse consumers and could not grant relief from reimbursement.

Obvious Errors

When either the APR or FC was understated and the other was correctly disclosed, Section 108(e)(2)(B) of the Act states that no adjustment will be required if the understated APR or FC was "10 percent or less of the amount that should have been disclosed." This means that the APR or FC is understated by 90% or more of what should have been disclosed, in order to qualify for the "obvious error" exemption from reimbursement.

REIMBURSEMENT GUIDELINES (cont'd)

Current Examination Legal Opinion

Section 108(e)(3)(i) of the Act provides that reimbursement shall not be required by institutions "…except in connection with violations arising from practices identified in the current examination and only in connection with transactions that are consummated after the date of the immediately preceding examination…" This led to various interpretations that FDIC would be "time-barred" from seeking (or ordering) uncompleted reimbursement found in the preceding examination once a subsequent examination took place.

In a March 28, 1989 opinion, the Legal Division concluded that such a time-bar does not apply to this situation. The thrust of the opinion is that the statute's reference to "the current examination" deals with the examination during which the reimbursable violations were found. This examination always remains the "current examination," for purposes of curing the reimbursable violations, until reimbursement is accomplished.

As a result, there is no statutory "time-bar" prohibition against conducting subsequent compliance examinations or visitations which cover Truth In Lending.

Unacceptable Defenses

Since provisions of the Act provide a "decision tree" indicating those points which the FDIC must consider in granting relief from reimbursement, anything outside of the Act's provisions is an unacceptable defense. Some of the more common unacceptable defenses are:

- Size of the institution
- Impact of reimbursement on the institution's reputation
- Previous examinations did not find the violation
- Examiners previously gave erroneous advice
- Redisclosure was made to consumers (but reimbursement was not)

Pattern or Practice

The Truth in Lending Act (Section 108(e)) requires reimbursement when a disclosure error involving an understated APR or finance charge exceeds the allowed tolerance and results from a "clear and consistent pattern or practice of violations." The term "pattern or practice" is not defined by the Act, Regulation Z or the Official Staff Commentary to the Regulation, the Interagency Policy Guide, or the FFIEC's interpretive Questions and Answers. The usual interpretation has been that a "pattern or practice" exists where there are more than isolated occurrences involving violations; however, a determination of whether a "pattern or practice" exists will depend on the facts and circumstances of individual situations.

The statute **does not** require that there be both a pattern **AND** practice to require reimbursement. Generally, patterns and practices, by their nature, are predictable and share a common cause. Isolated violations, on the other hand, do not share a common cause but rather tend to occur randomly by accident. Identifying the underlying cause of the violations is the key for confirming or

REIMBURSE-MENT GUIDELINES (cont'd)

Pattern or Practice (cont'd)

refuting a finding of a pattern or practice leading to he violations. The cause of the violations is generally more important than the absolute number of those violations. However, as the numbers of violations increase, it is more difficult to argue that the violations occurred by chance.

As previously noted, patterns and practices are by their very nature generally predictable and share a common cause. For instance, the FDIC's Board of Directors has considered many cases involving requests for relief from Truth in Lending reimbursement in which it determined that a pattern or practice may occur in one branch office of an institution or because of the actions of one officer of an institution. For example, if an employee responsible for calculating the amount financed does not know how to make that calculation correctly, the employee's error will result in an incorrect disclosed APR, regardless of the tool used to calculate the APR. In that case many of the loans done by that employee will have inaccurate APRs.

Where no specific underlying cause for a violation is easily identifiable, the common source or cause may be a lack of knowledge, training, internal review, or procedural guidance. The frequency of occurrence in such cases would be the key to demonstrating similar conduct to multiple consumers, and therefore the existence of a pattern or practice leading to violations.

Examiners should use the following guidance to determine if a pattern or practice exists for reimbursement purposes during the review of their initial sample of loans:

- If the frequency of a violation represents at least ten percent of the credit transactions sampled that have the same features or that are subject to the same regulatory requirements; **and**
- Within the given category of credit transactions two or more violations of the same type have been identified; then
- Examiners should determine if the cause of the violation is other than a random error. This may require the examiner to expand the sample of types of loans with violations to verify if the hypothesis of a particular pattern or practice is correct. In situations involving small samples where the number or percentage of violations noted are within the lower ranges of the minimum frequency requirements, examiners should <u>always</u> review additional files of the same type (if available) to confirm or refute the initial hypothesis.

Satisfying any one of the following three criteria will help demonstrate the existence of a pattern **OR** practice leading to violations discovered during the sampling process:

- Conduct grounded in written or unwritten policy, procedure or established practice
- Similar conduct by an institution toward multiple consumers
- Conduct having some common source or cause within the institution's control.

REIMBURSEMENT GUIDELINES (cont'd)

Pattern or Practice (cont'd)

Examiners should note that the minimum number of two violations would satisfy the ten percent minimum frequency requirement only in samples containing fewer than 25 loans. In a sample containing 55 loan transactions, at least six violations would be required to demonstrate a ten percent frequency for consideration of a hypothesis that a pattern or practice may exist.

Examiners should be certain that both the number of violations (numerator) and total sample of credit features reviewed (denominator) support their determination. Properly identifying the universe being sampled for the denominator is a key factor in this process.

- For example, samples of unsecured installment loans are normally separated from home mortgage loans, but it may be reasonable to combine them when a violation is discovered that involves the same or similar omission of credit-insurance disclosures, even though the types of loans are quite different. A review of two mortgage loans and three unsecured consumer loans, where credit life insurance was financed as part of the transactions, all lacked the affirmative written request for insurance and accompanying initials or signature, thereby reflecting a pattern or practice leading to the violations.

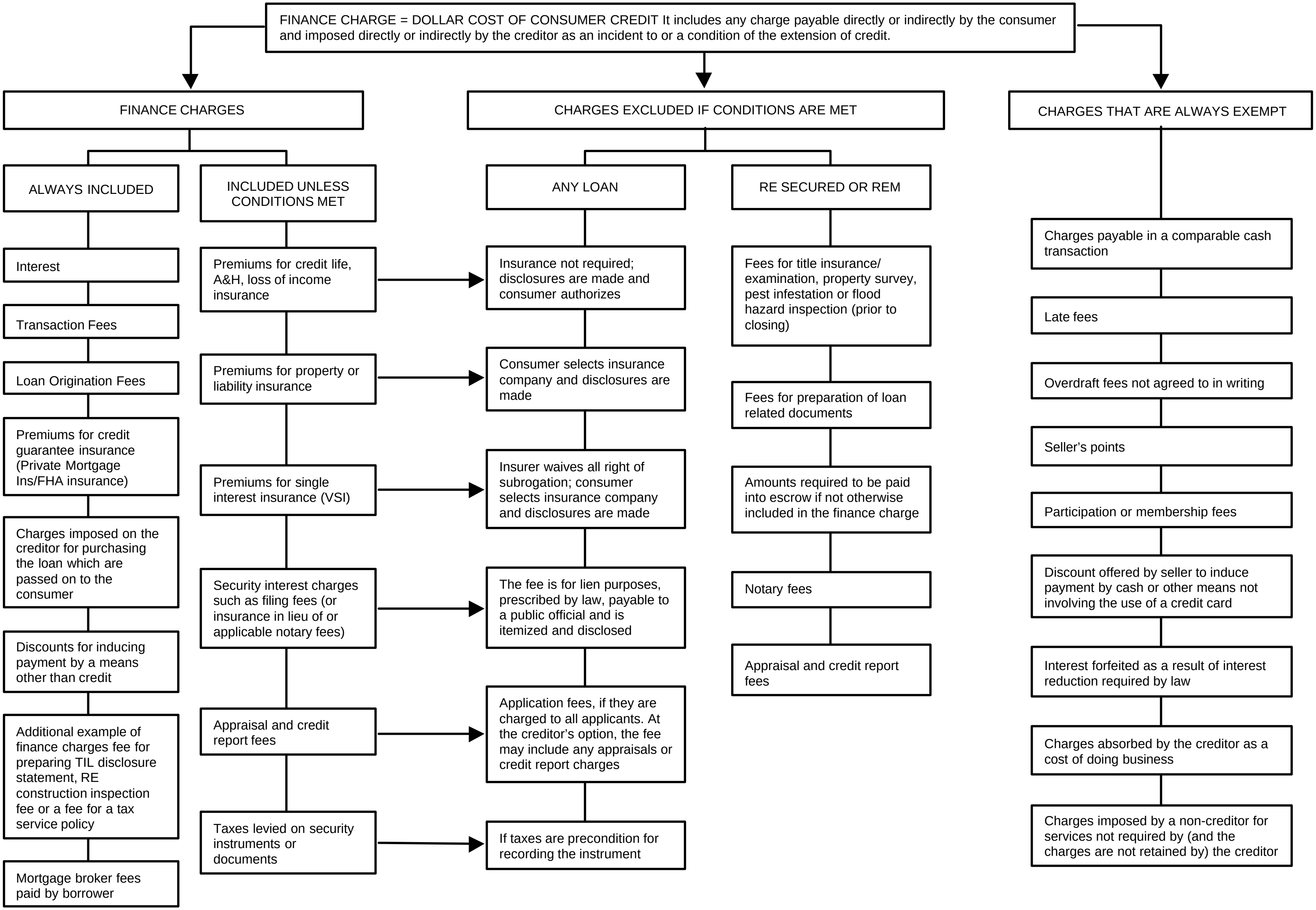
- In other cases, some combinations or separations of samples may be impacted by findings concerning the separation of banking functions, such as between employees or between different branch offices of the institution. For example, it is discovered that a new loan officer in the installment loan area has not been disclosing the amount of the premiums for disability insurance to customers, yet the mortgage loan department provides the correct disclosure when offering that insurance to customers. In this situation, it would be more appropriate to combine the samples from both departments because the cause of the error is solely within the installment loan area and confined to one loan officer.

- In another example, in a review of 65 consumer loans, errors in credit insurance disclosures were discovered in all six loans involving consumer purchases of credit life insurance; however, no errors were discovered in 59 loans where the consumer did not purchase credit insurance. The frequency of violations in this case is 100 percent (six of six instances) as these were the loans where the disclosures were required to be made but were not made correctly.

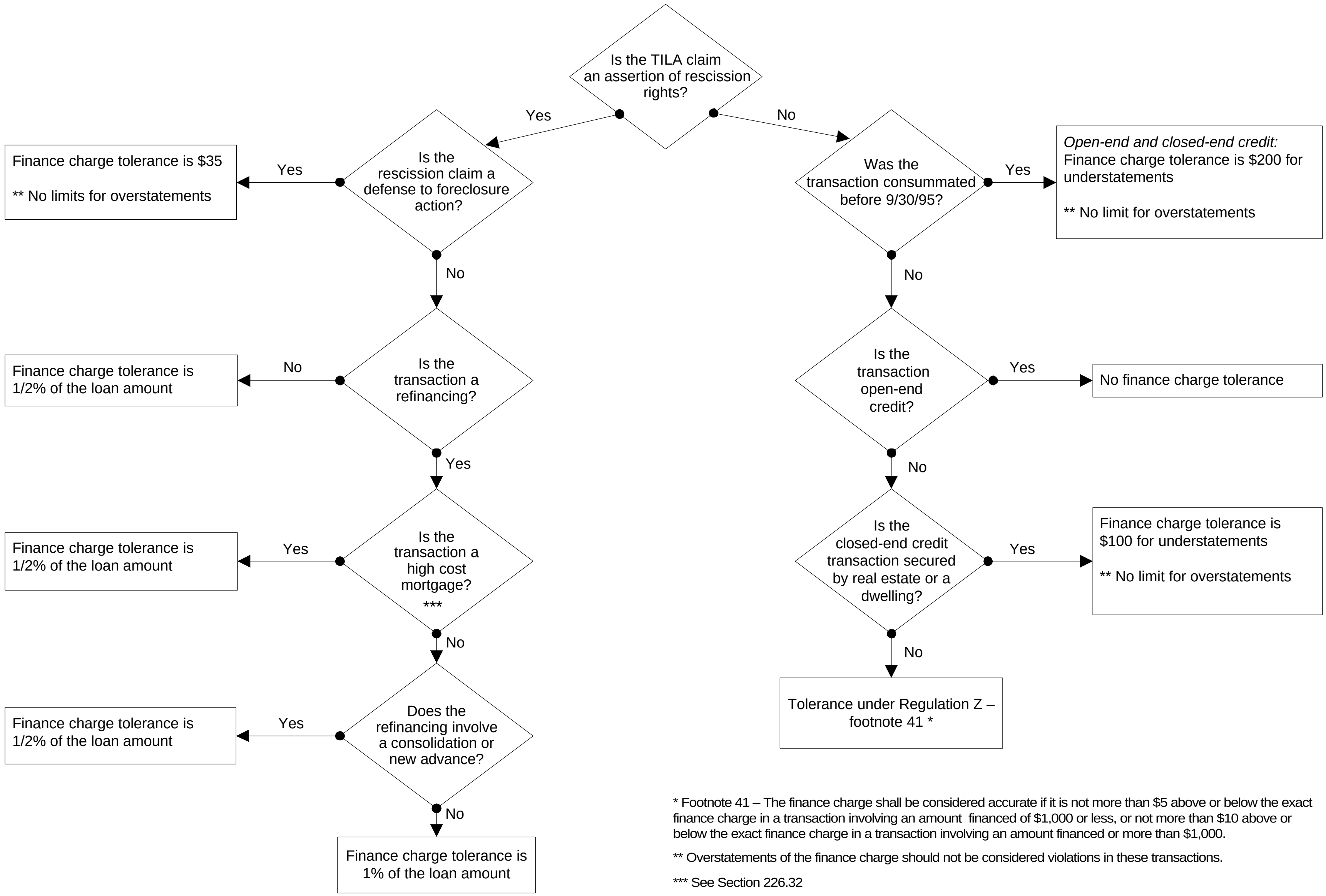
- Another example would be where violations are found involving private mortgage insurance (PMI). To further test whether this error would constitute a pattern or practice, the examiner should sample additional mortgage loans where the purchase of PMI was required. It would not be appropriate to consider loans where PMI was not a requirement for the loan.

In a situation where violations are discovered in some construction loans, it would not be correct to consider all real estate loans as the applicable universe. The universe in that situation should consist of only construction loans to determine whether a particular pattern or practice was the cause of the violation.

EXPLANATION OF FINANCE CHARGE



Post-Rodash Amendments
Finance Charge Tolerances Under Truth in Lending and Regulation Z

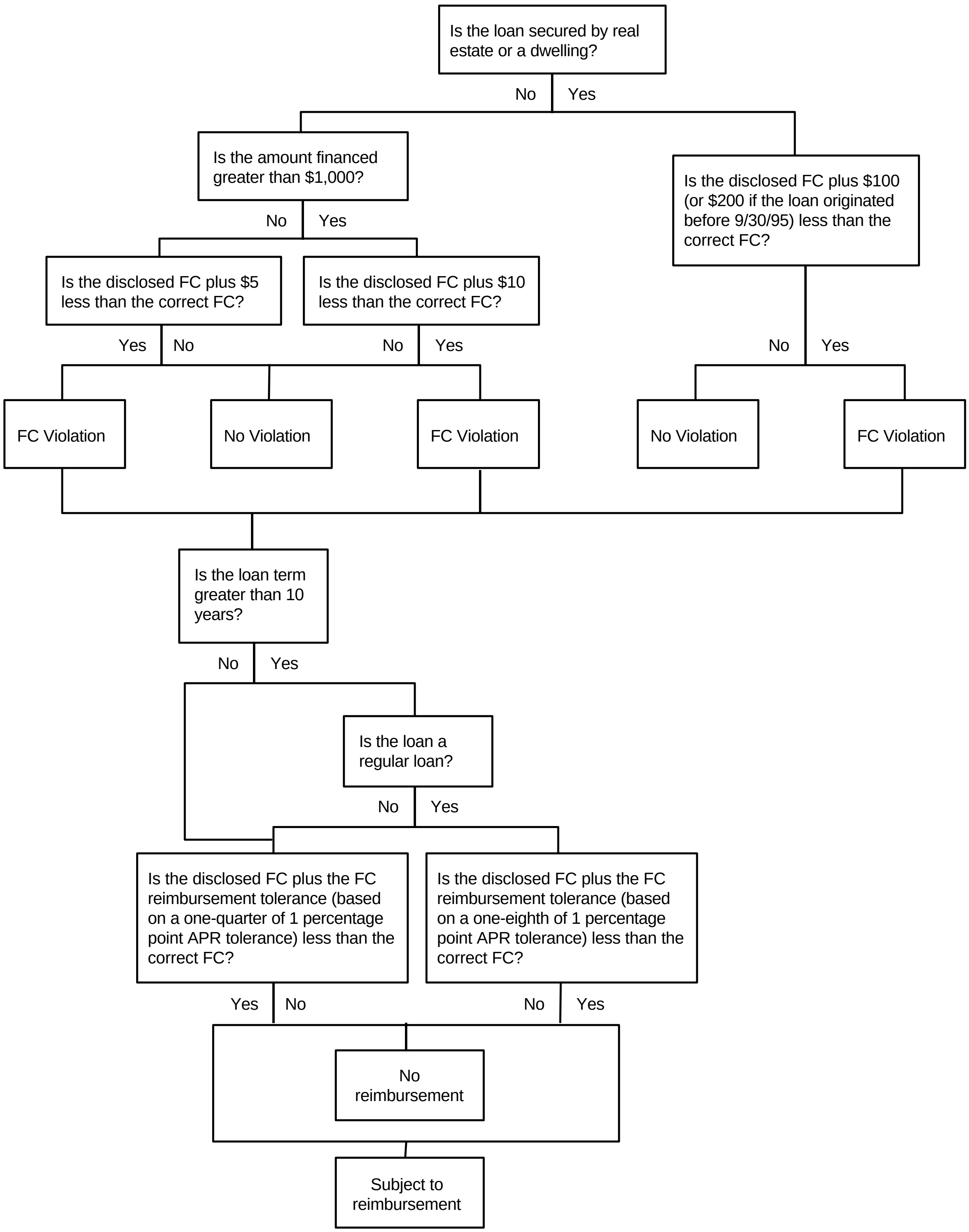


* Footnote 41 – The finance charge shall be considered accurate if it is not more than $5 above or below the exact finance charge in a transaction involving an amount financed of $1,000 or less, or not more than $10 above or below the exact finance charge in a transaction involving an amount financed or more than $1,000.

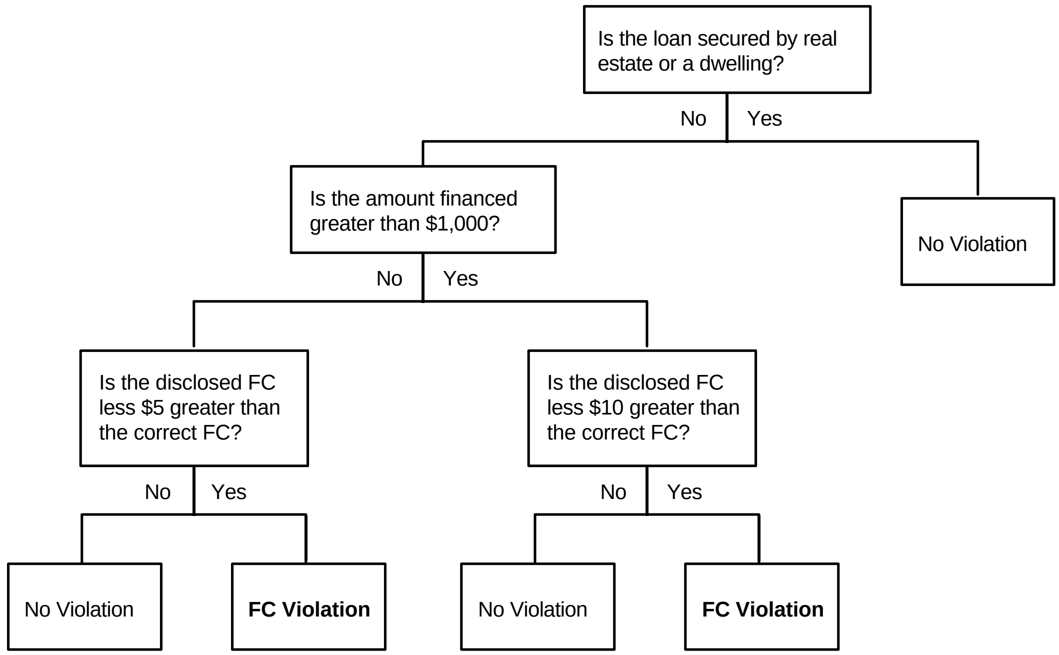
** Overstatements of the finance charge should not be considered violations in these transactions.

*** See Section 226.32

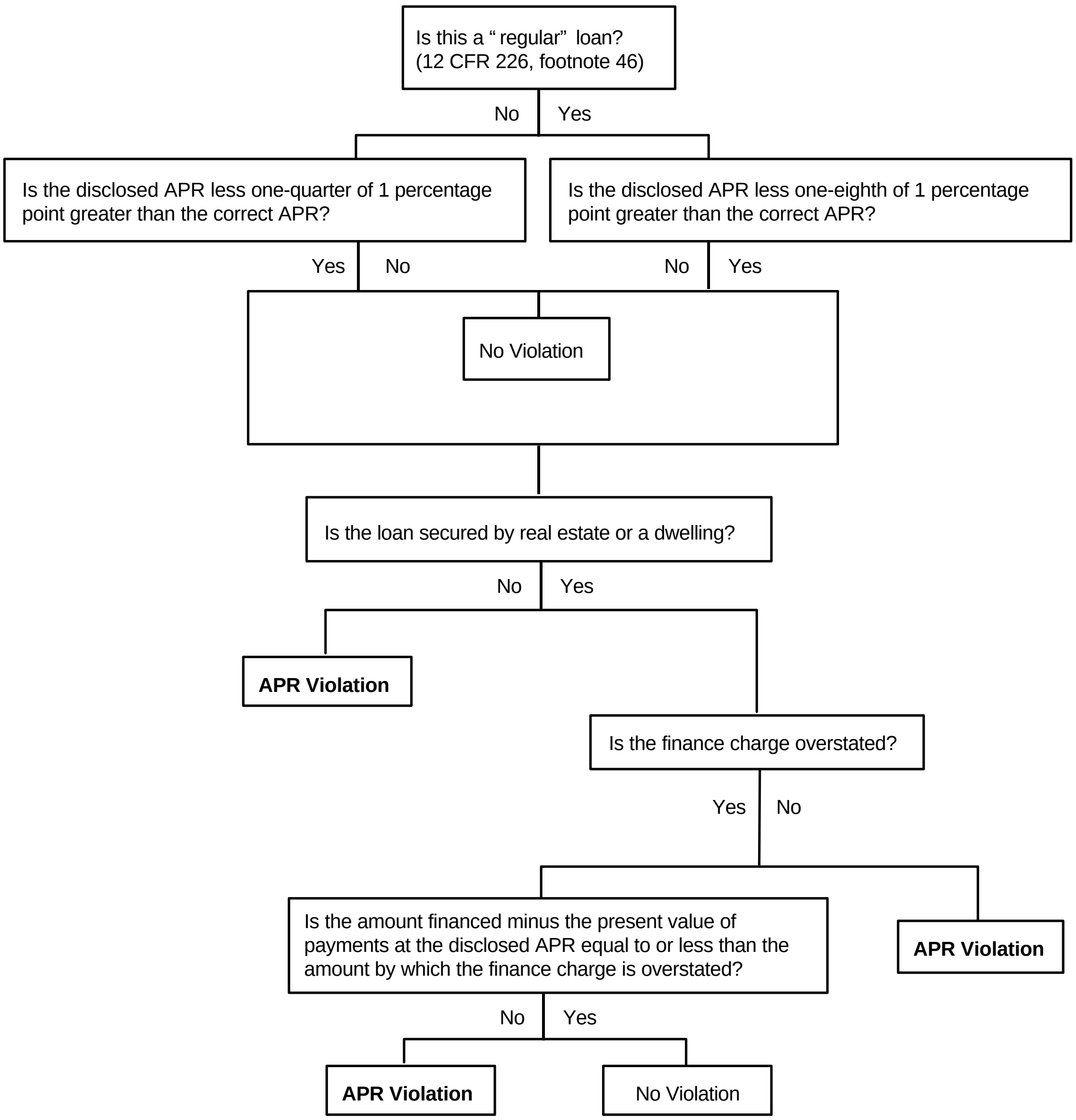
Closed-End Credit: Accuracy and Reimbursement Tolerances for **Understated** Finance Charges



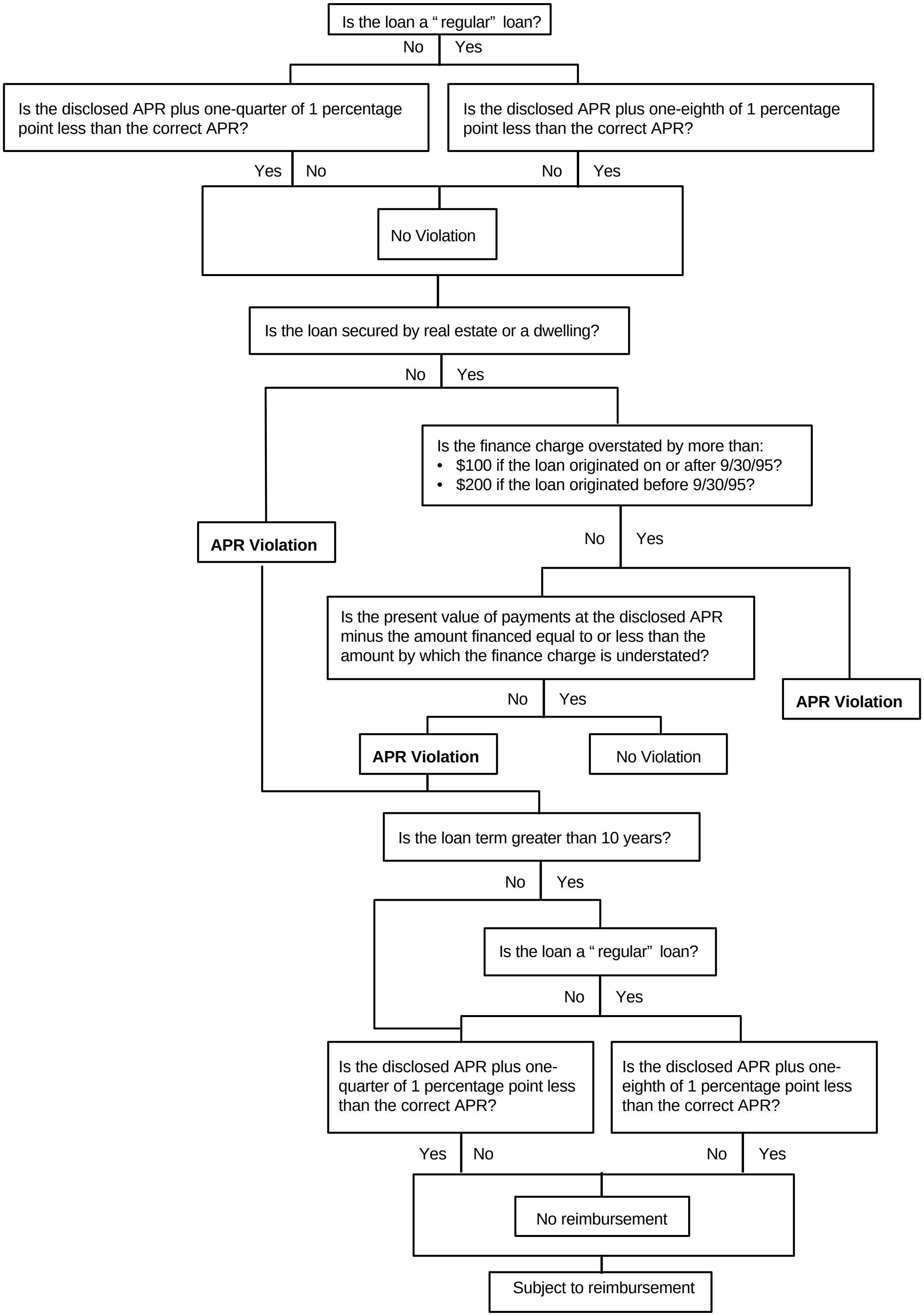
Closed-End Credit: Accuracy Tolerances for **Overstated** Finance Charges



Closed-End Credit: Accuracy Tolerances for **Overstated** APRs



Closed-End Credit: Accuracy and Reimbursement Tolerances for **Understated** APRs



FEDERAL FINANCIAL INSTITUTIONS EXAMINATION COUNCIL
Administrative Enforcement of the Truth in Lending Act - Restitution

ACTION: Notice and request for comment.

SUMMARY: The Consumer Compliance Task Force of the Federal Financial Institutions Examination Council (FFIEC) is issuing a revised Joint Statement of Policy on the Administrative Enforcement of the Truth in Lending Act - Restitution (Policy Statement). The Policy Statement issued by the FFIEC on July 21, 1980 must be revised to reflect the statutory changes to certain provisions of the Truth in Lending Act (TILA) made by the Congress in 1995 and 1996. The staffs of the Office of the Comptroller of the Currency (OCC), the Federal Reserve Board (FRB), the Federal Deposit Insurance Corporation (FDIC), the Office of Thrift Supervision (OTS) and the National Credit Union Administration (NCUA) have prepared this revised Policy Statement to reflect the changes made to the TILA.

DATES: Public comment is invited on a continuing basis.

ADDRESSES: Questions and comments may be sent to Keith J. Todd, Acting Executive Secretary, Federal Financial Institutions Examination Council, 2100 Pennsylvania Avenue NW, Suite 200, Washington, D.C. 20037, or by facsimile transmission to (202) 634-6556.

FOR FURTHER INFORMATION CONTACT:

OCC: Gene Ullrich, National Bank Examiner, Community and Consumer Policy, (202) 874-4866, Office of the Comptroller of the Currency, 250 E Street SW, Washington, D.C. 20219.

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SUPPLEMENTARY INFORMATION:

Background

The Truth in Lending Act Amendments of 1995 and the Economic Growth and Regulatory Paperwork Reduction Act of 1996 amended the TILA to incorporate new tolerances for disclosures of the finance charge and other disclosures affected by the finance charge on certain types of loans. These amendments specify that in closed-end consumer credit transactions secured by real property or a dwelling, the disclosed finance charge and other disclosures affected by the disclosed finance charge shall be treated as accurate if the amount disclosed as the finance charge is overstated, or is understated by no more than $100 for transactions consummated on or after September 30, 1995, or $200 for loans made before that date. The Federal Reserve Board proposed and adopted amendments to Regulation Z in 1996 to implement the statutory changes (12 CFR §226.18(d)(1), §226.18(d)(2), §226.22(a)(4) and §226.22(a)(5)).

The Policy Statement originally issued in 1980 was directly affected by the amendments to the TILA and the changes to Regulation Z in several respects. First, the changes to the tolerances affect the definition for understated annual percentage rates (APR) contained in the Policy Statement. Second, the amendments enhanced the agencies' abilities to make modifications to the amount or timing of restitution in the event that payment of restitution would adversely affect the capital position of the financial institution. In the main, the revisions to the Policy Statement make only those changes necessary to accommodate statutory requirements. Some other editorial changes were made, however, to reflect that some provisions of the original Policy Statement were no longer needed due to the passage of time.

Summary of Changes

The revised Policy Statement drops the definition of "Irregular Mortgage Transaction." The term is used in the Truth in Lending Simplification and Reform Act in the definition of an understated APR for loans secured by dwellings consummated prior to March 31, 1982. There is no longer any need for maintaining a separate definition of this term in the Policy Statement. A footnote has been included in the revised Policy Statement to indicate that, should loans consummated prior to March 31, 1982 having understated APRs be found, the original Policy Statement should be consulted for guidance.

The definition of the term "Understated APR" in the Policy Statement has been modified to reflect revised tolerances for certain real estate secured transactions. The Truth in Lending Amendments of 1995 and the Economic Growth and Regulatory Paperwork Reduction Act of 1996 mandated these revisions. The Policy Statement has also been revised to consolidate six separate sub-parts to the definition of an "Understated APR" into two sub-parts; (1) loans having an amortization schedule of ten years or less, and (2) loans with an amortization schedule of more than ten years.

- Loans having an amortization schedule of ten years or less will be provided a tolerance of 25 basis points (one-quarter of one percent). Loans that are secured by real estate or a dwelling will be provided the tolerances permitted by 12 CFR §226.22(a)(4) and (5).
- Loans having an amortization schedule of more than ten years will be provided a tolerance

of 12.5 basis points (one-eighth of one percent) in the case of a regular transaction and 25 basis points (one-quarter of one percent) in the case of an irregular transaction. Loans that are secured by real estate or a dwelling will be provided the tolerances permitted by 12 CFR § 226.22(a)(4) and (5).

References to 15 U.S.C. §1606(c) contained in the body of the definition of an understated APR in the original Policy Statement have now been moved to footnote 3 in the revised Policy Statement. The change was purely editorial in nature. A new footnote 4 has been added to more specifically identify the sections of Regulation Z (12 CFR § 226.14(a) and § 226.22(a)) that define the requirements for annual percentage rate disclosures.

The Corrective Action Period section of the original Policy Statement contains time frames for determining which loans are subject to adjustment when violations are discovered. Previously, the agencies have collectively taken the position that the phrase "immediately preceding examination" in subsection 2.b. means the most recent examination that precedes the current examination in which compliance with Regulation Z and the Act was reviewed. However, the United States Court of Appeals for the 8th Circuit (First National Bank of Council Bluffs v. Office of the Comptroller of the Currency, 956 F.2d 1456 (8th Cir. 1992)), and the United States Court of Appeals for the Eleventh Circuit, (Consolidated Bank, N.A. v. United States Department of the Treasury, 118 F.3d 1461 (11th Cir. 1997)) determined that the phrase "immediately preceding examination" should be read as referring to an examination of any type conducted immediately prior to the current examination, including examinations in which no review of compliance with Regulation Z or the Act is conducted. Consequently, the agencies, as a matter of policy, will now apply the decisions reached by the Eighth and Eleventh Circuit Courts in carrying out their enforcement responsibilities with respect to the meaning of "immediately preceding examination." No changes to the Policy Statement are necessary to effect this policy position made by the agencies. Additional guidance will be provided to the examination staff for each agency to advise on the proper period for corrective action when violations requiring adjustments are discovered.

In the section of the Policy Statement entitled “Violations Involving the Improper Disclosure of Credit Life, Accident, Health, or Loss of Income Insurance,” the original Policy Statement had a separate provision detailing how certain violations involving credit life insurance disclosures would be treated until March 31, 1982. Since this time period has now expired, that portion of the section has been deleted.

The Economic Growth and Regulatory Paperwork Reduction Act of 1996 provided additional flexibility for the regulatory agencies to require partial or delayed payments for reimbursements by an institution if the payment would cause the institution to become undercapitalized as that term is defined in § 38 of the Federal Deposit Insurance Act. Those provisions are now reflected in the section of the Policy Statement entitled “Safety and Soundness.” That section states that if the results of a full and immediate adjustment required under the Policy Statement would have a significant adverse impact on the capital position of the creditor, the agencies can permit partial adjustments to be made or permit partial payments over an extended period of time.

The text of the revised Policy Statement follows:

ADMINISTRATIVE ENFORCEMENT OF THE TRUTH IN LENDING ACT - RESTITUTION

Joint Statement of Policy

The Depository Institutions Deregulation and Monetary Control Act of 1980 (Pub. L. 96-221) was enacted on March 31, 1980. Title VI of that Act, the Truth in Lending Simplification and Reform Act, amends the Truth in Lending Act, 15 U.S.C. 1601, *et seq.* Section 608 of Title VI, effective March 31, 1980, authorizes the federal Truth in Lending enforcement agencies to order creditors to make monetary and other adjustments to the accounts of consumers where an annual percentage rate (APR) or finance charge was inaccurately disclosed. It generally requires the agencies to order restitution when such disclosure errors resulted from a clear and consistent pattern or practice of violations, gross negligence, or a willful violation which was intended to mislead the person to whom the credit was extended. However, the Act does not preclude the agencies from ordering restitution for isolated disclosure errors.

This policy guide summarizes and explains the restitution provisions of the Truth in Lending Act (Act), as amended. The material also explains corrective actions that the financial regulatory agencies believe will be appropriate and generally intend to take in those situations in which the Act gives the agencies the authority to take equitable remedial action.

The agencies anticipate that most financial institutions will voluntarily comply with the restitution provisions of the Act as part of the normal regulatory process. If a creditor does not voluntarily act to correct violations, the agencies will use their cease and desist authority to require correction pursuant to: 15 U.S.C. 1607 and 12 U.S.C. 1818(b) in the cases of the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision; and 15 U.S.C. 1607 and 12

U.S.C. 1786(e)(1) in the case of the National Credit Union Administration.

Restitution Provisions

Definitions

Except as provided below, all definitions are those found in the Act and Regulation Z, 12 CFR Part 226.

1. "Current examination" means the most recent examination begun on or after March 31, 1980, in which compliance with Regulation Z was reviewed.

2. "Lump sum method" means a method of reimbursement in which a cash payment equal to the total adjustment will be made to a consumer.

3. "Lump sum/payment reduction method" means a method of reimbursement in which the total adjustment to a consumer will be made in two stages:

   a. A cash payment that fully adjusts the consumer's account up to the time of the cash payment; and,

   b. A reduction of the remaining payment amounts on the loan.

4. "Understated APR" means a disclosed APR that is understated by more than the reimbursement tolerance provided in the Act,[1] as follows:

- For loans[2] with an amortization schedule of ten years or less, a disclosed APR which, when increased by the greater of the APR tolerance specified in the Act[3] and Regulation

[1] 15 U.S.C. §1607(e)

[2] For loans consummated after March 31, 1982. For loans consummated prior to that date refer to the Policy Guide dated July 21, 1980 (45 Fed. Reg. 48712) for additional guidance.

[3] 15 U.S.C. §1606(c)

Z[4] or one-quarter of one percent, is less than the actual APR calculated under the Act.[5]

- For loans with an amortization schedule of more than 10 years, a disclosed APR which, when increased by the APR tolerance specified in the Act and Regulation Z (i.e., one-quarter of one percent for irregular loans, one-eighth of one percent for all other closed-end loans) is less than the actual APR.[6]

5. "Understated finance charge" means a disclosed finance charge which, when increased by the greater of the finance charge dollar tolerance specified in the Act and Regulation Z or a dollar tolerance that is generated by the corresponding APR reimbursement tolerance,[7] is less than the

[4] 12 CFR §226.14(a) and §226.22(a)

[5] If, however, the loan is closed-end credit secured by real estate or a dwelling and the APR is understated by more than one-quarter of one percent, the APR will be considered accurate and not subject to reimbursement if: (1) the finance charge is understated but considered accurate in accordance with the Act and Regulation (i.e., the finance charge is not understated by more than $100 on loans made on or after 9/30/95, or $200 for loans made before that date); and (2) the APR is not understated by more than the dollar equivalent of the finance charge error and the understated APR resulted from the understated finance charge that is considered accurate.

[6] If, however, the loan is closed-end credit secured by real estate or a dwelling and the APR is understated by more than one-eighth of one percent, if the transaction is not considered to be an irregular transaction as defined by the Regulation (12 CFR §226.22(a)(3)), or one quarter of one percent if the transaction is irregular according to the definition, the APR will be considered accurate and not subject to reimbursement if: (1) the finance charge is understated but considered accurate according to the Act and Regulation (i.e., the finance charge is not understated by more than $100 on loans made on or after 9/30/95, or $200 for loans made before that date); and (2) the APR is not understated by more than the dollar equivalent of the finance charge error and the understated APR resulted from the understated finance charge that is considered accurate.

[7] The finance charge tolerance for each loan will be generated by the corresponding APR tolerance applicable to that loan. For example, consider a single-payment loan with a one-year maturity that is subject to a one-quarter of one percent APR tolerance. If the amount financed is $5,000 and the finance charge is $912.50, the actual APR will be 18.25%. The finance charge generated by an APR of 18% (applying the one-quarter of one percent APR tolerance to 18.25%) for that loan would be $900. The difference between $912.50 and $900 produces a numerical finance charge tolerance of $12.50. If the disclosed finance charge is not understated by more than $12.50, reimbursement would not be ordered.

finance charge calculated under the Act.

De Minimis Rule

If the amount of adjustment on an account is less than $1.00, no restitution will be ordered. However, the agencies may require a creditor to make any adjustments of less than $1.00 by paying into the United States Treasury, if more than one year has elapsed since the date of the violation.

Corrective Action Period

1. Open-end credit transactions will be subject to an adjustment if the violation occurred within the two-year period preceding the date of the current examination.

2. Closed-end credit transactions will be subject to an adjustment if the violation resulted from a clear and consistent pattern or practice or gross negligence where:

   a. There is an understated APR on a loan which originated between January 1, 1977 and March 31, 1980.

   b. There is an understated APR or understated finance charge, and the practice giving rise to the violation is identified during the current examination. Loans containing the violation which were consummated since the date of the immediately preceding examination are subject to an adjustment.

   c. There is an understated APR or understated finance charge, the practice giving rise to the violation was identified during a prior examination and the practice is not corrected by the date of the current examination. Loans containing the violation which were consummated since the creditor was first notified in writing of the violation are subject to an adjustment. (Prior examinations include any examinations conducted since July 1, 1969).

3. Each closed-end credit transaction, consummated since July 1, 1969, and containing a willful violation intended to mislead the consumer is subject to an adjustment.

4. For terminated loans subject to 2, above, an adjustment will not be ordered if the violation occurred in a transaction consummated more than two years prior to the date of the current examination.

Calculating the Adjustment

Consumers will not be required to pay any amount in excess of the finance charge or dollar equivalent of the APR actually disclosed on transactions involving:

1. Understated APR violations on transactions consummated between January 1, 1977 and March 31, 1980, or

2. Willful violations which were intended to mislead the consumer.

On all other transactions, applicable tolerances provided in the definitions of understated APR and understated finance charge may be applied in calculating the amount of adjustment to the consumer's account.

Methods of Adjustment

The consumer's account will be adjusted using the lump sum method or the lump sum/payment reduction method, at the discretion of the creditor.

Violations Involving the Non-Disclosure of the APR or Finance Charge

1. In cases where an APR was required to be disclosed but was not, the disclosed APR shall be considered to be the contract rate, if disclosed on the note or the Truth in Lending disclosure statement.

2. In cases where an APR was required to be disclosed but was not, and no contract rate was disclosed, consumers will not be required to pay an amount greater than the actual APR reduced

by one-quarter of one percentage point, in the case of first lien mortgage transactions, and by one percentage point in all other transactions.

3. In cases where a finance charge was not disclosed, no adjustment will be ordered.

Violations Involving the Improper Disclosure of Credit Life, Accident, Health, or Loss of Income Insurance

1. If the creditor has not disclosed to the consumer in writing that credit life, accident, health, or loss of income insurance is optional, the insurance shall be treated as having been required and improperly excluded from the finance charge. An adjustment will be ordered if it results in an understated APR or finance charge. The insurance will remain in effect for the remainder of its term.

2. If the creditor has disclosed to the consumer in writing that credit life, accident, health, or loss of income insurance is optional, but there is either no signed insurance option or no disclosure of the cost of the insurance, the insurance shall be treated as having been required and improperly excluded from the finance charge. An adjustment will be ordered if it results in an understated APR or finance charge. The insurance will remain in effect for the remainder of its term.

Special Disclosures

Adjustments will not be required for violations involving the disclosures required by sections 106(c) and (d) of the Act, (15 U.S.C. §1605(c) and (d)).

Obvious Errors

If an APR was disclosed correctly, but the finance charge required to be disclosed was understated, or if the finance charge was disclosed correctly, but the APR required to be disclosed was understated, no adjustment will be required if the error involved a disclosed value which was ten percent or less of the amount that should have been disclosed.

Agency Discretion

Adjustments will not be required if the agency determines that the disclosure error resulted from any unique circumstances involving a clearly technical and non-substantive disclosure violation which did not adversely affect information provided to the consumer and which did not mislead or otherwise deceive the consumer.

Safety and Soundness

In some cases, an agency may order, in place of an immediate, full adjustment, either a partial adjustment, or a full adjustment in partial payments over an extended time period that the agency considers reasonable. The agency may do so if it determines that (1) the full, immediate adjustment would have a significantly adverse impact upon the safety and soundness of the creditor, and (2) a partial adjustment, or making partial payments over an extended period of time, is necessary to avoid causing the creditor to become undercapitalized.[8]

Exemption from Restitution Orders

A creditor will not be subject to an order to make an adjustment if, within 60 days after discovering a disclosure error, whether pursuant to a final written examination report or through the creditor's own procedures, the creditor notifies the person concerned of the error and adjusts the account to ensure that such person will not be required to pay a finance charge in excess of that actually disclosed or the dollar equivalent of the APR disclosed, whichever is lower. This 60-day period for correction of disclosure errors is unrelated to the provisions of the civil liability section of the Act.

[8] The term "undercapitalized" will have the meaning as defined in §38 of the Federal Deposit Insurance Act (12 U.S.C. §1831o).

QUESTIONS AND ANSWERS REGARDING JOINT INTERAGENCY STATEMENT OF POLICY FOR ADMINISTRATIVE ENFORCEMENT OF THE TRUTH IN LENDING ACT – REIMBURSEMENT ISSUED BY THE FFIEC ON JULY 11, 1980 AND REVISED SEPTEMBER 1998.

General

1. Q. Do the enforcement standards and accuracy tolerances in the Policy Guide supersede the requirements of the Truth in Lending Act (Act) and Regulation Z?

   A. No, the Policy Guide applies only to agency enforcement procedures. It does not alter a creditor's responsibility to comply fully with all the requirements of the Act and Regulation Z, including finance charge and annual percentage rate (APR) accuracy requirements.

2. Q. When violations are discovered in purchased or assigned loans that are initially payable to a person other than the financial institution, will the financial institution be ordered to make the necessary adjustments to the accounts of affected customers?

   A. No, the financial institution is not the creditor, even if the obligation by its terms is initially payable to a third party and simultaneously assigned to the financial institution. The violations will be referred to the creditor's enforcing agency.

3. Q. If the creditor must itemize the amount financed but fails to disclose or understates the prepaid finance charge, will reimbursement be required?

   A. No, this violation of Regulation Z will require prospective corrective action only, assuming the prepaid finance charges are properly included in the computation of the APR and finance charge.

4. Q. If APR or finance charge disclosures not required by Regulation Z have been made, will reimbursement be required when such optional disclosures are understated?

   A. No, however, errors in disclosures not required by Regulation Z for a particular transaction are violations of either 12 CFR 226.5(a)(1) or 12 CFR 226.17(a)(1), both of which require that credit disclosures be made clearly and conspicuously.

Definitions

"Current examination"

1. Q. How should the Policy Guide apply to a situation where an examiner, in an examination in progress, discovers that reimbursement had not been undertaken as requested by the enforcement agency following the prior examination? What if the institution states that this examination is the "current examination," thereby requiring it to only make adjustments to those loans found to be in violation and consummated since the prior examination?

   A. TILA does not limit the agencies' authority to require correction of violations detected in earlier examinations and that have not been corrected as of the date of the current examination [see §108(e)(3)(C)(i) of the Act, found at 15 USC 1607(e)(3)(c)(i)]. In addition, if the practice giving rise to the violations identified in the earlier examination has not been corrected, the institution will be required to make adjustments on any loans containing the violation that were consummated since the date it was first notified in writing of the violation and comply with the corrective action already ordered.

"Understated APR"

1. Q. What is meant by "actual APR" and "annual percentage rate calculated in accordance with the Act," as used in the Policy Guide?

   A. Those terms mean the lowest permissible APR that can be computed, applying all applicable provisions of Regulation Z.

De Minimis Rule

1. Q. How should the de minimis rule be applied in closed-end credit transactions?

   A. The de minimis rule should always be applied to the amount of the adjustment calculated under the "lump sum method" of reimbursement as of the maturity date of the transaction, regardless of which reimbursement method is ultimately used by the creditor.

2. Q. How should the de minimis rule be applied in open-end credit transactions?

   A. The de minimis rule should be applied to the total amount of the adjustment calculated for each consumer's account under the "lump sum method" for the period of time from the date of the current examination back to the date of the first occurrence of the violation. However, the total time period may not exceed the two-year period prior to the date of the current examination.

Corrective Action Period

1. Q. Have the agencies changed their position on the time period required for taking corrective action for violations involving closed-end credit?

   A. Yes. Prior to 1997, the agencies took the position that the statutory phrase "immediately preceding examination" (which serves as the cutoff date for retroactive application of a reimbursement requirement) referred to the most recent examination (prior to the current examination) in which compliance with Regulation Z and the Act was reviewed. Because of decisions reached by the Eighth and Eleventh Circuits of the United States Courts of Appeal, the agencies have adopted a new policy. The agencies by policy now interpret the phrase "immediately preceding examination" to mean an examination of any type conducted for any purpose by a federal regulatory agency with designated administrative enforcement responsibility under the TILA. However, supervisory visitations, inspections, or other reviews that are not considered examinations by the agencies are not considered examinations for purposes of applying retroactivity limitation. In addition, an examination of an affiliated entity, such as an operating subsidiary or an institution's holding company, is not considered an examination for purposes of determining the corrective action time period under the Act.

2. Q. What is the effective date of the new policy change regarding the time period for corrective action for violations involving closed-end credit?

   A. The policy change regarding the

corrective action time period was effective as of August 7, 1997.

3. Q. Can an institution terminate the remainder of its restitution obligation to a borrower in light of this change in policy?

A. No. The policy change applies to future and pending cases as of the effective date. There will be no change in reimbursement obligations arising in connection with restitution cases that have been previously resolved. Once the institution makes its decision about the restitution method that it will pursue, it is expected to complete its obligations to affected borrowers as agreed.

For example, under the "Lump Sum/Payment Reduction" method of reimbursement, an institution remits to the borrower a lump sum covering excess money paid to the point that restitution is made, and then reduces future payments to cover the remaining restitution obligation. Under the new policy, the agencies will not permit the institution to terminate its remaining restitution obligation by increasing the borrower's payments to the level they were prior to the restitution action.

4. Q. How will the agencies apply the policy change when "concurrent" examinations are being conducted at a financial institution?

A. Concurrent examinations occur when several different types of examinations begin on the same day or when examinations begin in succession. Concurrent examinations may also begin several weeks or months apart but within the same examination cycle, based on factors such as the availability of working space for the examination teams, or the expressed preferences of the institution's management.

For purposes of applying the policy change regarding the corrective action time period, the agencies consider a concurrent examination to be one event. Assume, for example, the situation where a safety and soundness examination begins on Monday, a trust examination begins on Tuesday, and the compliance examination starts on Wednesday. Assume further that the compliance team identifies a pattern or practice of violations triggering the restitution provisions of the Act. The agencies will consider the immediately preceding examination to be the last completed examination, not the trust examination that began on Tuesday, or the safety and soundness examination that began on Monday.

Similarly, assume an institution's examination is to be conducted in succession, meaning that the compliance examination would begin after the safety and soundness and/or trust examination on site work in the institution is completed, which could be several months after the start date of the concurrent examination. The agencies will consider those concurrent examinations to be part of the same examination cycle for purposes of the policy.

5. Q. Does the policy change limit or otherwise affect the corrective action time period where a practice identified at a prior examination is not corrected by the date of the current examination?

A. No. The Policy Guide and statute provide that if a practice is identified during a current examination and the examiner determines that the same practice was identified during a prior examination but is not corrected by the date of the current examination, the corrective action time period is retroactive to the date of the prior examination in which the violation was identified. This will be true even if there have been intervening examinations that did not review for compliance with the Act and Regulation Z. [see § 108(e)(3)(c)(I) found at 15 USC 1107(e)(3)(c)(I)]

6. Q. Are there any differences in application of the policy change when restitution situations involve open-end credit rather than closed-end credit?

A. Yes. The Act provides different corrective action time periods for open-end and closed-end credit. The policy change applies to restitution situations involving closed-end credit. The corrective action time period for open-end credit covers the 24-month period preceding the date of the current examination, regardless of whether another examination intervenes during that period.

7. Q. What is the corrective action period with respect to terminated closed-end loans if an institution elects to comply voluntarily with the restitution provisions of the Policy Guide, absent a current examination?

A. The Policy Guide states that "for terminated loans... an adjustment will not be ordered if the violation occurred in a transaction consummated more than two years prior to the date of the current examination." If an institution elects to comply voluntarily with the Policy Guide absent a current examination, the financial institution will have the option of either:

(1) Deferring reimbursement on any terminated loans until its regulatory agency conducts a current examination, or (2) Reimbursing on any terminated loans falling within the period prior to the discovery of the violation up to the date of the immediately preceding examination. If that time frame is in excess of two years, then reimbursement may be limited to the two-year period prior to the date of discovery of the violation.

8. Q. How will the Policy Guide apply when loans subject to reimbursement are acquired through a merger, consolidation, or in exchange for the assumption of deposit liabilities?

A. In the case of a merger or consolidation, the receiving institution or the consolidated institution is liable for all liabilities of the merged or consolidating institutions, and the Policy Guide will apply.

In the case of loans acquired in exchange for the assumption of deposit liabilities, the Policy Guide will apply to the original creditor.

Calculating the Adjustment

1. Q. How will disclosures containing information properly estimated under 12 CFR 226.5(c), 12 CFR 226.17(c), and Appendix D be treated for reimbursement determinations and computations?

   A. If an APR or finance charge is in error for any reason other than a properly made estimate, the determination of whether the error constitutes a reimbursable overcharge will be made using the estimated information as disclosed. At the creditor's option, reimbursement will be based on either:

   (1)The actual amount of loan advances, with consideration given to the amount and dates payments were actually made by the borrower; or

   (2) The disclosed amounts of time intervals between advances and between payments.

   The basis selected shall be applied, using the lump sum or lump sum-payment reduction method (at the creditor's discretion), to all loans of the same type subject to reimbursement.

2. Q. If a creditor has failed to reflect private mortgage insurance premiums in the APR or finance charge disclosures, may the institution cancel the insurance after it first reimburses the customer with a lump sum payment to cover the period up to the date of the reimbursement?

   A. The creditor may elect to cancel the insurance if applicable laws and regulations are not violated. The effect of canceling the insurance will be to reduce the amount of the customer's future payments, as permitted by the " lump sum-payment reduction" method of reimbursement.

3. Q. If a creditor has failed to reflect private mortgage insurance premiums in the APR or finance charge disclosures and restitution is required, but the loan has been sold into the secondary market, how should reimbursement be made?

   A. The creditor is responsible for reimbursement, even if the loan has been sold. If its ability to cancel the insurance is limited by terms of the loan sales agreement, the creditor may make payments either to the consumer directly or (if it is agreeable to all parties) to the new owner of the loan. The new owner of the loan would make appropriate adjustments to the account so that the consumer receives the full benefit of the reimbursement.

4. Q. If the creditor failed to include any component of the finance charge (e.g., a loan origination fee) in the APR or finance charge disclosures, may the amount of reimbursement be reduced to account for fees excludable from the finance charge under 12 CFR 226.4(c) which are paid for by such finance charge components?

   A. If the borrower has not otherwise paid such excludable fees (e.g., title insurance fees) to the creditor or to a third party, reimbursement may be computed after first deducting from

B. the finance charge those fees qualifying under 12 CFR 226.4(c).

5. Q. A transaction involves a loan with a term of 36 months, a payment schedule where the first 35 payments are calculated using a 30-year amortization and a balloon amount for the final payment. What tolerance should be used when applying the Policy Guide? One eighth of one-percent or one quarter of one-percent?

A. The applicable tolerance is based on the amortization of the loan. Since the loan is completely amortized within a three-year period (i.e., the 36-month payment schedule), a tolerance of one quarter of one-percent should be used because the amortization period is less than ten years (15 USC 1607(e)(1)).

6. Q. How will the Policy Guide apply if a credit transaction has an interest rate or APR subject to increase and the variable rate feature was not provided on the disclosure statement?

A. If the disclosure statement did not state that the rate would be subject to change, the borrower may be charged only the original APR disclosed. Reimbursement under the Policy Guide will apply only to the period of time in which the borrower made payments at an increased rate.

7. Q. How will the Policy Guide apply if a creditor disclosed that a rate will be prospectively subject to increase, but the APR disclosed or the finance charge disclosed or both were originally understated?

A. The Policy Guide will apply as follows:

(1) If only the APR is understated, reimbursement will be required only for the period of time before the first scheduled change in rate under the variable rate feature in the contract. The term "the first scheduled change in rate" refers to a date on which the rate will change to a level that is unknown or unpredictable at consummation. It does not include changes, such as step-rates, that are agreed upon before consummation.

For example, if the loan terms provide for a 9 percent rate for the first year and a 10 percent rate for the second year, followed by a variable-rate feature to be invoked at the beginning of the third year, reimbursement will apply only to the initial 24-month period. The lump sum-payment reduction adjustment method may be used, using two payment streams for the initial two-year period. Payments after the 24th month would not be affected by the adjustment.

(2) If only the finance charge is understated, reimbursement generally will be required for a period covering the entire life of the loan consistent with the following:

- If a prepaid finance charge was not included in the disclosed finance charge (such as a loan origination fee paid separately by the consumer at loan closing), the entire loan fee (less the applicable dollar tolerance) must be refunded as a "lump sum" payment.

- If, however, the loan fee was financed (included in the loan amount), the finance charge reimbursement may be prorated on a straight-line basis over the life of the loan and refunded under the lump sum/payment reduction method.

However, a finance charge adjustment will be required only for the period of time before the first scheduled change in rate if the error occurred solely because the interest component of the disclosed finance charge was based on either:

(a) The interest to be earned before the first scheduled change in rate, or

(b) The interest to be earned assuming an initial discounted rate over the life of the loan.

For example, the interest component of the disclosed finance charge might incorrectly reflect only loan interest for the first year on a transaction with variable-rate changes scheduled annually. Alternatively, it might incorrectly reflect interest calculated only at an initial discounted variable rate for the full term of the loan. In either case, if the loan terms in the example provide that the variable interest rate is subject to change annually, the finance charge reimbursement will apply only to the initial 12-month period.

The adjustment may be prorated on a straight-line basis over the life of the loan. Reimbursement of prorated amounts covering the period of time after the first scheduled change in rate (after month 12 in this example) would not be required.

(3) If both the APR and finance charge are understated, normally the lump sum finance charge adjustment is compared to the lump sum APR adjustment as of the loan maturity date and the larger adjustment determines which disclosure error is subject to reimbursement. In the case of variable-rate transactions, however, the lump sum APR adjustment used for comparison is calculated for the period of time before the first scheduled change in rate in the manner indicated by (1) above and the finance charge adjustment is calculated in the manner indicated by (2) above.

For example, assume a loan in which both the APR and finance charge are understated on a 30-year, variable-rate loan that calls for rate changes annually. If both understatements were caused by the same failure to take into account a prepaid loan origination fee:

- The APR reimbursement amount is the lump sum value for a 12-month period, which is determined by using the lump sum/payment reduction method and appropriate reimbursement tolerances.

- The finance charge reimbursement amount is the lump sum value for a 360-month period, which is determined by subtracting the appropriate reimbursement tolerance from the amount of the loan fee.

The APR adjustment is compared to the finance charge adjustment to determine the larger of the two. In the example, the finance charge adjustment (and not the APR adjustment) would be reimbursable.

8. Q. If a creditor uses a simple interest rate, which is disclosed as the APR, to compute a monthly payment schedule, and the time interval from the date the finance charge begins to be earned to the date of the first payment is treated as if it were one month, even though that period is greater than one month and is not a "minor irregularity" under 12 CFR 226.17(c)(4), will the Policy Guide apply if the resulting application of the simple interest rate generates a higher finance charge than the one disclosed?

A. The Policy Guide will apply if:

(1) The creditor's method used to compute the payment schedule, as previously described, is also used to compute the disclosed finance charge (i.e., the total of payments less the amount financed); and

(2) The final payment collected or scheduled under the contract (as generated by the application of the simple interest rate to the unpaid principal balance over the life of the loan) is greater than the one disclosed; and

(3) The finance charge resulting from the conditions described under (1) and (2) is understated.

9. Q. Will reimbursement be required for demand loans with disclosures based on a one-year maturity when the demand loan contract calls for periodic payments that will amortize the loan over a definite time period?

A. Yes. A formal amortization schedule recorded in the demand loan contract is, under 12 CFR 226.17(c)(5), equivalent to an alternate maturity date, and disclosures based on the amortization schedule should be made, as opposed to the one-year disclosure.

10. Q. Will reimbursement be required on demand loans when:

(1) An alternate maturity date is disclosed and reflected in the contract, but the finance charge disclosure is based on one year?

(2) There is no alternate maturity date disclosed or reflected in the contract, but the finance charge disclosure is based on a period of time less than one year?

A. In the first case, since there is an alternate maturity date in the contract, which is disclosed, the finance charge disclosure should have been based on that alternate maturity date, as required under 12 CFR 226.17(c)(5), not on the disclosure period to be used when the instrument has no alternate maturity date.

In the second case, the actual finance charge disclosure should have been based on a one-year period, as required by 12 CFR 226.17(c)(5), not on some period less than that required when the instrument has no alternate maturity date.

After considering appropriate tolerances, reimbursement will be required in both cases if:

(1) The disclosed finance charge is less than the actual finance charge for the initial required disclosure period; and

(2) The demand loan has been on the institution's books past the period for which finance charge disclosures were made.

Reimbursement will be calculated for the required disclosure period only. The amount reimbursed to the consumer is the difference between the finance charge actually paid and the finance charge disclosed (which may be increased by the applicable finance charge reimbursement tolerance).

If the demand loan has not been on the institution's books past the period for which finance charge disclosures were made (e.g., the finance charge was disclosed for a one-year period, but should have been disclosed for a five-year period, and only ten months have elapsed), no reimbursement is required. However, if the institution takes no prospective corrective action (i.e., if it does not at least disclose in writing a refinancing of the original loan) and the loan remains on the institution's books past the period for which the original finance charge disclosures were made, reimbursement will be required as previously indicated.

Those concepts apply both to straight and variable rate demand loans whenever the disclosed finance charge is less than the actual finance charge after considering appropriate tolerances.

11. Q. How will the Policy Guide apply to violations of the early disclosure requirements of 12 CFR 226.19(a)?

A. As a general rule, the Policy Guide will not apply to violations involving early Truth in Lending disclosures, but will apply to violations of the pre-consummation disclosures required by 12 CFR 226.17. However, if the creditor has provided erroneous early disclosures and has not made pre-consummation disclosures, the Policy Guide will apply to the erroneous early disclosures.

Methods of Adjustment

1. Q. Must reimbursements resulting from understated finance charges always be made as a single "lump sum" amount?

A. No. Reimbursements resulting from the creditor's failure to include prepaid finance charges in the total finance charge must always be refunded as a "lump sum" payment, but reimbursements resulting from failure to include finance charge components that accrue over time may be prorated on a straight-line basis (no time value) over the life of the loan and refunded under the lump sum/payment reduction method.

2. Q. Must a creditor use one reimbursement method consistently on all affected loans?

A. No. The creditor's right to choose between the two methods (lump sum or lump sum/payment reduction) applies to each transaction.

3. Q. May a creditor apply a lump sum reimbursement to the consumer's loan balance on a loan requiring reimbursement instead of making a cash payment to the consumer?

A. If the loan is a closed-end loan, the creditor must make a cash payment or a deposit into an existing unrestricted consumer asset account such as, an unrestricted savings, NOW, or demand deposit account. However, if the loan is delinquent, in default, or has been charged off, the creditor may apply all or part of the reimbursement to the amount past due, if permissible under law.

If the reimbursement involves an open-end account, the creditor must make a cash payment or a deposit into an existing unrestricted consumer asset account such as an unrestricted savings, NOW, or demand deposit account. However, on a case-by-case basis, the agencies may permit the creditor to credit the consumer's open account by the amount of the reimbursement if the consumer consents. Creditors should be aware that crediting open-end accounts might create credit balances subject to the requirements of 12 CFR 226.11. In addition, if the open-end account is delinquent, in default, or has been charged off, the creditor may apply all or part of the reimbursement to the amount past due, if permissible under law.

4. Q. If a transaction involves more than one consumer, to whom must reimbursement be made?

   A. The reimbursement is the property of, and is to be made to, the primary obligor in the credit transaction. If there is more than one primary obligor, reimbursement must be made jointly. If the primary obligor(s) is deceased, the payment should be made pursuant to the estate and unclaimed property laws of the state. If the creditor is unable to locate the primary obligor(s), after having at least mailed the reimbursement amount to the consumer's last known address, the amount of the reimbursement is subject to the unclaimed property laws of the state.

5. Q. How will the Policy Guide apply to residential mortgage transactions that have been assumed by a third party?

   A. Reimbursement will be made only to the original borrower and only to the extent of overcharges that occurred before the assumption if:

   (1) A reimbursable violation is found on the original borrower's disclosure statement; and

   (2) The original borrower is not released from liability on the loan. The original transaction will be considered terminated with respect to the original borrower on the date of the assumption and the rules for application of the Policy Guide to terminated loans will apply.

   Reimbursement will be made to the original borrower for the period before the assumption occurred if:

   (1) A reimbursable violation is found on the original borrower's disclosure statement; and

   (2) The original borrower is not released from liability on the loan. However, in the event the subsequent borrower defaults and the original borrower must again assume payments on the loan, such payments will be based on the payment amount which would have been calculated under the lump sum-payment reduction method, at the time of reimbursement, had no assumption occurred.

   If a required disclosure to a subsequent borrower contains reimbursable violations, that borrower shall be reimbursed for the period after the assumption occurred, based on the new disclosure.

Non-Disclosure of the APR or Finance Charge

1. Q. How will the Policy Guide apply to loans for which no disclosure statements are on file?

   A. If there is no evidence that the creditor furnished disclosures or if there is a preponderance of evidence that disclosures containing violations subject to reimbursements were destroyed before the record retention period expired, either violation will be treated as a failure to disclose the APR. The creditor will be given the opportunity to substantiate the claim that an accurate disclosure was made before final action is taken. The absence of compliance documentation will be viewed relative to known practices of the creditor for record retention and Regulation Z compliance.

2. Q. How will the Policy Guide apply if a

creditor did not provide required disclosures to the consumer before consummation, but did supply them after consummation?

A. If required disclosures were not provided before consummation of the transaction, the transaction will be viewed as having no APR disclosed and the Policy Guide will apply. If the creditor's failure to provide disclosures included the credit life, accident, and health insurance disclosures, the insurance premiums must be treated as finance charges.

3. Q. Will the Policy Guide apply when a creditor has disclosed the APR as "2% OP" to mean a fluctuating rate of two percent over the prime rate, or has disclosed similar prime rate terminology instead of the APR?

A. If the disclosure statement (not the note) clearly provides the numerical value of the prime rate as it pertains to the credit transaction, as of the time disclosures are given to the consumer, that rate (the prime rate or 2% OP) will be considered to be the disclosed APR under the Policy Guide. If the prime rate is not provided on the disclosure statement, the transaction will be viewed under the Policy Guide as if no APR has been disclosed.

4. Q. Will reimbursement be required on demand loans when the variable rate feature has not been disclosed and the rate is increased?

A. Yes. If the consumer has not been notified in writing of the rate change on or before the date of the change, reimbursement will be required if the financial institution has not made the variable rate disclosures.

Each time the rate is changed and the customer is not given written notification of the new rate, the rate change period(s) will be treated as if no APR had been disclosed, and the Policy Guide will apply. The rate on the most recent notification will serve as the contract rate.

Improper Disclosure of Credit Life, Accident, Health, or Loss of Income Insurance

1. Q. Are the credit insurance provisions of the Policy Guide applicable to terminated loans?

   A. Yes. The credit insurance provisions apply if such loans originated within the Policy Guide's corrective action period for terminated loans.

2. Q. How will the Policy Guide apply if the cost of credit insurance premiums is disclosed as a rate (e.g., as a percentage or in dollars and cents per hundred per month) in a closed-end transaction?

   A. Regulation Z permits creditors to disclose credit insurance premiums on a unit-cost basis in closed-end transactions by mail or telephone under 12 CFR 226.17(g), and in certain closed-end transactions involving an insurance plan that limits the total amount of indebtedness subject to coverage.

   In all other closed-end credit transactions, however, the dollar amount of insurance premiums must be disclosed. If the premium cost in those cases is disclosed as dollars or cents per hundred or as a percentage, it will be treated as if no disclosure of the cost had been made and the Policy Guide will apply accordingly.

3. Q. How will the Policy Guide apply if:

   (1) The creditor does not include premiums for credit life, accident and health insurance in the APR or finance charge disclosures; and

   (2) The creditor fails to disclose the optional nature of the insurance; but

   (3) The creditor has afforded the borrower the option of taking or refusing the insurance by checking a block or initialing a line opposite a statement similar to the following, both of which are disclosed in writing to the borrower: "I desire credit life, accident and health insurance" and "I do not desire credit life, accident and health insurance?"

   A. In those cases, the Policy Guide will apply because the creditor has not disclosed to the customer in writing, as required by 12 CFR 226.4(d)(1)(i), that the credit life, accident and health insurance are optional.

4. Q. How will the Policy Guide apply if:

   (1) The consumer is charged for credit life, accident and health insurance premiums; and

   (2) The creditor did not include the premiums in the APR or finance charge disclosures; and

   (3) The creditor disclosed the optional nature and cost of credit life insurance to the consumer in writing and the customer signed or initialed close to those disclosures; and

   (4) Either no affirmative statement indicating a desire to obtain the insurance was provided or the appropriate box or line was not checked or otherwise marked to indicate whether the customer did or did not desire the insurance?

   A. If the disclosure provided a choice to the customer through statements such as "I desire the insurance" and "I do not desire the insurance" and neither choice has been marked to designate the customer's selection, the Policy Guide will apply because the creditor did not meet the requirements of 12 CFR 226.4(d)(1)(iii).

   If no affirmative statement indicating

a desire to purchase the insurance has been provided, and the customer has only signed or initialed near the optional nature statements or cost disclosures, the Policy Guide will apply because the creditor did not meet the requirements of 12 CFR 226.4(d)(1)(iii).

5. Q. How will the Policy Guide apply if:

(1) The creditor does not include premiums for credit life, accident and health insurance in the APR or finance charge disclosures; and

(2) The creditor provides disclosures stating that the insurance is not required; and

(3) The creditor provides the cost of each type of insurance, with a statement that the customer's signature will indicate a desire to purchase the insurance listed below and the customer signs once, below the cost disclosure, but does not initial each type of insurance desired?

A. If the disclosures clearly indicate that the customer, by signing where indicated, elects to purchase each type of insurance for which the cost has been provided, the Policy Guide will not apply. However, prospectively the creditor shall clarify such disclosures, by obtaining the customer's initials for each type of insurance selected, or by changing the manner in which the customer signs for credit insurance when more than one type is offered.

6. Q. If vendor's single interest (VSI) insurance is written in connection with a credit transaction, the insurance premiums are not included in the finance charge, and the creditor does not obtain a waiver of the right of subrogation from the insurer, is the resulting finance charge understatement subject to reimbursement under the Policy Guide?

A. Yes. However, if the insurer has not exercised such right of subrogation and agrees to prospectively waive that right for outstanding loans, the Policy Guide will not apply to those loans.

Obvious Errors

1. Q. What are examples of Obvious Errors described in the Policy Guide?

A. Consider a situation where the APR is disclosed correctly and the correct finance charge is $600, no adjustment would be required if the amount of the disclosed finance charge is shown as $60 or less. Likewise, if the finance charge is correctly disclosed and the correct APR is 18.568%, no adjustment would be required if the disclosed APR is shown as 1.8568% or less.