Determining Whether TIL Restitution is Required

Overview

This section provides information that relates to the identification of Truth in Lending violations subject to restitution, restitution calculations, and the determination of appropriate corrective action.

Section 108(e)(2) of the Truth in Lending Act (Act) directs that the FDIC shall require "adjustments" (restitution) to consumers for understated annual percentage rates (APR) or finance charges (FC).[1] Unless other statutory or regulatory exemptions are met, the FDIC is required to seek restitution and may not waive or grant relief from restitution. If an institution does not voluntarily comply with the law and make restitution, §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 general, the FDIC must require 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 restitution requirements of §108(e)(2) of the Act. In such instances, a file search may be requested to detect loans containing specific problems requiring restitution.

Historically, the FDIC has treated a request made by nonmember banks seeking relief from making restitution under the Truth in Lending Act, 15 USC §1601 et seq. (TILA), as an application under its regulations. The Board has delegated authority to the Director of the Division of Depositor and Consumer Protection to grant or deny these requests. The Director may further delegate this authority to the Regional Directors, but only to deny requests where the amount of restitution totals less than $25,000.

The TILA grants the enforcement agencies very little discretion to grant relief from restitution for violations. Because of this limited discretion, the FDIC has not been able to grant relief in many instances. Should a nonmember bank wish to pursue a request for relief or reconsideration, the request will be processed within the following time frames:

Regulation Z Request for Relief from Reimbursement		Regional Office	Washington Office
Initial Request	Deny Up to $25,000 aggregate	60 days	NA
	Deny $25,000 and above aggregate	30 days	30 days
	Approve	30 days	30 days
Reconsideration		30 days	30 days

Legal Requirements

Section 108(e) of the TILA, 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. If the exceptions apply, or in cases of similar disclosure errors, an agency may require an adjustment.

There are four instances where the FDIC has discretion to waive restitution. Three of these exceptions are straightforward and fact specific:

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.
4. 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 nonsubstantive;
   - The disclosure violations do not adversely affect information provided to the consumer; *and*
   - The disclosure violations have not misled or otherwise deceived the consumer.

Under provisions of the Act, a financial institution will generally have no civil or regulatory liability if it takes two affirma-

[1] For the purposes of this Manual, when referring to adjustments under Section 108(e)(2) of the Act, the term "restitution" will be used consistently to refer to all reimbursements, adjustments, or credits paid to consumers in connection with violations of the Act.

tive 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*
- Provide restitution to 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 re-disclosing the required information accurately, without providing restitution to the consumer, correction has not been effected. Consumer restitution is an inseparable part of the correction action.

Procedures for Making a Request

If an institution requests relief from restitution, 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 and shall contain a complete and concise statement of the action requested, all relevant facts, the reasons and analysis relied upon as the basis for such requested action, and all supporting documentation. 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.

If the initial request for relief is denied, the institution may petition the FDIC for reconsideration within 15 days of written receipt of the denial by filing a request for reconsideration with the appropriate Regional Director. The FDIC will acknowledge receipt of reconsideration within 15 days and will provide the applicant with written notification of its determination within 60 days of receipt of the request for reconsideration.

Process for Making Restitution

Restitution must be made expeditiously. 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 that triggered restitution is delinquent, in default, or has been charged off, the institution may apply all or part of the restitution to the amount past due, if permissible under law.

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

Determining Whether a Pattern or Practice Exists

The Truth in Lending Act (§108(e)) requires restitution 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.

However, 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.

Examiners should use the following guidance to determine if a pattern or practice exists for restitution 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 always 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.

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 separate 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.

Documenting Reimbursable Truth in Lending Violations

Truth in Lending reimbursable violations will be included under a separate heading, "Truth in Lending Violations Subject to Restitution," in the applicable Level 3 and Level 2 Violations pages. The FOCUS System will code these violations as reimbursable.

In the text of the violation write-up, the following information will be provided to support the presence of a "pattern or practice" for each type of reimbursable Truth in Lending violation:

- Type of loan;
- Special characteristics or features, if any; and
- Number of loans sampled with reimbursement violations.

For violations involving both understated annual percentage rates (APR) and finance charges, the larger of the reimbursable amounts will be identified.

In addition to the above information, the examiners will forward to the Regional Office or Field Office the following for each type of reimbursable violation cited (as applicable):

- APR calculation printouts;
- TRID disclosures;
- Contract note;
- Commitment letter;
- Private mortgage insurance agreements;
- Interest rate indices;
- Trial balances, loan history, or payment record showing first payment and at least one subsequent payment;
- Itemization of amount financed (if separate)/Good Faith Estimate;

- Amortization schedule; and
- Any other documentation supporting adjustments to the amount financed (e.g., credit insurance application forms, payment or rate change notices, etc.)

References

Joint Statement of Policy: Administrative Enforcement of the Truth in Lending Act—Restitution (FFIEC Policy Guide on TILA Restitution)