FEDERAL RESERVE BANK
OF DALLAS

ROBERT D. McTEER, JR.
PRESIDENT
AND CHIEF EXECUTIVE OFFICER

January 2, 1996

DALLAS, TEXAS
75265-5906

Notice 96-01

TO: The Chief Executive Officer of each member bank and others concerned in the Eleventh Federal Reserve District

SUBJECT

Request for Public Comment on Revisions to the Official Staff Commentary to Regulation Z (Truth in Lending)

DETAILS

The Board of Governors of the Federal Reserve System has requested public comment on proposed revisions to the Official Staff Commentary to Regulation Z (Truth in Lending).

The proposed update provides guidance mainly on issues related to reverse mortgages and mortgages bearing rates above a certain percentage or fees above a certain amount. Reverse mortgage transactions provide advances primarily to elderly homeowners and rely principally on the home's value for repayment triggered by a permanent move from the home, death, or sale of the home.

The revisions also address issues of general interest, such as the treatment of debt cancellation contracts and a card issuer's responsibilities when a cardholder asserts a claim or defense relating to a merchant dispute.

The Board must receive comments by February 2, 1996. Comments should be addressed to William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, D.C. 20551. All comments should refer to Docket No. R-0903.

ATTACHMENT

A copy of the Board's notice as it appears on pages 62764-72, Vol. 60, No. 235, of the *Federal Register* dated December 7, 1995, is attached.

This publication was digitized and made available by the Federal Reserve Bank of Dallas' Historical Library (FedHistory@dal.frb.org)

MORE INFORMATION

For more information, please contact Eugene Coy at (214) 922-6201. For additional copies of this Bank's notice, please contact the Public Affairs Department at (214) 922-5254.

Sincerely yours,

Robert D. McTeer, Jr.

FEDERAL REGISTER

December 7, 1995

Pages 62764-72

Request for Comments on

Proposed Revisions to

the Official Staff Commentary

on Regulation Z

(Truth in Lending)

Proposed Rules

Federal Register
Vol. 60, No. 235
Thursday, December 7, 1995

This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

FEDERAL RESERVE SYSTEM

12 CFR Part 226

[Regulation Z; Docket No. R–0903]

Truth in Lending

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Proposed rule; official staff interpretation.

SUMMARY: The Board is publishing for comment proposed revisions to the official staff commentary to Regulation Z (Truth in Lending). The commentary applies and interprets the requirements of Regulation Z. The proposed update provides guidance mainly on issues relating to reverse mortgages and mortgages bearing rates above a certain percentage or fees above a certain amount. It also addresses issues of general interest, such as the treatment of debt cancellation contracts and a card issuer's responsibilities when a cardholder asserts a claim or defense relating to a merchant dispute.

DATES: Comments must be received on or before February 2, 1996.

ADDRESSES: Comments should refer to Docket No. R–0903, and may be mailed to William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, DC 20551. Comments also may be delivered to Room B–2222 of the Eccles Building between 8:45 a.m. and 5:15 p.m. weekdays, or to the guard station in the Eccles Building courtyard on 20th Street, N.W. (between Constitution Avenue and C Street) at any time. Comments may be inspected in Room MP–500 of the Martin Building between 9:00 a.m. and 5:00 p.m. weekdays, except as provided in 12 CFR 261.8 of the Board's rules regarding the availability of information.

FOR FURTHER INFORMATION CONTACT: For Subparts A and B (open-end credit), Jane Jensen Gell or Obrea O. Poindexter, Staff Attorneys; for Subparts A, C and E (closed-end credit, reverse mortgages, and mortgages bearing rates or fees above a certain percentage or amount), Jane Ahrens, Senior Attorney, or Kyung Cho-Miller, Kurt Schumacher, or Manley Williams, Staff Attorneys, Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, at (202) 452–3667 or 452–2412. For users of Telecommunications Device for the Deaf (TDD) only, please contact Dorthea Thompson, at (202) 452–3544.

SUPPLEMENTARY INFORMATION:

I. Background

The purpose of the Truth in Lending Act (TILA; 15 U.S.C. 1601 *et seq.*) is to promote the informed use of consumer credit by requiring disclosures about its terms and cost. The act requires creditors to disclose credit terms and the cost of credit as an annual percentage rate (APR). The act requires additional disclosures for loans secured by a consumer's home, and permits consumers to cancel certain transactions that involve their principal dwelling. It also imposes limitations on some credit transactions secured by a consumer's principal dwelling. The act is implemented by the Board's Regulation Z (12 CFR part 226). The Board also has an official staff commentary (12 CFR part 226 (Supp. I)) that interprets the regulation, and provides guidance to creditors in applying the regulation to specific transactions. It is updated periodically to address significant questions that arise, and is a substitute for individual staff interpretations. The Board expects to adopt amendments in final form in March 1996 with compliance optional until October 1, 1996, the effective date for mandatory compliance.

On March 24, 1995, the Board published amendments to Regulation Z implementing the Home Ownership and Equity Protection Act of 1994, contained in the Riegle Community Development and Regulatory Improvement Act of 1994, Public Law 103–325, 108 Stat. 2160 (60 FR 15463). These amendments, which became effective on October 1, impose new disclosure requirements and substantive limitations on certain closed-end mortgage loans bearing rates or fees above a certain percentage or amount. The amendments also impose new disclosure requirements for reverse mortgage transactions, which provide advances primarily to elderly homeowners and rely principally on the home's value for repayment. In large measure, the proposed commentary incorporates the supplementary information accompanying that rulemaking, and addresses other issues that have arisen since the publication of the final rule.

The Congress recently amended TILA provisions concerning finance charge disclosures for home mortgage loans. The Truth in Lending Act Amendments of 1995 ("1995 Act," Public Law 104–29, 109 Stat. 271) clarify the treatment of several fees typically associated with real estate-related lending, and revise tolerances for finance charge calculations for loans secured by real estate or dwellings. The statutory amendments, which were enacted in response to a number of lawsuits, also address consumer remedies for creditors' past and future disclosure violations. The 1995 Act became effective immediately for provisions relating to tolerances, past and future liability, and the exclusion of certain closing costs from the finance charge calculation. The statutory amendments that exclude certain real estate related closing costs from the finance charge generally codify interpretations previously issued by the Board, and no further revisions to the commentary are contemplated at this time.

Another statutory provision categorizes all brokers fees paid by the consumer to the broker (or to the creditor for delivery to the broker) as finance charges; this provision will become effective 60 days after the Board issues a final rule or no later than 12 months after enactment of the amendments to the act. It is anticipated that the Board will issue a proposed amendment to Regulation Z addressing brokers fees during the first quarter of 1996, and will make any changes to the commentary relating to the treatment of brokers fees as part of that rulemaking.

II. Proposed Commentary

Subpart A—General

Section 226.4—Finance Charge

4(a) Definition

Proposed comment 4(a)–8 addresses the treatment of fees charged in connection with debt cancellation agreements. In the case of motor vehicle loans, debt cancellation agreements (sometimes referred to as "gap"

agreements) offer protection to consumers in the event the vehicle is stolen or destroyed and the motor vehicle insurance proceeds are insufficient to extinguish the debt. Under these agreements, in return for a fee paid, the consumer is not held liable for the remaining balance due on the loan. Other types of agreements may provide for debt cancellation if the borrower dies or becomes disabled. In some states, debt cancellation agreements may be regulated as or otherwise considered insurance contracts.

The Board has received questions from creditors about the proper treatment of fees for debt cancellation agreements. Section 226.4(d) allows a creditor to exclude optional credit life and certain property insurance premiums from the finance charge if the creditor meets certain conditions, including disclosure of the premium. Some creditors believe that debt cancellation fees should uniformly be treated as § 226.4(d) insurance premiums under the regulation. These creditors generally believe that the fees for optional debt cancellation contracts should be excluded from the finance charge. An alternative view is that the fees may be treated as insurance premiums only if the contract is considered insurance under state law.

Proposed comment 4(a)–8 follows the state law analysis. The proposed comment provides that if a debt cancellation agreement is regulated as or considered insurance under state law, the fee may be excludable from the finance charge in accordance with the rules in § 226.4(d). That is, under the proposed comment the fee may be excludable if the insurance is properly characterized as credit life, accident, health or loss-of-income insurance as specified in § 226.4(d)(1), or as insurance against loss of or damage to property, or against liability arising out of the ownership or use of property as specified in § 226.4(d)(2). Insurance protecting the creditor against credit loss is a finance charge. (See § 226.4(b)(5) and accompanying commentary.)

If state law does not regulate or consider the agreement to be insurance, then the general rules in § 226.4(a) apply. Under § 226.4(a), debt cancellation fees paid to a creditor are treated as finance charges because they are charged by the creditor as an incident to the extension of credit and, although optional, the fees are not of a type payable in a comparable cash transaction.

4(d) Insurance

Comment 4(d)–5 would be revised to clarify that insurance is deemed to be required—and the premiums treated and disclosed as finance charges—when a consumer has several alternatives to fulfill a condition to a credit extension, one of which is to purchase insurance from the creditor and the consumer elects that option. For example, where, as a condition to obtaining a credit card, a consumer must purchase a life insurance policy from the creditor, assign an existing policy, or pledge another form of security, such as a certificate of deposit, if the consumer purchases the insurance from the creditor, the premiums are finance charges.

Subpart B—Open-end Credit

Section 226.6—Initial Disclosure Statement

6(b) Other Charges

Comment 6(b)–1 would be revised to state that a membership fee to join an organization is an "other charge" if the primary benefit of membership is the opportunity to apply for a credit card and other benefits are incidental. For example, if an organization offers, in addition to the opportunity for a credit card account, only minor benefits such as a newsletter and a member information hotline, a fee to join the organization should be disclosed as an "other charge."

Section 226.12—Special Credit Card Rules

12(c) Right of Cardholder to Assert Claims or Defenses Against Card Issuer

12(c)(2) Adverse Credit Reports Prohibited

Proposed comment 12(c)(2)–2 provides guidance on when a card issuer may consider a dispute settled for purposes of reporting an amount in dispute as delinquent. Until the card issuer conducts a reasonable investigation, the disputed amount may not be collected or reported as delinquent.

Section 226.14—Determination of Annual Percentage Rate

14(c) Annual Percentage Rate for Periodic Statements

Comment 14(c)–10 would provide guidance on calculating the APR on periodic statements when a transaction occurs at the end of one cycle, but is posted to the account in a subsequent cycle, such as when a cardholder obtains a cash advance (for which there is a transaction fee) on the last day of a billing cycle and the transaction is posted to the cardholder's account on the second day of the following cycle. The transaction (and fee, if applicable) are included on the statement reflecting the cycle in which the transaction posted, and the proposed comment clarifies how creditors calculate the APR to reflect the delay in posting.

Subpart C—Closed-end Credit

Section 17—General Disclosure Requirements

17(c) Basis of Disclosure and Use of Estimates

Paragraph 17(c)(1)

Comment 17(c)(1)–10 would be revised to clarify that if a contract for a variable rate transaction provides for a delay in the implementation of changes to an index value, the creditor may use any index value in effect during the delay period. For example, if a contract specifies that rate changes are based on the index value in effect 45 days before the change date, the creditor may use any index value in effect within that 45-day delay period.

Proposed comment 17(c)(1)–18 addresses pawn transactions. There has been some confusion about the coverage and compliance of pawn transactions under the TILA. The comment clarifies how some of the items required to be disclosed under § 226.18 such as the amount financed, the finance charge, and the percentage should be disclosed. Disclosure of these transactions under the open-end credit provisions is not addressed based on the belief that typically pawn transactions are not open-end credit transactions.

Section 18—Content of Disclosures

18(c) Itemization of Amount Financed

Paragraph 18(c)(1)(iii)

Proposed comment 18(c)(1)(iii)–2 concerns the treatment of certain charges known as "upcharges" that creditors may sometimes add to a fee charged by a third party for services such as maintenance and service contracts on automobiles. The comment, which only applies in cases where a creditor charges the same amount of an upcharge in both cash and credit transactions, offers flexibility in how creditors can choose to itemize and disclose the amount charged for the service (including the amount of the upcharge). The treatment of these fees for purposes of disclosures under the TILA does not govern the imposition or amount of such upcharges.

Section 226.20—Subsequent Disclosure Requirements

20(a) Refinancings

The Board has been asked whether certain actions constitute adding a variable-rate feature for purposes of this section. Comment 20(a)–3 would be revised to clarify that changing the index on a variable-rate transaction is not adding a variable-rate feature, nor is substituting an index for one that no longer exists.

Subpart E—Special Rules for Certain Home Mortgage Transactions

Section 226.31—General Rules

31(c) Timing of Disclosures

31(c)(1) Disclosures for Certain Closed-end Home Mortgages

Numerous creditors have suggested that the rule for furnishing disclosures should be deemed to be satisfied as long as the creditor places the disclosures in the mail three days prior to consummation. The word "furnish" for purposes of § 226.32 disclosures has the same meaning as "deliver" for the other disclosure requirements of Regulation Z. Accordingly, proposed comment 31(c)(1)–1 clarifies that disclosures are furnished, or delivered, when received by the consumer, not when mailed by the creditor.

Proposed comment 31(c)(1)–2 clarifies that creditors may rely on the definition of "business days" in comment 2(a)(6)–2 for purposes of complying with the timing requirements for furnishing disclosures under this section.

31(c)(1)(i) Change in Terms

Proposed comment 31(c)(1)(i)–1 clarifies that a creditor must provide new § 226.32(c) disclosures if a change in terms (whether in the formal written agreement or otherwise, such as an oral agreement affecting the amount of a fee required to be paid at closing) makes the previously provided disclosures inaccurate.

31(c)(1)(iii) Consumer's Waiver of Waiting Period Before Consummation

Proposed comment 31(c)(1)(iii)–1 provides guidance on circumstances in which the consumer may modify or waive the right to the three-day waiting period to meet bona fide personal financial emergencies. Generally, whether a bona fide personal financial emergency exists is a matter to be decided between the parties. The provisions in comments 23(e)–1 and 34(e)–2 apply to this section. For example, a consumer's waiver does not automatically insulate the creditor from liability for failing to provide the three-day waiting period.

31(c)(2) Disclosures for Reverse Mortgages

Proposed comment 31(c)(2)–1 clarifies the definition of "business day" for purposes of providing reverse mortgage disclosures to consumers.

31(d) Basis of Disclosures and Use of Estimates

Section 226.31(d) mirrors the provisions in § 226.5(c) and § 226.17(c), and allows the use of estimates when information necessary for an accurate disclosure is unknown to the creditor, provided that the disclosure is clearly identified as an estimate. Proposed comment 31(d)–1 clarifies that when a disclosure required by § 226.32 is marked as an estimate and becomes inaccurate due to a change in terms that occurs before consummation, new disclosures must be provided.

Section 226.32—Requirements for Certain Closed-end Home Mortgages

32(a) Coverage

Paragraph 32(a)(1)(i)

Proposed comment 32(a)(1)(i)–1 clarifies when an application is received, for purposes of determining which Treasury securities yield should be used to compare the APR. Proposed comment 32(a)(1)(i)–2 provides guidance on comparing loan maturities to yields on Treasury securities, for purposes of determining whether a mortgage loan is covered by § 226.32. Proposed comment 32(a)(1)(i)–3 clarifies rules for calculating the APR for variable-rate, discount, premium, or stepped-rate loans.

Proposed comment 32(a)(1)(i)–4 clarifies which Treasury security to use for the APR test, and where the yields on these securities can be found. Creditors may request the Board statistical release H–15 by calling (202) 452–3245. Treasury security yields are also available from the Federal Reserve Bank of New York by calling (212) 720–6619.

Paragraph 32(a)(1)(ii)

Creditors must follow the rules in § 226.32 if, in part, the total points and fees payable by the consumer at or before loan closing exceed the greater of $400 or 8 percent of the total loan amount. The Board is required to adjust the $400 amount, based on the annual percentage change in the Consumer Price Index as reported on June 1, effective January 1 of the following year. The Board anticipates that adjustments to the $400 dollar figure will be published each yearend and incorporated into the commentary the following spring.

Paragraph 32(b)(1)

Paragraph 32(b)(1)(i)

Comment 32(b)(1)(i)–1 clarifies the scope of items defined as finance charges under § 226.4 that are considered "points and fees."

Paragraph 32(b)(1)(ii)

Proposed comment 32(b)(1)(ii)–1 addresses the treatment of mortgage brokers fees. Section 226.32(b)(1) defines "points and fees" to include all finance charges (except interest or the time-price differential), as well as all compensation paid to mortgage brokers. Accordingly, compensation paid to a mortgage broker must be included as "points and fees" even if the amount is not disclosed as a finance charge.

Section 32(b)(1)(ii) at the time it was issued was interpreted to include all mortgage broker fees that are required to be disclosed under the Real Estate Settlement Procedures Act. Under that interpretation, amounts paid by creditors to mortgage brokers would be included, as are amounts paid by consumers. Upon further analysis, a narrower interpretation is being proposed. Proposed comment 32(b)(1)(ii)–1 states that for purposes of the "points and fees" test, only mortgage broker fees paid by the consumer are included in the calculation. The comment further clarifies that mortgage broker fees should not be double counted; that is, where such fees are included in the finance charge, they are already included as "points and fees" under § 226.32(b)(1)(i) and should not be counted again under § 226.32(b)(1)(ii).

32(c)(3) Regular payment

Proposed comment 32(c)(3)–1 clarifies that the regulation contemplates the disclosure of monthly or other regularly scheduled periodic payments, such as bimonthy or quarterly. The comment also clarifies that there must be at least two payments, and they must be in an amount and occur at such intervals that the payments fully amortize the loan. For the amount of the payment, proposed comment 32(c)(3)–2 clarifies that creditors may rely on § 226.18(g) for guidance.

32(c)(4) Variable-rate

Proposed comment 32(c)(4)–1 provides additional guidance on calculating "worst-case" payment examples when the transaction has more than one payment stream.

32(d) Limitations

32(d)(1)(i) Balloon Payment

The statute and regulation prohibit the use of balloon payments for mortgages covered by § 226.32 that have a term of less than five years. For such loans, the repayment schedule must fully amortize the outstanding principal balance through "regular periodic payments." The proposed comment provides guidance on the definition of "regular periodic payments."

32(d)(2) Negative Amortization

Proposed comment 32(d)(2)–1 clarifies that the prohibition against including negative amortization in a mortgage covered by § 226.32 does not extend to increases in the principal balance unrelated to the payment schedule, such as an increase related to the purchase of force-placed insurance.

32(d)(4) Increased Interest Rate

Proposed comment 32(d)(4)–1 clarifies that a rate increase in a variable-rate transaction is not prohibited by the act or regulation, even if the rate increases after the consumer has defaulted on the obligation.

32(d)(5) Rebates

Section 226.32(d)(5) restricts how creditors may calculate refunds of interest when a mortgage loan subject to this section is accelerated due to a consumer's default. The proposed comment clarifies that this restriction applies to refunds of interest only, and not to refunds of other items such as origination fees or points. In addition, the proposed comment clarifies that the refund calculation includes odd-days interest, regardless of when it is paid.

32(d)(7) Prepayment Penalty Exception

Proposed comment 32(d)(7)–1 provides guidance on calculating a consumer's debt-to-income ratio. Proposed comment 32(d)(7)–2 clarifies that verification of employment satisfies the regulation's requirement that the creditor obtain "payment records for employment income."

32(e) Prohibited Acts and Practices

32(e)(1) Repayment Ability

For mortgage loans subject to § 226.32, the regulation prohibits creditors from engaging in a pattern or practice of extending such credit based on the consumer's collateral without regard to the consumer's repayment ability, including the consumer's current and expected income, current obligations, and employment. Proposed comment 32(e)(1)–1 provides guidance on determining the consumer's repayment ability. The comment clarifies that creditors may rely on the same information provided by the consumer in connection with § 226.32(d)(7), or other information, including information about unverified income.

Section 226.33—Requirements for Reverse Mortgages

The U.S. Department of Housing and Urban Development (HUD) has modified its software regarding reverse mortgages originated under the Home Equity Conversion Mortgage (HECM) program to conform with the requirements and the terminology used for reverse mortgages under Regulation Z and the appendices to the regulation. (The HECM program has been temporarily suspended, pending the reauthorization of funding by the Congress.) For example, HUD's software now allows creditors to use the initial interest rate, rather than the "expected interest rate," in calculating the total annual loan cost rate for a variable-rate transaction. Although creditors may find HUD's software helpful in meeting the disclosure requirements under Regulation Z, they should first take steps to verify the accuracy of the software, including any instructions, before using it. Neither HUD nor the Board provides a "safe harbor" to creditors regarding use of this software.

33(a) Definition

Proposed comment 33(a)–1 addresses an implication relative to the definition of a reverse mortgage transaction under the regulation. If a transaction structured as a reverse mortgage loan is a recourse transaction (that is, one that imposes personal liability on the consumer for the difference between the loan balance at maturity and the value of the property), it is not a reverse mortgage under § 226.33. Thus, if the transaction is also closed-end, and the annual percentage rate or the points and fees assessed in the transaction exceed those specified in § 226.32(a)(1), the transaction is covered by § 226.32. Such transactions may not generally contain a balloon payment or negative amortization (both of which are found in reverse mortgages by definition). Open-end credit plans are exempt from the provisions of § 226.32(a).

33(c)(2) Payments to Consumer

Proposed comment 33(c)(2)–1 provides guidance where the legal obligation of a reverse mortgage transaction includes a benefit, such as a "death benefit," in which a payment to the consumer's estate (or a credit to the outstanding loan balance) will be made upon the occurrence of an event (for example, the consumer's death within a certain period of time).

III. Form of Comment Letters

Comment letters should refer to Docket No. R–0903, and, when possible, should use a standard courier typeface with a type size of 10 or 12 characters per inch. This will enable the Board to convert the text to machine-readable form through electronic scanning, and will facilitate automated retrieval of comments for review. Also, along with an original document in paper form, commenters are encouraged to submit their comments on 3½ inch or 5¼ inch computer diskettes in any IBM-compatible DOS-based format.

List of Subjects in 12 CFR Part 226

Advertising, Banks, Banking, Consumer protection, Credit, Federal Reserve System, Mortgages, Reporting and recordkeeping requirements, Truth in lending.

Certain conventions have been used to highlight the proposed revisions to the regulation. New language is shown inside bold-faced arrows, while language that would be deleted is set off with bold-faced brackets. Comments are numbered to comply with new **Federal Register** publication rules.

For the reasons set forth in the preamble, the Board proposes to amend 12 CFR part 226 as follows:

PART 226—TRUTH IN LENDING (REGULATION Z)

1. The authority citation for part 226 continues to read as follows:

Authority: 12 U.S.C. 3806; 15 U.S.C. 1604 and 1637(c)(5).

2. In supplement I to Part 226, under section 226.4—Finance Charge, the following amendments would be made:

1. Under *4(a) Definition.*, a new paragraph 8. would be added; and

2. Under *4(d) Insurance.*, paragraph 5. would be revised.

The additions and revisions read as follows:

Supplement I—Official Staff Interpretations

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Subpart A—General

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Section 226.4—Finance Charge

4(a) Definition.

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►8. *Treatment of Debt Cancellation Agreements.* Some creditors may require debt cancellation agreements while others may offer them as an option. In the case of motor

vehicle loans, these agreements, sometimes referred to as "gap" agreements, offer protection to consumers if the vehicle is stolen or destroyed and the motor vehicle insurance proceeds are insufficient to extinguish the debt. In return for a fee, the consumer will not be held liable for the remaining balance due on the loan. Other types of agreements provide for debt cancellation if the borrower dies or becomes disabled. In some states these agreements are regulated as or otherwise considered insurance under state law.

i. *Insurance.* If the agreement is regulated as or considered insurance under state law, the fee paid by the consumer may be excludable from the finance charge if it meets the requirements in § 226.4(d). Insurance protecting the creditor against credit loss, however, is a finance charge under § 226.4(b)(5).

ii. *Other.* If the agreement is not considered insurance under state law, debt cancellation fees paid to the creditor, whether required or optional, are incident to the extension of credit and must be disclosed as a finance charge. An optional debt cancellation fee paid to a third-party is a finance charge only to the extent that the third-party shares the fee with the creditor. If a creditor cannot determine whether state law considers the agreement insurance, the fees must be treated as if the agreement is not insurance.◄

* * * * *

Paragraph 4(d).

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5. *Required credit life insurance.* Credit life, accident, health, or loss-of-income insurance must be voluntary in order for the premium or charges to be excluded from the finance charge. Whether the insurance is in fact required or optional is a factual question. If the insurance is required, the premiums must be included in the finance charge, whether the insurance is purchased from the creditor or from a third party. If the ►consumer is required to elect one of several options—such as◄ [only option the creditor gives the consumer is] to purchase credit life insurance from the creditor►,◄ [or to] assign an existing life insurance policy, ► or pledge security such as a certificate of deposit,◄ and the consumer purchases the credit life insurance, the premium must be included in the finance charge. (If the consumer assigns a preexisting policy instead, no premium is included in the finance charge. ►The security interest would be disclosed under § 226.6(c) or § 226.18(m).◄ See the commentary to § 226.(4)(b) (7) and (8).)

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3. In supplement I to part 226, under *section 226.6—Initial Disclosure Statement, under 6(b) Other charges.*, paragraph 1.v. would be revised to read as follows:

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Subpart B—Open-End Credit

* * * * *

Section 226.6—Initial Disclosure Statement

* * * * *

6(b) Other charges.

1. * * *

v. A membership or participation fee for a package of services that includes an open-end credit feature, unless the fee is required whether or not the open-end credit feature is included. For example, a membership fee to join a credit union is not an "other charge," even if membership is required to apply for credit. ►For the fee to be excluded from disclosure as an "other charge," however, the package of services must have some substantive purpose other than access to the credit feature. For example, if the primary benefit of membership in an organization is the opportunity to apply for a credit card, and the other benefits offered are incidental to the credit feature, the membership fee is an "other charge."◄

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4. In supplement I to part 226, under *Section 226.12—Special Credit Card Provisions*, under *12(c)(2) Adverse credit reports prohibited.*, new paragraph 2. would be added to read as follows:

* * * * *

Section 226.12—Special Credit Card Provisions

* * * * *

12(c)(2) Adverse credit reports prohibited.

* * * * *

►2. *Settlement of dispute.* A card issuer may not consider a dispute settled and report an amount disputed as delinquent or begin collection of the disputed amount until it has completed a reasonable investigation of the cardholder's claim. In conducting an investigation, the card issuer may reasonably request the cardholder's cooperation. The card issuer may not automatically consider a dispute settled due to the cardholder's failure or refusal to comply with a particular request.◄

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5. In supplement I to Part 226, under *Section 226.14—Determination of Annual Percentage Rate*, under *14(c) Annual percentage rate for periodic statements.*, a new paragraph 10. would be added to read as follows:

* * * * *

Section 226.14—Determination of Annual Percentage Rate

* * * * *

14(c) Annual percentage rate for periodic statements.

* * * * *

►10. *Transactions at end of billing cycle.* The annual percentage rate reflects transactions and charges imposed during the billing cycle. However, a transaction that occurs at the end of a billing cycle may be impracticable to post until the following cycle, such as a cash advance that occurs on the last day of a billing cycle. The transaction is posted to the account in the following cycle. In this case, the annual percentage rate shall be calculate as follows for the billing cycle in which the transaction and charges are posted:

i. The denominator shall be calculated as if the transaction occurred on the first day of the billing cycle, and

ii. The numerator shall include the amount of the transaction charge plus all finance charges derived from the application of the periodic rate to the amount of the transaction (including all charges from a prior cycle).◄

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6. In Supplement I to Part 226, under *Section 226.17—General Disclosure Requirements*, under *Paragraph 17(c)(1).*, paragraph 10. would be revised and a new paragraph 18. would be added to read as follows:

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Subpart C—Closed-End Credit

Section 226.17—General Disclosure Requirements

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17(c) Basis of disclosures and use of estimates.

Paragraph 17(c)(1).

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10. *Discounted and premium variable-rate transactions.* In some variable-rate transactions, creditors may set an initial interest rate that is not determined by the index or formula used to make later interest rate adjustments. Typically, this initial rate charged to consumers is lower than the rate would be if it were calculated using the index or formula. However, in some cases the initial rate may be higher. In a discounted transaction, for example, a creditor may calculate interest rates according to a formula using the six-month Treasury bill rate plus a 2 percent margin. If the Treasury bill rate at consummation is 10 percent, the creditor may forgo the 2 percent spread and charge only 10 percent for a limited time, instead of setting an initial rate of 12 percent.

►i.◄ When creditors use an initial interest rate that is not calculated using the index or formula for later rate adjustments, the disclosures should reflect a composite annual percentage rate based on the initial rate for as long as it is charged and, for the remainder of the term, the rate that would have been applied using the index or formula at the time of consummation. The rate at consummation need not be used if a contract provides for a delay in the implementation of changes in an index value. For example, if the contract specifies that rate changes are based on the index value in effect 45 days before the change date, creditors may use ►any◄ [the] index value in effect ►during the 45 day period◄ [not more than 45 days] before consummation in calculating a composite annual percentage rate.

►ii.◄ The effect of the multiple rates must also be reflected in the calculation and disclosure of the finance charge, total of payments, and payment schedule.

►iii.◄ If a loan contains a rate or payment cap that would prevent the initial rate or payment, at the time of the first adjustment, from changing to the rate determined by the index or formula at consummation, the effect of that rate or payment cap should be reflected in the disclosures.

►iv.◄ Because these transactions involve irregular payment amounts, an annual

percentage rate tolerance of ¼ of 1 percent applies, in accordance with § 226.22(a)(3) of the regulation.

►v.◄ Examples of discounted variable-rate transactions include:

►A.◄ A 30-year loan for $100,000 with no prepaid finance charges and rates determined by the Treasury bill rate plus 2 percent. Rate and payment adjustments are made annually. Although the Treasury bill rate at the time of consummation is 10 percent, the creditor sets the interest rate for one year at 9 percent, instead of 12 percent according to the formula. The disclosures should reflect a composite annual percentage rate of 11.63 percent based on 9 percent for one year and 12 percent for 29 years. Reflecting those two rate levels, the payment schedule should show 12 payments of $804.62 and 348 payments of $1,025.31. The finance charge should be $266,463.32 and the total of payments $366,463.32.

►B.◄ Same loan as above, except with a 2 percent rate cap on periodic adjustments. The disclosures should reflect a composite annual percentage rate of 11.53 percent based on 9 percent for the first year, 11 percent for the second year, and 12 percent for the remaining 28 years. Reflecting those three rate levels, the payment schedule should show 12 payments of $804.62, 12 payments of $950.09, and 336 payments of $1,024.34. The finance charge should be $265,234.76 and the total of payments $365,234.76.

►C.◄ Same loan as above, except with a 7½ percent cap on payment adjustments. The disclosures should reflect a composite annual percentage rate of 11.64 percent, based on 9 percent for one year and 12 percent for 29 years. Because of the payment cap, five levels of payments should be reflected. The payment schedule should show 12 payments of $804.62, 12 payments of $864.97, 12 payments of $929.84, 12 payments of $999.58, and 312 payments of $1,070.04. The finance charge should be $277,040.60, and the total of payments $377,040.60.

►D.◄ This paragraph does not apply to variable-rate loans in which the initial interest rate is set according to the index or formula used for later adjustments but is not set at the value of the index or formula at consummation. For example, if a creditor commits to an initial rate based on the formula on a date prior to consummation, but the index has moved during the period between that time and consummation, a creditor should base its disclosures on the initial rate.

* * * * *

►18. *Pawn Transactions.* For a transaction in which a consumer pledges or sells an item to a creditor in return for a sum of money, and retains the right to redeem the item for a greater sum (the redemption price) within a specified period of time:

i. The amount financed is the initial sum paid to the consumer.

ii. The finance charge is the difference between the initial sum paid to the consumer and the redemption price.

iii. The term of the transaction, for calculating the annual percentage rate, is the specified period of time agreed to by the creditor and the consumer.◄

* * * * *

7. In Supplement I to Part 226, under *Section 226.18—Content of Disclosures,* under *Paragraph 18(c)(1)(iii).*, a new paragraph 2. would be added to read as follows:

* * * * *

Section 226.18—Content of Disclosures

* * * * *

Paragraph 18(c)(1)(iii).

* * * * *

►2. *Creditor-imposed charges added to amounts paid to others.* A creditor that offers an item for sale in both cash and credit transactions sometimes adds an amount (often referred to as an "upcharge") to a fee charged to a consumer by a third party for a service (such as for a maintenance or service contract) that is payable in an equal amount in both types of transactions, and retains that amount. At its option, the creditor may list the total charge (including the portion retained by it) as an amount paid to others, or it may choose to reflect the amounts in the manner in which they were actually paid to or retained by the appropriate parties.◄

* * * * *

8. In Supplement I to Part 226, under *Section 226.20 Subsequent Disclosure Requirements,* under *Paragraph 20(a) Refinancings.*, paragraph 3. would be revised to read as follows:

* * * * *

Section 226.20—Subsequent Disclosure Requirements

Paragraph 20(a) Refinancings.

* * * * *

3. *Variable-rate.*

►i.◄ If a variable-rate feature was properly disclosed under the regulation, a rate change in accord with those disclosures is not a refinancing. ►For example, no new disclosures are required when the variable-rate feature is invoked on a renewable balloon-payment mortgage that was previously disclosed as a variable-rate transaction.◄ [For example, a renewable balloon-payment mortgage that was disclosed as a variable-rate transaction is not subject to new disclosure requirements when the variable-rate feature is invoked. However, even]

►ii. Even◄ if it is not accomplished by the cancellation of the old obligation and substitution of a new one, a new transaction subject to new disclosures results if the creditor either:

►A.◄ Increases the rate based on a variable-rate feature that was not previously disclosed, or

►B.◄ Adds a variable-rate feature to the obligation. ►A creditor does not add a variable-rate feature by changing the index of a variable-rate transaction or substituting a new index for one that no longer exists.

iii.◄ If either of ►the above◄ [these] two events occur in a transaction secured by a principal dwelling with a term longer than one year, the disclosures required under § 226.19(b) also must be given at that time.

* * * * *

9. In Supplement I to Part 226, a new *Subpart E—Special Rules for Certain Home Mortgage Transactions* would be added as follows:

* * * * *

►Subpart E—Special Rules for Certain Home Mortgage Transactions

Section 226.31—General Rules

31(c) Timing of disclosure.

Paragraph 31(c)(1) Disclosures for certain closed-end home mortgages.

1. *Furnishing disclosures.* Disclosures are considered furnished when received by the consumer.

2. *Pre-consummation waiting period.* A creditor must furnish the special disclosures at least three business days prior to consummation. For purposes of § 226.32, "business day" means every calendar day except Sundays and federal legal holidays. For example, if disclosures are provided on Friday, consummation could occur any time on Tuesday, the third business day following receipt of disclosures.

Paragraph 31(c)(1)(i) Change in terms.

1. *Redisclosure required.* Creditors must provide new disclosures if the regular payment or any other disclosure required by § 226.32(c) becomes inaccurate.

Paragraph 31(c)(1)(ii) Telephone disclosures.

1. *Telephone disclosures.* Disclosures by telephone must be furnished at least three calendar days prior to consummation.

Paragraph 31(c)(1)(iii) Consumer's waiver of waiting period before consummation.

1. *Modification or waiver.* A consumer may modify or waive the right to the three-day waiting period only after receiving the disclosures required by § 226.32 and only if the circumstances meet the criteria for establishing a bona fide personal financial emergency in § 226.23(e). Whether these criteria are met are determined by the facts surrounding individual situations. The impending sale of the consumer's home at foreclosure is one example of a bona fide personal financial emergency. Each consumer entitled to the three-day waiting period must sign a written statement for the waiver to be effective.

Paragraph 31(c)(2) Disclosures for reverse mortgages.

1. *Business days.* For purposes of providing reverse mortgage disclosures, "business day" means a day on which the creditor's offices are open to the public for carrying on substantially all of its business functions.

2. *Open-end plans.* Disclosures for open-end reverse mortgages must be provided three business days before the first transaction under the plan (see § 226.5(b)(1)).

31(d) Basis of disclosures and use of estimates.

1. *Redisclosure.* When a disclosure required by § 226.32 is based on and labeled as an estimate and becomes inaccurate due to a change in terms that occurs before consummation, new disclosures must be provided.

Section 226.32—Requirements for Certain Closed-End Home Mortgages

32(a) Coverage.

Paragraph 32(a)(1)(i).

1. *Application date.* An application is deemed received when it reaches the creditor in any of the ways applications are normally transmitted. (See § 226.19(a).) For example, if a borrower applies for a 10-year loan on September 30 and the creditor counteroffers with a 7-year loan on October 10, the creditor must measure the annual percentage rate against the appropriate Treasury security yield as of August 15. An application transmitted through an intermediary agent or broker is received when it reaches the creditor, rather than when it reaches the agent or broker.

2. *When fifteenth not a business day.* If the 15th day of the month immediately preceding the application date is not a business day, the creditor must use the yield as of the business day immediately preceding the 15th.

3. *Calculating annual percentage rates for variable-rate loans and discount loans.* Creditors must use the rules set out in the commentary to § 226.17(c)(1) in calculating the annual percentage rate for variable-rate loans (assume the rate in effect at the time of disclosure remains unchanged) and for discount, premium, and stepped-rate transactions (which must reflect composite annual percentage rates).

4. *Treasury securities.* To determine the yield on a Treasury security for the annual percentage rate test, creditors may use the Board's Selected Interest Rates (statistical release H–15) or the actual auction results. Treasury auctions are held at regular intervals for the different types of securities. These figures are published by major financial and metropolitan newspapers, and are also available from Federal Reserve Banks. Creditors must use the yield on the security that has the nearest maturity at issuance to the loan's maturity. For example, if a creditor must compare the annual percentage rate to Treasury securities with either seven-year or ten-year maturities, the annual percentage rate for an eight-year loan is compared with securities that have a seven-year maturity; the annual percentage rate for a nine-year loan is compared with securities that have a ten-year maturity. If the loan maturity is exactly halfway between, the annual percentage rate is compared with the Treasury security that has the lower yield. For example, if the loan has a maturity of 20 years and comparable securities have maturities of 10 years with a yield of 6.501 percent and 30 years with a yield of 6.906 percent, the annual percentage rate is compared with 10 percentage points over the yield of 6.501 percent, the lower of the two yields.

Paragraph 32(a)(1)(ii).

1. *Total loan amount.* For purposes of the "points and fees" test, the total loan amount is calculated by taking the amount financed, as determined according to § 226.18(b), and deducting any cost listed in § 226.32(b)(1)(iii) that is both included as points and fees under § 226.32(b)(1) and financed by the creditor. For example, if a consumer borrows $10,000, finances a $300 fee for a creditor-conducted appraisal, and pays $400 in points at closing, the amount financed according to § 226.18(b) is $9,900 ($10,000 plus the $300 appraisal fee that is financed by the creditor, less $400 in prepaid finance charges). The $300 appraisal fee paid to the creditor is added to other points and fees under § 226.32(b)(1)(iii). It is deducted from the amount financed under § 226.18(b) ($9,900) to derive a total loan amount of $9,600. If the $300 appraisal fee is paid in cash at closing, the $300 is included in the points and fees calculation. However, because it is not financed by the creditor, the $300 fee is not part of the amount financed under § 226.18(b) ($10,000, in this case). The total loan amount is $9,600 ($10,000, less $400 in prepaid finance charges).

32(b) Definitions.

Paragraph 32(b)(1)(i).

1. *General.* Items defined as finance charges under § 226.4(a) and 226.(4)(b) are included under this paragraph as a component of the total "points and fees." Items excluded from the finance charge under other provisions of § 226.4 are not included in the calculation under this paragraph 32(b)(1)(i), although the fee may be included in "points and fees" under paragraphs 32(b)(1)(ii) and 32(b)(1)(iii).

Paragraph 32(b)(1)(ii).

1. *Mortgage broker fees.* In determining "points and fees" for purposes of this section, compensation paid by a consumer to a mortgage broker (directly or through the creditor for delivery to the broker) is included in the calculation whether or not the amount is disclosed as a finance charge. Mortgage broker fees that are not paid by the consumer are not included. Broker fees already included in the calculation as finance charges under § 226.32(b)(1)(i) need not be counted again under § 226.32(b)(1)(ii).

2. *Example.* Section 226.32(b)(1)(iii) defines "points and fees" to include all items listed in § 226.4(c)(7), other than amounts held for future payment of taxes. An item listed in § 226.4(c)(7) may be excluded from the "points and fees" calculation, however, if the charge is reasonable, the creditor receives no direct or indirect compensation from the charge, and the charge is not paid to an affiliate of the creditor. For example, a reasonable fee paid by the consumer to an independent, third-party appraiser may be excluded from the points and fees calculation (assuming no compensation is paid to the creditor). A fee paid by the consumer for an appraisal performed by the creditor must be included in the calculation, even though the fee may be excluded from the finance charge if it is bona fide and reasonable in amount.

32(c) Disclosures.

1. *Format.* The disclosures must be clear and conspicuous but need not be in any particular type size or typeface, nor presented in any particular manner. For example, the disclosures need not be a part of the mortgage.

Paragraph 32(c)(3) Regular payment.

1. *General.* The regular payment is the amount due from the borrower at regular intervals, such as monthly, bimonthly, quarterly, or annually. There must be at least two payments, and the payments must be in an amount and at such intervals that they fully amortize the amount owed. If the loan has two payment streams, the regular payment for each must be disclosed.

2. *Discount and premium rates.* In disclosing the regular payment, creditors may rely on the rules set forth in § 226.18(g). In discounted or premium variable rate transactions where the creditor sets the initial interest rate and later rate adjustments are determined by an index or formula, the creditor must disclose both the payment based on the discount or premium and the payment that will be in effect thereafter. Additional explanatory material which does not detract from the required disclosures may accompany the disclosed amounts. For example, if a monthly payment is $250 for the first six months and then increases based on an index and margin, the creditor could use language such as the following: "Your regular monthly payment will be $250 for six months. After six months your regular monthly payment will be based on an index and margin, which currently would make your payment $350. Your actual payment at that time may be higher or lower."

Paragraph 32(c)(4) Variable-rate.

1. *Calculating "worst-case" payment example.* Creditors may rely on instructions in § 226.19(b)(2)(x) for calculating the maximum possible increases in rates in the shortest possible timeframe, based on the face amount of the note (not the hypothetical loan amount of $10,000 required by § 226.19(b)(2)(x)). The creditor must provide a maximum payment for each payment stream, where a payment schedule provides for more than one payment stream and more than one maximum payment amount is possible.

32(d) Limitations.

Paragraph 32(d)(1)(i) Balloon payment.

1. *Regular periodic payments.* The repayment schedule for a § 226.32 mortgage loan with a term of less than five years must fully amortize the outstanding principal balance through "regular periodic payments." A payment is a "regular periodic payment" if it is not more than twice the amount of other payments.

Paragraph 32(d)(2) Negative amortization.

1. *Negative amortization.* The prohibition against negative amortization in a mortgage covered by § 226.32 does not preclude increases in the principal balance that result from events unrelated to the payment schedule, such as when a consumer fails to obtain property insurance and the creditor purchases and adds the premium to the consumer's principal balance.

Paragraph 32(d)(4) Increased interest rate.

1. *Variable-rate transactions.* The limitation on interest rate increases does not apply to rate increases resulting from index changes in a variable-rate transaction, even if the increase occurs after default by the consumer.

Paragraph 32(d)(5) Rebates.

1. *Calculation of refunds.* The limitation applies only to refunds of interest and not to any other charges that are considered finance charges under § 226.4 (for example, points and fees paid at closing). The calculation of the refund of interest includes odd-days interest, whether paid at or after consummation.

Paragraph 32(d)(6) Prepayment penalties.

1. *State law.* If using the actuarial method defined by applicable state law results in a refund that is greater than the refund calculated by using the method described in section 933(d) of the Housing and Community Development Act of 1992, creditors must use the state law definition in determining if a refund is a prepayment penalty under § 226.32(d)(6).

32(d)(7) Prepayment penalty exception.

Paragraph 32(d)(7)(iii).

1. *Calculating debt-to-income ratio.* "Debt" does not include amounts paid by the borrower in cash at closing or amounts from the loan proceeds that directly repay an existing debt. Creditors may consider combined debt-to-income ratios for transactions involving joint applicants.

2. *Verification.* Verification of employment satisfies the requirement for payment records for employment income.

32(e) Prohibited acts and practices.

Paragraph 32(e)(1) Repayment ability.

1. *Determining repayment ability.* The information provided to the creditor in connection with § 226.32(d)(7) may be used to show that the creditor considered the consumer's income and obligations before extending the credit. Any expected income can be considered by the creditor, except equity income that the consumer would obtain through the foreclosure of a mortgage covered by § 226.32. For example, a creditor may use information about income other than regular salary or wages such as gifts, expected retirement payments, or income from housecleaning or childcare. The creditor also may use unverified income, so long as the creditor has a reasonable basis for believing that the income exists.

Paragraph 32(e)(2) Home-Improvement Contracts.

Paragraph 32(e)(2)(i).

1. *Joint payees.* If a creditor pays a contractor with an instrument jointly payable to the contractor and the consumer, the instrument must name as payee each consumer who is primarily obligated on the note.

Paragraph 32(e)(3) Notice to Assignee.

1. *Subsequent sellers or assignors.* Any person, whether or not the original creditor, that sells or assigns a mortgage subject to this section must furnish the notice of potential liability to the purchaser or assignee.

2. *Format.* While the notice of potential liability need not be in any particular format, the notice must be prominent. Placing it on the face of the note, such as with a stamp, is one means of satisfying the prominence requirement.

Section 226.33—Requirements for Reverse Mortgages

33(a) Definition.

1. *Nonrecourse transaction.* A nonrecourse reverse mortgage transaction limits the homeowner's liability to the proceeds of the sale of the home (or any lesser amount specified in the credit obligation). If a transaction structured as a closed-end reverse mortgage transaction allows recourse against the consumer, and the annual percentage rate or the points and fees exceed those specified under § 226.32(a)(1), the transaction is subject to all the requirements of § 226.32, including the limitations concerning balloon payments and negative amortization.

Paragraph 33(a)(2).

1. *Default.* Default is not defined by the regulation, but rather by the legal obligation between the parties and state or other law.

2. *Definite term or maturity date.* To meet the definition of a reverse mortgage transaction, a creditor cannot require any principal, interest, or shared appreciation or equity to be due and payable (other than in the case of default) until after the consumer's death, transfer of the dwelling, or the consumer ceases to occupy the dwelling as a principal dwelling. Some state laws require legal obligations secured by a mortgage to specify a definite maturity date or term of repayment in the instrument. Such a provision in an obligation does not violate the definition of a reverse mortgage transaction if the maturity date or term or repayment required by state law would in no case operate to cause maturity prior to the occurrence of any of the events recognized in the regulation. For example, a provision that allows a reverse mortgage loan to become due and payable only after the consumer's death, transfer, or cessation of occupancy, *or* after a specified term, but which automatically extends the term for consecutive periods as long as none of the other events has occurred would meet the definition of a reverse mortgage transaction.

33(c) Projected total cost of credit.

Paragraph 33(c)(1) Costs to consumer.

1. *Costs and charges to consumer—relation to finance charge.* All costs and charges to the consumer that are incurred in a reverse mortgage transaction are included in the projected total cost of credit, and thus in the total annual loan cost rates, whether or not the cost or charge is a finance charge under § 226.4 of the regulation.

2. *Annuity costs.* As part of the credit transaction, some creditors require or permit a consumer to purchase an annuity that immediately—or at some future time—supplements or replaces the creditor's payments. The amount paid by the consumer for the annuity is a cost to the consumer under this section, regardless of whether the annuity is purchased through the creditor or a third party, or whether the purchase is mandatory or voluntary.

3. *Disposition costs excluded.* Disposition costs incurred in connection with the sale or transfer of the property subject to the reverse mortgage are not included in the costs to the consumer under this paragraph. (However, see the definition of Val_n in appendix K to the regulation to determine the effect certain disposition costs may have on the total annual loan cost rates.)

Paragraph 33(c)(2) Payments to consumer.

1. *Payments upon a specified event.* The projected total cost of credit should not reflect contingent payments in which a credit to the outstanding loan balance or a payment to the consumer's estate is made upon the occurrence of an event (for example, a "death benefit" payable if the consumer's death occurs within a certain period of time). Thus, the table of total annual loan cost rates required under § 226.33(b)(2) would not reflect such payments. At its option, however, a creditor may put an asterisk, footnote, or similar type of notation in the table next to the applicable total annual loan cost rate, and state in the body of the note, apart from the table, the assumption upon which the total annual loan cost is made and any different rate that would apply if the contingent benefit were paid.

Paragraph 33(c)(3) Additional creditor compensation.

1. *Shared appreciation or equity.* Any shared appreciation or equity that the creditor is entitled to receive pursuant to the legal obligation must be included in the total cost of a reverse mortgage loan. For example, if a creditor agrees to a reduced interest rate on the transaction in exchange for a portion of the appreciation or equity that may be realized when the dwelling is sold, that portion is included in the projected total cost of credit.

Paragraph 33(c)(4) Limitations on consumer liability.

1. *In general.* Creditors must include any limitation on the consumer's liability (such as a nonrecourse limit or an equity conservation agreement) in the projected total cost of credit. These limits and agreements protect a portion of the equity in the dwelling for the consumer or the consumer's estate. For example, the following contractual provisions are limitations on the consumer's liability that must be included in the projected total cost of credit:

i. A limit on the consumer's liability to a certain percentage of the projected value of the home.

ii. A limit on the consumer's liability to the net proceeds from the sale of the property subject to the reverse mortgage.

2. *Uniform assumption for "net proceeds" recourse limitations.* If the legal obligation between the parties does not specify a percentage for the "net proceeds" liability of the consumer, for purposes of the disclosures required by § 226.33, a creditor must assume that the costs associated with selling the property will equal 7 percent of the projected sale price (see the definition of the Val_n symbol under appendix K(b)(6)).◄

* * * * *

10. In Supplement I to Part 226, a new *Appendix K—Total Annual Loan Cost Rate Computations for Reverse Mortgage Transactions* and a new *Appendix L—Assumed Loan Periods for Computations of Total Annual Loan Cost Rates* would be added to read as follows:

* * * * *

►Appendix K—Total Annual Loan Cost Rate Computations for Reverse Mortgage Transactions

1. *General.* The calculation of total annual loan cost rates under appendix K is based on the principles set and the estimation or "iteration" procedure used to compute annual percentage rates under appendix J. Rather than restate this iteration process in full, the regulation cross-references the procedures found in appendix J. In other aspects the appendix reflects the special

nature of reverse mortgage transactions. Special definitions and instructions are included where appropriate.

(b) Instructions and equations for the total annual loan cost rate.

(b)(5) Number of unit-periods between two given dates.

1. *Assumption as to when transaction begins.* The computation of the total annual loan cost rate is based on the assumption that the reverse mortgage transaction begins on the first day of the month in which consummation is estimated to occur. Therefore, fractional unit-periods (as used under appendix J for calculating annual percentage rates) are not used.

(b)(9) Assumption for discretionary cash advances.

1. *Amount of credit.* Creditors should compute the total annual loan cost rates for transactions involving discretionary cash advances by assuming that 50 percent of the initial amount of the credit available under the transaction is advanced at closing or, in an open-end transaction, when the consumer becomes obligated under the plan. (For the purposes of this assumption, the initial amount of the credit is the principle loan amount less any costs to the consumer under section 226.33(c)(1).)

(b)(10) Assumption for variable-rate reverse mortgage transactions.

1. *Initial discount or premium rate.* Where a variable-rate reverse mortgage transaction includes an initial discount or premium rate, the creditor should apply the same rules for calculating the total annual loan cost rate as are applied when calculating the annual percentage rate for a loan with an initial discount or premium rate (see the commentary to § 226.17(c)).

(d) Reverse mortgage model form and sample form.

(d)(2) Sample form.

1. *General.* The "clear and conspicuous" standard for reverse mortgage disclosures does not require disclosures to be printed in any particular type size. Disclosures may be made on more than one page, and use both the front and the reverse sides, so long as the pages constitute an integrated document.

Appendix L—Assumed Loan Periods for Computations of Total Annual Loan Cost Rates

1. *General.* The life expectancy figures used in this appendix are those found in the U.S. Decennial Life Tables for women, as rounded to the nearest whole year and as published by the U. S. Department of Health and Human Services. The figures contained in this appendix must be used by creditors for all consumers (men and women). This appendix will be revised periodically by the Board to incorporate revisions to the figures made in the Decennial Tables.◀

By order of the Board of Governors of the Federal Reserve System, acting through the Secretary of the Board under delegated authority, December 1, 1995.

Jennifer J. Johnson,

Deputy Secretary of the Board.

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