FEDERAL RESERVE BANK
OF DALLAS

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

DALLAS, TEXAS
75265-5906

December 9, 1996

Notice 96-124

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

SUBJECT

Request for Comment on the Official Staff Commentary to Regulation Z (Truth in Lending) and Correction to Regulation O

DETAILS

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

The proposed revisions provide guidance on the treatment of some fees paid in connection with mortgage loans and tolerances for accuracy in disclosing the finance charge and other costs. They also discuss such issues as the treatment of debt cancellation agreements and duties of creditors that provide periodic statements electronically.

Comments must be received by January 6, 1997. Please address comments 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-0942.

The Board also published a correction to recent amendments to Regulation O (Loans to Executive Officers, Directors, and Principal Shareholders of Member Banks) as announced in this Bank's notice 96-116. The final rule incorrectly stated that the effective date of the amendments was November 4, 1996, instead of November 8, 1996.

For additional copies, bankers and others are encouraged to use one of the following toll-free numbers in contacting the Federal Reserve Bank of Dallas: Dallas Office (800) 333-4460; El Paso Branch *Intrastate* (800) 592-1631, *Interstate* (800) 351-1012; Houston Branch *Intrastate* (800) 392-4162, *Interstate* (800) 221-0363; San Antonio Branch *Intrastate* (800) 292-5810.

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ATTACHMENT

A copy of the Board's notice as it appears on pages 60223-29, Vol. 61, No. 230, of the *Federal Register* dated November 27, 1996, is attached.

MORE INFORMATION

For more information regarding Regulation Z, please contact Eugene Coy at (214) 922-6201. For more information regarding Regulation O, please contact Jane Anne Schmoker at (214) 922-5101. For additional copies of this Bank's notice, please contact the Public Affairs Department at (214) 922-5254.

Sincerely yours,

Robert D. McTeer, Jr.

Proposed Rules

Federal Register
Vol. 61, No. 230
Wednesday, November 27, 1996

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–0942]

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 on issues relating to the treatment of certain fees paid in connection with mortgage loans. It addresses new tolerances for accuracy in disclosing the amount of the finance charge and other affected cost disclosures. In addition, the proposed update discusses issues such as the treatment of debt cancellation agreements and a creditor's duties if providing periodic statements via electronic means.

DATES: Comments must be received on or before January 6, 1997.

ADDRESSES: Comments should refer to Docket No. R–0942, 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 Availability of Information.

FOR FURTHER INFORMATION CONTACT: Jane E. Ahrens or James A. Michaels, Senior Attorneys, or Sheilah A. Goodman 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*, contact Dorothea 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 the cost of credit as a dollar amount (the finance charge) and as an annual percentage rate (the APR). Uniformity in creditors' disclosures is intended to assist consumers in comparison shopping. The TILA requires additional disclosures for loans secured by a consumer's home and permits consumers to rescind certain transactions that involve their principal dwelling. The act is implemented by the Board's Regulation Z (12 CFR Part 226). The Board's official staff commentary (12 CFR Part 226 (Supp. I)) interprets the regulation, and provides guidance to creditors in applying the regulation to specific transactions. The commentary is a substitute for individual staff interpretations; it is updated periodically to address significant questions that arise. The Board expects to adopt revisions to the commentary in final form in March 1997; to the extent the revisions impose new requirements on creditors, compliance would be optional until October 1, 1997, the effective date for mandatory compliance.

On September 19, 1996, the Board published amendments to Regulation Z (61 FR 49237) implementing the Truth in Lending Act Amendments of 1995 ("1995 Amendments," Pub. L. 104–29, 109 Stat. 271). The amendments clarify the treatment of fees typically associated with real estate-related lending, and revise tolerances for finance charge calculations for loans secured by real estate or dwellings. In the same rulemaking, the Board also addressed the treatment of fees charged in connection with debt cancellation agreements. In large measure, the proposed commentary incorporates the supplementary information accompanying that rulemaking.

II. Proposed Revisions

Supplement I—Official Staff Interpretations

Introduction

Comment I–5 updates the reference to the regulation's appendices.

Subpart A—General

Section 226.2—Definitions

2(a)(25) Security Interest

Comment 2(a)(25)–6 refers to model form H–9, which was revised in the September 1996 rulemaking. The comment reflects changes to the form's text.

Section 226.4—Finance Charge

4(a) Definition

Comments 4(a)–3 and –4 are deleted, and subsequent comments redesignated, in accord with the revision and reorganization of § 226.4(a) in the September 1996 rulemaking.

Paragraph 4(a)(1) Charges by Third Parties

Comment 4(a)(1)–1 retains the example of third-party charges currently in comment 4(a)–3.i. The example illustrates that amounts charged by a third party are included in the finance charge if the creditor requires the use of the third party, even if the consumer may choose the service provider.

Comment 4(a)(1)–2 addresses the treatment of annuity premiums associated with some reverse mortgages. The Board proposes to treat the cost of the premiums as a finance charge when the purchase of an annuity is effectively required incident to the credit.

4(a)(2) Special rule; closing agent charges

Proposed comment 4(a)(2)–1 retains the substance of the guidance currently in comment 4(a)–4; that is, charges by a third-party closing agent are finance charges only if the creditor requires the particular charge or service, or to the extent the creditor retains any portion of the fee (unless the charge is otherwise excluded). Technical amendments conform the text to new § 226.4(a)(2)—such as replacing "settlement agent" with "closing agent"—without any substantive change. The comment also clarifies that the special rule applies only to the third party serving as a closing agent for the particular loan. Charges by a third party who is not the

closing agent for the loan but who provides services typically performed by closing agents (recording the mortgage, for example) are covered by the general rule for third-party charges in paragraph 4(a)(1).

Paragraph 4(a)(3) Special Rule; Mortgage Broker Fees

Comments 4(a)(3)–1 and –2 address the treatment of mortgage broker fees. Under the 1995 Amendments, mortgage broker fees paid by the borrower are finance charges (unless otherwise excluded). Comment 4(a)(3)–1 clarifies that mortgage broker fees may be excluded from the finance charge if the fee would be excluded when charged by the creditor. The comment also provides that if the mortgage broker charges an application fee, the fee may be excluded from the finance charge if the broker charges the fee to all applicants, whether or not credit is extended.

Proposed comment 4(a)(3)–2 discusses the scope of the special rule for mortgage broker fees. It addresses the treatment of compensation paid by the creditor to a mortgage broker in addition to—or substitution for—compensation paid by the consumer to the broker.

4(b) Examples of Finance Charges

Paragraph 4(b)(10) Debt Cancellation Fees

Proposed comment 4(b)(10)–1 clarifies that for purposes of Regulation Z, the term "debt cancellation agreement" includes a specialized type of agreement known as guaranteed automobile protection or "GAP" agreements.

4(c) Charges Excluded From the Finance Charge

Paragraph 4(c)(5)

Numerous creditors have asked for additional guidance on certain finance charges paid by a noncreditor seller on a consumer's behalf before loan closing. Comment 4(c)(5)–2 currently states that these payments, such as for mortgage insurance premiums, should be excluded from the finance charge as seller's points. The proposal clarifies the standards for determining when to exclude such amounts from the finance charge.

Section 226.17(c)(1) states that disclosures must be based on the consumer's legal obligation. Comment 17(c)(1)–3 provides guidance for disclosing the effect of payments by a seller or another third party that reduce, for example, a consumer's interest rate. Disclosures should reflect the payment only if the consumer is no longer legally bound to the creditor for the amount paid. Comment 4(c)(5)–2 would be revised to clarify that the same standard applies for amounts paid by noncreditor sellers.

4(d) Insurance and Debt Cancellation Coverage

Paragraph 4(d)(3) Voluntary Debt Cancellation Fees

Proposed comment 4(d)(3)–1 clarifies that fees for GAP agreements must be disclosed in accord with paragraph 4(d)(3) rather than the property insurance provisions of paragraph 4(d)(2). Proposed comment 4(d)(3)–2 clarifies that creditors may characterize debt cancellation fees as insurance premiums in their TILA disclosures only if the debt cancellation coverage constitutes insurance under state law.

4(e) Certain Security Interest Charges

Section 226.4(e) excludes certain security interest charges paid to public officials from the finance charge if the amounts are itemized and disclosed. As an example, comment 4(e)–1 lists a tax imposed solely on the creditor that is charged to the consumer. To ease compliance, the proposed revision also provides a cross reference to comment 4(a)–7 (to be redesignated as 4(a)–5), which also addresses the treatment of taxes.

Subpart B—Open-End Credit

Section 226.5—General Disclosure Requirements

5(b) Time of Disclosures

5(b)(2) Periodic Statements

Paragraph 5(b)(2)(ii)

Comment 5(b)(2)(ii)–3 responds to technological developments in the way credit transactions are conducted via electronic means; it provides guidance on when periodic statements may be provided electronically, for example, via home banking systems. The proposal is part of a general review that will seek to adapt current rules to the way electronic disclosures may be provided and retained. For example, the Board has addressed similar issues in recent proposed amendments to Regulation E (Electronic Fund Transfers, 12 CFR Part 205, 61 FR 19696, May 2, 1996) and Regulation CC (Expedited Funds Availability, 12 CFR Part 229, 61 FR 27802).

Subpart C—Closed-End Credit

Section 226.17—General Disclosure Requirements

17(c) Basis of Disclosures and Use of Estimates

Paragraph 17(c)(2)(ii)

Proposed comment 17(c)(2)(ii)–1 addresses the new rule applicable to the disclosure of per-diem interest charges. Under the rule, any numerical disclosure affected by the per-diem interest charge is considered accurate if it is based on the information known to the creditor at the time the disclosure is prepared, whether or not the disclosure of per-diem interest is accurate when it is received by the consumer. The proposed comment clarifies that in such cases, the resulting finance charge is considered accurate without regard to the tolerance for errors under § 226.18(d)(1). The Board requests comment on whether a conforming comment to paragraph 31(d)(3) is necessary.

17(f) Early Disclosures

Paragraph 17(f)(2)

The Board proposes to reorganize comment 17(f)–1 and to add proposed comment 17(f)(2)–1 to conform to the new regulation. Comment 17(f)–1 includes an additional example relating to mortgage loans. The revision also clarifies that for purposes of determining if redisclosure is required, the changed terms must be redisclosed according to the rules for accuracy in paragraph 17(f) rather than the tolerances in § 226.18(d) or 226.22(a).

Section 226.18—Content of Disclosures

18(c) Itemization of Amount Financed

Comment 18(c)–4 provides that in transactions subject to the Real Estate Settlement Procedures Act (RESPA), no itemization of the amount financed is required with the early TILA disclosures if the creditor complies with the good faith estimate requirements of RESPA. The comment would be amended to clarify that in such transactions, if redisclosure is required under § 226.19(a)(2), no itemization need be provided if, at or prior to consummation, the consumer receives a settlement statement that conforms with the substantive requirements of RESPA.

The Department of Housing and Urban Development (HUD) recently solicited comment on whether creditors, in transactions subject to RESPA, should be allowed to show only the total amount collected for escrow on the settlement statement, rather than itemizing these amounts. Comment

18(c)(1)(iv) would be revised and expanded to address how creditors can determine the portion of the total amount collected for an escrow account that is a prepaid finance charge, if any.

18(d) Finance Charge

Paragraph 18(d)(2)

Proposed comment 18(d)(2)–1 incorporates the guidance formerly found in comment 18(d)–2 that was removed as part of the recent reorganization of § 226.18(d).

Paragraph 18(n) Insurance and debt Cancellation

Proposed comment 18(n)–2 provides guidance for disclosing debt cancellation fees under § 226.4(d)(3). The proposed comment clarifies that creditors may disclose debt cancellation fees as insurance premiums only if the coverage is insurance under state law, consistent with proposed comment 4(d)(3)–2.

Section 226.19—Certain Residential Mortgage and Variable-Rate Transactions

Paragraph 19(a)(2) Redisclosure Required

Comment 19(a)(2) is revised for consistency with proposed comment 17(f)(2)–1.

Section 226.22—Determination of the Annual Percentage Rate

22(a) Accuracy of the Annual Percentage Rate

Paragraphs 22(a)(4) and (a)(5)

Sections 226.22(a)(4) and (a)(5) provide two additional APR tolerances for mortgage loans when the finance charge has been misstated but is considered accurate. The proposed comments provide specific examples of these tolerances.

Section 226.23—Right of Rescission

23(g) Tolerances for Accuracy

Paragraph 23(g)(2) One Percent Tolerance

Proposed comment 23(g)(2)–1 clarifies that the phrase "new advance" has the same meaning in paragraph 23(g)(2) as it has in comment 23(f)–4. Both rules address rescission rights when home-secured loans are refinanced.

Paragraph 23(h) Special Rules for Foreclosures

Proposed comment 23(h)–1 clarifies that the special rules for foreclosures under paragraph 23(h) only apply to transactions that were originally subject to rescission under paragraph 226.23(a)(1).

Paragraph 23(h)(1)(i)

Proposed comment 23(h)(1)(i)–1 clarifies that a consumer may rescind a loan in foreclosure if a mortgage broker fee is omitted or understated, without regard to the dollar amount involved. An example illustrates the rule.

Subpart E—Special Rules for Certain Home Mortgage Transactions

Section 226.31—General Rules

31(c) Timing of disclosures

Section 226.31(c) discusses the timing rules for providing disclosures to consumers for transactions covered by § 226.32 (§ 226.3(c)(1)) and reverse mortgages (§ 226.31(c)(2)). Comment 31(c)(1)–1, which states that disclosures are furnished when received by the consumer, is redesignated as comment 31(c)–1 to reflect that the rule applies to all transactions covered by § 226.31(c).

Section 226.32—Requirements for Certain Closed-end Home Mortgages

32(b) Definitions

Paragraph 32(b)(1)(i)

Comment 32(b)(1)(i)–1 is revised to clarify that per diem interest, typically paid in a lump sum at closing, is nonetheless interest, and is not a component of "points and fees" under paragraph 32(b)(1).

32(c) Disclosures

32(c)(3) Regular payment

Balloon payments are prohibited in loans that are covered by § 226.32 and have a term of less than five years. Proposed comment 32(c)(3)–2 clarifies that if a loan with a term of five years or more provides for a balloon payment, the balloon payment must be disclosed under this paragraph.

Section 226.33—Requirements for Reverse Mortgages

33(a) Definition

Paragraph 33(a)(2)

Under § 226.33, a reverse mortgages can become due and payable only after the consumer dies, the dwelling is transferred, or the consumer ceases to occupy the dwelling as a principal dwelling. Some states require mortgages to have a definite maturity date. The proposed comment clarifies how a transaction can comply with those laws and have a definite maturity date while remaining a reverse mortgage under § 226.33.

Appendices G and H—Open-End and Closed-End Model Forms and Clauses

Comment app. G and H–2 would be revised, consistent with comments 4(d)(3)–1 and 18(n)–2, to reflect that creditors should not characterize debt cancellation fees as insurance premiums unless such coverage is insurance under state law.

Appendix H—Closed-End Model Forms and Clauses

The Board modified the current model form H–9 in the September 1996 rulemaking. Proposed comment app. H–11 would clarify that the revised H–9 is substantially similar to the current H–9, and creditors may continue to use the prior version. Creditors are encouraged to use the revised version when reordering or reprinting forms.

III. Form of Comment Letters

Comment letters should refer to Docket No. R–0942, 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 in machine-readable form through electronic scanning, and will facilitate automated retrieval of comments for review. Also, if accompanied by an original document in paper form, comments may be submitted 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.

Text of Proposed Revisions

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 *Introduction*, the last sentence in paragraph 5. would be revised to read as follows:

Supplement I—Official Staff Interpretations

Introduction

* * * * *

5. *Comment designations.* * * * ►Comments to the◄ [The] appendices may be cited►, for example,◄ as Comments app. A–1►.◄ [through J–2.]

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3. Supplement I to Part 226, under *Section 226.2—Definitions*, under *paragraph 2(a)(25)*, is amended by removing the last two sentences of the second undesignated paragraph of paragraph 6.

4. In Supplement I to Part 226, under *Section 226.4—Finance Charge*, the following amendments would be made:

a. Under *4(a) Definition.*, paragraphs 3. and 4. would be removed and paragraphs 5. through 7. would be redesignated as paragraphs 3. through 5., respectively, and new paragraphs 4(a)(1), 4(a)(2), and 4(a)(3) would be added preceding 4(b);

b. Under *4(b) Examples of finance charges.*, a new paragraph 4(b)(10) would be added;

c. Under *4(c) Charges excluded from the finance charge.*, under *4(c)(5)* paragraph 2. would be revised;

d. Under 4(d), the paragraph heading would be revised, and a new paragraph 4(d)(3) would be added; and

e. Under *4(e) Certain security interest charges.*, paragraph 1.i. would be revised. The additions and revisions would read as follows:

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Subpart A—General

* * * * *

Section 226.4—Finance Charge

4(a) Definition.

* * * * *

►*Paragraph 4(a)(1) Charges by third parties.*

1. *Choosing the provider of a required service.* An example of a third-party charge included in the finance charge is the cost of required mortgage insurance, even if the consumer is allowed to choose the insurer.

2. *Annuities associated with reverse mortgages.* Some creditors may offer annuities in connection with a reverse mortgage transaction. The amount of the premium is a finance charge if the creditor in effect requires the purchase of the annuity incident to the credit. Examples include the following:

i. The credit documents reflect the purchase of an annuity from a specific provider or providers.

ii. The creditor assesses an additional charges on consumers who do not purchase an annuity from a specific provider.

iii. The annuity is intended to supplement or replace the creditor's payments to the consumer either immediately or at some future date.

Paragraph 4(a)(2) Special rule; closing agent charges .

1. *General.* This rule applies to charges by a third party serving as the closing agent for the particular loan. Unless a charge is otherwise excluded (for example, a real estate-related closing cost under § 226.4(c)(7) or a fee paid in a comparable cash transaction), a fee charged by a third-party closing agent is included in the finance charge if the creditor requires the imposition of the charge or the provision of the service, or to the extent the creditor retains any portion of the charge. For example, a courier fee charged by a third-party closing agent is a finance charge if the creditor requires the use of a courier.

Paragraph 4(a)(3) Special rule; mortgage broker fees.

1. *Special rule—mortgage broker fees.* A fee charged by a mortgage broker is excluded from the finance charge if it is the type of fee that is also excluded when charged by the creditor. To exclude an application fee from the finance charge, a mortgage broker must charge the fee to all applicants for credit, whether or not credit is extended.

2. *Compensation by lender.* Compensation paid by a creditor to a mortgage broker under an arrangement between those parties is not included in the finance charge. For example, where a consumer is obligated to pay points to the creditor and a fee to a mortgage broker, those charges must be disclosed as finance charges. Under a separate arrangement between the creditor and the broker, the creditor may also agree to compensate the broker, such as in "yield spread premiums" or "back points." This compensation paid by the creditor to the broker is not a finance charge.◄

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4(b) Examples of finance charges.

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►*Paragraph 4(b)(10) Debt cancellation fees.*

1. *Definition.* The term "debt cancellation agreement" refers to a contract between a borrower and a creditor providing for satisfaction of all or part of the debt when a specified event occurs. The term includes guaranteed automobile protection or "GAP" agreements, which cancel the remaining debt after property insurance benefits are exhausted.◄

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Paragraph 4(c)(5).

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2. *Other seller-paid amounts. Mortgage insurance premiums and other* ►finance◄ charges are sometimes paid at or before consummation or settlement on the borrower's behalf by a noncreditor seller. [In such cases the] ►The creditor should treat the payment made by the seller as seller's points and exclude it from the finance charge ►if the consumer is not legally bound to the creditor for the charge◄. A creditor who gives disclosures before the payment has been made should base them on the best information reasonably available[, as called for by the estimate provisions of the regulation].

* * * * *

4(d) Insurance►and debt cancellation coverage◄.

* * * * *

►*Paragraph 4(d)(3).*

1. *General.* Fees charged for the specialized form of debt cancellation agreement known as guaranteed automobile protection or "GAP" agreements must be disclosed according to § 226. 4(d)(3) rather than according to § 226. 4(d)(2) for property insurance.

2. *Disclosures.* Creditors can comply with § 226. 4(d)(3) by providing a disclosure that refers to debt cancellation coverage whether or not the agreement is considered insurance. Creditors may use the model credit insurance disclosures only if the debt cancellation coverage constitutes insurance under state law.◄

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4(e) Certain security interest charges.

1. Examples.

i. *Excludable charges.* Sums must be actually paid to public officials to be excluded from the finance charge under § 226.4(e)(1). Examples are charges or other fees required for filing or recording security agreements, mortgages, continuation statements, and similar documents, as well as intangible property or other taxes imposed by the state solely on the creditor [and payable by] ►and charged to◄ the consumer (if the tax must be paid to record a security interest). ►(See comment 4(a)–5 (formerly 4(a)–7) regarding the treatment of taxes, generally.).◄

* * * * *

5. In Supplement I to Part 226, under *Section 226.5—General Disclosure Requirements*, under *Paragraph 5(b)(2)(ii).*, paragraph 3. would be revised to read as follows:

* * * * *

Subpart B—Open-End Credit

Section 226.5—General Disclosure Requirements

* * * * *

5(b) Timing of disclosures.

* * * * *

5(b)(2) Periodic statements.

* * * * *

Paragraph 5(b)(2)(ii).

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3. *Calling for periodic statements.* The creditor may permit consumers to call for their periodic statements, but may not require them to do so. If the consumer wishes to pick up the statement and the plan has a free-ride period, the statement ►(including a statement provided by electronic means)◄ must be made available in accordance with the 14-day rule.

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6. In Supplement I to Part 226, under *Section 226.17—General Disclosure Requirements*, the following amendments would be made:

a. Under *17(c) Basis of disclosures and use of estimates*, a new paragraph 17(c)(2)(ii) would be added; and

b. Under *17(f) Early disclosures*, paragraphs 1. introductory text, 1. i., the last sentence of 1. ii., and 1. iii. would be revised and a heading would be added to paragraph 1. ii; and a new paragraph 17(f)(2) preceding 17(g) would be added. The additions and revisions would read as follows:

* * * * *

Subpart C—Closed-End Credit

Section 226.17—General Disclosure Requirements

* * * * *

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

* * * * *

►*Paragraph 17(c)(2)(ii).*

1. *Per-diem interest.* This paragraph applies to any numerical disclosure (such as the finance charge or annual percentage rate) that is affected by the amount of the per-diem interest charge that will be collected at consummation. If the amount of per-diem interest used in preparing the disclosures for consummation is based on the information known to the creditor at the time the disclosure document is prepared, the disclosures are considered accurate under this rule, and the affected disclosures are also considered accurate. For example, if the amount of per-diem interest used to prepare disclosures is less than the amount of per-diem interest charged at consummation, and as a result the finance charge is understated by $200, the disclosed finance charge is considered accurate even though the understatement is not within the $100 tolerance of § 226.18(d)(1). In this example, if in addition to the understatement related to the per-diem interest, a $90 fee is incorrectly omitted from the finance charge, causing it to be understated by a total of $290, the finance charge is considered accurate because the $90 fee is within the tolerance in § 226.18(d)(1).◄

* * * * *

17(f) Early disclosures.

1. *Change in rate or other terms.* Redisclosure is required for changes that occur between the time disclosures are made and consummation if the annual percentage rate in the consummated transaction exceeds the limits prescribed in ►this section, even if the initial disclosures would be considered accurate under the tolerances in §§ 226.18(d) or 226.22(a).◄ [§ 226.22(a) (1/8 of 1 percentage point in regular transactions and 1/4 of one percentage point in irregular transactions. Redisclosure is also required, even if the annual percentage rate is within the permitted tolerance, if the disclosures were not based on estimates in accordance with § 226.17(c)(2) and labeled as such.] To illustrate:

i. ►*General. A.*◄ If disclosures are made in a regular transaction on July 1, the transaction is consummated on July 15, and the actual annual percentage rate varies by more than 1/8 of 1 percentage point from the disclosed annual percentage rate, the creditor must either redisclose the changed terms or furnish a complete set of new disclosures before consummation. Redisclosure is required even if the disclosures made on July 1 are based on estimates and marked as such.

►B. In a regular transaction, if early disclosures are marked as estimates and the disclosed annual percentage rate is within ⅛ of 1 percentage point of the rate at consummation, the creditor need not redisclose the changed terms (including the annual percentage rate).◄

ii. ►*Nonmortgage loan.*◄ * * * (See § 226.18(d)►(2)◄ [and footnote 41] of this part.)

iii. ►*Mortgage loan.* At the time TILA disclosures are prepared in July, the loan closing is scheduled for July 31 and the creditor does not plan to collect per-diem interest at consummation. Consummation actually occurs on August 5, and per-diem interest for the remainder of August is collected as a prepaid finance charge. Assuming there were no other changes requiring redisclosure, the creditor may rely on the disclosures prepared in July that were accurate when they were prepared. However, if the creditor prepares new disclosures in August that will be provided at consummation, the new disclosures must take into account the amount of the per-diem interest known to the creditor at that time.◄ [If early disclosures are marked as estimates and the disclosed annual percentage rate is within tolerance at consummation, the creditor need not redisclose the changed terms (including the annual percentage rate).]

►*Paragraph 17(f)(2).*

1. *Irregular transactions.* For purposes of this paragraph, a transaction is deemed to be "irregular" according to the definition in footnote 46 of § 226.22(a)(3).◄

* * * * *

7. In Supplement I to Part 226, under *Section 226.18—Content of Disclosures*, the following amendments would be made:

a. Under *18(c) Itemization of Amount Financed.*, paragraph 4. would be revised;

b. Under *18(c)(1)(iv).*, paragraph 2. would be revised;

c. Under *18(d) Finance charge.*, a new paragraph *18(d)(2) Other credit.* would be added after paragraph 1; and

d. Under *18(n) Insurance.*, the heading would be revised and paragraph 2. would be added.

The revisions and additions would read as follows:

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Section 226.18—Content of Disclosures

* * * * *

18(c) Itemization of amount financed.

* * * * *

4. *RESPA transactions.* The Real Estate Settlement Procedures Act (RESPA) requires creditors to provide ►a◄ good faith estimate[s] of closing costs ► and a settlement statement listing the amounts paid by the consumer◄. Transactions subject to RESPA are exempt from the requirements of § 226.18(c) if the creditor complies with ►RESPA's requirements for a◄ [the] good faith estimate[s] ► and settlement statement.◄ [requirement.]

The itemization of the amount financed need not be given, even though the content and timing of the good faith estimate[s] ►and settlement statement◄ under RESPA differ from the ►requirements of◄ § ►§ ◄ 226.18(c)►and 19(a)(2)◄ [requirement]. ►If the settlement statement is substituted for the itemization when redisclosure is required under § 226.19(a)(2), it must be delivered to the consumer at or prior to consummation.◄

* * * * *

Paragraph 18(c)(1)(iv).

* * * * *

[2. Prepaid mortgage insurance premiums. RESPA requires creditors to give consumers a settlement statement disclosing the costs associated with mortgage loan transactions. Included on the settlement statement are mortgage insurance premiums collected at settlement that are prepaid finance charges. In calculating the total amount of prepaid finance charges, creditors should use the amount for mortgage insurance listed on the line for mortgage insurance on the settlement statement (line 1002 on HUD–1 or HUD 1–A), without adjustment, even if the actual amount collected at settlement may vary because of RESPA's escrow accounting rules. Figures for mortgage insurance disclosed in conformance with RESPA shall be deemed to be accurate for purposes of Regulation Z.]

►2. *Escrow items.* RESPA requires creditors to give consumers a good faith estimate and settlement statement disclosing the costs associated with mortgage loan transactions. Included in these disclosures are amounts which are paid at or before consummation and placed in an escrow or impound account. Typically some, but not all, of the escrow items are prepaid finance charges, such as mortgage insurance premiums.

Regardless of how the escrow amounts are shown on the good faith estimate or settlement statement for RESPA purposes, creditors must be able to identify the amount attributable to finance charges in order to calculate the total prepaid finance charge under § 226.18(c)(1)(iv).

i. *Itemized amounts.* If the amounts paid into escrow are individually itemized on the good faith estimate and the settlement statement, the creditor may use the itemized amount even if the actual amount collected at settlement varies because of RESPA's escrow accounting rules. For example, if the itemized amount on the settlement statement includes mortgage insurance, creditors may rely on the amount listed on line 1002 of the HUD–1 or HUD 1–A, even though an adjustment to the aggregate amount of the escrow items may be shown on another line in the 1000 series. If an itemized escrow amount that is a finance charge is disclosed in conformance with RESPA, it shall be deemed to be accurate for purposes of Regulation Z.

ii. *Lump-sum amounts.* If an amount paid into escrow is listed as a lump sum on the good faith estimate and the settlement statement, and if that amount includes some costs that are finance charges, the creditor

must identify the amount attributable to finance charges to calculate the total prepaid finance charge under § 226.18(c)(1)(iv). To determine the amount attributable to the finance charge, creditors must use single-item accounting, as defined under RESPA (24 CFR §§ 3500.17(b) and (d)(2)). Alternatively, creditors may treat the entire amount paid into escrow as a prepaid finance charge.◄

* * * * *

18(d) Finance charge.

* * * * *

►*Paragraph 18(d)(2) Other credit.*

1. *Tolerance.* When a finance charge error results in a miscalculation of the amount financed, or of some other numerical disclosure for which the regulation provides no specific tolerance, the miscalculation does not violate the act or the regulation if the finance charge error is within the permissible tolerance under this paragraph.◄

* * * * *

Paragraph 18(n) Insurance ►and debt cancellation.◄

* * * * *

►2. *Debt cancellation.* Creditors may use the model credit insurance disclosures only if the debt cancellation coverage constitutes insurance under state law. Otherwise, they may provide a parallel disclosure that refers to debt cancellation coverage.◄

* * * * *

8. In Supplement I to Part 226, under *Section 226.19—Certain Residential Mortgage and Variable-Rate Transactions,* under *19(a)(2) Redisclosure required.*, the first sentence of paragraph 1. would be revised to read as follows:

* * * * *

Section 226.19—Certain Residential Mortgage and Variable-Rate Transactions

* * * * *

Paragraph 19(a)(2) Redisclosure required.

1. *Conditions for redisclosure.* Creditors must make new disclosures if the annual percentage rate at consummation differs from the estimate originally disclosed by more than ⅛ of 1 percentage point in regular transactions or ¼ of 1 percentage point in irregular transactions, as defined in ►footnote 46 of ◄§ 226.22►(a)(3)◄ * * *

* * * * *

9. In Supplement I to Part 226, *Section 226.22—Determination of the Annual Percentage Rate,* would be amended by adding new paragraphs 22(a)(4) and 22(a)(5) to read as follows:

* * * * *

Section 226.22—Determination of the Annual Percentage Rate

22(a) Accuracy of the annual percentage rate.

* * * * *

►*Paragraph 22(a)(4) Mortgage loans.*

1. Example. If a creditor improperly omits a $75 fee from the finance charge on a regular transaction, the understated finance charge is considered accurate under § 226.18(d)(1), and the annual percentage rate corresponding to that understated finance charge also is considered accurate even if it falls outside the tolerance of ⅛ of 1 percent provided under § 226.22(a)(2). In that case, an annual percentage rate corresponding to a $100 understatement of the finance charge would not be considered accurate.

Paragraph 22(a)(5) Additional tolerance for mortgage loans.

1. *Example.* This paragraph contains an additional tolerance for a disclosed annual percentage rate that is incorrect but is closer to the actual annual percentage rate than the rate that would be considered accurate under the tolerance in § 226.22(a)(4). To illustrate: in an irregular transaction subject to a ¼ of 1 percent tolerance, if the actual annual percentage rate is 9.00 percent and a $75 omission from the finance charge corresponds to a rate of 8.50 percent that is considered accurate under § 226.22(a)(4), a disclosed APR of 8.65 percent is within the tolerance in § 226.22(a)(5). In this example of an understated finance charge, a disclosed annual percentage rate below 8.50 or above 9.25 percent will not be considered accurate.◄

* * * * *

10. In Supplement I to Part 226, *Section 226.23—Right of Rescission* would be amended by adding new 23(g) and (23)(h) to read as follows:

* * * * *

Section 226.23—Right of Rescission

* * * * *

►*23(g) Tolerances for accuracy.*

Paragraph 23(g)(2) One percent tolerance.

1. *New advance.* The phrase "new advance" has the same meaning as in comment 23(f)–4.

23(h) Special Rules for Foreclosures.

1. *Rescission.* Section 226.23(h) applies only to transactions that are subject to rescission under § 226.23(a)(1).

Paragraph 23(h)(1)(i).

1. *Mortgage broker fees.* A consumer may rescind a loan in foreclosure if a mortgage broker fee was omitted or understated, without regard to the dollar amount involved. For example, a consumer—s right to rescind a loan in foreclosure is triggered by a $10 understatement of a mortgage broker fee; an understatement of more than $35 in other finance charges also triggers rescission.◄

* * * * *

11. In Supplement I to Part 226, under *Section 226.31—General Rules,* under *Paragraph 31(c)(1)* paragraph 1. would be redesignated as paragraph 1. under *31(c),* and paragraph 2., under *Paragraph 31 (c)(1)* would be redesignated as paragraph 1.

12. In Supplement I to Part 226, under *Section 226.32—Requirements for Certain Closed-End Home Mortgages,* the following amendments would be made:

a. Under *Paragraph 32(b)(1)(i).*, paragraph 1. would be revised; and

b. Under *32(c)(3).*, a new paragraph 2. would be added.

The revisions and additions would read as follows:

* * * * *

Section 226.32—Requirements for Certain Closed-End Home Mortgages

* * * * *

32(b) Definitions.

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

►1. *General.* Section 226.32(b)(1)(i) includes in the total "points and fees" items defined as finance charges under §§ 226.4(a) and 226.(4)(b). Items excluded from the finance charge under other provisions of § 226.4 are not included in the total "points and fees" under paragraph 32(b)(1)(i), but may be included in "points and fees" under paragraphs 32(b)(1)(ii) and 32(b)(1)(iii). Interest, including per diem interest, is excluded from "points and fees" under § 226.32(b)(1).◄

* * * * *

32(c) Disclosures.

* * * * *

32(c)(3) Regular payment.

* * * * *

►2. *Balloon payments.* If a loan with a term of five years or more provides for a balloon payment, the balloon payment must be disclosed. For a loan with a term of less than five years, a balloon payment is prohibited.◄

* * * * *

13. In Supplement I to Part 226, under *Section 226.33—Requirements for Reverse Mortgages,* under *Paragraph 33(a)(2),* in paragraph 2., the third and fourth sentences would be revised and a new sentence would be added at the end of the paragraph to read as follows.

* * * * *

Section 226.33—Requirements for Reverse Mortgages

33(a) Definition.

* * * * *

Paragraph 33(a)(2).

* * * * *

2. *Definite term or maturity date.* * * * Stating a definite maturity date or term of repayment in an obligation does not violate the definition of a reverse-mortgage transaction if the maturity date or term of repayment used would ►not◄ [in no case] operate to cause maturity prior to the occurrence of any of the maturity events recognized in the regulation.

►For example, some reverse mortgage programs specify that the final maturity date is the borrower's 150th birthday; other programs include a shorter term but provide that the term is automatically extended for consecutive periods if none of the other maturity events has yet occurred. These programs would be permissible.◄ [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 events specified in this section had yet occurred would be permissible.]

* * * * *

14. In Supplement I to Part 226, under *APPENDICES G AND H—OPEN-END AND CLOSED-END MODEL FORMS AND CLAUSES,* a new paragraph 2. would be added to read as follows:

* * * * *

Appendices G and H—Open-End and Closed-End Model Forms and Clauses

* * * * *

►2. *Debt cancellation coverage.* The regulation does not authorize creditors to characterize debt cancellation fees as insurance premiums for purposes of this regulation. Creditors may provide a disclosure that refers to debt cancellation coverage whether or not the agreement is considered insurance. Creditors may use the model credit insurance disclosures only if the debt cancellation coverage constitutes insurance under state law.◄

* * * * *

15. In Supplement I to Part 226, under *Appendix H—Closed-End Model Forms and Clauses*, a new sentence would be added to the end of paragraph 11. to read as follows:

* * * * *

Appendix H—Closed-End Model Forms and Clauses

* * * * *

11. *Models H–8 and H–9.* * * * ►The prior version of model form H–9 is substantially similar to the current version and creditors may continue to use it, as appropriate. Creditors are encouraged, however, to use the current version when reordering or reprinting forms.◄

By order of the Board of Governors of the Federal Reserve System, acting through the Secretary of the Board under delegated authority, November 14, 1996.

William W. Wiles,

Secretary of the Board

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