FEDERAL RESERVE press release

For immediate release

March 28, 1996

The Federal Reserve Board today published final revisions to its official staff commentary to Regulation Z, Truth in Lending.

The changes provide guidance mainly on issues relating to reverse mortgages and mortgages bearing rates above a certain percentage or fees above a certain amount. The update also addresses issues of general interest, such as a card issuer's responsibilities when a cardholder asserts a claim or defense relating to a merchant dispute.

The final rule is effective April 1, 1996. However, compliance is optional until October 1, 1996.

The Board's notice is attached.

Attachment

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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: Final rule; official staff interpretation.

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

DATES: This rule is effective April 1, 1996. Compliance is optional until October 1, 1996.

FOR FURTHER INFORMATION CONTACT: For Subparts A and B (open-end credit), Jane Ahrens, Senior Attorney or Jane Jensen Gell, Staff Attorney; for Subparts A, C and E (closed-end credit, reverse mortgages, and mortgages bearing rates or fees above a certain percentage or amount), Ms. Ahrens or Michael Hentrel, 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.

In December, the Board published proposed amendments to the commentary to Regulation Z (60 FR 62764, December 7, 1995). The Board received about 120 comments. Nearly 75 percent of the comments received were from financial institutions, mortgage lenders, credit or guarantee automobile protection (GAP) insurance providers, pawnbrokers or other creditors (or their representatives); the remainder were from consumer representatives, government officials, lawyers and individuals. Overall, commenters generally supported the proposed amendments. Views were mixed on a number of comments. In particular, nearly 60 percent of the commenters addressed the comment treating certain debt cancellation agreements as finance charges; most opposed the proposal. Except as discussed below, the update has been adopted as proposed. Technical amendments to proposed comments that respond to commenters' suggestions or concerns are not specifically addressed in these supplementary materials. Compliance with the commentary update is mandatory on October 1, 1996.

The revisions mainly incorporate guidance given in the supplementary information that accompanied an amendment to Regulation Z implementing the Home Ownership and Equity Protection Act of 1994 (HOEPA), contained in the Riegle Community Development and Regulatory Improvement Act of 1994, Pub. L. 103-325, 108 Stat. 2160. These amendments, published on March 24, 1995, and which became effective the following 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 (60 FR 15463). The amendments also impose new disclosure requirements for reverse mortgage transactions.

The update does not reflect changes to the commentary regarding recent amendments to the TILA concerning finance charge disclosures for home mortgage loans. The Truth in Lending Act Amendments of 1995 (1995 Amendments, Pub. L. 104-29, 109 Stat. 271) clarify the treatment of several fees typically associated with real estate-related lending. Some provisions exclude certain real estate-related closing costs from the finance charge, which generally codify interpretations already provided in this commentary. One provision categorizes all brokers fees paid by the consumer to the broker (or to the creditor for delivery to the broker) as finance charges. The 1995 Amendments also revise tolerances for finance charge calculations for loans secured by real estate or dwellings. The Board expects to publish proposed amendments to Regulation Z implementing the 1995 Amendments; corresponding revisions to the commentary will be proposed as part of that rulemaking.

II. Commentary Revisions

SUBPART A -- General

SECTION 226.4 -- Finance Charge

4(a) Definition

The Board received a substantial number of comments regarding proposed comment 4(a)-8, which addressed the treatment of fees charged in connection with debt cancellation agreements. Many commenters believed that debt cancellation fees should be treated as insurance premiums under § 226.4(d), which 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. As proposed, the comment sought to clarify that, under the existing regulation, debt cancellation fees can be excluded from the finance charge only if they are "insurance" and all the requirements of § 226.4(d) are satisfied. The Board has not defined the term "insurance" for purposes of the rules governing insurance premiums in § 226.4(d), but has instead deferred to state law. The proposed comment was consistent with this approach.

The comments, mostly from creditors or their trade associations, expressed concern about the need to determine on a state-by-state basis whether debt cancellation fees should be treated as insurance premiums. Many commenters believed that a state law analysis would create a lack of uniformity in measuring the cost of credit, contrary to the purposes of the TILA, because debt cancellation fees would be included in the finance charge and APR in some states and not in others. Several commenters expressed concern about potential liability if state law is unclear.

In response to these concerns, the proposed comment regarding debt cancellation fees has been withdrawn. The issues raised by the commenters regarding equal treatment of such fees would be better addressed in the context of a regulatory amendment; it is anticipated that a proposed rule governing debt cancellation fees would be considered along with proposed regulations to implement the 1995 Amendments.

SUBPART B -- Open-end Credit

SECTION 226.6 -- Initial Disclosure Statement

6(b) Other Charges

Comment 6(b)-1 clarifies 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 merely incidental. The comment clarifies that creditors cannot avoid disclosing a fee as an "other charge" by characterizing the fee as one entitling the consumer to belong to an organization, if the organization has no substantive benefits other than

obtaining the credit. If an independent organization and a card issuer enter into an agreement offering the opportunity to apply for a credit card as one of several benefits of membership in the organization, these benefits would generally not be considered to be merely incidental to the credit feature.

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

Comments 12(c)(2)-1 and -2 address a card issuer's responsibilities in responding to a cardholder's right to assert a claim or defense.

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. Several commenters expressed concern that the proposed comment would not permit card issuers to terminate the investigation if the cardholder fails to respond to requests for information the card issuer can reasonably obtain only from the cardholder. A sentence has been added to clarify that in conducting an investigation, a card issuer's lack of knowledge resulting from the cardholder's failure or refusal to comply with a particular request may be used as a factor in resolving the dispute.

Card issuers cannot satisfy the requirement to conduct a reasonable investigation by accepting a merchant's view of the dispute without also giving the cardholder an opportunity to respond. The comment clarifies that a reasonable investigation includes an independent assessment of the cardholder's claim based on information from both the merchant and the cardholder, if possible. The card issuer's dispute resolution experience, if any, with the merchant could be a factor in that assessment.

Comment 12(c)(2)-1 also has been revised to clarify that a card issuer may continue its normal collection activities for the portion of the balance that is delinquent and undisputed. Some commenters believed that the regulation would permit card issuers to begin collection actions on an amount in dispute. Although the card issuer is not prohibited from undertaking its normal collection activities for delinquent accounts, amounts in dispute are not considered delinquent.

One commenter recommended that consumers be given notice of their rights under the claims and defenses provision. Such a notice requirement would be better addressed in the context of a regulatory amendment.

SECTION 226.14 -- Determination of Annual Percentage Rate

14(c) Annual Percentage Rate for Periodic Statements

Comment 14(c)-10 provides 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. The comment clarifies how creditors using the date of the transaction to figure finance charges calculate the APR to reflect the delay in posting. Creditors using the posting date to calculate finance charges are not affected by the comment. Creditors that calculate the APR in accord with comment 14(c)-10 for the billing cycle in which the transaction is posted need not furnish an amended statement for the previous cycle to reflect the missing transaction.

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 is revised to clarify that if a contract for a variable-rate transaction provides for a delay in implementing changes in index values, the creditor may use any index in effect during the delay period. The last paragraph has been renumbered, and the first sentence in that paragraph is revised for clarity.

Comment 17(c)(1)-18 addresses pawn transactions. The comment clarifies that the term creditor may include pawnbrokers. The comment is adopted as proposed; it covers extensions of credit by pledging an item, or by selling an item with the opportunity to repurchase (which occurs seventy-five percent or more of the time, in the Board's understanding). Section 226.18 requires that creditors make certain disclosures as applicable, and this comment clarifies how some of the items required to be disclosed under § 226.18 (such as the amount financed, the finance charge, and the annual percentage rate) should be disclosed in a pawn transaction. The comment also provides guidance on when a separate itemization of the amount financed must be disclosed, and how to calculate the finance charge when fees are charged.

SECTION 18 -- Content of Disclosures

18(c) Itemization of Amount Financed
Paragraph 18(c)(1)(iii)

Comment 18(c)(1)(iii)-2 concerns the treatment of certain charges, such as finder's fees or commissions, that may sometimes be added to a fee charged by a third party for services such as extended warranties and service contracts on automobiles. The comment offers guidance on how creditors may itemize and disclose the amount charged for the service (including any amount the creditor may have retained).

For the most part, commenters agreed with the Board's proposed treatment. As proposed, the comment stated that a creditor could include in the "amount paid to others," any amount retained by the creditor without itemizing or noting this fact. Concern is raised about the appropriateness of such treatment under the TILA where a substantial portion of a fee categorized as "amounts paid to others," is in fact retained by the creditor. Accordingly, a sentence has been added to clarify that given the flexibility in itemizing the amount financed, creditors may reflect that they have retained a portion of the "amount paid to others" rather than disclosing the specific amount retained.

SECTION 226.20 -- Subsequent Disclosure Requirements

20(a) Refinancings

Comment 20(a)-3, as proposed, clarified that changing the index on a variable-rate transaction does not require new disclosures to consumers. Upon further analysis, the final comment provides that changing the index to a comparable index does not require new disclosures, whether the change replaces the existing index or substitutes 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

Comment 31(c)(1)-1 clarifies that for purposes of § 226.32, disclosures are furnished (that is, delivered) when received by the consumer, not when mailed by the creditor. The majority of the commenters opposed the proposal. Some suggested that the Board follow the timing requirements of § 226.19(a), which allows creditors to provide certain disclosures by mail. The timing rules in §§ 226.19(a) and 226.31 differ; however, the HOEPA requires a different interpretation of § 226.31(c)(1). The HOEPA's disclosure scheme is intended to ensure that consumers who have applied for a loan covered by § 226.32 are provided with basic cost information about the impending transaction, and have a period of time to consider whether to complete the transaction.

Comment 31(c)(1)-2 clarifies that while the definition of business days is the same as that for the right of rescission, the timing rules differ.

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

Comment 31(c)(1)(i)-1 addresses a creditor's duty to provide new § 226.32(c) disclosures after a change in terms. As adopted, the comment incorporates the substance of proposed comment 31(d)-1, which provides that where there is a change in terms of disclosures labelled as estimates redisclosure is required. Further, language from the

supplemental information accompanying the proposal has been added to clarify that a change in terms may result from a formal written agreement or otherwise.

31(c)(1)(ii) Telephone Disclosures

Based on comment and upon further analysis, comment 31(c)(1)(ii)-1, as adopted, uses business days for purposes of rescission, which is consistent with other timing requirements in § 226.31. The proposal would have allowed creditors to use calendar days to calculate the timing requirements for telephone disclosures which are permitted when a consumer initiates a change in terms.

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

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. Language has been added to clarify that the impending sale of the consumer's home at foreclosure is an example of a bona fide personal financial emergency where foreclosure would occur during the three-day waiting period.

31(c)(2) Disclosures for Reverse Mortgages

To achieve consistency with other timing rules in § 226.31, comment 31(c)(2)-1 clarifies that for purposes of providing reverse mortgage disclosures to consumers, creditors are to use the definition of "business day" found in comment 31(c)(1)-2.

31(d) Basis of Disclosures and Use of Estimates

Comment 31(d)-1, as adopted, clarifies that, for purposes of Subpart E, the rule in § 226.31(c)(1)(i) requiring new disclosures when creditors change terms also applies to disclosures marked as estimates.

SECTION 226.32 -- Requirements for Certain Closed-end Home Mortgages

32(a) Coverage

Paragraph 32(a)(1)(ii)

Comment 32(a)(1)(ii)-1, as adopted, includes an additional example illustrating the calculation of "total loan amount."

Creditors must follow the rules in § 226.32 if 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 each year. Comment 32(a)(1)(ii)-2 states the adjusted amount for 1996 ($412), and addresses how the Board calculates the adjustment.

32(c)(3) Regular payment

The substance of comments 32(c)(3)-1 and 32(c)(3)-2 are adopted as proposed, but the comments have been combined and reorganized to state more precisely the general rule and exceptions to that rule. The comment clarifies that creditors may rely on the rules in § 226.18(g) for determining the regular payment, with one exception. Section 18(g) provides flexibility to creditors in reflecting optional amounts such as voluntary credit life insurance in the payment schedule. Language has been added to clarify that only optional amounts to which the consumer has agreed at the time the disclosures are given may be disclosed as a part of the regular payment.

32(d) Limitations

32(d)(2) Negative Amortization

Comment 32(d)(2)-1 has been modified to clarify the interpretation of the prohibition against including negative amortization in a mortgage covered by § 226.32.

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.

For the reasons set forth in the preamble, the Board amends 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, under 4(d) Insurance., paragraph 5. is revised as follows.

Supplement I--Official Staff Interpretations

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Subpart A--General

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Section 226.4--Finance Charge

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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 to purchase credit life insurance, or to assign an existing life insurance policy, or to pledge security such as a certificate of deposit -- and the consumer purchases the credit life insurance policy, the premium must be included in the finance charge. (If the consumer assigns a preexisting policy or pledges security 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. is revised to read as follows:

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 (such as a newsletter or a member information hotline) are merely incidental to the credit feature, the membership fee would have to be disclosed as 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., paragraph 1 is revised and paragraph 2 is added to read as follows:

Section 226.12--Special Credit Card Provisions
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12(c)(2) Adverse credit reports prohibited.
1. Scope of prohibition. Although an amount in dispute may not be reported as delinquent until the matter is resolved:

i. That amount may be reported as disputed.

ii. Nothing in this provision prohibits the card issuer from undertaking its normal collection activities for the delinquent and undisputed portion of the account.

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. A reasonable investigation requires an independent assessment of the cardholder's claim based on information obtained from both the cardholder and the merchant, if possible. In conducting an investigation, the card issuer may request the cardholder's reasonable cooperation. The card issuer may not automatically consider a dispute settled if the cardholder fails or refuses to comply with a particular request. However, if the card issuer otherwise has no means of obtaining information necessary to resolve the dispute, the lack of information resulting from the cardholder's failure or refusal to comply with a particular request may lead the card issuer reasonably to terminate the investigation.
* * * * *

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. is added to read as follows:

Section 226.14--Determination of Annual Percentage Rate
* * * * *

14(c) Annual percentage rate for periodic statements.
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10. Transactions at end of billing cycle. The annual percentage rate reflects transactions and charges imposed during the billing cycle. However, it may be impracticable to post a transaction that occurs at the end of a billing cycle until the following cycle, such as a cash advance that occurs on the last day of a billing cycle and is posted to the account in the following cycle. A card issuer that uses the date of the transaction to figure finance charges should calculate the annual percentage rate as follows for the billing cycle in which the transaction and charges are posted:

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

ii. The numerator includes 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. is revised and a new paragraph 18. is added to read as follows:

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 index value in effect during the 45 day period 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 1/4 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 7 1/2 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.

vi. A loan 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 is not a discounted variable-rate loan. 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.

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18. Pawn Transactions. When, in connection with an extension of credit, a consumer pledges or sells an item to a pawnbroker 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, disclosures are required. In addition to other disclosure requirements that may be applicable under § 226.18, for purposes of pawn transactions:

i. The amount financed is the initial sum paid to the consumer. The pawnbroker creditor need not provide a separate itemization of the amount financed if that entire amount is paid directly to the consumer and the disclosed description of the amount financed is "the amount of cash given directly to you" or a similar phrase.

ii. The finance charge is the difference between the initial sum paid to the consumer and the redemption price plus any other finance charges paid in connection with the transaction. (See § 226.4.)

iii. The term of the transaction, for calculating the annual percentage rate, is the period of time agreed to by the pawnbroker creditor and the consumer. The term of the transaction does not include a grace period (including any statutory grace period) after the agreed redemption date.
* * * * *

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

Section 226.18--Content of Disclosures
* * * * *

Paragraph 18(c)(1)(iii).
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2. Charges added to amounts paid to others. A sum is sometimes added to the amount of a fee charged to a consumer for a service provided by a third party (such as for an extended warranty or a service contract) that is payable in the same amount in comparable cash and credit transactions. In the credit transaction, the amount is retained by the creditor. Given the flexibility permitted in meeting the requirements of the amount financed itemization (see the commentary to § 226.18(c)), the creditor in such cases may reflect that the creditor has retained a portion of the amount paid to others. For example, the creditor could add to the category "amount paid to others" language such as "(we may be retaining a portion of this amount)."
* * * * *

8. In Supplement I to Part 226, under Section 226.20 Subsequent Disclosure Requirements, under Paragraph 20(a) Refinancings., paragraph 3. is 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.

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 to a comparable index, whether the change replaces the existing index or substitutes an index for one that no longer exists.

iii. If either of the events in paragraph ii.A. or ii.B. occurs 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.
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9. In Supplement I to Part 226, a new Subpart E--Special Rules for Certain Home Mortgage Transactions is added as follows:
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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 § 226.32 disclosures at least three business days prior to consummation. Under § 226.32, "business day" has the same meaning as the rescission rule in comment 2(a)(6)-2 -- all calendar days except Sundays and

the federal legal holidays listed in 5 USC 6103(a). However, while the disclosure rule under §§ 226.15 and 226.23 extends to midnight of the third business day, the rule under § 226.32 does not. For example, under § 226.32, if disclosures were provided on a Friday, consummation could occur any time on Tuesday, the third business day following receipt of the disclosures. If the timing of the rescission rule were to be used, consummation could not occur until after midnight on Tuesday.

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

1. Redisclosure required. Creditors must provide new disclosures when a change in terms makes disclosures previously provided under § 226.32(c) inaccurate, including disclosures based on and labeled as an estimate. A change in terms may result from a formal written agreement or otherwise.

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

1. Telephone disclosures. Disclosures by telephone must be furnished at least three business days prior to consummation, calculated in accord with the timing rules under § 226.31(c)(1).

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 under § 226.23(e). Whether these criteria are met is determined by the facts surrounding individual situations. The imminent sale of the consumer's home at foreclosure during the three-day period is one example of a bona fide personal financial emergency. Each consumer entitled to the three-day waiting period must sign the handwritten 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" has the same meaning as in comment 31(c)(1)-2 -- all calendar days except Sundays and the federal legal holidays listed in 5 USC 6103(a). This means if disclosures are provided on a Friday, consummation could occur any time on Tuesday, the third business day following receipt of the disclosures.

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

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

1. Redisclosure. Section 226.31(d) 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. For purposes of Subpart E, the rule in § 226.31(c)(1)(i) requiring

new disclosures when the creditor changes terms also applies to disclosures labeled as estimates.

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 application is deemed received in September and 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. (See comment 19(b)-3 to determine whether a transaction involves an intermediary 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. Some examples follow, each using a $10,000 amount borrowed, a $300 appraisal fee, and $400 in points:

i. If the consumer finances a $300 fee for a creditor-conducted appraisal and pays $400 in points at closing, the amount financed under § 226.18(b) is $9,900 ($10,000 plus the $300 appraisal fee that is paid to and 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 ($9,900) to derive a total loan amount of $9,600.

ii. If the consumer pays the $300 fee for the creditor-conducted appraisal in cash at closing, the $300 is included in the points and fees calculation because it is paid to the creditor. However, because the $300 is not financed by the creditor, the 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).

iii. If the consumer finances a $300 fee for an appraisal conducted by someone other than the creditor or an affiliate, the $300 fee is not included with other points and fees under § 226.32(b)(1)(iii). The amount financed under § 226.18(b) is $9,900 ($10,000 plus the $300 fee for an independently-conducted appraisal that is financed by the creditor, less the $400 paid in cash and deducted as prepaid finance charges).

2. Annual adjustment of $400 amount. A mortgage loan is covered by § 226.32 if the total points and fees payable by the consumer at or before loan consummation exceed the greater of $400 or 8 percent of the total loan amount. The $400 figure is adjusted annually by the Board; the adjusted figure becomes effective on January 1 of the following year. The adjusted figure for 1996 is $412, reflecting a 3.00 percent increase in the CPI-U from June 1994 to June 1995, rounded to the nearest whole dollar. The Board will publish adjustments after the June figures become available each year. The adjustment for the upcoming year will be included in any proposed commentary published in the fall, and incorporated into the commentary the following spring.

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 under paragraph 32(b)(1)(i), although a 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. Mortgage 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 the 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. The disclosures need not be a part of the note or mortgage document.

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. In disclosing the regular payment, creditors may rely on the rules set forth in § 226.18(g); however, the amounts for voluntary items not agreed to by the consumer such as credit life insurance may not be included in the regular payment.

i If the loan has more than one payment level, the regular payment for each level must be disclosed. For example:

A. In a 30-year graduated payment mortgage where there will be payments of $300 for the first 120 months, $400 for the next 120 months, and $500 for the last 120 months, each payment amount must be disclosed, along with the length of time that the payment will be in effect.

B. If interest and principal are paid at different times, the regular amount for each must be disclosed.

C. 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 initial 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 level, where a payment schedule provides for more than one payment level 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 reasonable increases in the principal balance that result from events permitted by the legal obligation unrelated to the payment schedule. For example, when a consumer fails to obtain property insurance and the creditor purchases insurance, the creditor may add a reasonable premium to the consumer's principal balance, to the extent permitted by the legal obligation.

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 changes in accordance with the legal obligation 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 precomputed (such as add-on) 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. For purposes of computing a refund of unearned interest, 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 should use the state law definition in determining if a refund is a prepayment penalty.

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, as long as the creditor has a reasonable basis for believing that the income exists and will support the loan.

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 statute or 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. 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 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 events specified in this section had yet occurred would be permissible.

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 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 is 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 forth 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 (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 principal 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, as long as the pages constitute an integrated document and the table disclosing the total annual loan cost rates is on a single page.

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, March 28, 1996.

(signed) William W. Wiles
William W. Wiles
Secretary of the Board