

TRUTH IN LENDING ACT (TILA)

OVERVIEW

The Truth in Lending Act (TILA), 15 U.S.C. 1601 et seq., was enacted on May 29, 1968, as title I of the Consumer Credit Protection Act (Pub. L. 90-321). The TILA, implemented by Regulation Z (12 CFR 1026), became effective July 1, 1969.

The TILA was first amended in 1970 to prohibit unsolicited credit cards. Additional major amendments to the TILA and Regulation Z were made by the Fair Credit Billing Act of 1974, the Consumer Leasing Act of 1976, the Truth in Lending Simplification and Reform Act of 1980, the Fair Credit and Charge Card Disclosure Act of 1988, the Home Equity Loan Consumer Protection Act of 1988.

Regulation Z also was amended to implement section 1204 of the Competitive Equality Banking Act of 1987, and in 1988, to include adjustable rate mortgage loan disclosure requirements. All consumer leasing provisions were deleted from Regulation Z in 1981 and transferred to Regulation M (12 CFR 1013).

The Home Ownership and Equity Protection Act of 1994 amended the TILA. The law imposed new disclosure requirements and substantive limitations on certain closed-end mortgage loans bearing rates or fees above a certain percentage or amount. The law also included new disclosure requirements to assist consumers in comparing the costs and other material considerations involved in a reverse mortgage transaction and authorized the Federal Reserve Board to prohibit specific acts and practices in connection with mortgage transactions.

The TILA amendments of 1995 dealt primarily with tolerances for real estate secured credit. Regulation Z was amended on September 14, 1996 to incorporate changes to the TILA. Specifically, the revisions limit lenders' liability for disclosure errors in real estate secured loans consummated after September 30, 1995. The Economic Growth and Regulatory Paperwork Reduction Act of 1996 further amended the TILA. The amendments were made to simplify and improve disclosures related to credit transactions.

The Electronic Signatures in Global and National Commerce Act (the E-Sign Act), 15 U.S.C. 7001 et seq., was enacted in 2000 and did not require implementing regulations. On November 9, 2007, the amendments to Regulation Z and the official staff commentary were issued to simplify the regulation and provide guidance on the electronic delivery of disclosures consistent with the E-Sign Act.

In July 2008, Regulation Z was amended to protect consumers in the mortgage market from unfair, abusive, or deceptive lending and servicing practices. Specifically, the change applied protections to a newly defined category of "higher-priced mortgages" that includes virtually all closed-end subprime loans secured by a consumer's principal dwelling. The revisions also applied new protections to mortgage loans secured by a dwelling, regardless of loan price, and

required the delivery of early disclosures for more types of transactions. The revisions also banned several advertising practices deemed deceptive or misleading. The Mortgage Disclosure Improvement Act of 2008 (MDIA) broadened and added to the requirements of the Board's July 2008 final rule by requiring early truth-in-lending disclosures for more types of transactions and by adding a waiting period between the time when disclosures are given and consummation of the transaction. In 2009, Regulation Z was amended to address those provisions. The MDIA also requires disclosure of payment examples if the loan's interest rate or payments can change, as well as disclosure of a statement that there is no guarantee the consumer will be able to refinance in the future. In 2010, Regulation Z was amended to address these provisions, which became effective on January 30, 2011.

In December 2008, the Board adopted two final rules pertaining to open-end (not home-secured) credit. The first rule involved Regulation Z revisions and made comprehensive changes applicable to several disclosures required for: applications and solicitations, new accounts, periodic statements, change in terms notifications, and advertisements. The second was a rule published under the Federal Trade Commission (FTC) Act and was issued jointly with the Office of Thrift Supervision and the National Credit Union Administration. It sought to protect consumers from unfair acts or practices with respect to consumer credit card accounts. Before these rules became effective, however, the Credit Card Accountability Responsibility and Disclosure Act of 2009 (Credit CARD Act) amended the TILA and established a number of new requirements for open-end consumer credit plans. Several provisions of the Credit CARD Act are similar to provisions in the Board's December 2008 TILA revisions and the joint FTC Act rule, but other portions of the Credit CARD Act address practices or mandate disclosures that were not addressed in these rules. In light of the Credit CARD Act, the Board, NCUA, and OTS withdrew the substantive requirements of the joint FTC Act rule. On July 1, 2010, compliance with the provisions of the Board's rule that were not impacted by the Credit CARD Act became effective.

The Credit CARD Act provisions became effective in three stages. The provisions effective first (August 20, 2009) required creditors to increase the amount of notice consumers receive before the rate on a credit card account is increased or a significant change is made to the account's terms. These amendments also allowed consumers to reject such increases and changes by informing the creditor before the increase or change goes into effect. The provisions effective next (February 22, 2010) involved rules regarding interest rate increases, over-the-limit transactions, and student cards. Finally, the provisions effective last (August 22, 2010) addressed the reasonableness and proportionality of penalty fees and charges and re-evaluation of rate increases.

In 2009, Regulation Z was amended following the passage of the Higher Education Opportunity Act (HEOA) by adding disclosure and timing requirements that apply to lenders making private education loans.

In 2009, the Helping Families Save Their Homes Act amended the TILA to establish a new requirement for notifying consumers of the sale or transfer of their mortgage loans. The purchaser or assignee that acquires the loan must provide the required disclosures no later than 30 days after the date on which it acquired the loan.

In 2010, the Board further amended Regulation Z to prohibit payment to a loan originator that is

based on the terms or conditions of the loan, other than the amount of credit extended. The amendment applies to mortgage brokers and the companies that employ them, as well as to mortgage loan officers employed by depository institutions and other lenders. In addition, the amendment prohibits a loan originator from directing or “steering” a consumer to a loan that is not in the consumer’s interest to increase the loan originator’s compensation. Separately, the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) amended the TILA to include several provisions that protect the integrity of the appraisal process when a consumer’s home is securing the loan. The rule also requires that appraisers receive customary and reasonable payments for their services. The appraiser and loan originator compensation requirements became effective on April 1, 2011.

The Dodd-Frank Act granted rulemaking authority under the TILA to the Consumer Financial Protection Bureau (CFPB). Title XIV of the Dodd-Frank Act included a number of amendments to TILA, and in 2013, the CFPB issued rules to implement them. Prohibitions on mandatory arbitration and waivers of consumer rights, as well as requirements that lengthen the time creditors must maintain an escrow account for higher-priced mortgage loans, were effective June 1, 2013. The remaining amendments to Regulation Z are effective in January 2014. These amendments include ability-to-repay requirements for mortgage loans, appraisal requirements for higher-priced mortgage loans, a revised and expanded test for high-cost mortgages, as well as additional restrictions on those loans, expanded requirements for servicers of mortgage loans, and refined loan originator compensation rules and loan origination qualification standards. The amendments also established new record retention requirements for certain provisions of the TILA.

In 2013, the CFPB issued a final rule revising the general limitation on the total amount of account fees that a credit card issuer may require a consumer to pay. Effective March 28, 2013, the limit is 25 percent of the credit limit in effect when the account is opened. The limitation applies only during the first year after account opening.

In 2013, the CFPB also issued a final rule to remove the requirement that card issuers consider the consumer’s independent ability to pay for applicants who are 21 or older and to permit issuers to consider income and assets to which such consumers have a reasonable expectation of access. This change was effective May 3, 2013, with a mandatory compliance date of November 4, 2013.

Format of Regulation Z

The disclosure rules creditors must follow differ depending on whether the creditor is offering open-end credit, such as credit cards or home-equity lines, or closed-end credit, such as car loans or mortgages.

Subpart A (sections 1026.1 through 1026.4) of the regulation provides general information that applies to open-end and closed-end credit transactions. It sets forth definitions and stipulates which transactions are covered and which are exempt from the regulation. It also contains the rules for determining which fees are finance charges.

Subpart B (sections 1026.5 through 1026.16) relates to open-end credit. It contains rules on account-opening disclosures and periodic statements. It also describes special rules that apply to

credit card transactions, treatment of payments and credit balances, procedures for resolving credit billing errors, annual percentage rate calculations, rescission requirements, and advertising.

Subpart C (sections 1026.17 through 1026.24) relates to closed-end credit. It contains rules on disclosures, treatment of credit balances, annual percentage rate calculations, rescission requirements, and advertising.

Subpart D (sections 1026.25 through 1026.30) contain rules on oral disclosures, disclosures in languages other than English, record retention, effect on state laws, state exemptions, and rate limitations.

Subpart E (sections 1026.31 through 1026.45) contains special rules for certain mortgage transactions. It contains rules on certain disclosures and provides limitations for closed-end loans that have rates or fees above specified amounts and disclosure requirements for home equity plans. It contains requirements for reverse mortgage transactions. It provides for additional prohibitions for specific acts and practices in connection with an extension of credit secured by a dwelling. Finally, it contains rules on valuation independence independence, loan originator compensation in loans secured by a dwelling, loan originator qualification standards, and homeownership counseling requirements for certain types of loans secured by a dwelling. It also contains certain servicing requirements, such as the requirement to provide periodic billing statements. It establishes minimum standards for transactions secured by a dwelling, including repayment ability and qualified mortgage standards.

Subpart F (sections 1026.46 through 1026.48) relates to private education loans. It contains rules on disclosures, limitations on changes in terms after approval, the right to cancel the loan, and limitations on co-branding in the marketing of private education loans.

Subpart G (sections 1026.51 through 1026.60) relates to credit card accounts under an open-end (not home-secured) consumer credit plan (except for § 1026.57(c), which applies to all open-end credit plans). This subpart contains rules regarding credit and charge card application and solicitation disclosures. It also contains rules on evaluation of a consumer's ability to make the required payments under the terms of an account, limits the fees that a consumer can be required to pay, and contains rules on allocation of payments in excess of the minimum payment. It also sets forth certain limitations on the imposition of finance charges as the result of a loss of a grace period, and on increases in annual percentage rates, fees, and charges for credit card accounts, including the reevaluation of rate increases. This subpart prohibits the assessment of fees or charges for over-the-limit transactions unless the consumer affirmatively consents to the creditor's payment of over-the-limit transactions. This subpart also sets forth rules for reporting and marketing of college student open-end credit. Finally, it sets forth requirements for the Internet posting of credit card accounts under an open-end (not home-secured) consumer credit plan.

Several appendices contain information such as the procedures for determinations about state laws, state exemptions and issuance of official interpretations, special rules for certain kinds of credit plans, and the rules for computing annual percentage rates in closed-end credit transactions and total-annual-loan-cost rates for reverse mortgage transactions.

Official staff interpretations of the regulation are published in a commentary. Good faith compliance with the commentary protects creditors from civil liability under the TILA. In addition, the commentary includes more detailed information on disclosures or other actions required of creditors. It is virtually impossible to comply with Regulation Z without reference to and reliance on the commentary.

NOTE: The following narrative does not discuss all the sections of Regulation Z, but rather highlights only certain sections of the regulation and the TILA.

Subpart A – General

Purpose of the TILA and Regulation Z

The TILA is intended to ensure that credit terms are disclosed in a meaningful way so consumers can compare credit terms more readily and knowledgeably. Before its enactment, consumers were faced with a bewildering array of credit terms and rates. It was difficult to compare loans because they were seldom presented in the same format. Now, all creditors must use the same credit terminology and expressions of rates. In addition to providing a uniform system for disclosures, the act:

- Protects consumers against inaccurate and unfair credit billing and credit card practices;
- Provides consumers with rescission rights;
- Provides for rate caps on certain dwelling-secured loans;
- Imposes limitations on home equity lines of credit and certain closed-end home mortgages;
- Provides minimum standards for most dwelling-secured loans; and
- Delineates and prohibits unfair or deceptive mortgage lending practices.

The TILA and Regulation Z do not, however, tell financial institutions how much interest they may charge or whether they must grant a consumer a loan.

Summary of Coverage Considerations – Sections 1026.1 & 1026.2

Lenders must carefully consider several factors when deciding whether a loan requires Truth in Lending disclosures or is subject to other Regulation Z requirements. The coverage considerations under Regulation Z are addressed in more detail in the commentary to Regulation Z. For example, broad coverage considerations are included under section 1026.1(c) of the regulation and relevant definitions appear in section 1026.2.

Exempt Transactions – Section 1026.3

The following transactions are exempt from Regulation Z:

- Credit extended primarily for a business, commercial, or agricultural purpose;
- Credit extended to other than a natural person (including credit to government agencies or instrumentalities);
- Credit in excess of an annually adjusted threshold not secured by real property or by personal property used or expected to be used as the principal dwelling of the consumer;

(The Dodd-Frank Act requires that this threshold be adjusted annually by any annual percentage increase in the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W). Accordingly, based on the annual percentage increase in the CPI-W as of June 1, 2012, the exemption threshold increased from \$51,800 to \$53,000, effective January 1, 2013.)

- Public utility credit;
- Credit extended by a broker-dealer registered with the Securities and Exchange Commission (SEC) or the Commodity Futures Trading Commission (CFTC), involving securities or commodities accounts;
- Home fuel budget plans not subject to a finance charge; and
- Certain student loan programs.

However, when a credit card is involved, generally exempt credit (e.g., business purpose credit) is subject to the requirements that govern the issuance of credit cards and liability for their unauthorized use. Credit cards must not be issued on an unsolicited basis and, if a credit card is lost or stolen, the cardholder must not be held liable for more than \$50 for the unauthorized use of the card. (Comment 3-1)

When determining whether credit is for consumer purposes, the creditor must evaluate all of the following:

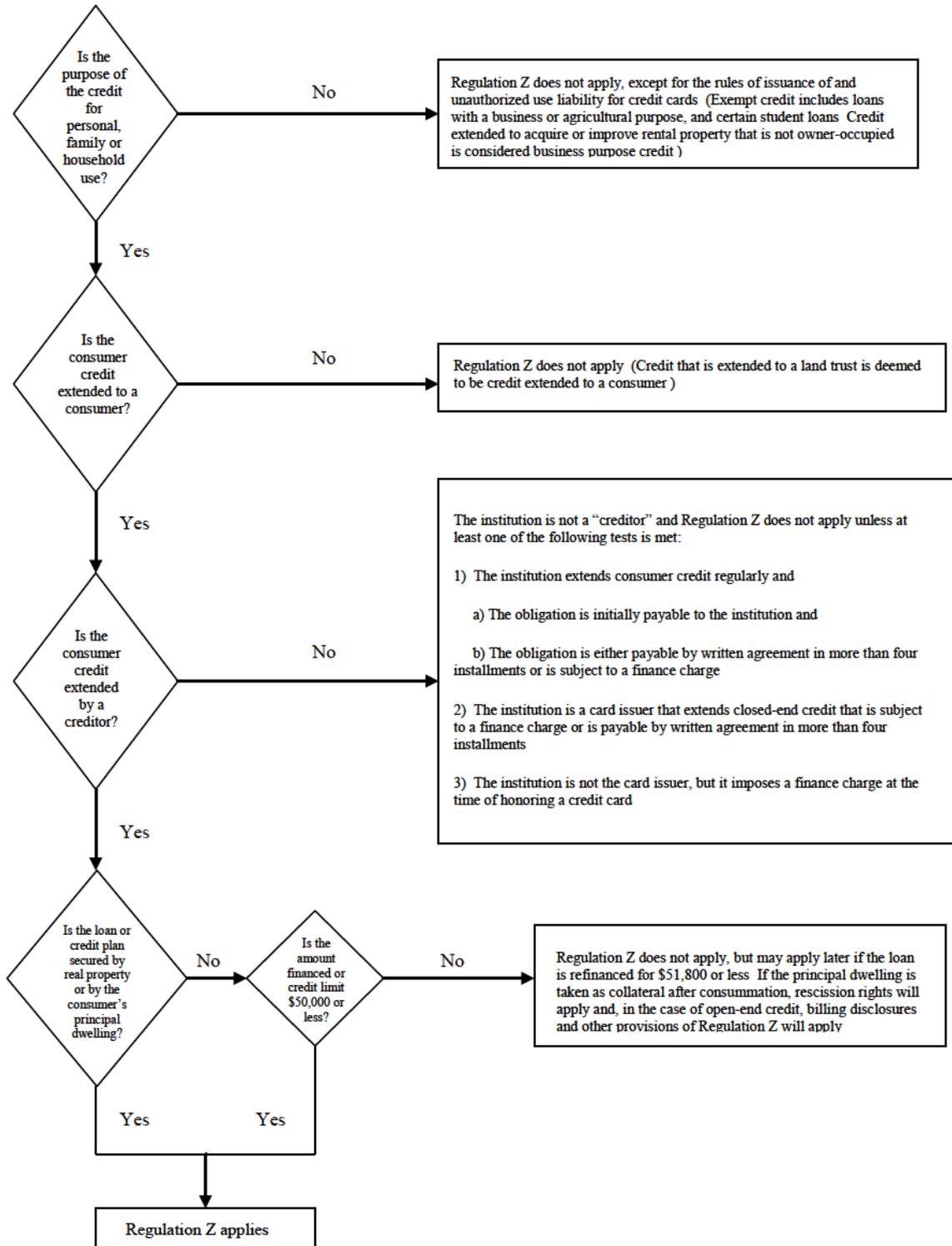
- Any statement obtained from the consumer describing the purpose of the proceeds.
 - o For example, a statement that the proceeds will be used for a vacation trip would indicate a consumer purpose.
 - o If the loan has a mixed-purpose (e.g., proceeds will be used to buy a car that will be used for personal and business purposes), the lender must look to the primary purpose of the loan to decide whether disclosures are necessary. A statement of purpose from the consumer will help the lender make that decision.
 - o A checked box indicating that the loan is for a business purpose, absent any documentation showing the intended use of the proceeds could be insufficient evidence

that the loan did not have a consumer purpose.

- The consumer's primary occupation and how it relates to the use of the proceeds. The higher the correlation between the consumer's occupation and the property purchased from the loan proceeds, the greater the likelihood that the loan has a business purpose. For example, proceeds used to purchase dental supplies for a dentist would indicate a business purpose.
- Personal management of the assets purchased from proceeds. The lower the degree of the borrower's personal involvement in the management of the investment or enterprise purchased by the loan proceeds, the less likely the loan will have a business purpose. For example, money borrowed to purchase stock in an automobile company by an individual who does not work for that company would indicate a personal investment and a consumer purpose.
- The size of the transaction. The larger the size of the transaction, the more likely the loan will have a business purpose. For example, if the loan is for a \$5,000,000 real estate transaction, that might indicate a business purpose.
- The amount of income derived from the property acquired by the loan proceeds relative to the borrower's total income. The lesser the income derived from the acquired property, the more likely the loan will have a consumer purpose. For example, if the borrower has an annual salary of \$100,000 and receives about \$500 in annual dividends from the acquired property, that would indicate a consumer purpose.

All five factors must be evaluated before the lender can conclude that disclosures are not necessary. Normally, no one factor, by itself, is sufficient reason to determine the applicability of Regulation Z. In any event, the financial institution may routinely furnish disclosures to the consumer. Disclosure under such circumstances does not control whether the transaction is covered, but can assure protection to the financial institution and compliance with the law.

Coverage Considerations under Regulation Z



Determination of Finance Charge and Annual Percentage Rate ("APR")

Finance Charge (Open-End and Closed-End Credit) – Section 1026.4

The finance charge is a measure of the cost of consumer credit represented in dollars and cents. Along with APR disclosures, the disclosure of the finance charge is central to the uniform credit cost disclosure envisioned by the TILA.

The finance charge does not include any charge of a type payable in a comparable cash transaction. Examples of charges payable in a comparable cash transaction may include taxes, title, license fees, or registration fees paid in connection with an automobile purchase.

Finance charges include any charges or fees payable directly or indirectly by the consumer and imposed directly or indirectly by the financial institution either as an incident to or as a condition of an extension of consumer credit. The finance charge on a loan always includes any interest charges and often, other charges. Regulation Z includes examples, applicable both to open-end and closed-end credit transactions, of what must, must not, or need not be included in the disclosed finance charge (§1026.4(b)).

Accuracy Tolerances (Closed-End Credit) – Sections 1026.18(d) & 1026.23(g)

Regulation Z provides finance charge tolerances for legal accuracy that should not be confused with those provided in the TILA for reimbursement under regulatory agency orders. As with disclosed APRs, if a disclosed finance charge were legally accurate, it would not be subject to reimbursement.

Under the TILA and Regulation Z, finance charge disclosures for open-end credit must be accurate since there is no tolerance for finance charge errors. However, both the TILA and Regulation Z permit various finance charge accuracy tolerances for closed-end credit.

Tolerances for the finance charge in a closed-end transaction, other than a mortgage loan, are generally \$5 if the amount financed is less than or equal to \$1,000 and \$10 if the amount financed exceeds \$1,000. Tolerances for certain transactions consummated on or after September 30, 1995 are noted below.

- Credit secured by real property or a dwelling (closed-end credit only):
 - o The disclosed finance charge is considered accurate if it is not understated by more than \$100.
 - o Overstatements are not violations.

- Rescission rights after the three-business-day rescission period (closed-end credit only):
 - o The disclosed finance charge is considered accurate if it does not vary from the actual finance charge by more than one-half of 1 percent of the credit extended or \$100, whichever is greater.
 - o The disclosed finance charge is considered accurate if it does not vary from the actual finance charge by more than 1 percent of the credit extended for the initial and subsequent refinancing of residential mortgage transactions when the new loan is made at a different financial institution. (This excludes high cost mortgage loans subject to section 1026.32, transactions in which there are new advances, and new consolidations.)
- Rescission rights in foreclosure:
 - o The disclosed finance charge is considered accurate if it does not vary from the actual finance charge by more than \$35.
 - o Overstatements are not considered violations.
 - o The consumer can rescind if a mortgage broker fee that should have been included in the finance charge was not included.

NOTE: Normally, the finance charge tolerance for a rescindable transaction is either 0.5 percent of the credit transaction or, for certain refinancing, 1 percent of the credit transaction. However, in the event of a foreclosure, the consumer may exercise the right of rescission if the disclosed finance charge is understated by more than \$35.

See the “Finance Charge Tolerances” charts within these examination procedures for help in determining appropriate finance charge tolerances.

Calculating the Finance Charge (Closed-End Credit)

One of the more complex tasks under Regulation Z is determining whether a charge associated with an extension of credit must be included in, or excluded from, the disclosed finance charge. The finance charge initially includes any charge that is, or will be, connected with a specific loan. Charges imposed by third parties are finance charges if the **financial institution requires use of the third party**. Charges imposed by settlement or closing agents are finance charges if the bank requires the specific service that gave rise to the charge and the charge is not otherwise excluded. The “Finance Charge Tolerances” charts within this document briefly summarize the rules that must be considered.

Prepaid Finance Charges – Section 1026.18(b)(3)

A prepaid finance charge is any finance charge paid separately to the financial institution or to a third party, in cash or by check before or at closing, settlement, or consummation of a transaction, or withheld from the proceeds of the credit at any time.

Prepaid finance charges effectively reduce the amount of funds available for the consumer's use; usually before or at the time the transaction is consummated.

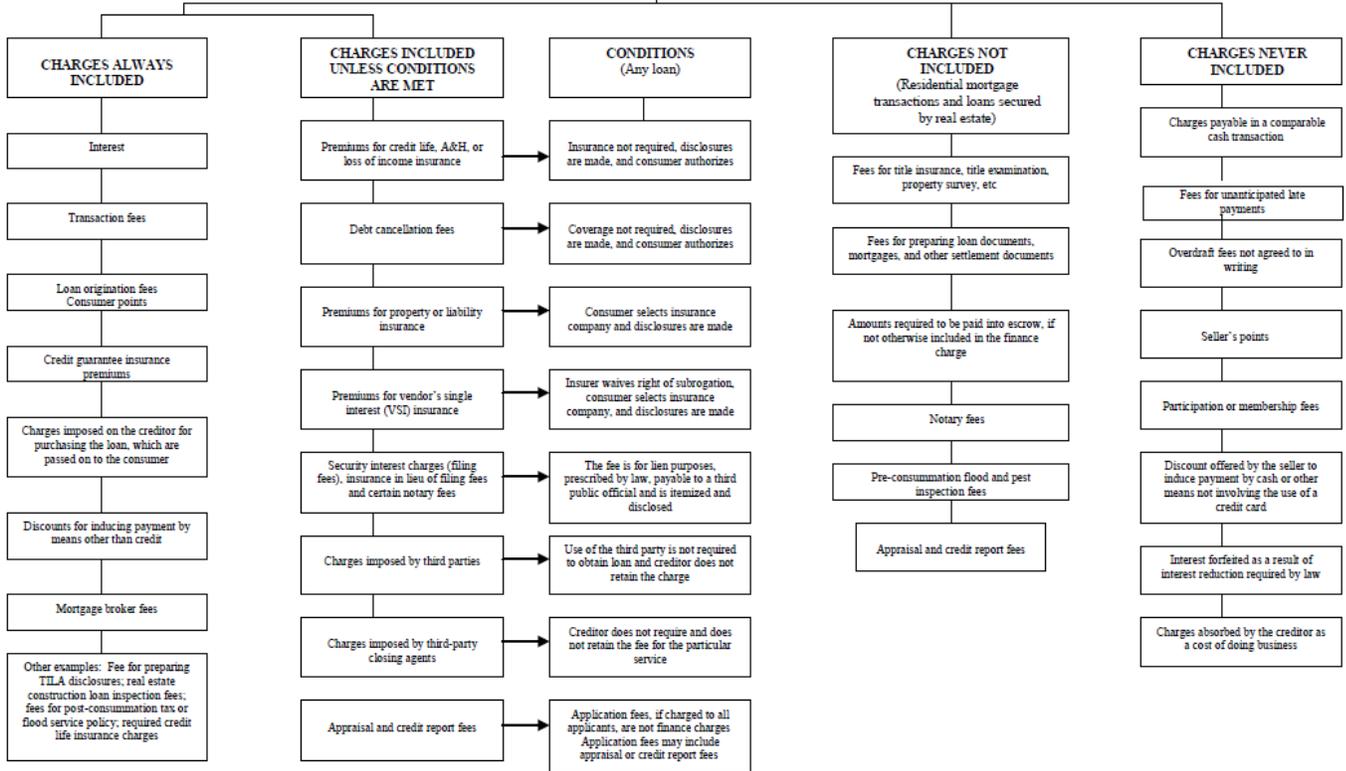
Examples of finance charges frequently prepaid by consumers are borrower's points, loan origination fees, real estate construction inspection fees, odd days' interest (interest attributable to part of the first payment period when that period is longer than a regular payment period), mortgage guarantee insurance fees paid to the Federal Housing Administration, private mortgage insurance (PMI) paid to such companies as the Mortgage Guaranty Insurance Company (MGIC), and, in non-real-estate transactions, credit report fees.

Pre-computed Finance Charges

A pre-computed finance charge includes, for example, interest added to the note amount that is computed by the add-on, discount, or simple interest methods. If reflected in the face amount of the debt instrument as part of the consumer's obligation, finance charges that are not viewed as prepaid finance charges are treated as pre-computed finance charges that are earned over the life of the loan.

Finance Charge Chart

FINANCE CHARGE = DOLLAR COST OF CONSUMER CREDIT: It includes any charge payable directly or indirectly by the consumer and imposed directly or indirectly by the creditor as a condition of or incident to the extension of credit.



Instructions for the Finance Charge Chart

The finance charge initially includes any charge that is, or will be, connected with a specific loan. Charges imposed by third parties are finance charges if the creditor requires use of the third party. Charges imposed on the consumer by a settlement agent are finance charges only if the creditor requires the particular services for which the settlement agent is charging the borrower and the charge is not otherwise excluded from the finance charge.

Immediately below the finance charge definition, the chart presents five captions applicable to determining whether a loan related charge is a finance charge.

The first caption is charges always included. This category focuses on specific charges given in the regulation or commentary as examples of finance charges.

The second caption, charges included unless conditions are met, focuses on charges that must be included in the finance charge unless the creditor meets specific disclosure or other conditions to exclude the charges from the finance charge.

The third caption, conditions, focuses on the conditions that need to be met if the charges identified to the left of the conditions are permitted to be excluded from the finance charge. Although most charges under the second caption may be included in the finance charge at the creditor's option, third-party charges and application fees (listed last under the third caption) must be excluded from the finance charge if the relevant conditions are met. However, inclusion of appraisal and credit report charges as part of the application fee is optional.

The fourth caption, charges not included, identifies fees or charges that are not included in the finance charge under conditions identified by the caption. If the credit transaction is secured by real property or the loan is a residential mortgage transaction, the charges identified in the column, if they are bona fide and reasonable in amount, must be excluded from the finance charge. For example, if a consumer loan is secured by a vacant lot or commercial real estate, any appraisal fees connected with the loan must not be included in the finance charge.

The fifth caption, charges never included, lists specific charges provided by the regulation as examples of those that automatically are not finance charges (e.g., fees for unanticipated late payments).

Annual Percentage Rate Definition – Section 1026.22 (Closed-End Credit)

Credit costs may vary depending on the interest rate, the amount of the loan and other charges, the timing and amounts of advances, and the repayment schedule. The APR, which must be disclosed in nearly all consumer credit transactions, is designed to take into account all relevant factors and to provide a uniform measure for comparing the cost of various credit transactions.

The APR is a measure of the cost of credit, expressed as a nominal yearly rate. It relates the amount and timing of value received by the consumer to the amount and timing of payments made. The disclosure of the APR is central to the uniform credit cost disclosure envisioned by the TILA.

The value of a closed-end credit APR must be disclosed as a single rate only, whether the loan has a single interest rate, a variable interest rate, a discounted variable interest rate, or graduated payments based on separate interest rates (step rates), and it must appear with the segregated disclosures. Segregated disclosures are grouped together and do not contain any information not directly related to the disclosures required under section 1026.18.

Since an APR measures the total cost of credit, including costs such as transaction charges or premiums for credit guarantee insurance, it is not an “interest” rate, as that term is generally used. APR calculations do not rely on definitions of interest in state law and often include charges, such as a commitment fee paid by the consumer, that are not viewed by some state usury statutes as interest. Conversely, an APR might not include a charge, such as a credit report fee in a real property transaction, which some state laws might view as interest for usury purposes. Furthermore, measuring the timing of value received and of payments made, which is essential if APR calculations are to be accurate, must be consistent with parameters under Regulation Z.

The APR is often considered to be the finance charge expressed as a percentage. However, two loans could require the same finance charge and still have different APRs because of differing values of the amount financed or of payment schedules. For example, the APR is 12 percent on a loan with an amount financed of \$5,000 and 36 equal monthly payments of \$166.07 each. It is 13.26 percent on a loan with an amount financed of \$4,500 and 35 equal monthly payments of \$152.18 each and final payment of \$152.22. In both cases the finance charge is \$978.52. The APRs on these example loans are not the same because an APR does not only reflect the finance charge. It relates the amount and timing of value received by the consumer to the amount and timing of payments made.

The APR is a function of:

- The amount financed, which is not necessarily equivalent to the loan amount. For example, if the consumer must pay at closing a separate 1 percent loan origination fee (prepaid finance charge) on a \$100,000 residential mortgage loan, the loan amount is \$100,000, but the amount financed would be \$100,000 less the \$1,000 loan fee, or \$99,000.
- The finance charge, which is not necessarily equivalent to the total interest amount (interest is not defined by Regulation Z, but rather is defined by state or other federal law). For example:

- If the consumer must pay a \$25 credit report fee for an auto loan, the fee must be included in the finance charge. The finance charge in that case is the sum of the interest on the loan (i.e., interest generated by the application of a percentage rate against the loan amount) plus the \$25 credit report fee.
- If the consumer must pay a \$25 credit report fee for a home improvement loan secured by real property, the credit report fee must be excluded from the finance charge. The finance charge in that case would be only the interest on the loan.
- The payment schedule, which does not necessarily include only principal and interest (P + I) payments. For example:
 - If the consumer borrows \$2,500 for a vacation trip at 14 percent simple interest per annum and repays that amount with 25 equal monthly payments beginning one month from consummation of the transaction, the monthly P + I payment will be \$115.87, if all months are considered equal, and the amount financed would be \$2,500. If the consumer's payments are increased by \$2.00 a month to pay a non-financed \$50 loan fee during the life of the loan, the amount financed would remain at \$2,500 but the payment schedule would be increased to \$117.87 a month, the finance charge would increase by \$50, and there would be a corresponding increase in the APR. This would be the case whether or not state law defines the \$50 loan fee as interest.
 - If the loan above has 55 days to the first payment and the consumer prepays interest at consummation (\$24.31 to cover the first 25 days), the amount financed would be \$2,500 \$ 24.31, or \$2,475.69. Although the amount financed has been reduced to reflect the consumer's reduced use of available funds at consummation, the time interval during which the consumer has use of the \$2,475.69, 55 days to the first payment, has not changed. Since the first payment period exceeds the limitations of the regulation's minor irregularities provisions (see §1026.17(c)(4)), it may not be treated as regular. In calculating the APR, the first payment period must not be reduced by 25 days (i.e., the first payment period may not be treated as one month).

Financial institutions may, if permitted by state or other law, precompute interest by applying a rate against a loan balance using a simple interest, add-on, discount or some other method, and may earn interest using a simple interest accrual system, the Rule of 78's (if permitted by law) or some other method. Unless the financial institution's internal interest earnings and accrual methods involve a simple interest rate based on a 360-day year that is applied over actual days (even that is important only for determining the accuracy of the payment schedule), it is not relevant in calculating an APR, since an APR is not an interest rate (as that term is commonly used under state or other law). Since the APR normally need not rely on the internal accrual systems of a bank, it always may be computed after the loan terms have been agreed upon (as long as it is disclosed before actual consummation of the transaction).

Special Requirements for Calculating the Finance Charge and APR

Proper calculation of the finance charge and APR are of primary importance. The regulation requires that the terms “finance charge” and “annual percentage rate” be disclosed more conspicuously than any other required disclosure, subject to limited exceptions. The finance charge and APR, more than any other disclosures, enable consumers to understand the cost of the credit and to comparison shop for credit. A creditor’s failure to disclose those values accurately can result in significant monetary damages to the creditor, either from a class action lawsuit or from a regulatory agency’s order to reimburse consumers for violations of law.

If an APR or finance charge is disclosed incorrectly, the error is not, in itself, a violation of the regulation if:

- The error resulted from a corresponding error in a calculation tool used in good faith by the financial institution.
- Upon discovery of the error, the financial institution promptly discontinues use of that calculation tool for disclosure purposes.
- The financial institution notifies the CFPB in writing of the error in the calculation tool.

When a financial institution claims a calculation tool was used in good faith, the financial institution assumes a reasonable degree of responsibility for ensuring that the tool in question provides the accuracy required by the regulation. For example, the financial institution might verify the results obtained using the tool by comparing those results to the figures obtained by using another calculation tool. The financial institution might also verify that the tool, if it is designed to operate under the actuarial method, produces figures similar to those provided by the examples in appendix J to the regulation. The calculation tool should be checked for accuracy before it is first used and periodically thereafter.

Subpart B – Open-End Credit

Time of Disclosures (Periodic Statements) – Section 1026.5(b)

For credit card accounts under an open-end (not home-secured) consumer credit plan, creditors must adopt reasonable procedures designed to ensure that periodic statements are mailed or delivered at least 21 days prior to the payment due date disclosed on the periodic statement and that payments are not treated as late for any purpose if they are received within 21 days after mailing or delivery of the statement. In addition, for all open-end consumer credit accounts with grace periods, creditors must adopt reasonable procedures designed to ensure that periodic statements are mailed or delivered at least 21 days prior to the date on which a grace period (if any) expires and that finance charges are not imposed as a result of the loss of a grace period if a

payment is received within 21 days after mailing or delivery of a statement. For purposes of this requirement, a “grace period” is defined as a period within which any credit extended may be repaid without incurring a finance charge due to a periodic interest rate. For non-credit card open-end consumer plans without a grace period, creditors must adopt reasonable policies and procedures designed to ensure that periodic statements are mailed or delivered at least 14 days prior to the date on which the required minimum periodic payment is due. Moreover, the creditor must adopt reasonable policies and procedures to ensure that it does not treat as late a required minimum periodic payment received by the creditor within 14 days after it has mailed or delivered the periodic statement.

Subsequent Disclosures (Open-End Credit) – Section 1026.9

For open-end, not home-secured credit, the following applies:

Creditors are required to provide consumers with 45 days’ advance written notice of rate increases and other significant changes to the terms of their credit card account agreements. The list of “significant changes” includes most fees and other terms that a consumer should be aware of before use of the account. Examples of such fees and terms include:

- Penalty fees;
- Transaction fees;
- Fees imposed for the issuance or availability of the open-end plan;
- Grace period; and
- Balance computation method.

Changes that do not require advance notice include:

- Reductions of finance charges;
- Termination of account privileges resulting from an agreement involving a court proceeding;
- The change is an increase in an APR upon expiration of a specified period of time previously disclosed in writing;
- The change applies to increases in variable APRs that change according to an index not under the card issuer’s control; and
- Rate increases due to the completion of, or failure of a consumer to comply with, the terms of a workout or temporary hardship arrangement, if those terms are disclosed prior to commencement of the arrangement.

A creditor may suspend account privileges, terminate an account, or lower the credit limit without notice. However, a creditor that lowers the credit limit may not impose an over limit fee or penalty rate as a result of exceeding the new credit limit without a 45-day advance notice that the credit limit has been reduced.

For significant changes in terms (with the exception of rate changes, increases in the minimum payment, certain changes in the balance computation method, and when the change results from the consumer's failure to make a required minimum periodic payment within 60 days after the due date), a creditor must also provide consumers the right to reject the change. If the consumer does reject the change prior to the effective date, the creditor may not apply the change to the account (§1026.9(h)(2)(i)).

In addition, when a consumer rejects a change or increase, the creditor must not:

- Impose a fee or charge or treat the account as in default solely as a result of the rejection; or
- Require repayment of the balance on the account using a method that is less beneficial to the consumer than one of the following methods: (1) the method of repayment prior to the rejection; (2) an amortization period of not less than five years from the date of rejection; or (3) a minimum periodic payment that includes a percentage of the balance that is not more than twice the percentage included prior to the date of rejection.

Finance Charge (Open-End Credit) – Sections 1026.6(a)(1) & 1026.6(b)(3)

Each finance charge imposed must be individually itemized. The aggregate total amount of the finance charge need not be disclosed.

Determining the Balance and Computing the Finance Charge

The examiner must know how to compute the balance to which the periodic rate is applied. Common methods used are the previous balance method, the daily balance method, and the average daily balance method, which are described as follows:

- **Previous balance method.** The balance on which the periodic finance charge is computed is based on the balance outstanding at the start of the billing cycle. The periodic rate is multiplied by this balance to compute the finance charge.
- **Daily balance method.** A daily periodic rate is applied to either the balance on each day in the cycle or the sum of the balances on each of the days in the cycle. If a daily periodic rate is multiplied by the balance on each day in the billing cycle, the finance charge is the sum of the products. If the daily periodic rate is multiplied by the sum of all the daily balances, the result is the finance charge.
- **Average daily balance method.** The average daily balance is the sum of the daily balances (either including or excluding current transactions) divided by the number of days in the

billing cycle. A periodic rate is then multiplied by the average daily balance to determine the finance charge. If the periodic rate is a daily one, the product of the rate multiplied by the average balance is multiplied by the number of days in the cycle.

In addition to those common methods, financial institutions have other ways of calculating the balance to which the periodic rate is applied. By reading the financial institution's explanation, the examiner should be able to calculate the balance to which the periodic rate was applied. In some cases, the examiner may need to obtain additional information from the financial institution to verify the explanation disclosed. Any inability to understand the disclosed explanation should be discussed with management, who should be reminded of Regulation Z's requirement that disclosures be clear and conspicuous.

When a balance is determined without first deducting all credits and payments made during the billing cycle, that fact and the amount of the credits and payments must be disclosed.

If the financial institution uses the daily balance method and applies a single daily periodic rate, disclosure of the balance to which the rate was applied may be stated as any of the following:

- A balance for each day in the billing cycle. The daily periodic rate is multiplied by the balance on each day and the sum of the products is the finance charge.
- A balance for each day in the billing cycle on which the balance in the account changes. The finance charge is figured by the same method as discussed previously, but the statement shows the balance only for those days on which the balance changed.
- The sum of the daily balances during the billing cycle. The balance on which the finance charge is computed is the sum of all the daily balances in the billing cycle. The daily periodic rate is multiplied by that balance to determine the finance charge.
- The average daily balance during the billing cycle. If this is stated, the financial institution may, at its option, explain that the average daily balance is or can be multiplied by the number of days in the billing cycle and the periodic rate applied to the product to determine the amount of interest.

If the financial institution uses the daily balance method, but applies two or more daily periodic rates, the sum of the daily balances may not be used. Acceptable ways of disclosing the balances include:

- A balance for each day in the billing cycle;
- A balance for each day in the billing cycle on which the balance in the account changes; or
- Two or more average daily balances. If the average daily balances are stated, the financial institution may, at its option, explain that interest is or may be determined by 1) multiplying each of the average daily balances by the number of days in the billing cycle (or if the daily rate varied during the cycle), 2) by multiplying each of the results by the applicable daily

periodic rate, and 3) adding these products together.

In explaining the method used to find the balance on which the finance charge is computed, the financial institution need not reveal how it allocates payments or credits. That information may be disclosed as additional information, but all required information must be clear and conspicuous.

NOTE: Section 1026.54 prohibits a credit card issuer from calculating finance charges based on balances for days in previous billing cycles as a result of the loss of a grace period (a practice sometimes referred to as “double-cycle billing”).

Finance Charge Resulting from Two or More Periodic Rates

Some financial institutions use more than one periodic rate in computing the finance charge. For example, one rate may apply to balances up to a certain amount and another rate to balances more than that amount. If two or more periodic rates apply, the financial institution must disclose all rates and conditions. The range of balances to which each rate applies also must be disclosed. It is not necessary, however, to break the finance charge into separate components based on the different rates.

Annual Percentage Rate (Open-End Credit)

The disclosed APR on an open-end credit account is accurate if it is within one-eighth of one percentage point of the APR calculated under Regulation Z.

Determination of APR – Section 1026.14

The basic method for determining the APR in open-end credit transactions involves multiplying each periodic rate by the number of periods in a year. This method is used in all types of openend disclosures, including:

- The corresponding APR in the initial disclosures;
- The corresponding APR on periodic statements;
- The APR in early disclosures for credit card accounts;
- The APR in early disclosures for home-equity plans;
- The APR in advertising; and
- The APR in oral disclosures.

The corresponding APR is prospective and it does not involve any particular finance charge or periodic balance.

A second method of calculating the APR is the quotient method. At a creditor’s option, the

quotient method may be disclosed on periodic statements for home-equity plans subject to section 1026.40 (“HELOCs”). The quotient method reflects the annualized equivalent of the rate that was actually applied during a cycle. This rate, also known as the effective APR, will differ from the corresponding APR if the creditor applies minimum, fixed, or transaction charges to the account during the cycle. (§1026.14(c)).

(If a creditor does not disclose the effective (or quotient method) APR on a HELOC periodic statement, it must instead disclose the charges (fees and interest) imposed as provided in section 1026.7(a).

Brief Outline for Open-End Credit APR Calculations on Periodic Statements

NOTE: Assume monthly billing cycles for each of the calculations below.

I. Basic method for determining the APR in an open-end credit transaction. This is the corresponding APR. (§1026.14(b))

A. Monthly rate x 12 = APR

II. Optional effective APR that may be disclosed on home-equity line of credit (HELOC) periodic statements

A. APR when only periodic rates are imposed (§1026.14(c)(1))

1. Monthly rate x 12 = APR Or,
2. (Total finance charge / sum of the balances) x 12 = APR

B. APR when minimum or fixed charge, but not transaction charge imposed. (§1026.14(c)(2))

1. (Total finance charge / amount of applicable balance) x 12 = APR

(For the following formulas, the APR cannot be determined if the applicable balance is zero. (§1026.14(c)(2)). Loan fees, points, or similar finance charges that relate to the opening, renewing, or continuing of the account must not be included in the calculation of the APR.)

C. APR when the finance charge includes a charge related to a specific transaction (such as a cash advance fee), even if the total finance charge also includes any other minimum, fixed, or other charge not calculated using a periodic rate. (1026.14(c)(3))

1. (Total finance charge / (all balances + other amounts on which a finance charge was imposed during the billing cycle without duplication) x 12 = APR

(The sum of the balances may include the average daily balance, adjusted balance, or previous balance method. When a portion of the finance charge is determined by application of one or more daily periodic rates, the sum of the balances also means the average of daily balances. See Appendix F to Regulation Z. Cannot be less than the highest periodic rate applied, expressed as an APR. Loan fees, points, or similar finance charges that relate to the opening of the account must not be included in the calculation of the APR.)

D. APR when the finance charge imposed during the billing cycle includes a minimum

or fixed charge that does not exceed \$.50 for a monthly or longer billing cycles (or pro rata part of \$.50 for a billing cycle shorter than monthly). (§1026.14(c)(4))

1. Monthly rate x 12 = APR

E. APR calculation when daily periodic rates are applicable if only the periodic rate is imposed or when a minimum or fixed charge (but not a transactional charge is imposed. (§1026.14(d))

1. (Total finance charge / average daily balance) x 12 = APR Or

2. (Total finance charge / sum of daily balances) x 365 = APR

Change in Terms Notices for Home Equity Plans Subject to Section 1026.40 – Section 1026.9(c)

Servicers are required to provide consumers with 15 days' advance written notice of a change to any term required to be disclosed under section 1026.6(a) or where the required minimum periodic payment is increased. Notice is not required when the change involves a reduction of any component of a finance charge or other charge or when the change results from an agreement involving a court proceeding. If the creditor prohibits additional extensions of credit or reduces the credit limit in certain circumstances (if permitted by contract), a written notice must be provided no later than three business days after the action is taken and must include the specific reasons for the action. If the creditor requires the consumer to request reinstatement of credit privileges, the notice also must state that fact.

Timely Settlement of Estates – Section 1026.11(c)

Issuers are required to establish procedures to ensure that any administrator of an estate can resolve the outstanding credit card balance of a deceased account holder in a timely manner. If an administrator requests the amount of the balance:

- The issuer is prohibited from imposing additional fees on the account;
- The issuer is required to disclose the amount of the balance to the administrator in a timely manner (safe harbor of 30 days); and
- If the balance is paid in full within 30 days after disclosure of the balance, the issuer must waive or rebate any trailing or residual interest charges that accrued on the balance following the disclosure.

Minimum Payments – Section 1026.7(b)(12)

For credit card accounts under an open-end credit plan, card issuers generally must disclose on periodic statements an estimate of the amount of time and the total cost (principal and interest) involved in paying the balance in full by making only the minimum payments, and an estimate of the monthly payment amount required to pay off the balance in 36 months and the total cost (principal and interest) of repaying the balance in 36 months. Card issuers also must disclose a

minimum payment warning, and an estimate of the total interest that a consumer would save if that consumer repaid the balance in 36 months, instead of making minimum payments.

Subpart C – Closed-End Credit

Timing of Disclosures – Sections 1026.17(b) and 1026.19

Creditors are generally required to make disclosures required by the TILA before the consummation of the transaction. Residential mortgage transactions have special timing requirements that include providing disclosures to consumers no later than the third business day after receipt of the consumer's application. Creditors are also required to provide consumers with updated disclosures three days prior to consummation of the mortgage transaction if certain terms of the mortgage change. Finally, certain variable rate transactions secured by a dwelling have additional disclosure obligations with specific timing requirements both prior to and after consummation (see §§1026.20(c) and (d) below).

Finance Charge (Closed-End Credit) – Section 1026.17(a)

The aggregate total amount of the finance charge must be disclosed. Each finance charge imposed need not be individually itemized and must not be itemized with the segregated disclosures.

Annual Percentage Rate (Closed-End Credit) – Section 1026.22

Accuracy Tolerances

The disclosed APR on a closed-end transaction is accurate for:

- Regular transactions (which include any single advance transaction with equal payments and equal payment periods, or an irregular first payment period and/or a first or last irregular payment), if it is within one-eighth of 1 percentage point of the APR calculated under Regulation Z (§1026.22(a)(2)).
- Irregular transactions (which include multiple advance transactions and other transactions not considered regular), if it is within one-quarter of 1 percentage point of the APR calculated under Regulation Z (§1026.22(a)(3)).
- Mortgage transactions, if it is within one-eighth of 1 percentage point for regular transactions or one-quarter of 1 percentage point for irregular transactions or if:
 - i. The rate results from the disclosed finance charge, and the disclosed finance is considered accurate under sections 1026.18(d)(1) or 1026.23(g) or (h) (§1026.22(a)(4)); or
 - ii. The disclosed finance charge is calculated incorrectly but is considered accurate under sections 1026.18(d)(1) or 1026.23(g) or (h) and either:

(A) the finance charge is understated and the disclosed APR is also understated but is closer to the actual APR than the APR that would be considered accurate under section 1026.22(a)(4); or

(B) the disclosed finance charge is overstated and the disclosed APR is also overstated but is closer to the actual APR than the APR that would be considered accurate under section 1026.22(a)(4).

For example, in an irregular transaction subject to a tolerance of ¼th of 1 percentage point, if the actual APR is 9.00% and a \$75 omission from the finance charge corresponds to a rate of 8.50% that is considered accurate under section 1026.22(a)(4), a disclosed APR of 8.65% is considered accurate under section 1026.22(a)(5). However, a disclosed APR below 8.50% or above 9.25% would not be considered accurate.

Construction Loans – Section 1026.17(c)(6) & Appendix D

Construction and certain other multiple advance loans pose special problems in computing the finance charge and APR. In many instances, the amount and dates of advances are not predictable with certainty since they depend on the progress of the work. Regulation Z provides that the APR and finance charge for such loans may be estimated for disclosure.

At its option, the financial institution may rely on the representations of other parties to acquire necessary information (for example, it might look to the consumer for the dates of advances). In addition, if either the amounts or dates of advances are unknown (even if some of them are known), the financial institution may, at its option, use appendix D to the regulation to make calculations and disclosures. The finance charge and payment schedule obtained through appendix D may be used with volume one of the CFPB's APR tables or with any other appropriate computation tool to determine the APR. If the financial institution elects not to use appendix D, or if appendix D cannot be applied to a loan (e.g., appendix D does not apply to a combined construction-permanent loan if the payments for the permanent loan begin during the construction period), the financial institution must make its estimates under section 1026.17(c)(2) and calculate the APR using multiple advance formulas.

On loans involving a series of advances under an agreement to extend credit up to a certain amount, a financial institution may treat all of the advances as a single transaction or disclose each advance as a separate transaction. If advances are disclosed separately, disclosures must be provided before each advance occurs, with the disclosures for the first advance provided before consummation.

In a transaction that finances the construction of a dwelling that may or will be permanently financed by the same financial institution, the construction-permanent financing phases may be disclosed in one of three ways listed below.

- As a single transaction, with one disclosure combining both phases.
- As two separate transactions, with one disclosure for each phase.

- As more than two transactions, with one disclosure for each advance and one for the permanent financing phase.

If two or more disclosures are furnished, buyer's points or similar amounts imposed on the consumer may be allocated among the transactions in any manner the financial institution chooses, as long as the charges are not applied more than once. In addition, if the financial institution chooses to give two sets of disclosures and the consumer is obligated for both construction and permanent phases at the outset, both sets of disclosures must be given to the consumer initially, before consummation of each transaction occurs.

If the creditor requires interest reserves for construction loans, special appendix D rules apply that can make the disclosure calculations quite complicated. The amount of interest reserves included in the commitment amount must not be treated as a prepaid finance charge.

If the lender uses appendix D for construction-only loans with required interest reserves, the lender must estimate construction interest using the interest reserve formula in appendix D. The lender's own interest reserve values must be completely disregarded for disclosure purposes.

If the lender uses appendix D for combination construction-permanent loans, the calculations can be much more complex. Appendix D is used to estimate the construction interest, which is then measured against the lender's contractual interest reserves.

If the interest reserve portion of the lender's contractual commitment amount exceeds the amount of construction interest estimated under appendix D, the excess value is considered part of the amount financed if the lender has contracted to disburse those amounts whether they ultimately are needed to pay for accrued construction interest. If the lender will not disburse the excess amount if it is not needed to pay for accrued construction interest, the excess amount must be ignored for disclosure purposes.

Calculating the Annual Percentage Rate – Section 1026.22

The APR must be determined under one of the following:

- The actuarial method, which is defined by Regulation Z and explained in appendix J to the regulation.
- The U.S. Rule, which is permitted by Regulation Z and briefly explained in appendix J to the regulation. The U.S. Rule is an accrual method that seems to have first surfaced officially in an early nineteenth century United States Supreme Court case, *Story v. Livingston*, 38 U.S. 359 (1839).

Whichever method is used by the financial institution, the rate calculated will be accurate if it is able to “amortize” the amount financed while it generates the finance charge under the accrual method selected. Financial institutions also may rely on minor irregularities and accuracy tolerances in the regulation, both of which effectively permit somewhat imprecise, but still legal,

APRs to be disclosed.

360-Day and 365-Day Years – Section 1026.17(c)(3)

Confusion often arises over whether to use the 360-day or 365-day year in computing interest, particularly when the finance charge is computed by applying a daily rate to an unpaid balance. Many single payment loans or loans payable on demand are in this category. There are also loans in this category that call for periodic installment payments. Regulation Z does not require the use of one method of interest computation in preference to another (although state law may). It does, however, permit financial institutions to disregard the fact that months have different numbers of days when calculating and making disclosures. This means financial institutions may base their disclosures on calculation tools that assume all months have an equal number of days, even if their practice is to take account of the variations in months to collect interest.

For example, a financial institution may calculate disclosures using a financial calculator based on a 360-day year with 30-day months, when, in fact, it collects interest by applying a factor of 1/365 of the annual interest rate to actual days.

Disclosure violations may occur, however, when a financial institution applies a daily interest factor based on a 360-day year to the actual number of days between payments. In those situations, the financial institution must disclose the higher values of the finance charge, the APR, and the payment schedule resulting from this practice.

For example, a 12 percent simple interest rate divided by 360 days results in a daily rate of .033333 percent. If no charges are imposed except interest, and the amount financed is the same as the loan amount, applying the daily rate on a daily basis for a 365-day year on a \$10,000 one year, single payment, unsecured loan results in an APR of 12.17 percent ($.033333\% \times 365 = 12.17\%$), and a finance charge of \$1,216.67. There would be a violation if the APR were disclosed as 12 percent or if the finance charge were disclosed as \$1,200 ($12\% \times \$10,000$).

However, if there are no other charges except interest, the application of a 360-day year daily rate over 365 days on a regular loan would not result in an APR in excess of the one eighth of one percentage point APR tolerance unless the nominal interest rate is greater than 9 percent. For irregular loans, with one-quarter of 1 percentage point APR tolerance, the nominal interest rate would have to be greater than 18 percent to exceed the tolerance.

Variable Rate Information – Section 1026.18(f) & Commentary to Section 1026.17(c)

If the terms of the legal obligation allow the financial institution, after consummation of the transaction, to increase the APR, the financial institution must furnish the consumer with certain information on variable rates. Graduated payment mortgages and step-rate transactions without a variable rate feature are not considered variable rate transactions. In addition, variable rate

disclosures are not applicable to rate increases resulting from delinquency, default, assumption, acceleration, or transfer of the collateral.

Some of the more important transaction-specific variable rate disclosure requirements follow.

- Disclosures for variable rate loans must be given for the full term of the transaction and must be based on the terms in effect at the time of consummation.
- If the variable rate transaction includes either a seller buy-down that is reflected in a contract or a consumer buy-down, the disclosed APR should be a composite rate based on the lower rate for the buy-down period and the rate that is the basis for the variable rate feature for the remainder of the term.
- If the initial rate is not determined by the index or formula used to make later interest rate adjustments, as in a discounted variable rate transaction, the disclosed APR must reflect a composite rate based on the initial rate for as long as it is applied and, for the remainder of the term, the rate that would have been applied using the index or formula at the time of consummation (i.e., the fully indexed rate).
 - If a loan contains a rate or payment cap that would prevent the initial rate or payment, at the time of the adjustment, from changing to the fully indexed rate, the effect of that rate or payment cap needs to be reflected in the disclosures.
 - The index at consummation need not be used if the contract provides a delay in the implementation of changes in an index value (e.g., the contract indicates that future rate changes are based on the index value in effect for some specified period, like 45 days before the change date). Instead, the financial institution may use any rate from the date of consummation back to the beginning of the specified period (e.g., during the previous 45-day period).
- If the initial interest rate is set according to the index or formula used for later adjustments, but is set at a value as of a date before consummation, disclosures should be based on the initial interest rate, even though the index may have changed by the consummation date.

For variable-rate loans that are not secured by the consumer's principal dwelling or that are secured by the consumer's principal dwelling but have a term of one year or less, creditors must disclose the circumstances under which the rate may increase, any limitations on the increase, the effect of an increase, and an example of the payment terms that would result from an increase. (§1026.18(f)(1))

For variable-rate consumer loans secured by the consumer's principal dwelling and having a maturity of more than one year, creditors must state that the loan has a variable-rate feature and that the disclosures were previously given. (§1026.18(f)(2)) Extensive disclosures about the loan program are provided when consumers apply for such a loan (§1026.19(b)), and throughout the loan term when the rate or payment amount is changed (§1026.20(c)).

Payment Schedule – Section 1026.18(g)

The disclosed payment schedule must reflect all components of the finance charge. It includes all payments scheduled to repay loan principal, interest on the loan, and any other finance charge payable by the consumer after consummation of the transaction.

However, any finance charge paid separately before or at consummation (e.g., odd days' interest) is not part of the payment schedule. It is a prepaid finance charge that must be reflected as a reduction in the value of the amount financed.

At the creditor's option, the payment schedule may include amounts beyond the amount financed and finance charge (e.g., certain insurance premiums or real estate escrow amounts such as taxes added to payments). However, when calculating the APR, the creditor must disregard such amounts.

If the obligation is a renewable balloon payment instrument that unconditionally obligates the financial institution to renew the short-term loan at the consumer's option or to renew the loan subject to conditions within the consumer's control, the payment schedule must be disclosed using the longer term of the renewal period or periods. The long-term loan must be disclosed with a variable rate feature.

If there are no renewal conditions or if the financial institution guarantees to renew the obligation in a refinancing, the payment schedule must be disclosed using the shorter balloon payment term. The short-term loan must be disclosed as a fixed rate loan, unless it contains a variable rate feature during the initial loan term.

Amount Financed – Section 1026.18(b)

Definition – The amount financed is the net amount of credit extended for the consumer's use. It should not be assumed that the amount financed under the regulation is equivalent to the note amount, proceeds, or principal amount of the loan. The amount financed normally equals the total of payments less the finance charge.

To calculate the amount financed, all amounts and charges connected with the transaction, either paid separately or included in the note amount, must first be identified. Any prepaid, pre-computed, or other finance charge must then be determined.

The amount financed must not include any finance charges. If finance charges have been included in the obligation (either prepaid or pre-computed), they must be subtracted from the face amount of the obligation when determining the amount financed. The resulting value must be reduced further by an amount equal to any prepaid finance charge paid separately. The final resulting value is the amount financed.

When calculating the amount financed, finance charges (whether in the note amount or paid separately) should not be subtracted more than once from the total amount of an obligation. Charges not in the note amount and not included in the finance charge (e.g., an appraisal fee paid separately in cash on a real estate loan) are not required to be disclosed under Regulation Z and

must not be included in the amount financed.

In a multiple advance construction loan, proceeds placed in a temporary escrow account and awaiting disbursement in draws to the developer are not considered part of the amount financed until actually disbursed. Thus, if the entire commitment amount is disbursed into the lender's escrow account, the lender must not base disclosures on the assumption that all funds were disbursed immediately, even if the lender pays interest on the escrowed funds.

Required Deposit – Section 1026.18(r)

A required deposit, with certain exceptions, is one that the financial institution requires the consumer to maintain as a condition of the specific credit transaction. It can include a compensating balance or a deposit balance that secures the loan. The effect of a required deposit is not reflected in the APR. Also, a required deposit is not a finance charge since it is eventually released to the consumer. A deposit that earns at least 5 percent per year need not be considered a required deposit.

Calculating the Amount Financed

A consumer signs a note secured by real property in the amount of \$5,435. The note amount includes \$5,000 in proceeds disbursed to the consumer, \$400 in pre-computed interest, \$25 paid to a credit reporting agency for a credit report, and a \$10 service charge. Additionally, the consumer pays a \$50 loan fee separately in cash at consummation. The consumer has no other debt with the financial institution. The amount financed is \$4,975.

The amount financed may be calculated by first subtracting all finance charges included in the note amount ($\$5,435 - \$400 - \$10 = \$5,025$). The \$25 credit report fee is not a finance charge because the loan is secured by real property. The \$5,025 is further reduced by the amount of prepaid finance charges paid separately, for an amount financed of $\$5,025 - \$50 = \$4,975$. The answer is the same whether finance charges included in the obligation are considered prepaid or pre-computed finance charges.

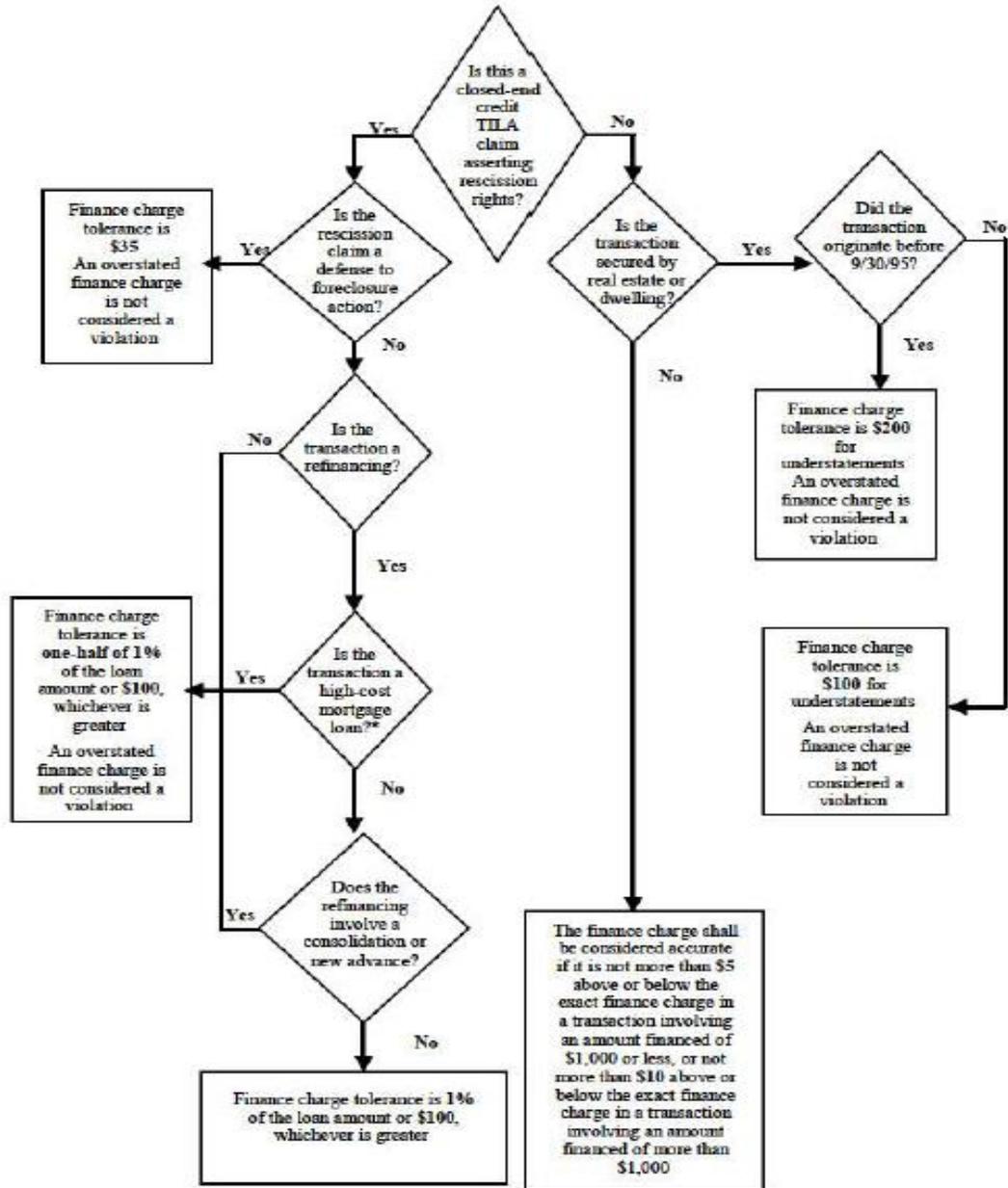
The financial institution may treat the \$10 service charge as an addition to the loan amount and not as a prepaid finance charge. If it does, the loan principal would be \$5,000. The \$5,000 loan principal does not include either the \$400 or the \$10 pre-computed finance charge in the note. The loan principal is increased by other amounts that are financed which are not part of the finance charge (the \$25 credit report fee) and reduced by any prepaid finance charges (the \$50 loan fee, not the \$10 service charge) to arrive at the amount financed of $\$5,000 + \$25 - \$50 = \$4,975$.

Other Calculations

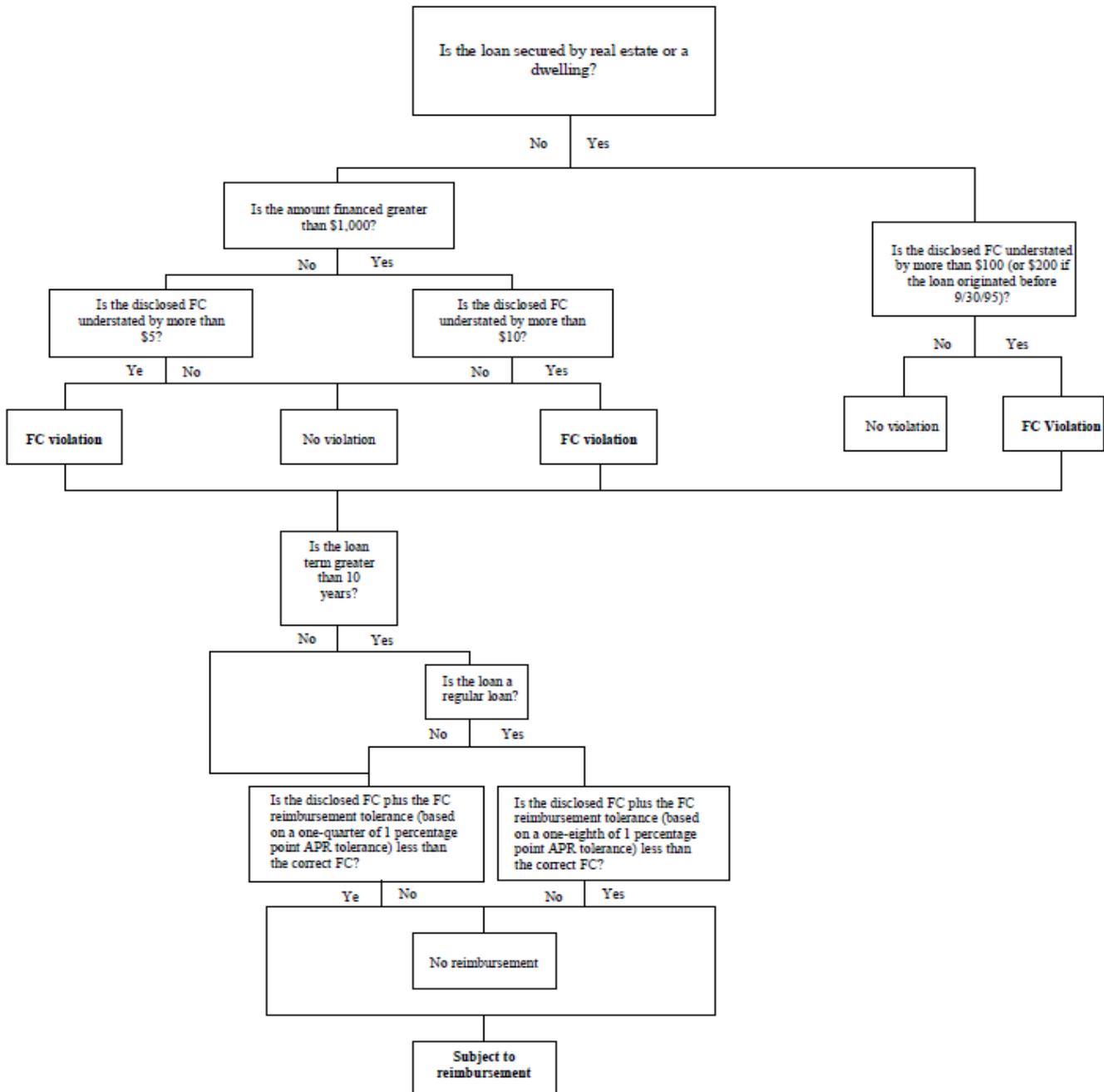
The financial institution may treat the \$10 service charge as a prepaid finance charge. If it does, the loan principal would be \$5,010. The \$5,010 loan principal does not include the \$400 pre-computed finance charge. The loan principal is increased by other amounts that are financed which are not part of the finance charge (the \$25 credit report fee) and reduced by any prepaid

finance charges (the \$50 loan fee and the \$10 service charge withheld from loan proceeds) to arrive at the same amount financed of $\$5,010 + \$25 - \$50 - \$10 = \$4,975$.

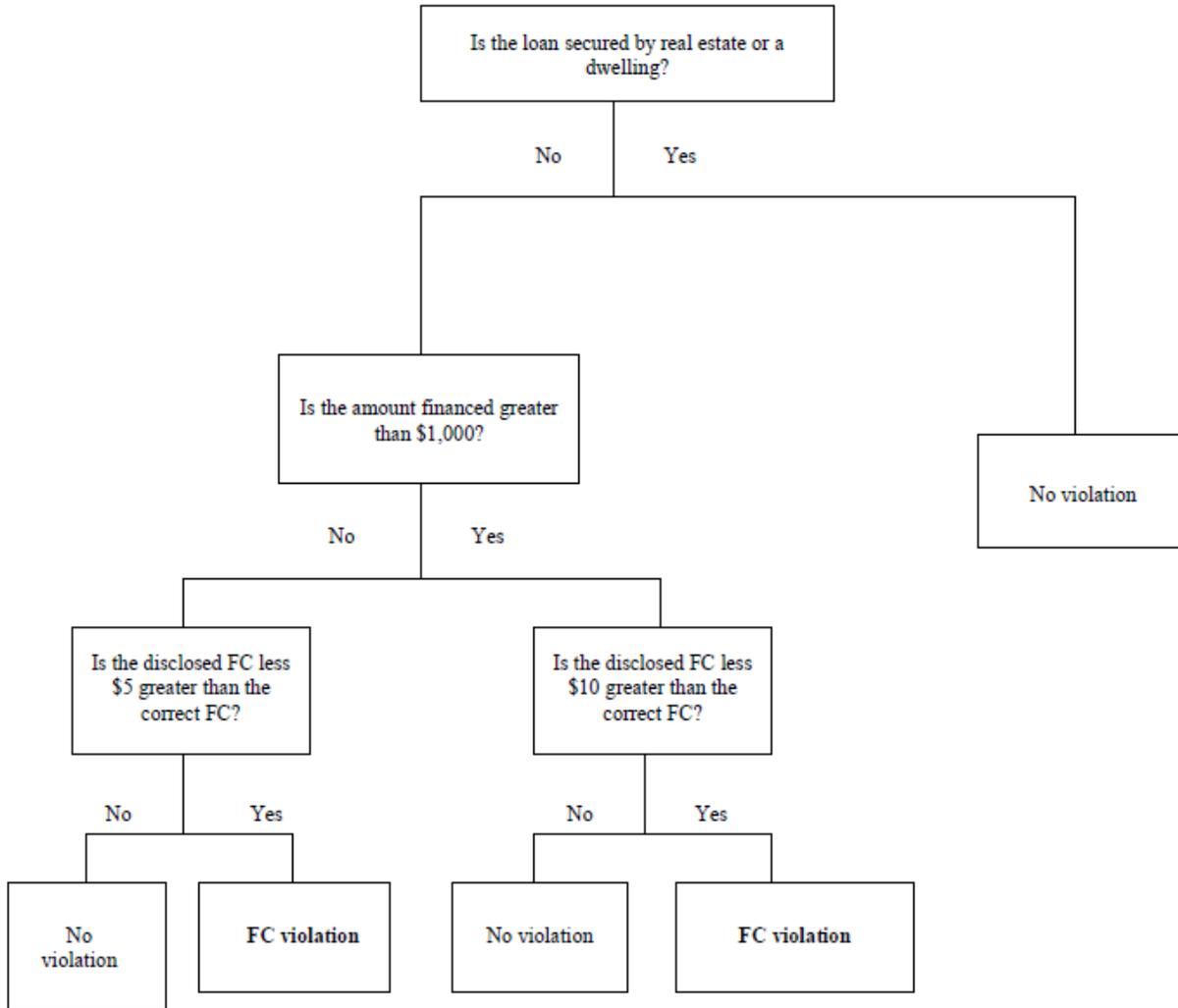
Closed-End Credit: Finance Charge Accuracy Tolerances



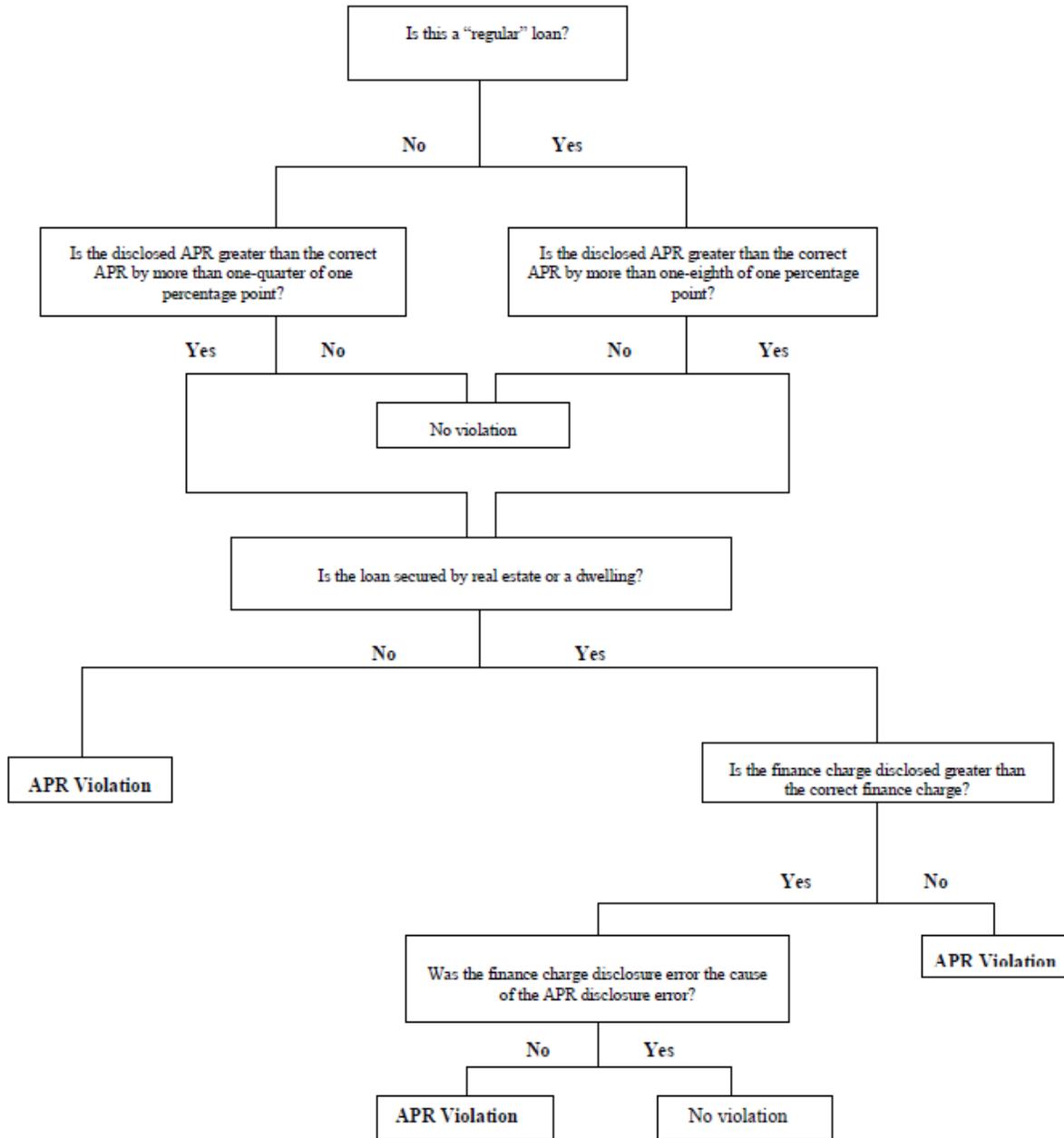
Closed-End Credit: Accuracy and Reimbursement Tolerances for UNDERSTATED FINANCE CHARGES



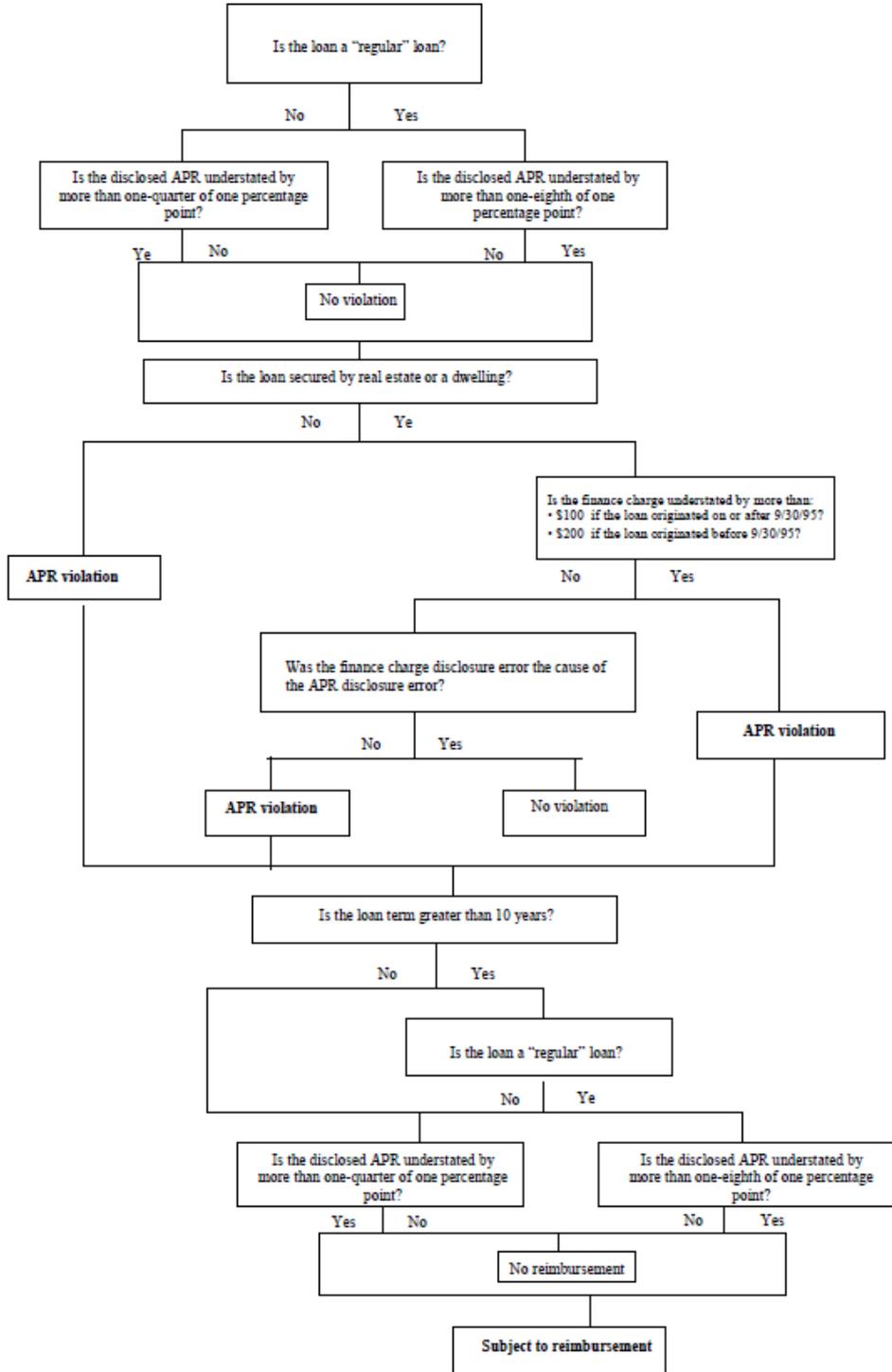
**Closed-End Credit: Accuracy Tolerances for
OVERSTATED FINANCE CHARGES**



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



Closed-End Credit: Accuracy and Reimbursement Tolerances for UNDERSTATED APRs



Refinancing – Section 1026.20

When an obligation is satisfied and replaced by a new obligation to the original financial institution (or a holder or servicer of the original obligation) and is undertaken by the same consumer, it must be treated as a refinancing for which **a complete set of new disclosures must be furnished**. A refinancing may involve the consolidation of several existing obligations, disbursement of new money to the consumer, or the rescheduling of payments under an existing obligation. In any form, the new obligation must completely replace the earlier one to be considered a refinancing under the regulation. The finance charge on the new disclosure must include any unearned portion of the old finance charge that is not credited to the existing obligation. (§1026.20(a))

The following transactions are not considered refinancing even if the existing obligation is satisfied and replaced by a new obligation undertaken by the same consumer:

- A renewal of an obligation with a single payment of principal and interest or with periodic interest payments and a final payment of principal with no change in the original terms.
- An APR reduction with a corresponding change in the payment schedule.
- An agreement involving a court proceeding.
- Changes in credit terms arising from the consumer's default or delinquency.
- The renewal of optional insurance purchased by the consumer and added to an existing transaction, if required disclosures were provided for the initial purchase of the insurance.

However, 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 financial institution:

- Increases the rate based on a variable rate feature that was not previously disclosed; or
- Adds a variable rate feature to the obligation.

If, at the time a loan is renewed, the rate is increased, the increase is not considered a variable rate feature. It is the cost of renewal, similar to a flat fee, as long as the new rate remains fixed during the remaining life of the loan. If the original debt is not canceled in connection with such a renewal, the regulation does not require new disclosures. Also, changing the index of a variable rate transaction to a comparable index is not considered adding a variable rate feature to the feature to the obligation.

Refinancing of Non-Standard Mortgages – Section 1026.43(d)

Section 1026.43(d) provides special rules for refinancing a “non-standard mortgage” into a “standard mortgage.”

A “non-standard mortgage” is a **covered transaction** as defined under section 1026.43(a) that is:

- An adjustable rate mortgage with an introductory fixed interest rate for a period of one year or longer;

(A covered transaction is a consumer credit transaction that is secured by a dwelling, including any real property attached to the dwelling. A covered transaction is not a home equity line of credit under section 1026.40; a mortgage secured by a consumer’s interest in a timeshare plan; a reverse mortgage under section 1026.33; a temporary or “bridge” loan with a term of 12 months or less; a construction phase of 12 months or less of a construction-to-permanent loan; or an extension of credit made: pursuant to a program administered by a housing finance agency; by certain community development or non-profit lenders, as specified in section 1026.43(a)(3)(v); or in connection with certain federal emergency economic stabilization programs.)

- An interest-only loan; or
- A negative amortization loan.

A “standard mortgage” is a covered transaction as defined under section 1026.43(a) with:

- Periodic payments that do not cause the principal balance to increase, do not allow the consumer to defer repayment of the principal, or do not result in balloon payments;
- Total points and fees that are not more than those allowed in section 1026.43(e)(3);
- A term that does not exceed 40 years;
- An interest rate that is fixed for the first five years of the loan; and
- Proceeds that are used solely to pay off the outstanding principal on the non-standard mortgage and closing or settlement costs (that are required to be disclosed under RESPA).

Current holders of non-standard mortgages or their servicers (collectively referred to here as “holders”) can refinance non-standard mortgages into standard mortgages without considering a consumer’s ability to repay under section 1026.43(c), if certain conditions are met.

To qualify for the exemption from the ability-to-repay requirements, the standard mortgage must have:

- A monthly payment that is “materially lower” than the non-standard mortgage,

(When comparing the payments, the holder must calculate the payment for the standard mortgage based on substantially equal, monthly, fully amortizing payments based on the maximum interest rate that may apply in the first five years. The holder must calculate the non-standard mortgage payment based on substantially equal, monthly, fully amortizing payments of principal and interest using:

- The fully indexed rate as of a reasonable period of time before or after the date on which the creditor receives the consumer’s application for the standard mortgage;
- The term of the loan remaining as of the date on which the recast occurs, assuming all scheduled payments have been made up to the recast date and the payment due on the recast date is made and credited as of that date; and
- The remaining loan amount, which is calculated differently depending on whether the loan is an adjustable rate mortgage, interest-only loan, or negative amortization loan.)

- The creditor must receive a written application from the consumer for the standard mortgage no later than two months after the non-standard mortgage is recast, and
- On the non-standard mortgage, consumers must have made no more than one payment more than 30 days late during the preceding 12 months and must have made no late payments more than 30 days late in the preceding six months of the holder receiving the application for a standard mortgage.

For non-standard loans consummated on or after January 10, 2014, that are refinanced into standard mortgages, the exemption from the ability-to-repay requirements for the refinancing is available only if the non-standard mortgage met the repayment ability requirements under section 1026.43(c) or the qualified mortgage requirements under section 1026.43(e) as applicable.

If these conditions are satisfied and if the holder has considered whether the standard mortgage is likely to prevent the consumer from defaulting on the non-standard mortgage once the loan terms are recast, the holder is not required to meet the ability-to-repay requirements in section 1026.43(c). Finally, holders refinancing a non-standard mortgage to a standard mortgage may offer consumers rate discounts and terms that are the same as (or better than) rate discounts and terms that the holder offers to new consumers, consistent with the holder's documented underwriting practices and to the extent not prohibited by applicable laws. For example, a holder would comply with this requirement if it has documented underwriting practices that provide for offering rate discounts to consumers with credit scores above a certain threshold, even though the consumer would not normally qualify for that discounted rate.

Disclosure of Initial Rate Change for Adjustable Rate Mortgages – Section 1026.20(d)

Creditors, assignees, or servicers¹¹ (referred to collectively as creditors) of adjustable rate mortgages, or ARMs, secured by the consumer's principal dwelling and with terms of more than one year are generally required to provide consumers with certain information pertaining to the ARM's initial rate change.¹² This information must be provided in a disclosure that is separate from all other documents, and the disclosure must be provided between 210 and 240 days before the first payment at the adjusted rate is due. If the first payment at a new rate is due within the first 210 days after consummation, the creditor must provide the rate change disclosure at consummation.

(Creditors, assignees, and servicers are all subject to the requirements of this section 1026.20(d). Creditors, assignees, and servicers may decide among themselves which of them will provide the required disclosures. However, establishing a business relationship where one party agrees to provide disclosures on behalf of the other parties does not absolve all other parties from their legal obligations.)

(Exemptions to disclosure requirements are covered in the section titled, "Exemptions to the Adjustable Rate Mortgage Disclosure Requirements – Sections 1026.20(c)(1)(ii) and (d)(1)(ii)" below.)

Disclosures required under this section must provide consumers with information related to the timing and nature of the rate change. If the new rate pursuant to the change disclosed is not known and the creditor provides an estimate, the rate must be identified as an estimate. If the creditor is using an estimate, it must be based on the index within 15 business days prior to the date of the disclosure. The calculation is made using the index reported in the source of information that the creditor uses in the explanation of how the interest rate is determined.

Disclosures required under section 1026.20(d) must also include, among others:

- The date of the disclosure.
- A statement explaining that the time period that the current rate has been in effect is ending, that the current rate is expiring, and that a change in the rate may result in a change in the required payment; providing the effective date of the change and a schedule of any future changes; and describing any other changes to the loan terms, features, or options taking effect on the same date (including expiration of interest-only or payment-option features).
- A table containing the current and new interest rates, the current and new payments, including the date the new payment is due, and for interest-only or negative amortization loans, the amount of the current and new payment allocated to principal, interest, and escrow (if applicable).

NOTE: The new payment allocation disclosed is the expected payment allocation for the first payment for which the new interest rate will apply.

- An explanation of how the interest rate is determined, including (among other things) an explanation of the index or formula used to determine the new rate and the margin.
- Any limitations on the interest rate or payment increase for each scheduled increase and over the life of the loan. Creditors must also include a statement regarding the extent to which such limitations result in foregone interest rate increases and the earliest date such foregone interest rate increases may apply to future interest rate adjustments.
- An explanation of how the new payment is determined, including an explanation of the index or formula used to determine the new rate, including the margin, the expected loan balance on the date of the rate adjustment, and the remaining loan term or any changes to the term caused by the rate change. ○ If the creditor is using an estimated rate or payment, a statement that the actual new interest rate and new payment will be provided to the consumer between two and four months prior to the first payment at the new rate.
- For negative amortization loans, creditors must provide a statement indicating that the new payment will not be allocated to pay loan principal and will not reduce the balance of the loan; instead, the payment will only apply to part of the interest, thereby increasing the amount of principal.
- A statement indicating the circumstances under which any prepayment penalty may be imposed, the time period during which it may be imposed, and a statement that the consumer may contact the servicer for additional information, including the maximum amount of the penalty that may be charged to the consumer.
- The telephone number of the creditor, assignee, or servicer for use if the consumer anticipates that he or she may not be able to make the new payments.
- A statement providing specified alternatives (which include refinancing, selling the property, loan modification, and forbearance) available if the consumer anticipates not being able to make the new payment.

A website address for either the CFPB's or the Department of Housing and Urban Development's (HUD) list of homeownership counselors and counseling organizations, the HUD toll-free telephone number to access the HUD list of homeownership counselors and counseling organizations, and the CFPB's website address for state housing finance authorities contact information.

For more information pertaining to the required format of the disclosures required under section 1026.20(d), please see section 1026.20(d)(3) and the model and sample forms H-4(D)(3) and (4) in Appendix H.

Disclosure of Rate Adjustments Resulting in Payment Changes – Section 1026.20(c)

Creditors, assignees, or servicers¹³ (referred to collectively as creditors) of ARMs secured by a consumer's principal dwelling with a term greater than one year are generally required to provide consumers with disclosures prior to the adjustment of the interest rate on the mortgage,¹⁴ if the interest rate change will result in a payment change as follows:

(Creditors, assignees, and servicers are all subject to the requirements of section 1026.20(c). Creditors, assignees, and servicers may decide among themselves which of them will provide the required disclosures. However, establishing a business relationship where one party agrees to provide disclosures on behalf of the other parties does not absolve all other parties from their legal obligations.)

(Exemptions to disclosure requirements are covered in the section titled, "Exemptions to the Adjustable Rate Mortgage Disclosure Requirements – Sections 1026.20(c)(1)(ii) and (d)(1)(ii)" below.)

- For ARMs where the payment changes along with a rate change, disclosures must be provided to consumers between 60 and 120 days before the first payment at the new amount is due.
- For ARMs where the payment changes in connection with a uniformly scheduled interest rate adjustment occurring every 60 days (or more frequently), the disclosures must be provided between 25 and 120 days before the first payment at the new amount is due.
- For ARMs originated prior to January 10, 2015, in which the contract requires the adjusted interest and payment to be calculated based on an index that is available on a date less than 45 days prior to the adjustment date, disclosures must be provided between 25 and 120 days before the first payment at the new amount is required.
- For ARMs where the first adjustment occurs within 60 days of consummation and the new interest rate disclosed at the time was an estimate, the disclosures must be provided as soon as practicable, but no less than 25 days before the first payment at the new amount is due.

Disclosures required under section 1026.20(c) must contain specific information, which includes, among others:

- A statement explaining that the time period during which the consumer's current rate has been in effect is ending and that the rate and payment will change; when the interest rate will change; dates when additional interest rate adjustments are scheduled to occur; and any other change in loan terms or features that take effect on the same date that the interest rate and payment change, such as an expiration of interest-only treatment or payment-option feature.

- A table explaining the current and new interest rates; the current and new payments, including the date the new payment is due; and for interest-only or negative amortizing loans, the amount of the current and new payment allocated to principal, interest, and amounts for escrow (if applicable).
- An explanation of how the new interest rate is determined, including (among other things) the index or formula used to determine the new rate and the margin, and any application of previously foregone interest rate increases from past adjustments;
- Any limitations on the interest rate and payment increase for each scheduled increase for the duration of the loan. Creditors must also include a statement regarding the extent to which such limitations result in foregone interest rate increases and the earliest date such foregone interest rate increases may apply to future interest rate adjustments.
- An explanation of how the new payment is determined, including an explanation of the index or formula used to determine the new rate, including the margin, the expected loan balance on the date of the rate adjustment, and the remaining loan term or any changes to the term caused by the rate change;
- For negative amortization loans, creditors must provide a statement indicating that the new payment will not reduce the balance of the loan, rather, the payment will only apply to part of the interest, thereby increasing the amount of principal; and
- A statement indicating the circumstances under which any prepayment penalty may be imposed, the time period during which it may be imposed, and a statement that the consumer may contact the servicer for additional information, including the maximum amount of the penalty that may be charged to the consumer.

For more information pertaining to the required format of the disclosures required under section 1026.20(c), please see section 1026.20(c)(3) and the model and sample forms H-4(D)(1) and (2) in Appendix H.

Exemptions to the Adjustable Rate Mortgage Disclosure Requirements – Sections 1026.20(c)(1)(ii) and (d)(1)(ii)

Disclosures under sections 1026.20(c) and (d) are not required for ARMs with a term of one year or less. Likewise, disclosures under section 1026.20(c) are not required if the first interest rate and payment adjustment occurs within the first 210 days and the new rate disclosed at consummation pursuant to section 1026.20(d) was not an estimate.

Advertising – Sections 1026.16 & 1026.24

The regulation requires that loan product advertisements provide accurate and balanced information, in a clear and conspicuous manner, about rates, monthly payments, and other loan features. The advertising rules ban several deceptive or misleading advertising practices, including representations that a rate or payment is “fixed” when in fact it can change.

Advertising Rules for Open-End Plans – Section 1026.16

If an advertisement for credit states specific credit terms, it must state only those terms that actually are or will be arranged or offered by the creditor. If any finance charges or other charges are set forth in an advertisement, the advertisement must also clearly and conspicuously state the following:

- Any minimum, fixed, transaction, activity or similar charge that is a finance charge under section 1026.4 that could be imposed;
- Any periodic rate that may be applied expressed as an APR as determined under section 1026.14(b). If the plan provides for a variable periodic rate, that fact must be disclosed; and
- Any membership or participation fee that could be imposed.

If any finance charges or other charge or payment terms are set forth, affirmatively or negatively, in an advertisement for a home-equity plan subject to the requirements of section 1026.40, the advertisement also must clearly and conspicuously set forth the following:

- Any loan fee that is a percentage of the credit limit under the plan and an estimate of any other fees imposed for opening the plan, stated as a single dollar amount or a reasonable range;
- Any periodic rate used to compute the finance charge, expressed as an APR as determined under section 1026.14(b); and
- The maximum APR that may be imposed in a variable-rate plan.

Regulation Z's open-end home-equity plan advertising rules include a clear and conspicuous standard for home-equity plan advertisements, consistent with the approach taken in the advertising rules for consumer leases under Regulation M. Commentary provisions clarify how the clear and conspicuous standard applies to advertisements of home-equity plans with promotional rates or payments, and to Internet, television, and oral advertisements of home-equity plans. The regulation allows alternative disclosures for television and radio advertisements for home-equity plans. The regulation also requires that advertisements adequately disclose not only promotional plan terms, but also the rates or payments that will apply over the term of the plan.

Regulation Z also contains provisions implementing the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, which requires disclosure of the tax implications of certain home-equity plans.

Closed-End Advertising – Section 1026.24

If an advertisement for credit states specific credit terms, it must state only those terms that actually are or will be arranged or offered by the creditor.

Disclosures required by this section must be made “clearly and conspicuously.” To meet this standard in general, credit terms need not be printed in a certain type size nor appear in any particular place in the advertisement. For advertisements for credit secured by a dwelling, a clear and conspicuous disclosure means that the required information is disclosed with equal prominence and in close proximity to the advertised rates or payments triggering the required disclosures.

If an advertisement states a rate of finance charge, it must state the rate as an “annual percentage rate,” using that term. If the APR may be increased after consummation, the advertisement must state that fact.

If an advertisement is for credit not secured by a dwelling, the advertisement must not state any other rate, except that a simple annual rate or periodic rate that is applied to an unpaid balance may be stated in conjunction with, but not more conspicuously than, the APR.

If an advertisement is for credit secured by a dwelling, the advertisement must not state any other rate, except that a simple annual rate that is applied to an unpaid balance may be stated in conjunction with, but not more conspicuously than, the APR. That is, an advertisement for credit secured by a dwelling may not state a periodic rate, other than a simple annual rate, that is applied to an unpaid balance.

“Triggering terms” - The following are triggering terms that require additional disclosures:

- The amount or percentage of any down payment;
- The number of payments or period of repayment;
- The amount of any payment; and
- The amount of any finance charge.

An advertisement stating a triggering term must also state the following terms as applicable:

- The amount or percentage of any down payment;
- The terms of repayment, which reflect the repayment obligations over the full term of the loan, including any balloon payment; and
- The “annual percentage rate,” using that term, and, if the rate may be increased after consummation, that fact.

For any advertisement secured by a dwelling, other than television or radio advertisements, that

states a simple annual rate of interest and more than one simple annual rate of interest will apply over the term of the advertised loan, the advertisement must state in a clear and conspicuous manner:

- Each simple rate of interest that will apply. In variable-rate transactions, a rate determined by adding an index and margin must be disclosed based on a reasonably current index and margin.
- The period of time during which each simple annual rate of interest will apply.
- The APR for the loan.

The regulation prohibits the following seven deceptive or misleading acts or practices in advertisements for closed-end mortgage loans:

- Stating that rates or payments for loans are “fixed” when those rates or payments can vary without adequately disclosing that the interest rate or payment amounts are “fixed” only for a limited period of time, rather than for the full term of the loan;
- Making comparisons between actual or hypothetical credit payments or rates and any payment or rate available under the advertised product that are not available for the full term of the loan, with certain exceptions for advertisements for variable rate products;
- Characterizing the products offered as “government loan programs,” “government-supported loans,” or otherwise endorsed or sponsored by a federal or state government entity even though the advertised products are not government-supported or -sponsored loans;
- Displaying the name of the consumer’s current mortgage lender, unless the advertisement also prominently discloses that the advertisement is from a mortgage lender not affiliated with the consumer’s current lender;
- Making claims of debt elimination if the product advertised would merely replace one debt obligation with another;
- Creating a false impression that the mortgage broker or lender is a “counselor” for the consumer; and
- In foreign-language advertisements, providing certain information, such as a low introductory “teaser” rate, in a foreign language, while providing required disclosures only in English.

Subpart D – Miscellaneous

Civil Liability - TILA Sections 129B, 129C, 130 and 131

If a creditor fails to comply with any requirements of the TILA, other than with the advertising provisions of chapter 3, it may be held liable to the consumer for

- actual damage, and.
- cost of any successful legal action together with reasonable attorney's fees.

The creditor also may be held liable for any of the following:

- In an individual action, twice the amount of the finance charge involved.
- In an individual action relating to an open-end credit transaction that is not secured by real property or a dwelling, twice the amount of the finance charge involved, with a minimum of \$500 and a maximum of \$5,000 or such higher amount as may be appropriate in the case of an established pattern or practice of such failure.
- In an individual action relating to a closed-end credit transaction secured by real property or a dwelling, not less than \$400 and not more than \$4,000.
- In a class action, such amount as the court may allow (with no minimum recovery for each class member). However, the total amount of recovery in any class actions arising out of the same failure to comply by the same creditor cannot be more than **\$1,000,000** or 1 percent of the creditor's net worth, whichever is less.

A creditor that fails to comply with section 129 of TILA, 15 U.S.C. section 1639, (requirements for certain mortgages) may be held liable to the consumer for all finance charges and fees paid by the consumer unless the creditor demonstrates that the failure was not material. A mortgage originator that is not a creditor and that fails to comply with section 129B (requirements for mortgage loan originators) also may be liable to consumers for the greater of actual damages or an amount equal to three times the total amount of direct and indirect compensation or gain to the mortgage originator in connection with the loan, plus costs, including reasonable attorney's fees. In addition, TILA section 130(a) provides that a creditor may be liable for failure to comply with the ability-to-repay requirements of TILA section 129C(a) unless the creditor demonstrates that the failure to comply was not material.

Generally, civil actions that may be brought against a creditor may be maintained against any assignee of the creditor only if the violation is apparent on the face of the disclosure statement or other documents assigned, except where the assignment was involuntary. For high-cost mortgage loans (under section 1026.32(a)), any subsequent purchaser or assignee is subject to all claims and defenses that the consumer could assert against the creditor, unless the assignee demonstrates that it could not reasonably have determined that the loan was a high-cost mortgage loan subject to section 1026.32.

In specified circumstances, the creditor or assignee has no liability if it corrects identified errors within 60 days of discovering the errors and prior to the institution of a civil action or the receipt of written notice of the error from the obligor. Additionally, a creditor and assignee will not be liable for bona fide errors that occurred despite the maintenance of procedures reasonably adapted to avoid any such error.

Moreover, the TILA also provides consumers with the right to assert a violation of the TILA's anti-steering provisions or the ability-to-repay standards for residential mortgage loan requirements "as a matter of defense by recoupment or setoff" against a foreclosure action. In general, the amount of recoupment or setoff shall be equal to the amount that the consumer would be entitled to generally under 15 U.S.C. 1640(a) for a valid claim, plus the cost to the consumer of the action (including reasonable attorney's fees).

Refer to Sections 129B, 129C, 130 and 131 of TILA for more information.

Criminal Liability – TILA Section 112

Anyone who willingly and knowingly fails to comply with any requirement of the TILA will be fined not more than \$5,000 or imprisoned not more than one year, or both.

Administrative Actions – TILA Section 108

The TILA authorizes federal regulatory agencies to require financial institutions to make monetary and other adjustments to the consumers' accounts when the true finance charge or APR exceeds the disclosed finance charge or APR by more than a specified accuracy tolerance. That authorization extends to unintentional errors, including isolated violations (e.g., an error that occurred only once or errors, often without a common cause, that occurred infrequently and randomly).

Under certain circumstances, the TILA requires federal regulatory agencies to order financial institutions to reimburse consumers when understatement of the APR or finance charge involves:

- Patterns or practices of violations (e.g., errors that occurred, often with a common cause, consistently or frequently, reflecting a pattern with a specific type or types of consumer credit).
- Gross negligence.
- Willful noncompliance intended to mislead the person to whom the credit was extended.

Any proceeding that may be brought by a regulatory agency against a creditor may be maintained against any assignee of the creditor if the violation is apparent on the face of the disclosure statement or other documents assigned, except where the assignment was involuntary under section 131 (15 U.S.C. 1641).

Relationship to State Law – TILA Section 111

State laws providing rights, responsibilities, or procedures for consumers or financial institutions for consumer credit contracts may be:

- Preempted by federal law;
- Not preempted by federal law; or
- Substituted in lieu of the TILA and Regulation Z requirements.

State law provisions are preempted to the extent that they contradict the requirements in the following chapters of the TILA and the implementing sections of Regulation Z:

- Chapter 1, “General Provisions,” which contains definitions and acceptable methods for determining finance charges and annual percentage rates.
- Chapter 2, “Credit Transactions,” which contains disclosure requirements, rescission rights, and certain credit card provisions.
- Chapter 3, “Credit Advertising,” which contains consumer credit advertising rules and APR oral disclosure requirements.

For example, a state law would be preempted if it required a bank to use the terms “nominal annual interest rate” in lieu of “annual percentage rate.”

Conversely, state law provisions are generally not preempted under federal law if they call for, without contradicting chapters 1, 2, or 3 of the TILA or the implementing sections of Regulation Z, either of the following:

- Disclosure of information not otherwise required. A state law that requires disclosure of the minimum periodic payment for open-end credit, for example, would not be preempted because it does not contradict federal law.
- Disclosures more detailed than those required. A state law that requires itemization of the amount financed, for example, would not be preempted, unless it contradicts federal law by requiring the itemization to appear with the disclosure of the amount financed in the segregated closed-end credit disclosures.

The relationship between state law and chapter 4 of the TILA (“Credit Billing”) involves two parts. The first part is concerned with sections 161 (correction of billing errors) and 162 (regulation of credit reports) of the act; the second part addresses the remaining sections of chapter 4.

State law provisions are preempted if they differ from the rights, responsibilities, or procedures contained in sections 161 or 162. An exception is made, however, for state law that allows a

consumer to inquire about an account and requires the bank to respond to such inquiry beyond the time limits provided by federal law. Such a state law would not be preempted for the extra time period.

State law provisions are preempted if they result in violations of sections 163 through 171 of chapter 4. For example, a state law that allows the card issuer to offset the consumer's creditcard indebtedness against funds held by the card issuer would be preempted, since it would violate 12 CFR 1026.12(d). Conversely, a state law that requires periodic statements to be sent more than 14 days before the end of a free-ride period would not be preempted, since no violation of federal law is involved.

A bank, state, or other interested party may ask the CFPB to determine whether state law contradicts chapters 1 through 3 of the TILA or Regulation Z. They also may ask if the state law is different from, or would result in violations of, chapter 4 of the TILA and the implementing provisions of Regulation Z. If the CFPB determines that a disclosure required by state law (other than a requirement relating to the finance charge, APR, or the disclosures required under section 1026.32) is substantially the same in meaning as a disclosure required under the act or Regulation Z, generally creditors in that state may make the state disclosure in lieu of the federal disclosure.

Subpart E – Special Rules for Certain Home Mortgage Transactions

General Rules – Section 1026.31

The requirements and limitations of this subpart are in addition to and not in lieu of those contained in other subparts of Regulation Z. The disclosures for high cost and reverse mortgage transactions must be made clearly and conspicuously in writing, in a form that the consumer may keep and in compliance with specific timing requirements.

Requirements for High-Cost Mortgages – Section 1026.32

The requirements of this section generally apply to a high-cost mortgage, which is a consumer credit transaction secured by the consumer's principal dwelling (subject to the exemptions discussed below) that meets any one of the following three coverage tests.

- The APR will exceed the *average prime offer rate* (APOR), as defined in section 1026.35(a)(2), applicable for a comparable transaction as of the date the interest rate is set by:
 - More than 6.5 percentage points for first-lien transactions (other than as described below);
 - More than 8.5 percentage points for first-lien transactions where the dwelling is personal property and the loan amount is less than \$50,000; or
 - More than 8.5 percentage points for subordinate-lien transactions.

- The total points and fees (see definition below) for the transaction will exceed:
 - For transactions with a loan amount of \$20,000 or more, five percent of the total loan amount; or
 - For transactions with a loan amount of less than \$20,000, the lesser of eight percent of the total transaction amount or \$1,000 for the calendar year 2014.

The \$20,000 and \$1,000 dollar amounts will be adjusted annually based on changes in the Consumer Price Index and will be reflected in official interpretations of section 1026.32(a)(1)(ii). The official interpretation of section 1026.32(a)(1)(ii) also contains a historical list of dollar amount adjustments for transactions originated prior to January 10, 2014.

NOTE: The “total loan amount” (using the face amount of the note) for closed-end credit is calculated by taking the amount financed (see §1026.18(b)) and deducting any cost listed in sections 1026.32(b)(1)(iii), (iv), or (vi) that is both included in points and fees and financed by the creditor. The “total loan amount” for open-end credit is the credit plan limit when the account is opened.

- The terms of the loan contract or open-end credit agreement permit the creditor to charge a prepayment penalty (see definition below) more than 36 months after consummation or account opening, or prepayment penalties that exceed more than two percent of the amount prepaid (§1026.32(a)(1)(iii)).

NOTE: Section 1026.32(d)(6) prohibits prepayment penalties for high-cost mortgages. However, if a mortgage loan has a prepayment penalty that may be imposed more than 36 months after consummation or account opening or that is greater than two percent of the amount prepaid, the loan is a high-cost mortgage regardless of interest rate or fees. Therefore, the prepayment penalty coverage test above effectively bans transactions of the types subject to HOEPA coverage that permit creditors to charge prepayment penalties that exceed the prescribed limits.

Exemptions from HOEPA Coverage – Section 1026.32(a)(2)

- Reverse mortgage transactions subject to section 1026.33;
- A transaction that finances the initial construction of a dwelling;
- A transaction originated by a Housing Finance Agency, where the Housing Finance Agency is the creditor for the transaction; or
- A transaction originated pursuant to the United States Department of Agriculture’s Rural Development Section 502 Direct Loan Program.

Determination of APR for High-Cost Mortgages – Section 1026.32(a)(3)

The APR used to determine whether a mortgage is a high-cost mortgage is calculated differently than the APR that is used on TILA disclosures. Specifically, the APR for HOEPA coverage is based on the following:

- If the APR will not vary during the length of the loan or credit plan (i.e., for fixed-rate transactions), the interest rate in effect as of the date the interest rate for the transaction is set (§1026.32(a)(3)(i));

- If the interest rate may vary during the term of the loan or credit plan in accordance with an index, the interest rate that results from adding the maximum margin permitted at any time during the term of the loan or credit plan to the index rate in effect as of the date the interest rate for the transaction is set, or to the introductory interest rate, whichever is greater (§1026.32(a)(3)(ii)); or
- If the interest rate may or will vary during the term of the loan or credit plan other than as described above (i.e., as in a step-rate transaction), the maximum interest rate that may be imposed during the life of the loan or credit plan. (§1026.32(a)(3)(iii))

Points and Fees for High-Cost Mortgages – Section 1026.32(b)

NOTE: Points and fees calculations for high-cost mortgages depend upon whether the transaction is closed end or open end.

For a **closed-end transaction**, calculate the points and fees by including the following charges (§1026.32(b)(1)):

- All items included in the finance charge under sections 1026.4(a) and (b), except that the following items are excluded:
 - Interest or the time-price differential;
 - Any premiums or other charges imposed in connection with a federal or state agency program for any guaranty or insurance that protects the creditor against the consumer's default or other credit loss (i.e., up-front and annual FHA premiums, VA funding fees, and USDA guarantee fees);
 - Premiums or other charges for any guaranty or insurance that protects creditors against the consumer's default or other credit loss and IS NOT in connection with a federal or state agency program (i.e., private mortgage insurance (PMI) premiums) as follows:
 - The entire amount of any premiums or other charges payable after consummation (i.e., monthly or annual PMI premiums); or
 - If the premium or other charge is payable at or before consummation, the portion of any such premium or other charge that is not in excess of the permissible up-front mortgage insurance premium for FHA loans, but only if the premium or charge is refundable on a pro rata basis and the refund is automatically issued upon the notification of the satisfaction of the underlying mortgage loan. The permissible up-front mortgage insurance premiums for FHA loans are published in HUD Mortgagee Letters, available online at:

http://portal.hud.gov/hudportal/HUD?src=/program_offices/administration/hudclips/letters/mortgagee.
 - Bona fide third-party charges not retained by the creditor, loan originator, or an affiliate of either, unless the charge is required to be included under section 1026.32(b)(1)(i)(C), (iii), or (v);
 - Up to two bona fide discount points payable by the consumer in connection with the transaction, provided that the interest rate without any discount does not exceed:

- The APOR for a comparable transaction by more than one percentage point; or
 - If the transaction is secured by personal property, the average rate for a loan insured under Title I of the National Housing Act by more than one percentage point, or
- If no discount points have been excluded above, then up to one bona fide discount point payable by the consumer in connection with the transaction, provided that the interest rate without any discount does not exceed:
- The APOR for a comparable transaction by more than two percentage points; or
 - If the transaction is secured by personal property, the average rate for a loan insured under Title I of the National Housing Act by more than two percentage points.

NOTE: In the case of a closed-end plan, a bona fide discount point means an amount equal to one percent of the loan amount paid by the consumer that reduces the interest rate or time-price differential applicable to the transaction based on a calculation that is consistent with established industry practices for determining the amount of reduction in the interest rate or time-price differential appropriate for the amount of discount points paid by the consumer. (§1026.32(b)(3))

- All compensation paid directly or indirectly by a consumer or creditor to a loan originator (as defined in section 1026.36(a)(1) that can be attributed to the transaction at the time the interest rate is set unless:
 - That compensation is paid by a consumer to a mortgage broker, as defined in section 1026.36(a)(2), and already has been included in points and fees under section 1026.32(b)(1)(i);
 - That compensation is paid by a mortgage broker, as defined in section 1026.36(a)(2), to a loan originator that is an employee of the mortgage broker; or
 - That compensation is paid by a creditor to a loan originator that is an employee of the creditor.
- All items listed in section 1026.4(c)(7), other than amounts held for future taxes, unless ALL of the following conditions are met:
 - The charge is reasonable;
 - The creditor receives no direct or indirect compensation in connection with the charge; and
 - The charge is not paid to an affiliate of the creditor.
- Premiums or other charges paid at or before consummation, whether paid in cash or financed, for any credit life, credit disability, credit unemployment, or credit property insurance, or for any other life, accident, health, or loss-of-income insurance for which the creditor is a beneficiary, or any payments directly or indirectly for any debt cancellation or suspension agreement or contract.
- The maximum prepayment penalty that may be charged or collected under the terms of the mortgage or credit plan; and
- The total prepayment penalty incurred by the consumer if the consumer refinances an existing closed-end mortgage with a new mortgage transaction extended by the current holder of the existing loan, a servicer acting on behalf of the current holder, or an affiliate of either.

For an **open-end credit plan**, points and fees mean the following charges that are known at or before account opening: (§1026.32(b)(2))

• All items included in the finance charge under sections 1026.4(a) and (b), except that the following items are excluded:

○ Interest or the time-price differential;

○ Any premiums or other charges imposed in connection with a federal or state agency program for any guaranty or insurance that protects the creditor against the consumer's default or other credit loss (i.e., up-front and annual FHA premiums, VA funding fees, and USDA guarantee fees);

○ Premiums or other charges for any for guaranty or insurance that protects creditors against the consumer's default or other credit loss and IS NOT in connection with a federal or state agency program (i.e., private mortgage insurance (PMI) premiums) as follows:

▪ If the premium or other charge is payable after account opening, the entire amount of such premium or other charge, or

▪ If the premium or other charge is payable at or before account opening, the portion of any such premium or other charge that is not in excess of the permissible up-front mortgage insurance premium for FHA loans, but only if the premium or charge is refundable on a pro rata basis and the refund is automatically issued upon the notification of the satisfaction of the underlying mortgage loan. The permissible up-front mortgage insurance premiums for FHA loans are published in HUD Mortgage Letters, available online at:

http://portal.hud.gov/hudportal/HUD?src=/program_offices/administration/hudclips/letters/mortgagee

○ Bona fide third-party charges not retained by the creditor, loan originator, or an affiliate of either, unless the charge is required to be included under section 1026.32(b)(2)(i)(C), (iii), or (iv); ○ Up to two bona fide discount points payable by the consumer in connection with the transaction, provided that the interest rate without any discount does not exceed:

▪ The APOR by more than one percentage point; or

▪ If the transaction is secured by personal property, the average rate for a loan insured under Title I of the National Housing Act by more than one percentage point, or

○ If no discount points have been excluded above, then up to one bona fide discount point payable by the consumer in connection with the transaction, provided that the interest rate without any discount does not exceed:

▪ The APOR by more than two percentage points; or

▪ If the transaction is secured by personal property, the average rate for a loan insured under Title I of the National Housing Act by more than two percentage points.

NOTE: A bona fide discount point means an amount equal to one percent of the credit limit when the account is opened, paid by the consumer, that reduces the interest rate or time-price differential applicable to the transaction based on a calculation that is consistent with established industry practices for determining the amount of reduction in the interest rate or time-price differential appropriate for the amount of discount points paid by the consumer. (§1026.32(b)(3)(ii))

- All compensation paid directly or indirectly by a consumer or creditor to a loan originator (as defined in section 1026.36(a)(1) that can be attributed to the transaction at the time the interest rate is set unless:

- That compensation is paid by a consumer to a mortgage broker, as defined in section 1026.36(a)(2) and already has been included in points and fees under section 1026.33(b)(2)(i);

- That compensation is paid by a mortgage broker as defined in section 1026.36(a)(2) to a loan originator that is an employee of the mortgage broker; or

- That compensation is paid by a creditor to a loan originator that is an employee of the creditor.

- All items listed in section 1026.4(c)(7), other than amounts held for future taxes, unless ALL of the following conditions are met: ○ The charge is reasonable;

- The creditor receives no direct or indirect compensation in connection with the charge; and

- The charge is not paid to an affiliate of the creditor.

- Premiums or other charges paid at or before account opening for any credit life, credit disability, credit unemployment, or credit property insurance, or for any other life, accident, health, or loss-of-income insurance for which the creditor is a beneficiary, or any payments directly or indirectly for any debt cancellation or suspension agreement or contract.

- The maximum prepayment penalty that may be charged or collected under the terms of the credit plan; and

- The total prepayment penalty incurred by the consumer if the consumer refinances an existing closed-end credit transaction or terminates an existing open-end credit plan in connection with obtaining a new closed- or open-end credit transaction with the current holder of the existing loan or plan, a servicer acting on behalf of the current holder, or an affiliate of either.

In addition to the charges listed above, points and fees for open-end credit plans also include the following items:

- Fees charged for participation in the credit plan, payable at or before account opening, as described in section 1026.4(c)(4), and

- Any transaction fee that will be charged to draw funds on the credit line, as described in section 1026.32(b)(2)(viii).

Prepayment Penalty Definition – Section 1026.32(b)(6)

For closed-end credit transactions, a prepayment penalty is a charge imposed for paying all or part of the transaction's principal before the date on which the principal is due with limited exceptions.

For open-end credit plans, a prepayment penalty is a charge imposed by the creditor if the consumer terminates the credit plan prior to the end of its term.

NOTE: Waived, bona fide third-party charges that are later imposed if the transaction is prepaid sooner than 36 months after consummation or account opening are not considered prepayment penalties. For closed-end transactions insured by the Federal Housing Administration and consummated before January 21, 2015, interest charged consistent with the monthly interest accrual amortization method is not a prepayment penalty, so long as the interest is charged consistent with the monthly interest accrual amortization method used for those loans. See Commentary 32(b)(6)-1(iv).

High-Cost Mortgage Disclosures – Section 1026.32(c)

In addition to the other disclosure requirements of Regulation Z, high-cost mortgages require certain additional information to be disclosed in conspicuous type size to consumers before consummation of the transaction or account opening. These disclosures include:

- Notice to the consumer using the required language in section 1026.32(c)(1);
- The annual percentage rate (§1026.32(c)(2));
- Specified information concerning the regular or minimum periodic payment and the amount of any balloon payment, if permitted under the high-cost mortgage limitations in section 1026.32(d); (§1026.32(c)(3))
- For variable-rate transactions, a statement that the interest and monthly payment may increase, and the amount of the single maximum monthly payment based on the maximum interest rate required to be included in the contract; (§1026.32(c)(4)) and
- The total amount borrowed for closed-end credit transactions or the credit limit for the plan when the account is opened for an open-end credit plan. (§1026.32(c)(5))

NOTE: For closed-end credit transactions, if the amount borrowed includes charges to be financed under section 1026.34(a)(10), this fact must be stated, grouped together with the disclosure of amount borrowed. The disclosure of the amount borrowed will be treated as accurate if it is not more than \$100 above or below the amount required to be disclosed.

High-Cost Mortgage Limitations – Section 1026.32(d)

Certain loan terms, including negative amortization, interest rate increases after default, and prepayment penalties are prohibited for high-cost mortgages. Others, including balloon payments and due-on-demand clauses, are restricted.

- Balloon payments, defined as payments that are more than two times a regular periodic payment, are generally prohibited for high-cost mortgages. (§1026.32(d)(1)(i)) However, balloon payments are allowed in certain limited circumstances.

- For closed-end transactions, balloon payments are permitted when (a) the loan has a payment schedule that is adjusted to seasonal or irregular income of the consumer; (b) the loan is a “bridge” loan made in connection with the purchase of a new dwelling and matures in 12 months or less; or (c) the creditor meets criteria for serving a predominantly rural or underserved area, and the loan meets specific criteria set forth in sections 1026.43(f)(1)(i) through (vi) and 1026.43(f)(2). (§1026.32(d)(1)(ii))
- For an open-end credit plan where the terms of the plan provide for a draw period where no payment is required, followed by a repayment period where no further draws may be taken, the initial payment required after conversion to the repayment phase of the credit plan is not considered a “balloon” payment. However, if the terms of an open-end credit plan do not provide for a separate draw period and repayment period, the balloon payment limitation applies. (§1026.32(d)(1)(iii))
- Acceleration clauses or demand features are limited and may only permit creditors to accelerate and demand repayment of the entire outstanding balance of a high-cost mortgage if:
 - There is fraud or material misrepresentation by the consumer in connection with the loan (§1026.32(d)(8)(i));
 - The consumer fails to meet the repayment terms of the agreement for any outstanding balance that results in a default on the loan (§1026.32(d)(8)(ii)); or
 - There is any action (or inaction) by the consumer that adversely affects the rights of the creditor’s security interest for the loan, such as the consumer failing to pay required taxes on the property. (§1026.32(d)(8)(iii) and comments 32(d)(8)(iii)-1 and -2)

Prohibited Acts or Practices in Connection with High-Cost Mortgages – Section 1026.34

In addition to the requirements in section 1026.32, Regulation Z imposes additional requirements for high-cost mortgages, several of which are discussed below.

Refinancing Within One-Year – Section 1026.34(a)(3)

A creditor or assignee cannot refinance a consumer’s high-cost mortgage into a second high-cost mortgage within the first year of the origination of the first loan, unless the second high-cost mortgage is in the consumer’s interest.

Repayment Ability for High-Cost Mortgages – Section 1026.34(a)(4)

Among other requirements, a creditor extending high-cost mortgage credit subject to section 1026.32 must not make such loans without regard to the consumer’s repayment ability as of consummation or account opening as applicable. (§1026.34(a)(4))

For closed-end credit transactions that are high-cost mortgages, section 1026.34(a)(4) requires a creditor to comply with the repayment ability requirements set forth in section 1026.43.

For open-end credit plans that are high-cost mortgages, a creditor may not open a credit plan for a consumer where credit is or will be extended without regard to the consumer's repayment ability as of account opening, including the consumer's current and reasonably expected income, employment, assets other than the collateral, and current obligations, including any mortgage-related obligations.

- For the purposes of these open-end requirements, mortgage-related obligations include, among other things, property taxes, premiums and fees for mortgage-related insurance that are required by the creditor, fees and special assessments such as those imposed by a condominium association, and similar expenses required by another credit obligation undertaken prior to or at account opening and secured by the same dwelling that secures the high-cost mortgage transaction. (§1026.34(a)(4)(i))

- A creditor must also verify both current obligations and the amounts of income or assets that it relies on to determine repayment ability using W-2s, tax returns, payroll receipts, financial institution records, or other third-party documents that provide reasonably reliable evidence of the consumer's income or assets (§1026.34(a)(4)(ii)).

For open-end high-cost mortgages, a presumption of compliance is available but only if the creditor:

- Verifies the consumer's repayment ability as required under section 1026.34(a)(4)(ii));

- Determines the consumer's repayment ability taking into account current obligations and mortgage-related obligations, using the largest required minimum periodic payment based on the assumptions that:

- The consumer borrows the full credit line at account opening with no additional extensions of credit;

- The consumer makes only required minimum periodic payments during the draw period and any repayment period; and

- If the APR can increase, the maximum APR that is included in the contract applies to the plan at account opening and will apply during the draw and any repayment period. (§1026.34(a)(4)(iii)(B))

- Assesses the consumer's repayment ability, taking into account either the ratio of total debts to income or the income the consumer will have after paying current obligations. (§1026.34(a)(4)(iii)(C))

NOTE: No presumption of compliance will be available for an open-end high-cost mortgage transaction in which the regular periodic payments, when aggregated, do not fully amortize the outstanding principal balance except for transactions with balloon payments permitted under section 1026.32(d)(1)(ii).

High-Cost Mortgage Pre-Loan Counseling – Section 1026.34(a)(5)

Creditors that originate high-cost mortgages must receive written certification that the consumer has obtained counseling on the advisability of the mortgage from a counselor approved by HUD, or if permitted by HUD, a state housing finance authority (specific content for the certifications can be found in section 1026.34(a)(5)(iv)). Counseling must occur after the consumer receives a good faith estimate or initial TILA disclosure. Additionally, counseling cannot be provided by a counselor who is employed by, or affiliated with, the creditor. A creditor may pay the fees for counseling but is prohibited from conditioning the payment of fees upon the consummation of the mortgage transaction or, if the consumer withdraws his or her application, upon receipt of the certification.

However, a creditor may confirm that a counselor provided counseling to the consumer prior to paying these fees. Finally, a creditor is prohibited from steering a consumer to a particular counselor.

Recommended Default – Section 1026.34(a)(6)

Creditors (and mortgage brokers) are prohibited from recommending or encouraging a consumer to default on an existing loan or other debt prior to, and in connection with, the consummation or account opening of a high-cost mortgage that refinances all or any portion of the existing loan or debt.

Loan Modification and Deferral Fees – Section 1026.34(a)(7)

Creditors, successors-in-interest, assignees, or any agents of these parties may not charge a consumer any fee to modify, renew, extend, or amend a high-cost mortgage, or to defer any payment due under the terms of the mortgage.

Late Fees – Section 1026.34(a)(8)

Late payment charges for a high-cost mortgage must be permitted by the terms of the loan contract or open-end agreement and may not exceed **four** percent of the amount of the payment that is past due. Late payment charges are permitted only if payment is not received by the end of the 15-day period beginning on the day the payment is due or, where interest on each installment is paid in advance, by the end of the 30-day period beginning on the day the payment is due.

Creditors are also prohibited from “pyramiding” late fees—that is, charging late payments if any delinquency is attributable only to a late payment charge that was imposed due to a previous late payment, and the payment otherwise is considered a full payment for the applicable period (and any allowable grace period). If a consumer fails to make a timely payment by the due date, then subsequently resumes making payments but has not paid all past due payments, the creditor can continue to impose late payment charges for the payments outstanding until the default is cured.

Fees for Payoff Statements – Section 1026.34(a)(9)

A creditor or servicer may not charge a fee for providing consumers (or authorized representatives) with a payoff statement on a high-cost mortgage. Payoff statements must be provided to consumers within **five** business days after receiving the request for a statement. A creditor or servicer may charge a processing fee to cover the cost of providing the payoff statement by fax or courier only, provided that such fee may not exceed an amount that is comparable to fees imposed for similar services provided in connection with a non-high-cost mortgage and that a payoff statement be made available to the consumer by an alternative method without charge. If a creditor charges a fee for providing a payoff statement by fax or courier, the creditor must disclose the fee prior to charging the consumer and must disclose to the consumer that other methods for providing the payoff statement are available at no cost. Finally a creditor is permitted to charge a consumer a reasonable fee for additional payoff statements during a calendar year in which four payoff statements have already been provided without charge other than permitted processing fees.

Credit Subject to – Section 1026.32

The requirements of this section apply to a consumer credit transaction secured by the consumer's principal dwelling, in which either:

- The APR at consummation will exceed by more than 8 percentage points for first-lien mortgage loans, or by more than 10 percentage points for subordinate-lien mortgage loans, the yield on Treasury securities having comparable periods of maturity to the loan's maturity (as of the 15th day of the month immediately preceding the month in which the application for the extension of credit is received by the creditor); or
- The total points and fees (see definition below) payable by the consumer at or before loan closing will exceed the greater of eight percent of the total loan amount or \$611 for the calendar year 2012. This dollar amount is adjusted annually based on changes in the Consumer Price Index. See staff commentary to 1026.32(a)(1)(ii) for a historical list of dollar amount adjustments. (§1026.32(a)(1))

Exemptions to the Requirements of 1026.32:

- Residential mortgage transactions (generally purchase money mortgages);
- Reverse mortgage transactions subject to section 1026.33; or
- Open-end credit plans subject to Subpart B of Regulation Z.

Points and fees include the following:

- All items required to be disclosed under section 1026.4(a) and (b), except interest or the time-price differential;
- All compensation paid to mortgage brokers; and
- All items listed in section 1026.4(c)(7), other than amounts held for future taxes, unless all of the following conditions are met:
 - The charge is reasonable;
 - The creditor receives no direct or indirect compensation in connection with the charge; and
 - The charge is not paid to an affiliate of the creditor; and
- Premiums or other charges paid at or before closing whether paid in cash or financed, for optional credit life, accident, health, or loss-of-income insurance, and other debt-protection or debt cancellation products written in connection with the credit transaction. (§1026.32(b)(1))

Prohibited Acts or Practices in Connection with Credit Subject to Section 1026.32 – Section 1026.34

Among other requirements, a creditor extending mortgage credit subject to section 1026.32 (“high-cost” mortgage loans) must not make such loans based on the value of the consumer’s collateral without regard to the consumer’s repayment ability as of consummation, including mortgage-related obligations (§1026.34(a)(4)).

- Mortgage-related obligations are expected property taxes, premiums for mortgage-related insurance required by the creditor, and similar expenses (§1026.34(a)(4)(i)).
- A creditor must also verify amounts of income or assets that it relies on to determine repayment ability using tax returns, payroll receipts, financial institution records, or other third-party documents that provide reasonably reliable evidence of the consumer’s income or assets (§1026.34(a)(4)(ii)).
- A creditor must also verify the consumer’s current obligations. (§1026.34(a)(4)(ii)(C))

A presumption of compliance is available for some transactions, but only if the creditor:

- Verifies the consumer’s repayment ability as required;
- Determines the consumer’s repayment ability using the largest payment of principal and interest scheduled in the first seven years following consummation and taking into account current obligations and mortgage-related obligations; and
- Assesses the consumer’s repayment ability taking into account either the ratio of total debts to income or the income the consumer will have after paying debt obligations (§1026.34(a)(4)(iii)).

For high-cost mortgage loans, the regulation prohibits the imposition of prepayment penalties under certain circumstances, and in no case may a penalty be imposed after two years following consummation.

The regulation prohibits prepayment penalties at any time for high-cost mortgage if:

- Other applicable law (e.g., state law) prohibits such penalty;
- The penalty applies where the source of the prepayment funds is a refinancing by the same mortgage lender or an affiliate;
- The consumer’s mortgage payment can change during the first four years of the loan term (applicable only to loans originated on or after October 1, 2009); or,
- The consumer’s total monthly debt payments (at consummation), including amounts owed

under the mortgage, exceed 50 percent of the consumer's monthly gross income.

The regulation prohibits creditors from structuring a home-secured loan as an open-end plan to evade these requirements.

Reverse Mortgages – Section 1026.33

A reverse mortgage is a non-recourse transaction secured by the consumer's principal dwelling which ties repayment (other than upon default) to the homeowner's death or permanent move from, or transfer of the title of, the home. Special disclosure requirements apply to reverse mortgages.

Higher-Priced Mortgage Loans – Section 1026.35(a)

A mortgage loan subject to section 1026.35 (*higher-priced mortgage loan*) is a closed-end consumer credit transaction secured by the consumer's principal dwelling with an APR that *exceeds the average prime offer rate* for a comparable transaction as of the date the interest rate is set by:

- 1.5 or more percentage points for loans secured by a first lien on a dwelling where the amount of the principal obligation at the time of consummation does not exceed the maximum principal obligation eligible for purchase by Freddie Mac;
- 2.5 or more percentage points for loans secured by a first lien on a dwelling, where the amount of the principal obligation at the time of consummation exceeds the maximum principal obligation eligible for purchase by Freddie Mac; or
- 3.5 or more percentage points for loans secured by a subordinate lien on a dwelling.

Average prime offer rate means an APR that is derived from average interest rates, points, and other loan pricing terms currently offered to consumers by a representative sample of creditors for mortgage transactions that have low-risk pricing characteristics. The CFPB publishes average prime offer rates for a broad range of types of transactions in a table updated at least weekly, as well as the methodology it uses to derive these rates. These rates are available on the website of the Federal Financial Institutions Examination Council (FFIEC). <http://www.ffiec.gov/ratespread/newcalchelp.aspx>

Additionally, creditors extending mortgage loans subject to 1026.43(c) must verify a consumer's ability to repay as required by section 1026.43(c).

Finally, the regulation prohibits creditors from structuring a home-secured loan that does not meet the definition of open-end credit as an open-end plan to evade these requirements.

Higher-Priced Mortgage Loans Escrow Requirement – Section 1026.35(b)

In general, a creditor may not extend a higher-priced mortgage loan (including high-cost mortgages that also meet the definition of a higher-priced mortgage loan), secured by a first lien on a principal dwelling

unless an escrow account is established before consummation for payment of property taxes and premiums for mortgage-related insurance required by the creditor.

An escrow account for a higher-priced mortgage loan need not be established for:

- a transaction secured by shares in a cooperative,
- a transaction to finance the initial construction of a dwelling,
- a temporary or “bridge” loan with a term of 12 months or less, or
- a reverse mortgage subject to section 1026.33.

There is also a limited exemption that allows creditors to establish escrow accounts for property taxes only (rather than for both property taxes and insurance) for loans secured by dwellings in a “common interest community” under section 1026.35(b)(2)(ii), where dwelling ownership requires participation in a governing association that is obligated to maintain a master insurance policy insuring all dwellings. (§1026.35(b)(2)(ii))

An exemption to the higher-priced mortgage loan escrow requirement is available for first-lien higher-priced mortgage loans made by certain creditors that operate predominantly in “rural” or “underserved” areas. To make use of this exemption, a creditor must:

1) Make over half its covered transactions in counties that meet the definition of “rural” or “underserved” as laid out in the regulation,

(The regulation generally defines these two terms by reference to “urban influence codes” (for “rural”) and HMDA data (for “underserved”). To ease compliance, however, the CFPB will post on its public website a list of “rural” and “underserved” counties that creditors may rely on as a safe harbor. See comment 35(b)(2)(iv)-1.)

2) Together with any affiliates must not have made more than 500 covered transactions in the preceding calendar year,

3) Must have had less than \$2 billion in total assets as of the end of the preceding calendar year, and

(The asset threshold will be adjusted automatically each year, based on the year-to-year change in the average of the Consumer Price Index for Urban Wage Earners and Clerical Workers.)

4) Together with any affiliates must not maintain escrow accounts for any extensions of consumer credit secured by real property or a dwelling that it or its affiliate currently services. However, such creditors (and their affiliates) are permitted to offer an escrow account to accommodate distressed borrowers and may continue to maintain escrow accounts established to comply with the rule for applications received before June 1, 2013 without losing the exemption.

For first-lien higher-priced mortgage loans originated by a creditor that would not be required to establish an escrow account based on the above exemption, if that creditor has obtained a commitment for a higher-priced mortgage loan to be acquired by another company that is not eligible for the exemption, an escrow account must be established. Since an escrow account will be established for this loan, however, note that if the creditor that has obtained a commitment for the higher-priced mortgage loan to be acquired by a non-exempt company would like to remain eligible for the exemption above, neither the creditor nor its affiliates can service the loan on or beyond the second periodic payment under the terms of the loan.

A creditor or servicer may cancel an escrow account only upon the earlier of termination of the underlying loan, or a cancellation request from the consumer five years or later after consummation.

However, a creditor or servicer is not permitted to cancel an escrow account, even upon request from the consumer unless the unpaid principal balance of the higher-priced mortgage loan is less than 80 percent of the original value of the property securing the loan and the consumer is not currently delinquent or in default on the loan. (§1026.35(b)(3))

Higher-Priced Mortgage Loans Appraisal Requirement – Section 1026.35(c)

(The higher-priced mortgage loans appraisal requirement was adopted pursuant to an interagency rulemaking conducted by the Board, the CFPB, the FDIC, FHFA, NCUA, and OCC. The Board codified the rule at 12 CFR 226.43, and the OCC codified the rule at 12 CFR Part 34 and 12 CFR Part 164. There is no substantive difference among these three sets of rules.)

General Requirements, Exception, and Safe Harbor

A creditor may not extend a higher-priced mortgage loan without first obtaining a written appraisal of the property to be mortgaged. The appraisal must be performed by a state-certified or licensed appraiser (defined in part as an appraiser who conducts the appraisal in conformity with the Uniform Standards of Professional Appraisal Practice (USPAP) and the requirements applicable to appraisers in title IX of FIRREA and its implementing regulations). The appraisal must include a physical visit of the interior of the dwelling. The appraisal requirements do **not** apply to:

- Qualified mortgages under section 1026.43;
- A transaction secured by a new manufactured home;
- A transaction secured by a mobile home, boat, or trailer;
- A transaction to finance the initial construction of a dwelling;
- A loan with maturity of 12 months or less, if the purpose of the loan is a “bridge” loan connected with the acquisition of a dwelling intended to become the consumer’s principal dwelling; or
- A reverse mortgage transaction subject to 12 CFR 1026.33(a). (§1026.35(c)(2)).

A creditor may obtain a safe harbor for compliance with section 1026.35(c)(3)(i) by ordering that the appraisal be completed in conformity with USPAP and the requirements applicable to appraisers in title IX of FIRREA and its implementing regulations, verifying that the appraiser is certified or licensed through the National Registry; and confirming that the written appraisal contains the elements listed in Appendix N of Regulation Z. In addition, the creditor must have no actual knowledge that the facts or certifications contained in the appraisal are inaccurate (§1026.35(c)(3)(ii)).

Second Appraisals

The appraisal provisions in section 1026.35(c) also require creditors to obtain a second written appraisal before extending a higher-priced mortgage loan in two instances:

- First, when the dwelling that is securing the higher-priced mortgage loan was acquired by the seller 90 or fewer days prior to the consumer’s agreement to purchase the property and the price of the property has increased by more than 10 percent.
- Second, when the dwelling was acquired by the seller between 91 and 180 prior to the consumer’s agreement to purchase the property, and the price of the property has increased by more than 20 percent.

A creditor must obtain a second interior appraisal unless the creditor can demonstrate, by exercising reasonable diligence, that the two instances necessitating a second appraisal do not apply. A creditor can meet the reasonable diligence requirement if it bases its determination on information contained in certain written source documents (such as a copy of the seller's recorded deed or a copy of a property tax bill). See Appendix O. If, after exercising reasonable diligence, the creditor is unable to determine whether the two instances necessitating a second appraisal apply, the creditor must obtain a second appraisal.

If the creditor is required to obtain a second written appraisal, the two required appraisals must be conducted by different appraisers. Each appraisal obtained must include a physical visit of the interior of the dwelling. In instances where two appraisals are required, creditors are allowed to charge for only one of the two appraisals.

The second written appraisal must contain an analysis of the difference between the price at which the seller obtained the property and the price the consumer agreed to pay to acquire the property, an analysis of changes in market conditions between when the seller acquired the property and when the consumer agreed to purchase the property, and a review of improvements made to the property between the two dates.

The higher-priced mortgage loan second appraisal requirements do not apply to the extension of credit financing acquisition of a property:

- From a local, state, or federal government agency;
- From a person who acquired title to the property through foreclosure, deed-in-lieu of foreclosure, or other similar judicial or non-judicial procedures as a result of the person's exercise of rights as the holder of a defaulted mortgage;
- From a non-profit entity as part of a local, state, or federal government program permitted to acquire single-family properties for resale from a person who acquired title through foreclosure, deed-in-lieu of foreclosure, or other similar judicial or non-judicial procedures;
- From a person who acquired title to the property by inheritance or by court order as a result of a dissolution of marriage, civil union, or domestic partnership, or of partition of joint or marital assets;
- From an employer or relocation agency in connection with the relocation of an employee;
- From a service member who received a deployment or permanent change of station order after the service member purchased the property;
- Located in a federal disaster area if and for as long as the requirements of title XI of FIRREA have been waived by the federal financial institutions regulatory agencies; or
- Located in a rural county as defined by the Bureau in section 1026.35(b)(2)(iv)(A).

Application Disclosures and Copy of Appraisal

Finally, creditors must provide consumers who apply for a loan covered by the appraisal requirements in section 1026.35(c) with a disclosure providing information relating to appraisals. A creditor must provide consumers with disclosures no later than the third business day after the creditor receives an application for a higher-priced mortgage loan, or no later than the third business day after the loan requested becomes a higher-priced mortgage loan. Additionally, a creditor must provide, at no cost to the consumer, a copy of each written appraisal performed in connection with a loan covered by the appraisal requirements in section 1026.35(c) no later than three business days

prior to consummation or, if the loan will not be consummated, no later than 30 days after the creditor determines that the loan will not be consummated.

Prohibited Acts or Practices in Connection with Credit Secured by a Consumer's Dwelling – Section 1026.36

Loan Originator – Section 1026.36(a)

The term “loan originator” means a person who, in expectation of direct or indirect compensation or other monetary gain or for direct or indirect compensation or other monetary gain, performs any of the following activities:

- Takes an application, offers, arranges, assists a consumer in obtaining or applying to obtain, negotiates, or otherwise obtains or makes an extension of consumer credit for another person; or
- Through advertising or other means of communication represents to the public that such person can or will perform any of these activities.

The term “loan originator” includes an employee, agent, or contractor of the creditor or loan originator organization if the employee, agent, or contractor meets this definition. The term “loan originator” also includes a creditor that engages in loan origination activities if the creditor does not finance the transaction at consummation out of the creditor’s own resources, including by drawing on a *bona fide* warehouse line of credit or out of deposits held by the creditor.

The term “loan originator” does not include:

- A person who performs purely administrative or clerical tasks on behalf of a person who takes applications or offers or negotiates credit terms;
- An employee of a manufactured home retailer who does not take a consumer credit application, offer or negotiate credit terms, or advise consumers on available credit terms;
- A person that performs only real estate brokerage activity and is licensed or registered in accordance with applicable state law, unless that person is compensated by a creditor or loan originator for a consumer credit transaction subject to section 1026.36;
- A seller financier that meets the criteria established in sections 1026.36(a)(4) or (a)(5); or
- A servicer, or a servicer’s employees, agents, and contractors who offer or negotiate the terms of a mortgage for the purpose of renegotiating, modifying, replacing, or subordinating principal of an existing mortgage where consumers are behind in their payments, in default, or have a reasonable likelihood of becoming delinquent or defaulting. This exception does not, however, apply to such persons if they refinance a mortgage or assign a mortgage to a different consumer.

An “individual loan originator” is a natural person who meets the definition of “loan originator.” Finally, a “loan originator organization” is any loan originator that is not an individual loan originator. A loan originator organization would include banks, thrifts, finance companies, credit unions and mortgage brokers.

Prohibited Loan Originator Compensation: Payments Based on a Term of a Transaction – Section 1026.36(d)(1)

With limited exceptions, loan originators cannot receive (and no person can pay directly or indirectly), compensation in connection with closed-end consumer credit transactions secured by a dwelling based on a term of a transaction, the terms of multiple transactions, or the terms of multiple transactions by multiple individual loan originators. The loan originator compensation provisions do not apply to open-end home-equity lines of credit secured by a consumer's interest in a timeshare plan described in 11 U.S.C. 101(53D).

A "term of a transaction" is any right or obligation of the parties to a credit transaction. The amount of credit extended is not a term of a transaction, provided that such compensation is based on a fixed percentage of the amount of credit extended (but may be subject to a minimum or maximum dollar amount).

NOTE: A review of whether compensation, which includes salaries, commissions, and any financial or similar incentive, is based on the terms of a transaction requires an objective analysis. If compensation would have been different if a transaction term had been different, then the compensation is prohibited. The regulation does not prevent compensating loan originators differently on different transactions, provided the difference is not based on a term of a transaction or on a proxy for a term of a transaction (a factor that consistently varies with a term or terms of the transaction over a significant number of transactions and which the loan originator has the ability to manipulate).

An individual loan originator may receive (and a person may pay):

- Compensation in the form of a contribution to a defined contribution plan that is a designated tax-advantage plan unless the contribution is tied to the terms of the individual's transaction(s); (§1026.36.(d)(1)(iii))
 - Compensation in the form of a benefit under a defined benefit plan that is a designated tax-advantaged plan (§1026.36(d)(1)(iii))
 - Compensation under a non-deferred profits-based compensation plan provided that:
 - The compensation paid to an individual loan originator is not directly or indirectly based on the terms of the individual's transaction(s); and
 - Either:
 - The compensation paid to the individual loan originator does not exceed 10 percent (in aggregate) of the individual loan originator's total compensation corresponding to the time period for which the compensation under the non-deferred profits-based compensation plan is paid; or
 - The individual loan originator was the loan originator of 10 or fewer transactions during the 12 months preceding the date the compensation was determined. (§1026.36(d)(1)(iv))
- For more information pertaining to permissible compensation, see the Commentary at section 1026.36(d).

(In addition to the requirements listed here, section 1026.25(c) imposes specific record retention requirements for creditors and loan originator organizations that compensate loan originators.)

Prohibited Loan Originator Compensation: Dual Compensation – Section 1026.36(d)(2)

Loan originators that receive compensation directly from consumers in consumer credit transactions secured by a dwelling, (except for open-end home-equity lines of credit or to loans secured by a consumer's interest in a timeshare plan) may not receive additional compensation directly or indirectly from any other person in connection with that transaction. (§1026.36(d)(1)(i)(A)(I)) This prohibition includes compensation received from a third-party to the transaction to pay for some or all of the consumer's costs. (§1026.36(d)(1)(i)(B)) Further, a person is prohibited from compensating a loan originator when that person "knows or has reason to know" that the consumer has paid compensation to the loan originator. (§1026.36(d)(2)(i)(A)(2))

However, even if a loan originator organization receives compensation directly from a consumer, the organization can compensate the individual loan originator, subject to section 1026.36(d)(1). (§1026.36(d)(2)(i)(C))

Prohibition on Steering – Section 1026.36(e)

Loan originators are prohibited from directing or "steering" consumers to loans based on the fact that the originator will receive greater compensation for the loan from the creditor than in other transactions the originator offered or could have offered to the consumer, unless the consummated transaction is in the consumer's interest. A loan originator complies with the prohibition on steering (but not the loan originator compensation provisions) by obtaining loan options from a significant number of the creditors with which the loan originator regularly does business and, for each loan type in which the consumer has expressed interest, presenting the consumer with loan options for which the loan originator believes in good faith the consumer likely qualifies, provided that the presented loan options include all of the following:

- The loan with the lowest interest rate;
- The loan with the lowest interest rate without certain enumerated risky features (such as prepayment penalties, negative amortization, or a balloon payment in the first seven years); and
- The loan with the lowest total dollar amount of discount points, origination points or origination fees (or, if two or more loans have the same total dollar amount of discount points, origination points or origination fees, the loan with the lowest interest rate that has the lowest total dollar amount of discount points, origination points or origination fees).

The anti-steering provisions do not apply to open-end home-equity lines of credit or to loans secured by a consumer's interest in a timeshare plan.

Loan Originator Qualification Requirements – Section 1026.36(f)

Individual loan originators and loan originator organizations must, when required under state or federal law, be registered and licensed under those laws, including the Safe and Fair Enforcement for Mortgage Licensing Action of 2008 (SAFE Act). Loan originator organizations other than government agencies or state housing finance agencies must:

(Section 1026.36(f) applies to closed-end consumer credit transactions secured by a dwelling except a loan that is secured by a consumer's interest in a timeshare plan described in 11 U.S.C. 101(53D). For purposes of 1026.36(f), a loan originator includes all creditors that engage in loan origination activities, not just those who table fund.)

- Comply with all applicable state law requirements for legal existence and foreign qualification; (§1026.36(f)(1))
- Ensure that each individual loan originator who works for the loan originator organization (e.g., an employee, under a brokerage agreement) is licensed or registered to the extent the individual is required to be licensed or registered under the SAFE Act prior to acting as a loan originator in a consumer credit transaction secured by a dwelling. (§1026.36(f)(2))

The requirements are different for loan originator organizations whose employees are not required to be licensed and are not licensed pursuant to 12 CFR section 1008.103 or state SAFE Act implementing laws (including employees of depository institutions and bona fide non-profits). For their employees hired on or after January 10, 2014 (or hired before this date but not subject to any statutory or regulatory background standards at the time, or for any individual loan originators regardless of when hired that the organization believes, based on reliable information do not meet the qualification standards), loan originator employers must obtain before the individual acts as a loan originator in a consumer credit transaction secured by a dwelling:

- A criminal background check through the Nationwide Mortgage Licensing System and Registry (NMLSR) or, in the case of an individual loan originator who is not a registered loan originator under NMLSR, a criminal background check from a law enforcement agency or commercial service; (§1026.36(f)(3)(i)(A))
- A credit report from a consumer reporting agency (as defined in section 603(p) of the Fair Credit Reporting Act) secured, where applicable, in compliance with section 604(b) of FCRA; (§1026.36(f)(3)(i)(B)) and
- Information from the NMLSR about any administrative, civil, or criminal findings by any government jurisdiction or, in the case of an individual loan originator who is not a registered loan originator under the NMLSR, such information from the individual loan originator. (§1026.36(f)(3)(i)(C))

Based on the information obtained above and any other information reasonably available, the loan originator employer must determine for such an employee prior to allowing the individual to act as a loan originator in a consumer credit transaction secured by a dwelling:

- That the individual has not been convicted of, or pleaded guilty or *nolo contendere* to, a felony in a domestic or military court during the preceding seven-year period or, in the case of a felony involving an act of fraud, dishonesty, a breach of trust, or money laundering, at any time; and (§1026.36(f)(3)(ii)(A)(I))

NOTE: Whether the conviction of a crime is considered a felony is determined by whether the conviction was classified as a felony under the law of the jurisdiction under which the individual is convicted. Additionally, a loan originator organization may employ an individual with a felony conviction (or a plea of *nolo contendere*) as a loan originator if that individual has received consent from the FDIC, (or the FRB, as applicable) the NCUA, or the Farm Credit Administration under their own applicable statutory authority. (§1026.36(f)(3)(iii))

- Has demonstrated financial responsibility, character, and general fitness such as to warrant a determination that the individual loan originator will operate honestly, fairly, and efficiently.

The loan originator organization must also provide periodic training to each such employee that covers federal and state legal requirements that apply to the individual loan originator's loan origination activities.

Name and NMLSR ID on Loan Documentation – Section 1026.36(g)

Section 1026.36(g) applies to closed-end consumer credit transactions secured by a dwelling except a loan that is secured by a consumer's interest in a timeshare plan described in 11 U.S.C. 101(53D). For purposes of 1026.36(g), a loan originator includes all creditors that engage in loan origination activities, not just those who table fund.

For consumer credit transactions secured by a dwelling, loan originator organizations must include certain identifying information on loan documentation provided to consumers. The loan documents must include the loan originator organization's name, NMLSR ID (if applicable), and the name of the individual loan originator that is primarily responsible for the origination as it appears in the NMLSR, as well as the individual's NMLSR ID. This information is required on credit applications, the note or loan contract and the documents securing an interest in the property.

Policies and Procedures to Ensure and Monitor Compliance – Section 1026.36(j)

Depository institutions (including credit unions) must establish and maintain written policies and procedures reasonably designed to ensure and monitor compliance of the depository institution, its employees, and its subsidiaries and their employees with the requirements of section 1026.36(d) (prohibited payments to loan originators), section 1026.36(e) (prohibition on steering), section 1026.36(f) (loan originator qualifications), and section 1026.36(g) (name and NMLSR ID on loan documents). The written policies and procedures must be appropriate to the nature, size, complexity, and scope of the mortgage lending activities of the depository and its subsidiaries. (§1026.36(j))

Prohibition on Mandatory Arbitration or Waivers of Certain Consumer Rights – Section 1026.36(h)

A contract or other agreement for a consumer credit transaction secured by a dwelling (including a home equity line of credit secured by the consumer's principal dwelling) may not include terms that require mandatory arbitration or any other non-judicial procedure to resolve any controversy arising out of the transaction. Also, a contract or other agreement relating to such a consumer credit transaction may not be applied or interpreted to bar a consumer from bringing a claim in court under any provision of law for damages or other relief in connection with an alleged violation of any federal law. However, a creditor and a consumer could agree, after a dispute or claim under the transaction arises, to settle or use arbitration or other non-judicial procedure to resolve that dispute or claim.

Prohibition on Financing Single-Premium Credit Insurance – Section 1026.36(i)

Creditors are prohibited from financing, either directly or indirectly, premiums or fees for credit insurance in connection with a consumer credit transaction secured by a dwelling (including a home equity line of credit secured by the consumer’s principal dwelling). This prohibition includes financing fees for credit life, credit disability, credit unemployment, credit property insurance, or any other accident, loss-of-income, life, or health insurance or payment for debt cancellation or suspension. This prohibition does not apply to credit unemployment insurance where the premiums are reasonable, the creditor receives no direct or indirect compensation in connection with the premiums, and the premiums are paid under a separate insurance contract and not to an affiliate of the creditor. This prohibition also does not apply to credit insurance where premiums or fees are calculated and paid in full on a monthly basis.

Negative Amortization Counseling – Section 1026.36(k)

A creditor may not extend a negative amortizing mortgage loan to a first-time borrower in connection with a closed-end transaction secured by a dwelling, other than a reverse mortgage or a transaction secured by a timeshare, unless the creditor receives documentation that the consumer has obtained homeownership counseling from a HUD certified or approved counselor.

Additionally, a creditor extending a negative amortizing mortgage loan to a first-time borrower may not steer, direct, or require the consumer to use a particular counselor.

Loan Servicing Practices

Servicers of mortgage loans are prohibited from engaging in certain practices, such as pyramiding late fees. In addition, servicers are required to credit consumers’ loan payments as of the date of receipt and provide a payoff statement within a reasonable time, not to exceed seven business days of a written request.

Payment Processing – Section 1026.36(c)(1)

For a consumer credit transaction secured by a consumer’s principal dwelling, a loan servicer:

- Cannot fail to credit a periodic payment to the consumer’s loan account as of the date of receipt, except in instances where the delay will not result in a charge to the consumer or in the reporting of negative information to a consumer reporting agency.

NOTE: For the purposes of section 1026.36(c) a periodic payment is “an amount sufficient to cover principal, interest, and escrow for any given billing cycle.” If the consumer owes late fees, other fees, or non-escrow payments but makes a full periodic payment, the servicer must credit the periodic payment as of the date of receipt.

- Cannot retain a partial payment (any amount less than a periodic payment) in a suspense or unapplied payment account without disclosing to the consumer in the periodic statement (if required) the total

amount(s) held in the suspense account and applying the payment to the balance upon accumulation of sufficient funds to equal a periodic payment.

If a servicer has provided written requirements for accepting payments in writing but then accepts payments that do not conform to the written requirements, the servicer must credit the payment as of five days after receipt.

Pyramiding of Late Fees – Section 1026.36(c)(2)

A servicer may not impose on the consumer any late fee or delinquency charge in connection with a timely payment made in full, when the only delinquency is attributable to late fees or delinquency charges assessed on an earlier payment.

Providing Payoff Statements – Section 1026.36(c)(3)

A creditor, assignee, or servicer may not fail to provide, within a reasonable time, but no more than seven business days, after receiving a written request from the consumer or person acting on behalf of the consumer, an accurate statement of the total outstanding balance that would be required to satisfy the consumer's obligations in full as of a specific date.

NOTE: For purposes of section 1026.36(c)(3), when a creditor, assignee, or servicer is not able to provide the statement within seven business days because a loan is in bankruptcy or foreclosure, because the loan is a reverse mortgage or shared appreciation mortgage, or because of natural disasters or similar circumstances, the payoff statement must be provided within a reasonable time.

Notification of Sale or Transfer of Mortgage Loans – Section 1026.39

Notice of new owner – No later than 30 calendar days after the date on which a mortgage loan is acquired by or otherwise sold, assigned, or otherwise **transferred** to a third party, the “**covered person**” shall notify the consumer clearly and conspicuously in writing, in a form that the consumer may keep, of such transfer and include:

- Identification of the loan that was sold, assigned, or otherwise transferred;
- Name, address, and telephone number of the covered person ;

(The date of transfer to the covered person may, at the covered person's option, be either the date of acquisition recognized in the books and records of the acquiring party or the date of transfer recognized in the books and records of the transferring party.)

(A “covered person” means any person, as defined in 12 CFR 1026.2(a)(22), that becomes the owner of an existing mortgage loan by acquiring legal title to the debt obligation, whether through a purchase, assignment, or other transfer, and who acquires more than one mortgage loan in any 12-month period. For purposes of this section, a servicer of a mortgage loan shall not be treated as the owner of the obligation if the servicer holds title to the loan or it is assigned to the servicer solely for the administrative convenience of the servicer in servicing the obligation. See 12 CFR 1026.39(a)(1).)

- Date of transfer;
- Name, address, and telephone number of an agent or party having authority, on behalf of the covered person, to receive notice of the right to rescind and resolve issues concerning the consumer's payments on the mortgage loan;
- Location where transfer of ownership of the debt to the covered person is or may be recorded in public records or, alternatively, that the transfer of ownership has not been recorded in public records at the time the disclosure is provided; and
- At the option of the covered person, any other information regarding the transaction.

This notice of sale or transfer must be provided for any consumer credit transaction that is secured by the principal dwelling of a consumer. Thus, it applies to both closed-end mortgage loans and open-end home equity lines of credit. This notification is required of the covered person even if the loan servicer remains the same.

Regulation Z also establishes special rules regarding the delivery of the notice when there is more than one covered person. In a joint acquisition of a loan, the covered persons must provide a single disclosure that lists the contact information for all covered persons. However, if one of the covered persons is authorized to receive a notice of rescission and to resolve issues concerning the consumer's payments, the disclosure may state contact information only for that covered person. In addition, if the multiple covered persons each acquire a partial interest in the loan pursuant to separate and unrelated agreements, they may provide either a single notice or separate notices. Finally, if a covered person acquires a loan and subsequently transfers it to another covered person, a single notice may be provided on behalf of both of them, as long as the notice satisfies the timing and content requirements with respect to each of them.

In addition, there are three exceptions to the notice requirement to provide the notice of sale or transfer:

- The covered person sells, assigns, or otherwise transfers legal title to the mortgage loan on or before the 30th calendar day following the date of transfer on which it acquired the mortgage loan;
- The mortgage loan is transferred to the covered person in connection with a repurchase agreement that obligates the transferring party to repurchase the mortgage loan (unless the transferring party does not repurchase the mortgage loan); or
- The covered person acquires only a partial interest in the mortgage loan and the agent or party authorized to receive the consumer's rescission notice and resolve issues concerning the consumer's payments on the mortgage loan does not change as a result of that transfer.

Periodic Statements for Closed-End Mortgages – Section 1026.41

Creditors, assignees, or servicers of closed-end mortgages are generally required to provide consumers with periodic statements for each billing cycle unless the loan is a fixed rate loan and the servicer provides the consumer with a coupon book meeting certain conditions. Periodic statements must be provided by the servicer within a reasonably prompt time after the payment is due, or at the end of any courtesy period provided by the servicer for the previous billing cycle. Delivering, emailing or placing the periodic statements in the mail within four days of the close of the courtesy period of the previous billing cycle is generally acceptable. However, periodic statements are not required for:

(Creditors, assignees, and servicers are all subject to the requirements of section 1026.41, as applicable. Creditors, assignees, or servicers may decide among themselves which of them will provide the required disclosures. However, establishing a business relationship where one party agrees to provide disclosures on behalf of the other parties does not absolve all other parties from their legal obligations. However, a creditor or assignee that currently does not own the mortgage loan or mortgage servicing rights is not subject to the periodic statement requirement.)

- Reverse mortgage transactions covered under section 1026.33;
- Mortgage loans secured by a consumer’s interest in a timeshare plan;
- Fixed-rate loans where the servicer currently provides consumers with coupon books that contain certain specified account information, contact information for the servicer, delinquency information (if applicable), and information that consumers can use to obtain more information about their account; and
- Creditors, assignees, or servicers that meet the “small servicer” exemption.

NOTE: Sections 1026.41(e)(4)(ii) and (iii) define a “small servicer” and provide clarification how a small servicer will be determined. A small servicer is a servicer that either services, together with any affiliates, 5,000 or fewer mortgage loans, for all of which it or an affiliate is the creditor or assignee, or a servicer that meets the definition of a Housing Finance Agency under 24 CFR 266.5. To determine whether a servicer services 5,000 loans or fewer, a servicer should be evaluated based on the number of mortgage loans serviced by the servicer and any affiliate as of January 1 for the remainder of the calendar year. If a servicer crosses the 5,000 loan threshold, it will have the later of six months after crossing the threshold or until the next January 1 to come into compliance with the requirements of section 1026.41.

Servicers must provide consumers with the following information in the specified format on the periodic statements:

The Amount Due

- The payment due date, the amount of any late payment fee, the date that late payment fees will be assessed to the consumer’s account if timely payment is not made, and the amount due, which must be shown more prominently than other disclosures on the page;

NOTE: If the transaction has multiple payment options, the amount due under each of the payment options must be provided.

- An explanation of the amount due, including the monthly payment amount with a breakdown of how much will be applied to principal, interest, and escrow, the total sum of any fees/charges imposed since

the last statement, and any payment amount past due. Mortgage loans with multiple payment options must also have a breakdown of each payment option, along with information regarding how each payment option will impact the principal;

Past Payment Breakdown

- The total of all payments received since the last statement and the total of all payments received since the start of the calendar year, including, for each payment, a breakdown of how the payment(s) was applied to principal, interest, escrow, and/or fees and charges, and any amount held in a suspense or unapplied funds account (if applicable);

Transaction Activity

- A list of transaction activity (including dates, a brief description, and amount) for the current billing cycle, including any credits or debits that affect the current amount due, with the date, amount, and brief description of each transaction;

Partial Payment Information

- If a statement reflects a past partial payment held in suspense or unapplied funds account, information explaining what the consumer must do to have the payment applied to the mortgage. Information must be on the front page or a separate page of the statement or separate letter;

Contact Information

- Contact information for the servicer, including a toll-free telephone number and email address (if applicable) that the consumer may use to obtain information regarding the account. Contact information must be on the front page of the statement; and

Account Information

- Account information, including the outstanding principal balance, the current interest rate, the date after which the interest rate may change if the loan is an ARM, and any prepayment penalty, as well as the web address for CFPB's or HUD's list of homeownership counselors or counseling organizations and the HUD toll-free telephone number to contact the counselors or counseling organizations.

Servicers must provide consumers that are more than 45 days delinquent on past payments additional information regarding their accounts on their periodic statements. These items must be grouped together in close proximity to each other and must include:

- The date on which the consumer became delinquent;
- A notification of the possible risks of being delinquent, such as foreclosure and related expenses;
- An account history for either the previous six months or the period since the last time the account was current (whichever is shorter), which details the amount past due from each billing cycle and the date on which payments were credited to the account as fully paid;
- A notice stating any loss mitigation program that the consumer has agreed to (if applicable);
- A notice stating whether the servicer has initiated a foreclosure process;
- Total payments necessary to bring the account current; and
- A reference to homeownership counseling information (see **Account Information** above).

The regulation does not prohibit adding to the required disclosures, as long as the additional information does not overwhelm or obscure the required disclosures. For example, while certain information about the escrow account (such as the account balance) is not required on the periodic statement, this information may be included.

The periodic statement may be provided electronically if the consumer agrees. The consumer must give affirmative consent to receive statements electronically.

For sample periodic statements, see Appendix H-30

Valuation Independence – Section 1026.42

Regulation Z seeks to ensure that real estate appraisers, and others preparing valuations, are free to use their independent professional judgment in assigning home values without influence or pressure from those with interests in the transactions. Regulation Z also seeks to ensure that appraisers receive customary and reasonable payments for their services. Regulation Z's valuation rules apply to creditors and settlement services providers for consumer credit transactions secured by the consumer's principal dwelling ("covered transaction") and includes several provisions that protect the integrity of the appraisal process when a consumer's principal dwelling is securing the loan. In general, the rule prohibits "covered persons" from engaging in coercion, bribery, and other similar actions designed to cause anyone who prepares a valuation to base the value of the property on factors other than the person's independent judgment. More specifically, Regulation Z:

(This section applies to any consumer credit transaction secured by the consumer's principal dwelling. A "covered person" means a creditor with respect to a covered transaction or a person that provides "settlement services," as defined in 12 U.S.C. 2602(3) and implementing regulations, in connection with a covered transaction. A "covered transaction" means an extension of consumer credit that is or will be secured by the consumer's principal dwelling, as defined in 12 CFR 1026.2(a)(19).)

- Prohibits coercion and other similar actions designed to cause appraisers to base the appraised value of properties on factors other than their independent judgment;
- Prohibits appraisers and appraisal management companies hired by lenders from having financial or other interests in the properties or the credit transactions;
- Prohibits creditors from extending credit based on appraisals if they know beforehand of violations involving appraiser coercion or conflicts of interest, unless the creditors determine that the values of the properties are not materially misstated;
- Prohibits a person that prepares a valuation from materially misrepresenting the value of the consumer's principal dwelling, and prohibits a covered person other than the person that prepares valuations from materially altering a valuation. A misrepresentation or alteration is material if it is likely to significantly affect the value assigned to the consumer's principal dwelling;
- Prohibits any covered person from falsifying a valuation or inducing a misrepresentation,

falsification, or alteration of value;

- Requires that creditors or settlement service providers that have information about appraiser misconduct file reports with the appropriate state licensing authorities if the misconduct is material (i.e., likely to significantly affect the value assigned to the consumer's principal dwelling; and
- Requires the payment of reasonable and customary compensation to appraisers who are not employees of the creditors or of the appraisal management companies hired by the creditors.

Minimum Standards for Transactions Secured by a Dwelling (Ability to Repay and Qualified Mortgages) – Section 1026.43

Minimum standards for transactions secured by a dwelling – Sections 1026.43(a), (g), (h)

Creditors originating certain mortgage loans are required to make a reasonable and good faith determination at or before consummation that a consumer will have the ability to repay the loan. The ability-to-repay requirement applies to most closed-end mortgage loans; however, there are some exclusions, including:

- Home equity lines of credit;

(For open-end credit transactions that are high-cost mortgages as defined in 12 CFR 1026.32, creditors are required to determine a borrower's ability to repay under section 1026.34.)

- Mortgages secured by an interest in a timeshare;
- Reverse mortgages;
- A temporary bridge loan with a term of 12 months or less, such as a loan to finance the purchase of a new dwelling where the consumer plans to sell a current dwelling within 12 months or a loan to finance the initial construction of a dwelling;
- A construction phase of 12 months or less of a construction-to-permanent loan; and
- An extension of credit made pursuant to a program authorized by sections 101 and 109 of the Emergency Economic Stabilization Act of 2008 (12 U.S.C. 5211; 5219).

NOTE: There are additional exclusions under 1026.43(a) that generally include extensions of credit by various state or federal government agencies or programs or by creditors with specific designations under such programs or extensions of credit that meet certain criteria and are extended by certain creditors that the IRS has determined are 501(c)(3) non-profits. For a full list, please see sections 1026.43(a)(3)(iv)–(vi).

Generally, loans covered under this section (which, for purposes of the prepayment penalty provisions in section 1026.43(g), includes reverse mortgages and temporary loans otherwise excluded²⁵ from the ability-to-repay provisions) may not have prepayment penalties; however, there are exceptions for certain fixed-rate and step-rate qualified mortgages that are not higher-priced mortgage loans (as defined in section 1026.35(a)), and only if otherwise permitted by law. For such mortgages, the prepayment

penalties must be limited to the first three years of the loan and may not exceed two percent for the first two years and one percent for the third year. The creditor must offer the consumer an alternative loan without such penalties that the creditor has a good faith belief that the consumer likely qualifies for, with the same term, a fixed rate or step rate, substantially equal payments, and limited points and fees (see §1026.43(g)).

(These include a temporary or “bridge” loan with a term of 12 months or less; a construction phase of 12 months or less of a construction-to-permanent loan; or an extension of credit made pursuant to a program administered by a housing finance agency; by certain community development or non-profit lenders, as specified in section 1026.43(a)(3)(v); or in connection with certain federal emergency economic stabilization programs. 12 CFR §1026.43(a)(3))

Ability to Repay – Section 1026.43(c)

Except as provided under section 1026.43(d) (refinancing of non-standard mortgages), (e) (qualified mortgages), and (f)(balloon payment qualified mortgages by certain creditors), creditors must consider the following eight underwriting factors when making a determination of the consumer’s ability to repay:

- The consumer’s current or reasonably expected income or assets (excluding the value of the dwelling and any attached real property);
- The consumer’s current employment status if the creditor relies on the consumer’s income in determining repayment ability;
- The consumer’s monthly payment for the mortgage loan;
- The consumer’s monthly payment on any simultaneous loan (i.e., a covered transaction or HELOC that is being consummated generally at the same or similar time) secured by the same dwelling that the creditor knows or has reason to know will be made, calculated in accordance with section 1026.43(c)(6);
- The consumer’s monthly payment for mortgage-related obligations, including property taxes;
- The consumer’s current debt obligations, alimony, and child support;
- The consumer’s monthly debt-to-income ratio or residual income, calculated in accordance with section 1026.43(c)(7) ; and
- The consumer’s credit history.

Creditors are required to verify this information using reasonably reliable third-party records, with specific rules for verification of income or assets and employment status. In the case of the consumer’s income or assets, the creditor must use third-party records that provide reasonably reliable evidence of such income or assets. Creditors may verify the information considered using the consumer’s income tax return transcripts issued by the IRS, copies of tax returns filed by the consumer, W-2s or similar documentation, payroll statements, financial institution records, receipts from check-cashing or fund transfer services, and records from the consumer’s employer or other specified records. (§1026.43(c)(4))

Regulation Z also provides rules for how creditors must apply certain underwriting factors when determining whether a consumer has the ability to repay the mortgage. For example, creditors must calculate the monthly payment for the covered transaction using the greater of the fully indexed rate or any introductory interest rate, and the monthly, fully amortizing payments that are substantially equal during the loan term. However, special rules apply to mortgages with a balloon payment, interest-only loans, and negative amortization loans due to the unique characteristics of the mortgage. (§1026.43(c)(5))

Finally, creditors may not evade the ability-to-repay requirements by structuring a closed-end loan secured by a dwelling as open-end credit that does not meet the definition of open-end credit plan.

Qualified Mortgages: Rebuttable Presumption and Safe Harbor – Section 1026.43(e)

The rule provides a presumption of compliance with the ability-to-repay requirements for creditors that originate certain types of loans called “qualified mortgages.” There are several categories of qualified mortgages, which are discussed below. Qualified mortgages afford creditors and assignees greater protection against liability under the ability-to-repay provisions. Qualified mortgages that are not higher-priced covered transactions receive a safe harbor under the ability-to-repay provisions, which means the presumption of compliance cannot be rebutted. A qualified mortgage is higher priced if the loan’s APR exceeds the APOR by 1.5 percentage points or more for first-lien loans that either fall within the general qualified mortgage definition or the temporary qualified mortgage definition for loans that are eligible to be purchased, guaranteed or insured by GSEs or federal agencies, and 3.5 percentage points for first-lien loans that fall within the small creditor balloon payment, temporary small creditor balloon payment, or small creditor portfolio qualified mortgage definitions, or for second-lien loans.

Generally, the safe harbor provides a conclusive presumption that the creditor made a good faith and reasonable determination of the consumer’s ability to repay. Qualified mortgages that are higher priced receive a rebuttable presumption of compliance rather than a safe harbor with the ability-to-repay provisions. This means that the loan is presumed to comply with the ability-to-repay provisions, but, for example, the consumer would have the opportunity to rebut that presumption in future ability-to-repay litigation.

For a qualified mortgage that is a higher-priced covered transaction, the presumption of compliance is rebuttable by showing that at consummation, the consumer’s income, debt obligations, alimony, child support, and monthly payments on the loan and mortgage-related obligations and simultaneous loans of which the creditor was aware at consummation would leave the consumer with insufficient residual income or assets (other than the value of the dwelling and real property) to meet living expenses (including recurring and material non-debt obligations that the creditor was aware of at consummation).

General Requirements for Qualified Mortgages – Section 1026.43(e)(2)

Loans that are qualified mortgages under the general definition may not have negative amortization, interest-only payments, balloon payments, or terms exceeding 30 years. A qualified mortgage for loans greater than or equal to \$100,000 may not have points and fees paid by the consumer that exceed three percent of the total loan amount (although certain “bona fide discount points” are excluded for certain loans with pricing within prescribed ranges of APOR— the average prime offer rate). The rule provides guidance on calculating points and fees and thresholds for smaller loans.

(The definition and calculation rules for points and fees are the same as those used to determine whether a closed-end mortgage is a HOEPA loan, discussed above at section 1026.32(b)(2))

The rule also provides underwriting criteria for qualified mortgages. Generally, the rule requires that monthly payments be calculated based on the highest payment that will apply in the first five years of the loan after the date on which the first periodic payment is due and that the consumer have a total (or

“back-end”) debt-to-income ratio that is less than or equal to 43 percent. Appendix Q, drawing upon Federal Housing Administration guidelines, details the calculation of debt-to-income for these purposes. The rule also requires that the creditor consider and verify the consumer’s current or reasonably expected income or assets and current debt obligations, alimony and child support, also in accordance with Appendix Q.

Temporary Category of Qualified Mortgages – Section 1026.43(e)(4)

Regulation Z provides a temporary category of qualified mortgages that satisfy the underwriting requirements of, and are therefore eligible to be purchased, guaranteed or insured by, either (1) the Government Sponsored Enterprises (Fannie Mae and Freddie Mac) while they operate under federal conservatorship or receivership; or (2) the U.S. Department of Housing and Urban Development, the U.S. Department of Veterans Affairs, the U.S. Department of Agriculture, or the Rural Housing Service. This temporary provision will phase out over time as the various federal agencies issue their own qualified mortgage rules or if GSE conservatorship ends, and in any event after seven years (January 10, 2021). These mortgages must satisfy certain requirements applicable to qualified mortgages, including prohibitions on negative-amortization, interest-only, and balloon payment features; maximum loan terms of 30 years; and points-and-fees restrictions. However, the flat 43 percent debt-to-income threshold for qualified mortgages does not apply.

Qualified Mortgage – Small Creditor Portfolio Loans – Section 1026.43(e)(5)

Mortgages that are originated and held in portfolio by certain small creditors are also qualified mortgages if they meet certain requirements.

These mortgages must generally satisfy the requirements applicable to qualified mortgages, including prohibitions on negative-amortization, balloon-payment, and interest-only features; maximum loan terms of 30 years; and points-and-fees restrictions. However, while the creditor must consider and verify the consumer’s current or reasonably expected income or assets and current debt obligations, alimony, and child support, it may do so without regard to the standards in Appendix Q. In addition, debt-to-income ratios must be considered and verified, but the 43 percent threshold for qualified mortgages under the general definition does not apply.

A small creditor that satisfies the exemption criteria in section 1026.35(b)(2)(iii)(B) and (C) is eligible to make small creditor portfolio qualified mortgages. (In contrast to section 1026.43(f), below, eligibility for this qualified mortgage category is not conditioned on the small creditor operating predominantly in a rural or underserved area). For a period of three years after consummation, the creditor may not transfer the loan, or the loan will lose its status as a qualified mortgage. The qualified mortgage status continues under section 1026.43(e)(5)(ii), however, if the creditor transfers the loan to another creditor that meets the requirements to be a small lender, or when the loan is transferred due to a capital restoration plan, bankruptcy, or state or federal governmental agency order, or if the mortgage is transferred pursuant to a merger or acquisition of the creditor. A qualified mortgage can be transferred after three years without losing its status.

Small Creditor Rural or Underserved Balloon-Payment Qualified Mortgages and Temporary Balloon-Payment Qualified Mortgages – Sections 1026.43(f) and 1026.43(e)(6)

Balloon-payment mortgages are qualified mortgages if they are originated and held in portfolio by small creditors operating predominantly in rural or underserved areas and meet certain other requirements. These mortgages must satisfy certain requirements applicable to qualified mortgages, including prohibitions on negative-amortization and interest-only features; maximum loan terms of 30 years; and points-and-fees restrictions. These loans must have a term of at least five years, a fixed interest rate, and meet certain basic underwriting standards; debt-to-income ratios must be considered and verified, but the 43 percent threshold for qualified mortgages under the general definition does not apply. The rule also requires that the creditor consider and verify the consumer's current or reasonably expected income or assets and current debt obligations, alimony, and child support, but without regard to the standards in Appendix Q. This category of qualified mortgage is not available for a loan that, at origination, is subject to a forward commitment to be acquired by a person that does not itself qualify for the category (under the requirements outlined in the next paragraph).

A small creditor that satisfies the exemption criteria in section 1026.35(b)(2)(iii)(A), (B), and (C) (higher-priced mortgage escrow requirements) is eligible to make rural or underserved balloon-payment qualified mortgages. For a period of three years after consummation, the creditor may not transfer the loan, or it will lose its status as a qualified mortgage. The qualified mortgage status continues under section 1026.43(f)(2), however, if the creditor transfers the loan to another creditor that meets the requirements to be a small rural lender, or when the loan is transferred due to a capital restoration plan, bankruptcy, or state or federal governmental agency order, or if the mortgage is transferred pursuant to a merger or acquisition of the creditor. A qualified mortgage can be transferred after three years without losing its status.

There is also a temporary qualified mortgage definition for balloon-payment mortgages that would otherwise meet the requirements of section 1026.43(f), but that are originated by small creditors that do not operate predominantly in rural or underserved areas. This category is applicable to covered transactions consummated on or before January 10, 2016.

Subpart F – Special Rules for Private Education Loans

Special Disclosure Requirements for Private Education Loans – Section 1026.46

The disclosures required under Subpart F apply only to private education loans. Except where specifically provided otherwise, the requirements and limitations of Subpart F are in addition to the requirements of the other subparts of Regulation Z.

A private education loan means an extension of credit that:

- Is not made, insured, or guaranteed under title IV of the Higher Education Act of 1965;
- Is extended to a consumer expressly, in whole or part, for postsecondary educational expenses, regardless of whether the loan is provided by the educational institution that the student attends; and

- Does not include open-end credit or any loan that is secured by real property or a dwelling.

A private education loan does not include an extension of credit in which the covered educational institution is the creditor if:

- The term of the extension of credit is 90 days or less, or
- An interest rate will not be applied to the credit balance and the term of the extension of credit is one year or less, even if the credit is payable in more than four installments.

Content of Disclosures – Section 1026.47

Disclosure Requirements

This section establishes the content that a creditor must include in its disclosures to a consumer at three different stages in the private education loan origination process:

- 1) Application or Solicitation Disclosures – With any application or solicitation;
- 2) Approval Disclosures – With any notice of approval of the private education loan; and
- 3) Final Disclosures – After the consumer accepts the loan. In addition, section 1026.48(d) requires that the disclosures must be provided at least three business days prior to disbursement of the loan funds.

Rights of the Consumer

The creditor must disclose that, if approved for the loan, the consumer has the right to accept the loan on the terms approved for up to 30 calendar days. The disclosure must inform the consumer that the rate and terms of the loan will not change during this period, except for changes to the rate based on adjustments to the index used for the loan and other changes permitted by law. The creditor must disclose that the consumer also has the right to cancel the loan, without penalty, until midnight of the third business day following the date on which the consumer receives the final disclosures.

Limitations on Private Educational Loans – Section 1026.48

This section contains rules and limitations on private education loans, including:

- 1) A prohibition on co-branding in the marketing of private education loans;
- 2) Rules governing the 30-day acceptance period and three business-day cancellation period and prohibition on disbursement of loan proceeds until the cancellation period has expired;

3) The requirement that the creditor obtain a self-certification form from the consumer before consummation; and

4) The requirement that creditors in preferred lender arrangements provide certain information to covered educational institutions.

Co-Branding Prohibited

Regulation Z prohibits creditors from using the name, emblem, mascot, or logo of a covered institution (or other words, pictures, or symbols readily identified with a covered institution) in the marketing of private education loans in a way that implies endorsement by the educational institution. Marketing that refers to an educational institution does not imply endorsement if the marketing includes a clear and conspicuous disclosure that is equally prominent and closely proximate to the reference to the institution that the educational institution does not endorse the creditor's loans, and that the creditor is not affiliated with the educational institution. There is also an exception in cases where the educational institution actually does endorse the creditor's loans, but the marketing must make a clear and conspicuous disclosure that is equally prominent and closely proximate to the reference to the institution that the creditor, and not the educational institution, is making the loan.

Subpart G - Special Rules Applicable To Credit Card Accounts and Open-End Credit Offered To College Students

Evaluation of the Consumer's Ability to Pay – Section 1026.51

Regulation Z requires credit card issuers to consider a consumer's independent ability to pay before opening a new credit card account or increasing the credit limit for an existing credit card account. Additionally, the rule provides specific requirements that must be met before opening a new credit card account or increasing the credit limit on an existing account when the consumer is under the age of 21.

When evaluating a consumer's ability to pay, credit card issuers must perform a review of a consumer's independent income or assets and current obligations. Creditors are permitted, however, to rely on information provided by the consumer. The rule does not require issuers to verify a consumer's statements; a creditor may base its determination of ability to repay on facts and circumstances known to the card issuer (Comment 51(a)(1)(i)-2). A card issuer may also consider information obtained through any empirically derived, demonstrably and statistically sound model that reasonably estimates a consumer's income or assets.

The rule also requires that issuers consider at least one of the following:

- The ratio of debt obligations to income;
- The ratio of debt obligations to assets; or
- The income the consumer will have after paying debt obligations (i.e., residual income).

The rule also provides that it would be unreasonable for an issuer not to review any information about a consumer's income, assets, or current obligations, or to issue a credit card to a consumer who does not have any income or assets.

Because credit card accounts typically require consumers to make a minimum monthly payment that is a percentage of the total balance (plus, in some cases, accrued interest and fees), creditors are required to consider the consumer's ability to make the required minimum payments. Card issuers must also establish and maintain reasonable written policies and procedures to consider a consumer's income or assets and current obligations. Because the minimum payment is unknown at account opening, the rule requires that creditors use a reasonable method to estimate a consumer's minimum payment. The regulation provides a safe harbor for issuers to estimate the required minimum periodic payment if the card issuer:

1. Assumes utilization, from the first day of the billing cycle, of the full credit line that the issuer is considering offering to the consumer; and
2. Uses a minimum payment formula employed by the issuer for the product the issuer is considering offering to the consumer or, in the case of an existing account, the minimum payment formula that currently applies to that account, provided that:
 - (a) If the minimum payment formula includes interest charges, the card issuer estimates those charges using an interest rate that the issuer is considering offering to the consumer for purchases or, in the case of an existing account, the interest rate that currently applies to purchases; and
 - (b) If the applicable minimum payment formula includes mandatory fees, the card issuer must assume that such fees have been charged to the account.

Specific Requirements for Underage Consumers – Section 1026.51(b)(1)

Regulation Z prohibits the issuance of a credit card to a consumer who has not attained the age of 21 unless the consumer has submitted a written application and the creditor has:

- Information indicating that the underage consumer has an independent ability to make the required minimum payments on the account; or
- The signature of a cosigner, guarantor, or joint applicant who has attained the age of 21, who has the means to repay debts incurred by the underage consumer in connection with the account, and who assumes joint liability for all debts or secondary liability for any debts

incurred before the underage consumer attains 21 years of age.

For credit line increases:

- If an account was opened based on the underage consumer's independent ability to repay, in order to increase the consumer's credit line before he or she turns 21, the issuer either must determine that the consumer has an independent ability to make the required minimum payments at the time of the contemplated increase, or must obtain an agreement from a cosigner, guarantor, or joint applicant who is 21 or older and who has the ability to repay debts to assume liability for any debt incurred on the account.
- If the account was opened based on the ability of a cosigner over the age of 21 to pay, the issuer must obtain written consent from that cosigner before increasing the credit limit.

Limitations of Fees – Section 1026.52

Limitations on Fees During First Year After Account Opening – Section 1026.52(a)

During the first year after account opening, issuers are prohibited from requiring consumers to pay fees (other than fees for late payments, returned payments, and exceeding the credit limit) that in the aggregate exceed 25 percent of the initial credit limit in effect when the account is opened. An account is considered open no earlier than the date on which the account may first be used by the consumer to engage in transactions.

NOTE: The 25 percent limitation on fees does not apply to fees assessed prior to opening the account.

Limitations on Penalty Fees – Section 1026.52(b)

TILA requires that penalty fees imposed by card issuers be reasonable and proportional to the violation of the account terms. Among other things, the regulation prohibits credit card issuers from charging a penalty fee of more than \$25 for paying late or otherwise violating the account's terms for the first violation (or \$35 for an additional violation of the same type during the same billing cycle or one of the next six billing cycles) unless the issuer determines that a higher fee represents a reasonable proportion of the costs it incurs as a result of that type of violation and reevaluates that determination at least once every 12 months.

Credit card issuers are banned from charging penalty fees that exceed the dollar amount associated with the consumer's violation of the terms or other requirements of the credit card account. For example, card issuers are no longer permitted to charge a \$39 fee when a consumer is late making a \$20 minimum payment. Instead, in this example, the fee cannot exceed \$20. The regulation also bans imposition of penalty fees when there is no dollar amount associated with the violation, such as "inactivity" fees based on the consumer's failure to use the account to make new purchases. It also prohibits issuers from charging multiple penalty fees based on a single late payment or other violation of the account terms.

Payment Allocation – Section 1026.53

When different rates apply to different balances on a credit card account, issuers are generally required to allocate payments in excess of the minimum payment first to the balance with the highest APR and any remaining portion to the other balances in descending order based on the applicable APR.

For deferred interest programs, however, issuers must allocate excess payments first to the deferred interest balance during the last two billing cycles of the deferred interest period. In addition, during a deferred interest period, issuers are permitted (but not required) to allocate excess payments in the manner requested by the consumer.

For accounts with secured balances, issuers are permitted (but not required) to allocate excess payments to the secured balance if requested by the consumer.

Double-Cycle Billing and Partial Grace Period – Section 1026.54

Issuers are generally prohibited from imposing finance charges on balances for days in previous billing cycles as a result of the loss of a grace period. In addition, when a consumer pays some, but not all, of a balance prior to the expiration of a grace period, an issuer is prohibited from imposing finance charges on the portion of the balance that has been repaid.

Restrictions on Applying Increased Rates to Existing Balances and Increasing Certain Fees and Charges – Section 1026.55

Unless an exception applies, a card issuer must not increase an annual percentage rate or a fee or charge required to be disclosed under sections 1026.6(b)(2)(ii), (b)(2)(iii), or (b)(2)(xii) on a credit card account. There are some general exceptions to the prohibition against applying increased rates to existing balances and increasing certain fees or charges:

- A temporary or promotional rate or temporary fee or charge that lasts at least six months, and that is required to be disclosed under sections 1026.6(b)(2)(ii), (b)(2)(iii), or (b)(2)(xii), provided that the card issuer complied with applicable disclosure requirements. Fees and charges required to be disclosed under sections 1026.6(b)(2)(ii), (b)(2)(iii), or (b)(2)(xii) are periodic fees for issuance or availability of an open-end plan (such as an annual fee); a fixed finance charge (and any minimum interest charge) that exceeds \$1; or a charge for required insurance, debt cancellation, or debt suspension;
- The rate is increased due to the operation of an index available to the general public and not under the card issuer's control (i.e., the rate is a variable rate);
- The minimum payment has not been received within 60 days after the due date, provided that

the card issuer complied with applicable disclosure requirements and adheres to certain requirements when a series of on time payments are received;

- The consumer successfully completes or fails to comply with the terms of a workout arrangement, provided that card issuer complied with applicable disclosure requirements and adheres to certain requirements upon the completion or failure of the arrangement; and
- The APR on an existing balance or a fee or charge required to be disclosed under sections 1026.6(b)(2)(ii), (b)(2)(iii), or (b)(2)(xii) has been reduced pursuant to the Servicemembers Civil Relief Act (SCRA) or a similar federal or state statute or regulation. The creditor is permitted to increase the rate, fee, or charge once the SCRA ceases to apply, but only to the rate, fee, or charge that applied prior to the reduction.

Regulation Z's limitations on the application of increased rates and certain fees and charges to existing balances continue to apply when the account is closed, acquired by another institution through a merger or the sale of a credit card portfolio, or when the balance is transferred to another credit account issued by the same creditor (or its affiliate or subsidiary).

Issuers are generally prevented from increasing the APR applicable to new transactions or a fee or charge subject to sections 1026.6(b)(2)(ii), (b)(2)(iii), or (b)(2)(xii) during the first year after an account is opened. After the first year, issuers are permitted to increase the APRs that apply to new transactions or a fee or charge subject to sections 1026.6(b)(2)(ii), (b)(2)(iii), or (b)(2)(xii) so long as the creditor complies with the regulation's 45-day advance notice requirement (§1026.9).

Regulation Z's limitations on the application of increased rates to existing balances and limitations on the increase of certain fees or charges apply upon cessation of a waiver or rebate of interest, fees, or charges if the issuer promotes the waiver or rebate.

Fees for Transactions that Exceed the Credit Limit – Section 1026.56

Consumer consent requirement – Regulation Z requires an issuer to obtain a consumer's express consent (or opt in) before the issuer may impose any fees on a consumer's credit card account for making an extension of credit that exceeds the account's credit limit. Prior to providing such consent, the consumer must be notified by the issuer of any fees that may be assessed for an over-the-limit transaction. If the consumer consents, the issuer is also required to provide written confirmation (or electronic confirmation if the consumer agrees) of the consumer's consent and a notice of the consumer's right to revoke that consent on the front page of any periodic statement that reflects the imposition of an over-the-limit fee.

Prior to obtaining a consumer's consent to the payment of over-the-limit transactions, the issuer must provide the consumer with a notice disclosing, among other things, the dollar amount of any charges that will be assessed for an over-the-limit transaction, as well as any increased rate that may apply if the consumer exceeds the credit limit. Issuers are prevented from assessing any over-the-limit fee or charge on an account unless the consumer consents to the payment of transactions that exceed the credit limit.

Prohibited practices – Even if the consumer has affirmatively consented to the issuer’s payment of over-the-limit transactions, Regulation Z prohibits certain issuer practices in connection with the assessment of over-the-limit fees or charges. An issuer can only charge one over-the-limit fee or charge per billing cycle. In addition, an issuer cannot impose an over-the-limit fee on the account for the same transaction in more than three billing cycles. Furthermore, fees may not be imposed for the same transaction in the second or third billing cycle unless the consumer has failed to reduce the account balance below the credit limit by the payment due date in that cycle.

Regulation Z also prohibits unfair or deceptive acts or practices in connection with the manipulation of credit limits in order to increase over-the-limit fees or other penalty charges. Specifically, issuers are prohibited from engaging in three practices:

- Assessing an over-the-limit fee because the creditor failed to promptly replenish the consumer’s available credit;
- Conditioning the amount of available credit on the consumer’s consent to the payment of over-the-limit transactions (e.g., opting in to an over-the-limit service to obtain a higher credit limit); and
- Imposing any over-the-limit fee if the credit limit is exceeded solely because of the issuer’s assessment of accrued interest charges or fees on the consumer’s account.

Special Rules for Marketing to Students – Section 1026.57

Regulation Z establishes several requirements related to the marketing of credit cards and other open-end consumer credit plans to students at an institution of higher education. The regulation limits a creditor’s ability to offer a college student any tangible item to induce the student to apply for or participate in an open-end consumer credit plan offered by the creditor. Specifically, Regulation Z prohibits a card issuer from offering tangible items as an inducement:

- On the campus of an institution of higher education;
- Near the campus of an institution of higher education; or
- At an event sponsored by or related to an institution of higher education

A tangible item means physical items, such as gift cards, t-shirts, or magazine subscriptions, but does not include non-physical items such as discounts, reward points, or promotional credit terms. With respect to offers “near” the campus, the commentary to the regulation states that a location that is within 1,000 feet of the border of the campus is considered near the campus. Regulation Z also requires card issuers to submit an annual report to the CFPB containing the terms and conditions of business, marketing, or promotional agreements with an institution of higher education or an alumni organization or foundation affiliated with an institution of higher education.

Online Disclosure of Credit Card Agreements – Section 1026.58

The regulation requires that issuers post credit card agreements on their websites and to submit those agreements to the CFPB for posting on a website maintained by the CFPB. There are three exceptions for when issuers are not required to provide statements to the CFPB:

- The issuer has fewer than 10,000 open credit card accounts; or
- The agreement currently is not offered to the public and the agreement is used only for one or more private label credit card plans with credit cards usable only at a single merchant or group of affiliated merchants and that involves fewer than 10,000 open accounts; or
- The agreement currently is not offered to the public and the agreement is for one or more plans offered to test a new product offered only to a limited group of consumers for a limited time that involves fewer than 10,000 open accounts.

Reevaluation of Rate Increases – Section 1026.59

For any rate increase imposed on or after January 1, 2009, that requires 45 days advance notice, the regulation requires card issuers to review the account no less frequently than once each six months and, if appropriate based on that review, reduce the annual percentage rate. The requirement to reevaluate rate increases applies both to increases in annual percentage rates based on consumer-specific factors, such as changes in the consumer's creditworthiness, and to increases in annual percentage rates imposed based on factors that are not specific to the consumer, such as changes in market conditions or the issuer's cost of funds. If based on its review a card issuer is required to reduce the rate applicable to an account, the final regulation requires that the rate be reduced within 45 days after completion of the evaluation.

This review must consider either the same factors on which the increase was originally based or the factors the card issuer currently considers in determining the annual percentage rate applicable to similar new credit card accounts.

Specific Defenses – TILA Section 108

Defense Against Civil, Criminal, and Administrative Actions

A financial institution in violation of TILA may avoid liability by:

- Discovering the error before an action is brought against the financial institution, or before the consumer notifies the financial institution, in writing, of the error.
- Notifying the consumer of the error within 60 days of discovery.
- Making the necessary adjustments to the consumer's account, also within 60 days of

discovery. (The consumer will pay no more than the lesser of the finance charge actually disclosed or the dollar equivalent of the APR actually disclosed.)

The above three actions also may allow the financial institution to avoid a regulatory order to reimburse the customer.

An error is “discovered” if it is:

- Discussed in a final, written report of examination.
- Identified through the financial institution’s own procedures.
- An inaccurately disclosed APR or finance charge included in a regulatory agency notification to the financial institution.

When a disclosure error occurs, the financial institution is not required to re-disclose after a loan has been consummated or an account has been opened. If the financial institution corrects a disclosure error by merely re-disclosing required information accurately, without adjusting the consumer’s account, the financial institution may still be subject to civil liability and an order to reimburse from its regulator.

The circumstances under which a financial institution may avoid liability under the TILA do not apply to violations of the Fair Credit Billing Act (chapter 4 of the TILA).

Additional Defenses Against Civil Actions

The financial institution may avoid liability in a civil action if it shows by a preponderance of evidence that the violation was not intentional and resulted from a bona fide error that occurred despite the maintenance of procedures to avoid the error.

A bona fide error may include a clerical, calculation, computer malfunction, programming, or printing error. It does not include an error of legal judgment.

Showing that a violation occurred unintentionally could be difficult if the financial institution is unable to produce evidence that explicitly indicates it has an internal controls program designed to ensure compliance. The financial institution’s demonstrated commitment to compliance and its adoption of policies and procedures to detect errors before disclosures are furnished to consumers could strengthen its defense.

Statute of Limitations – TILA Sections 108 and 130

Civil actions may be brought within one year after the violation occurred. For private education loans, civil actions may be brought within one year from the date on which the first regular payment of principal and interest is due. After that time, and if allowed by state law, the consumer may still assert the violation as a defense if a financial institution were to bring an

action to collect the consumer's debt.

The statute of limitations for a violation of TILA section 129 (requirements for certain mortgages), 129B (residential mortgage loan origination), or 129C (minimum standards for mortgages) is three years from the date of the occurrence of the violation (as compared to one year for most other TILA violations). TILA section 130(e).

Moreover, TILA provides that when a creditor, assignee, other holder or anyone acting on such a person's on behalf initiates a foreclosure action on, or any other action to collect the debt in connection with a residential mortgage loan, a consumer may assert a violation of TILA section 129C(a) "as a matter of defense by recoupment or set off." TILA section 130(k). There is no time limit on the use of this defense and the amount of recoupment or setoff is limited, with respect to the special statutory damages, to no more than three years of finance charges and fees.

Criminal actions are not subject to the TILA one-year statute of limitations.

Regulatory administrative enforcement actions also are not subject to the one-year statute of limitations. Actions brought under section 129, 129B, or 129C and actions brought by a state attorney general to enforce a violation of section 129, 129B, 129C, 129D, 129E, 129F, 129G, or 129H, may be brought not later than 3 years after the date on which the violation occurs. ,Actions involving private education loans under 15 U.S.C. 1650(a) may be brought not later than one year from the due date of first regular payment of principal. TILA section 130(e).

However, enforcement actions under the policy guide involving erroneously disclosed APRs and finance charges are subject to time limitations by the TILA. Those limitations range from the date of the last regulatory examination of the financial institution, to as far back as 1969, depending on when loans were made, when violations were identified, whether the violations were repeat violations, and other factors.

There is no time limitation on willful violations intended to mislead the consumer. A summary of the various time limitations follows.

- For open-end credit, reimbursement applies to violations not older than two years.
- For closed-end credit, reimbursement is generally directed for loans with violations occurring since the immediately preceding examination.

Rescission Rights (Open-End and Closed-End Credit) – Sections 1026.15 & 1026.23

TILA provides that for certain transactions secured by the consumer's principal dwelling, a consumer has three business days after becoming obligated on the debt to rescind the transaction. The right of rescission allows consumer(s) time to reexamine their credit agreements and cost disclosures and to reconsider whether they want to place their homes at risk by offering it as security for the credit. A higher-priced mortgage loan (whether or not it is a HOEPA loan) having a prepayment penalty that does not conform to the prepayment penalty limitations

(§§1026.32(c) and (d) and §1026.35(b)(2)) is also subject to a three-year right of rescission. Transactions exempt from the right of rescission include residential mortgage transactions (§1026.2(a)(24)) and refinancing or consolidations with the original creditor where no “new money” is advanced.

If a transaction is rescindable, consumers must be given a notice explaining that the creditor has a security interest in the consumer’s home, that the consumer may rescind, how the consumer may rescind, the effects of rescission, and the date the rescission period expires.

To rescind a transaction, a consumer must notify the creditor in writing by midnight of the third business day after the latest of three events:

- Consummation of the transaction,
- Delivery of material TILA disclosures, or
- **Receipt** of the required notice of the right to rescind.

(12 CFR 1026.15(b) and 1026.23(b)(1) were amended to include the electronic delivery of the notice of the right to rescind. If a paper notice of the right to rescind is used, a creditor must deliver two copies of the notice to each consumer entitled to rescind. However, under the final rule on electronic delivery of disclosures if the notice is in electronic form, in accordance with the consumer consent and other applicable provisions of the E-Sign Act, only one copy to each customer is required.)

For purposes of rescission, business day means every calendar day except Sundays and the legal public holidays (§1026.2(a)(6)). The term “material disclosures” is defined in section 1026.23(a)(3) to mean the required disclosures of the APR, the finance charge, the amount financed, the total of payments, the payment schedule, and the disclosures and limitations referred to in section 1026.32(c) and (d) and 1026.35(e)(2).

The creditor may not disburse any monies (except into an escrow account) and may not provide services or materials until the three-day rescission period has elapsed and the creditor is reasonably satisfied that the consumer has not rescinded. If the consumer rescinds the transaction, the creditor must refund all amounts paid by the consumer (even amounts disbursed to third parties) and terminate its security interest in the consumer’s home.

A consumer may waive the three-day rescission period and receive immediate access to loan proceeds if the consumer has a “bona fide personal financial emergency.” The consumer must give the creditor a signed and dated waiver statement that describes the emergency, specifically waives the right, and bears the signatures of all consumers entitled to rescind the transaction. The consumer provides the explanation for the bona fide personal financial emergency, but the creditor decides the sufficiency of the emergency.

If the required rescission notice or material TILA disclosures are not delivered or if they are inaccurate, the consumer’s right to rescind may be extended from three days after becoming obligated on a loan to up to three years.

REFERENCE: 2012 CFPB Examination Manual, & August 2013 Updated Procedures