Restitution

The Truth in Lending Simplification and Reform Act of 1980 gave the agencies that enforce the Truth in Lending Act (FRB, OCC, FDIC, NCUA, and the OTS) the authority to require Financial institutions that violate certain provisions of the law to reimburse borrowers for faulty disclosures. Generally, the agencies are empowered to order restitution under their cease and desist authority for understatements of the annual percentage rate (APR) and finance charge disclosures resulting from:

- a clear and consistent pattern or practice of disclosure errors;
- gross negligence; or,
- a willful violation of the Act.

LINKS

Program

Appendix A

Appendix B

The agencies may also require restitution for isolated disclosure errors.

The term "clear and consistent pattern or practice" is not defined in the Act. Consequently, the Interagency Policy Guide does not contain any precepts for application of this phrase.

However, in making a determination, the examiner should attempt to detect the cause for a particular type of violation and determine whether that cause gives rise to violations in other transactions. Patterns or practices can arise from a particular loan officer, a form, a chart, a calculator or computer, or just plain sloppiness, to name a few examples. Patterns or practices can also be present in only certain transactions, e.g. real estate loans and not in other loans.

Section 608 of the TIL Simplification and Reform Act (which contains the restitution provisions) is implemented by the Interagency Policy Guide for Restitution (see Appendix A). The Policy Guide was adopted by each agency represented on the Federal Financial Institutions Examination Council. The Policy Guide summarizes and explains the restitution provisions of the law and also explains the corrective actions that the agencies generally intend to take in those instances where the Act gave the agencies the authority to take equitable remedial action.

The Interagency Policy Guide for Restitution

Definitions

The Policy Guide contains several definitions that are critical to both the understanding and the application of the restitution provisions to individual cases. Some of these definitions are discussed below.

1. Current Examination – this is the most recent examination begun on or after March 31, 1980 (the effective date of Section 608) in which compliance with Regulation Z was reviewed.

   This is an extremely important definition because corrective action time periods are measured from the date of the current examination.

2. Understated APR – an understated APR is a disclosed APR which is one-quarter of one percent less than the actual APR for all transactions except for regular mortgage loans which have an amortization schedule of more than ten years; for these transactions the tolerance is one-eighth of one percent.

   To explain, if a transaction has a disclosed APR of 10.00 percent and the actual APR is 10.26 or more, the disclosed figure is understated and restitution would be required. If, however, a transaction has an amortization schedule of greater than ten years, and it is otherwise regular (equal payments with or without an odd first or last payment such as a balloon, with a single advance) then the tolerance is only one-eighth of one percent and a corresponding tolerance of .125 would be applied.

3. Understated Finance Charge – a finance charge is considered understated if it is lower than the finance charge that would be generated on the transaction by the APR reduced by the corresponding tolerance. The footnote to this definition in the Policy Guide provides a simple example that explains the application of the tolerance.

   To determine whether a finance charge is understated, it is necessary to compare the disclosed finance charge to the finance charge generated by reducing the lowest permissible APR by the applicable tolerance. If the disclosed finance charge falls below the finance charge generated by the reduced APR, then the disclosed finance charge would be understated. If the resulting difference between the disclosed finance charge and the finance charge generated by the reduced APR is more than one dollar, the difference would be reimbursed.

De Minimus Rule

The statute contains a de minimus rule for adjustment amounts that fall below $1.00. However, the agencies could still require a creditor to reimburse the de minimus amounts to the U.S. Treasury.

Corrective Action Period

Generally, the corrective action time period for closed-end credit runs from the date of the current examination back to the date of the prior examination in which Regulation Z was reviewed. However, if the same violation was cited at the date of the prior examination, the corrective action time period continues backwards to the date of the examination in which the creditor was first notified of the violation. Given the fact that restitution has been part of the examination process for a number of years now, rarely will the time periods extend further back than the date of the prior examination.

The Policy Guide also makes reference to requiring restitution on transactions that were originated between January 1, 1977 and March 31, 1980. This was a provision that had meaning and applicability during the first few years of implementation after the effective date of the act. It was designed to assure that those institutions that had restitution requests pending during the time that the Congress was deliberating the restitution provisions within the context of the amended Truth In Lending Act, would still be required to reimburse affected customers.

Terminated closed-end credit transactions have a different corrective action period. An adjustment on a terminated loan will only be requested if the loan was consummated and terminated within the two year period preceeding the date of the current examination.

Open-end credit transactions are subject to an adjustment if the violation occurred within the two-year period preceding the date of the current examination.

Corrective action applies to all applicable transactions during the corrective action period and is not limited to only those found by the examiner to require restitution.

Calculating the Adjustment

The tolerance amount may be applied in calculating the amount of any adjustment to the consumer's account. This means that if a disclosed APR, for example, is understated by .40 percent, the creditor need only reimburse the dollar difference represented by .15 percent.

Methods of Adjustment

Only two methods of reimbursement are permitted, the lump sum, and lump sum/payment reduction methods.

Under the lump sum method, the creditor reimburses to the borrower a cash payment equal to the total adjustment over the life of the loan. Under the lump sum/payment reduction method, the creditor reimburses a cash payment equal to the overcharge up to the time of the adjustment, and reduces the remaining payments on the loan. This latter method is typically used in real estate transactions to mitigate the effects of restitution on cash flow.

Non-Disclosure of the APR or Finance Charge

The Policy Guide provides special guidance for situations where a creditor has failed to disclose either the APR or finance charge on a transaction. If an APR was not disclosed, the contract rate of interest is considered to be the APR for purposes of application of the Policy Guide. If both the APR and the contract rate of interest were not disclosed, a consumer will not be required to pay an amount greater than the actual APR reduced by one-quarter of one percentage point in the case of first lien mortgage transactions, and one percentage point in all other transactions.

A failure to disclose the finance charge altogether does not require reimbursement.

Credit Life, Accident and Health Insurance Disclosure Violations

Violations of the Regulation Z provisions that enable creditors to exclude credit life premiums from the finance charge are to be treated as violations of either the APR of finance charge disclosure rules.

Special Disclosures

Violations of either the property insurance or security interest fee or non-Fling insurance provisions in Section 226.4(e) of Regulation Z are exempt from the restitution requirements by statute.

Obvious Errors

The Policy Guide contains a special rule for errors in the APR or finance charge disclosures that are so obvious that a reasonable person could not have relied on them in making a credit shopping decision. If the APR of finance charge that was disclosed is ten percent or less of the amount that should have been disclosed, no adjustment will be required. This rule is aimed primarily at common clerical mistakes such as disclosing an APR as "1.000" instead of "10.00" or a finance charge as "$37,678.32" instead of "$376,783.20."

This special rule is infrequently applicable. However, when it has been applied, it has usually been in connection with finance charge disclosure mistakes where the creditor merely discloses the prepaid finance charge as the entire finance charge on a long-term loan, and, consequently, fails to include the much larger interest component.

Agency Discretion

The statute gave the agencies very limited discretion to exempt a creditor from reimbursement if some stringent tests are satisfied. First, the disclosure error had to result from unique circumstances; second, it had to involve a clearly technical and nonsubstantive disclosure violation; third, it did not adversely affect information provided to the borrower; and, fourth, it did not mislead or otherwise deceive the borrower.

This is a very strict series of tests that are very difficult to satisfy. Basically, it would be highly unusual to reach a finding where an APR or a finance charge disclosure violation is considered clearly technical or nonsubstantive. A violation of either of these items, which are the focus of the Truth in Lending Act, would always adversely affect information provided to the borrower. Moreover, a regulatory agency is not in the position to reach a determination that a borrower was not misled or otherwise deceived by a disclosure error.

Given the exacting nature of this very limited exibility, ARDs (Assistant Regional Director for Compliance) should consult with the Division of Compliance Programs within the Office of Thrift Supervision when a situation involving the potential application of the agency discretion clause is being considered.

Safety and Soundness

The statute does not provide the agencies with much latitude for forgiving restitution even when restitution would have a significantly adverse impact on the solvency of the creditor. The agencies are, however, permitted to allow partial, installment payments of reimbursement amounts to borrowers over an extended period to minimize adverse impact on a creditor's safety and soundness.

Exemption from Restitution Orders

The Policy Guide indicates that a creditor would not be subject to an agency order requiring restitution if it adjusts the accounts on its own within 60 days of learning of the disclosure violation. This is unrelated to the civil liability provisions of Section 130 of the Truth in Lending Act.

Question and Answer Document

To facilitate understanding of application of the Policy Guide to various, common fact situations, the agencies have prepared an internal question and answer document. This document is contained in Appendix B of this Handbook section.

Documentation Requirements

When an understated APR or finance charge is discovered, certain documentation should be recorded on a separate workpaper. Information on this workpaper should be adequate to facilitate calculation of the APR, finance charge, and reimbursement amount for each loan without further reference to the loan file. At a minimum, the following should be recorded for each affected loan:

- loan amount
- note rate
- actual prepaid finance charge

- actual amount financed
- disclosed amount financed
- disclosed finance charge
- actual finance charge
- disclosed APR
- actual APR
- date finance charge began to accrue
- first payment due date
- number of payments made to date
- payment schedule (amount and number, and if on demand, state "demand")
- term of the loan

Report Requirements

A pattern or practice of violations involving understated APRs or finance charges must be included in the report comments. It is not necessary to identify individual loans in the comments except in cases where a lawsuit or consumer complaint has been fled or is anticipated.

The report comments should include the following supporting information for understated APR or finance charge violations constituting a pattern or practice:

- number of violations found by loan type or source
- sample sizes
- volume of lending by loan type or source
- pertinent information establishing the cause of the violations and the extent of the problem
- a statement identifying the specific institution management member(s) with whom the violations were discussed and to whom the exception sheets identifying all violations were given.