

BACKGROUND

The Truth in Lending Act Amendments of 1995 and the Economic Growth and Regulatory Paperwork Reduction Act of 1996 amended the TILA to incorporate new tolerances for disclosures of the finance charge and other disclosures affected by the finance charge on certain types of loans. These amendments specify that in closed-end consumer credit transactions secured by real property or a dwelling, the disclosed finance charge and other disclosures affected by the disclosed finance charge shall be treated as accurate if the amount disclosed as the finance charge is overstated, or is understated by no more than \$100 for transactions consummated on or after September 30, 1995, or \$200 for loans made before that date. The Federal Reserve Board proposed and adopted amendments to Regulation Z in 1996 to implement the statutory changes (12 CFR 226.18(d)(1), 226.18(d)(2), 226.22(a)(4) and 226.22(a)(5)).

The Policy Statement originally issued in 1980 was directly affected by the amendments to the TILA and the changes to Regulation Z in several respects. First, the changes to the tolerances affect the definition for understated annual percentage rates (APR) contained in the Policy Statement. Second, the amendments enhanced the agencies' abilities to make modifications to the amount or timing of restitution in the event that payment of restitution would adversely affect the capital position of the financial institution. In the main, the revisions to the Policy Statement make only those changes necessary to accommodate statutory requirements. Some other editorial changes were made, however, to reflect that some provisions of the original Policy Statement were no longer needed due to the passage of time.

Summary of Changes

The revised Policy Statement drops the definition of "Irregular Mortgage Transaction." The term is used in the Truth in Lending Simplification and Reform Act in the definition of an understated APR for loans secured by dwellings consummated prior to March 31, 1982. There is no longer any need for maintaining a separate definition of this term in the Policy Statement. A footnote has been included in the revised Policy Statement to indicate that, should loans consummated prior to March 31, 1982 having understated APRs be found, the original Policy Statement should be consulted for guidance.

The definition of the term "Understated APR" in the Policy Statement has been modified to reflect revised tolerances for certain real estate secured transactions. The Truth in Lending Amendments of 1995 and the Economic Growth and Regulatory Paperwork Reduction Act of 1996 mandated these revisions. The Policy Statement has also been revised to consolidate six separate sub-parts to the definition of an "Understated APR" into two sub-parts; (1) Loans having an amortization schedule of 10 years or less, and (2) loans with an amortization schedule of more than 10 years.

- Loans having an amortization schedule of 10 years or less will be provided a tolerance of 25 basis points (one-quarter of one percent). Loans that are secured by real estate or a dwelling will be provided the tolerances permitted by 12 CFR 226.22(a)(4) and (5).
- Loans having an amortization schedule of more than 10 years will be provided a tolerance of 12.5 basis points (one-eighth of one percent) in the case of a regular transaction and 25 basis

points (one-quarter of one percent) in the case of an irregular transaction. Loans that are secured by real estate or a dwelling will be provided the tolerances permitted by 12 CFR 226.22(a)(4) and (5).

References to 15 U.S.C. 1606(c) contained in the body of the definition of an understated APR in the original Policy Statement have now been moved to footnote 3 in the revised Policy Statement. The change was purely editorial in nature. A new footnote 4 has been added to more specifically identify the sections of Regulation Z (12 CFR 226.14(a) and 226.22(a)) that define the requirements for annual percentage rate disclosures.

The “Corrective Action Period” section of the original Policy Statement contains time frames for determining which loans are subject to adjustment when violations are discovered. Previously, the agencies have collectively taken the position that the phrase “immediately preceding examination” in subsection 2.b. means the most recent examination that precedes the current examination in which compliance with Regulation Z and the Act was reviewed. However, the United States Court of Appeals for the 8th Circuit (*First National Bank of Council Bluffs v. Office of the Comptroller of the Currency*, 956 F.2d 1456 (8th Cir. 1992)), and the United States Court of Appeals for the Eleventh Circuit, (*Consolidated Bank, N.A. v. United States Department of the Treasury*, 118 F.3d 1461 (11th Cir. 1997)) determined that the phrase “immediately preceding examination” should be read as referring to an examination of any type conducted immediately prior to the current examination, including examinations in which no review of compliance with Regulation Z or the Act is conducted. Consequently, the agencies, as a matter of policy, will now apply the decisions reached by the Eighth and Eleventh Circuit Courts in carrying out their enforcement responsibilities with respect to the meaning of “immediately preceding examination.” No changes to the Policy Statement are necessary to effect this policy position made by the agencies. Additional guidance will be provided to the examination staff for each agency to advise on the proper period for corrective action when violations requiring adjustments are discovered.

In the section of the Policy Statement entitled “Violations Involving the Improper Disclosure of Credit Life, Accident, Health, or Loss of Income Insurance,” the original Policy Statement had a separate provision detailing how certain violations involving credit life insurance disclosures would be treated until March 31, 1982. Since this time period has now expired that portion of the section has been deleted.

The Economic Growth and Regulatory Paperwork Reduction Act of 1996 provided additional flexibility for the regulatory agencies to require partial or delayed payments for reimbursements by an institution if the payment would cause the institution to become undercapitalized as that term is defined in section 38 of the Federal Deposit Insurance Act. Those provisions are now reflected in the section of the Policy Statement entitled “Safety and Soundness.” That section states that if the results of a full and immediate adjustment required under the Policy Statement would have a significant adverse impact on the capital position of the creditor, the agencies can permit partial adjustments to be made or permit partial payments over an extended period of time.

ADMINISTRATIVE ENFORCEMENT OF THE TRUTH IN LENDING ACT— RESTITUTION (REVISED SEPTEMBER 8, 1998)

Joint Statement of Policy

The Depository Institutions Deregulation and Monetary Control Act of 1980 (Pub. L. 96-221) was enacted on March 31, 1980. Title VI of that Act, the Truth in Lending Simplification and Reform Act, amends the Truth in Lending Act, 15 U.S.C. 1601, et seq. Section 608 of Title VI, effective March 31, 1980, authorizes the federal Truth in Lending enforcement agencies to order creditors to make monetary and other adjustments to the accounts of consumers where an annual percentage rate (APR) or finance charge was inaccurately disclosed. It generally requires the agencies to order restitution when such disclosure errors resulted from a clear and consistent pattern or practice of violations, gross negligence, or a willful violation which was intended to mislead the person to whom the credit was extended. However, the Act does not preclude the agencies from ordering restitution for isolated disclosure errors.

This policy guide summarizes and explains the restitution provisions of the Truth in Lending Act (Act), as amended. The material also explains corrective actions the financial regulatory agencies believe will be appropriate and generally intend to take in those situations in which the Act gives the agencies the authority to take equitable remedial action.

The agencies anticipate that most financial institutions will voluntarily comply with the restitution provisions of the Act as part of the normal regulatory process. If a creditor does not voluntarily act to correct violations, the agencies will use their cease and desist authority to require correction pursuant to: 15 U.S.C. 1607 and 12 U.S.C. 1818(b) in the cases of the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision; and 15 U.S.C. 1607 and 12 U.S.C. 1786(e)(1) in the case of the National Credit Union Administration.

Restitution Provisions

Definitions

Except as provided below, all definitions are those found in the Act and Regulation Z, 12 CFR part 226.

1. “Current examination” means the most recent examination begun on or after March 31, 1980, in which compliance with Regulation Z was reviewed.
2. “Lump sum method” means a method of reimbursement in which a cash payment equal to the total adjustment will be made to a consumer.
3. “Lump sum/payment reduction method” means a method of reimbursement in which the total adjustment to a consumer will be made in two stages:
 - a. A cash payment that fully adjusts the consumer’s account up to the time of the cash payment; and,

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- b. A reduction of the remaining payment amounts on the loan.
4. “Understated APR” means a disclosed APR that is understated by more than the reimbursement tolerance provided in the Act as follows:
 - a. For loans with an amortization schedule of 10 years or less, a disclosed APR which, when increased by the greater of the APR tolerance specified in the Act and Regulation Z or one-quarter of one percent, is less than the actual APR calculated under the Act.
 - b. For loans consummated after March 31, 1982. For loans consummated prior to that date refer to the Policy Guide dated July 21, 1980 (45 FR 48712) for additional guidance.
 - c. 15 U.S.C. 1606(c)
 - d. 12 CFR 226.14(a) and 226.22(a)
 - e. If, however, the loan is closed-end credit secured by real estate or a dwelling and the APR is understated by more than one-quarter of one percent, the APR will be considered accurate and not subject to reimbursement if: (1) The finance charge is understated but considered accurate in accordance with the Act and Regulation (i.e., the finance charge is not understated by more than \$100 on loans made on or after 9/30/95, or \$200 for loans made before that date); and (2) the APR is not understated by more than the dollar equivalent of the finance charge error and the understated APR resulted from the understated finance charge that is considered accurate.
 - f. For loans with an amortization schedule of more than 10 years, a disclosed APR which, when increased by the APR tolerance specified in the Act and Regulation Z (i.e., one-quarter of one percent for irregular loans, one-eighth of one percent for all other closed-end loans) is less than the actual APR.
 - g. If, however, the loan is closed-end credit secured by real estate or a dwelling and the APR is understated by more than one-eighth of one percent if the transaction is not considered to be an irregular transaction as defined by the Regulation (12 CFR 226.22(a)(3)) or one quarter of one percent if the transaction is irregular according to the definition, the APR will be considered accurate and no subject to reimbursement if: (1) The finance charge is understated but considered accurate according to the Actual Regulation (i.e., the finance charge is understated but considered accurate according to the Act and Regulation i.e., the finance charge is not understated by more than \$100 on loans made on or after 9/30/95, or \$200 for loans made before that date); and (2) the APR is not understated by more than the dollar equivalent of the finance charge error and the understated APR resulted from the understated finance charge that is considered accurate.
 5. “Understated finance charge” means a disclosed finance charge which, when increased by the greater of the finance charge dollar tolerance specified in the Act and Regulation Z or a dollar tolerance that is generated by the corresponding APR reimbursement tolerance is less than the finance charge calculated under the Act.
 - a. The finance charge tolerance for each loan will be generated by the corresponding APR tolerance applicable to that loan. For example, consider a single-payment loan with a one-year maturity that is subject to a one-quarter of one percent APR tolerance. If the amount financed

is \$5,000 and the finance charge is \$912.50, the actual APR will be 18.25%. The finance charge generated by an APR of 18% (applying the one-quarter of one percent APR tolerance to 18.25%) for that loan would be \$900. The difference between \$912.50 and \$900 produces a numerical finance charge tolerance of \$12.50. If the disclosed finance charge is not understated by more than \$12.50, reimbursement would not be ordered.

De Minimis Rule

If the amount of adjustment on an account is less than \$1.00, no restitution will be ordered. However, the agencies may require a creditor to make any adjustments of less than \$1.00 by paying into the United States Treasury, if more than one year has elapsed since the date of the violation.

Corrective Action Period

1. Open-end credit transactions will be subject to an adjustment if the violation occurred within the two-year period preceding the date of the current examination.
2. Closed-end credit transactions will be subject to an adjustment if the violation resulted from a clear and consistent pattern or practice or gross negligence where:
 - a. There is an understated APR on a loan which originated between January 1, 1977 and March 31, 1980.
 - b. There is an understated APR or understated finance charge, and the practice giving rise to the violation is identified during the current examination. Loans containing the violation which were consummated since the date of the immediately preceding examination are subject to an adjustment.
 - c. There is an understated APR or understated finance charge, the practice giving rise to the violation was identified during a prior examination and the practice is not corrected by the date of the current examination. Loans containing the violation which were consummated since the creditor was first notified in writing of the violation are subject to an adjustment. (Prior examinations include any examinations conducted since July 1, 1969).
3. Each closed-end credit transaction, consummated since July 1, 1969, and containing a willful violation intended to mislead the consumer is subject to an adjustment.
4. For terminated loans subject to 2, above, an adjustment will not be ordered if the violation occurred in a transaction consummated more than two years prior to the date of the current examination.

Calculating the Adjustment

Consumers will not be required to pay any amount in excess of the finance charge or dollar equivalent of the APR actually disclosed on transactions involving:

1. Understated APR violations on transactions consummated between January 1, 1977 and March 31, 1980, or
2. Willful violations which were intended to mislead the consumer.

On all other transactions, applicable tolerances provided in the definitions of understated APR and understated finance charge may be applied in calculating the amount of adjustment to the consumer's account.

Methods of Adjustment

The consumer's account will be adjusted using the lump sum method or the lump sum/payment reduction method, at the discretion of the creditor.

Violations Involving the Non-Disclosure of the APR or Finance Charge

1. In cases where an APR was required to be disclosed but was not, the disclosed APR shall be considered to be the contract rate, if disclosed on the note or the Truth in Lending disclosure statement.
2. In cases where an APR was required to be disclosed but was not, and no contract rate was disclosed, consumers 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 by one percentage point in all other transactions.
3. In cases where a finance charge was not disclosed, no adjustment will be ordered.

Violations Involving the Improper Disclosure of Credit Life, Accident, Health, or Loss of Income Insurance

If the creditor has not disclosed to the consumer in writing that credit life, accident, health, or loss of income insurance is optional, the insurance shall be treated as having been required and improperly excluded from the finance charge. An adjustment will be ordered if it results in an understated APR or finance charge. The insurance will remain in effect for the remainder of its term.

If the creditor has disclosed to the consumer in writing that credit life, accident, health, or loss of income insurance is optional, but there is either no signed insurance option or no disclosure of the cost of the insurance, the insurance shall be treated as having been required and improperly excluded from the finance charge. An adjustment will be ordered if it results in an understated APR or finance charge. The insurance will remain in effect for the remainder of its term.

Special Disclosures

Adjustments will not be required for violations involving the disclosures required by sections 106(c) and (d) of the Act, (15 U.S.C. 1605(c) and (d)).

Obvious Errors

If an APR was disclosed correctly, but the finance charge required to be disclosed was understated, or if the finance charge was disclosed correctly, but the APR required to be disclosed was understated, no adjustment will be required if the error involved a disclosed value which was 10 percent or less of the amount that should have been disclosed.

Agency Discretion

Adjustments will not be required if the agency determines that the disclosure error resulted from any unique circumstances involving a clearly technical and non-substantive disclosure violation which did not adversely affect information provided to the consumer and which did not mislead or otherwise deceive the consumer.

Safety and Soundness

In some cases, an agency may order, in place of an immediate, full adjustment, either a partial adjustment, or a full adjustment in partial payments over an extended time period that the agency considers reasonable. The agency may do so if it determines that (1) the full, immediate adjustment would have a significantly adverse impact upon the safety and soundness of the creditor, and (2) a partial adjustment, or making partial payments over an extended period of time, is necessary to avoid causing the creditor to become undercapitalized.

- a. The term “undercapitalized” will have the meaning as defined in section 38 of the Federal Deposit Insurance Act (12 U.S.C. 1831o).

Exemption from Restitution Orders

A creditor will not be subject to an order to make an adjustment if within 60 days after discovering a disclosure error, whether pursuant to a final written examination report or through the creditor’s own procedures, the creditor notifies the person concerned of the error and adjusts the account to ensure that such person will not be required to pay a finance charge in excess of that actually disclosed or the dollar equivalent of the APR disclosed, whichever is lower. This 60-day period for correction of disclosure errors is unrelated to the provisions of the civil liability section of the Act.