TRUTH IN LENDING ACT

(REGULATION Z)

OVERVIEW

Overview

The Truth in Lending Act 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 credit unions must use the same credit terminology and expressions of rates. In addition to providing a uniform system for disclosures, the act is designed to:

- Protect consumers against inaccurate and unfair credit billing and credit card practices;
- Provide consumers with rescission rights;
- Provide for disclosure of rate caps on certain dwelling-secured variable-rate loans; and,
- Impose limitations on home equity lines of credit and certain closed-end Home mortgages.

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

Regulation Z

Regulation Z, which implements the Truth in Lending Act (TILA), generally promotes the informed use of consumer credit by requiring disclosures about its terms and cost. The disclosure rules credit unions must follow differ depending on whether the credit union is offering open-end credit, such as credit cards or home-equity lines, or closed-end credit, such as car loans or mortgages. Noncompliance with the requirements of Regulation Z can result in administrative actions, civil liability, and/or criminal liability. Administrative actions based on inaccurate (understated) disclosures of finance charges or annual percentage rates may result in a requirement that a credit union reimburse affected customers. Regulation Z is formatted into the following sections:

- Subpart A General
- Subpart B Open-end Credit
- Subpart C Closed-end Credit
- Subpart D Miscellaneous
- Subpart E Special Rules for Certain Home Mortgage Transactions
- Subpart F Electronic Communication

Subpart A – General Information [§ 226.1 through 226.4]

Subpart A 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.

Open End and Closed End Credit

Subpart A defines "open-end" credit and "closed-end" credit. Open-end credit involves consumer credit extended under a plan in which: (i) repeated transactions are contemplated; (ii) a finance charge may be imposed on outstanding unpaid balances; and (iii) credit extensions are available to the extent that any outstanding balance is repaid (examples: credit card accounts, home equity lines of credit). Closed-end credit encompasses all consumer credit transactions not extended under an open-end plan (examples: residential mortgage transactions, automobile loans).

Exempt Transactions

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;
- Credit in excess of $25 thousand not secured by real or personal property used as the principal dwelling of the consumer;
- 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; and
- Certain student loan programs.

If a credit card is involved, generally exempt credit (e.g., business or agricultural purpose credit) is still subject to requirements that govern the issuance of credit cards and liability for their unauthorized use. As provided in Subpart B, 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.

When determining whether credit is for business purposes, the credit union must evaluate all of the following:

- Any statement obtained from the borrower describing the purpose of the proceeds.
    1. For example, a statement that the proceeds will be used for a vacation trip would indicate a consumer purpose, rather than a business purpose.

2. 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 borrower will help the lender make that decision.
3. 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 had a business purpose.

- The borrower's primary occupation and how it relates to the use of the proceeds. The higher the correlation between the borrower'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 credit union 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 credit union and compliance with the law. The Federal Reserve Board's official staff interpretation contains additional information on determining the purpose. 12 C.F.R. Part 226, Supplement I, Paragraph 3(a).

<u>Finance Charge (Open-End and Closed-End Credit) Definition</u>

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.

Finance charges include any charges or fees payable directly or indirectly by the consumer and imposed directly or indirectly by the credit union 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. 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. 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 [(226.4(b)].

Calculating the Finance Charge

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 credit union requires use of a third party, even if the consumer can choose the third party; or the lender retains a portion of the third-party charge, to the extent of the portion retained. In addition, charges imposed by settlement or closing agents are finance charges if the credit union requires the specific service that gave rise to the charge and the charge is not otherwise excluded.

Prepaid Finance Charges

A prepaid finance charge is any finance charge paid separately to the credit union 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.

Precomputed Finance Charges

A precomputed 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 note as part of the consumer's obligation, finance charges that are not viewed as prepaid finance charges are treated as precomputed finance charges that are earned over the life of the loan.

Subpart B-Open-end Credit [§(226.5 through 226.16)]

Open-end credit plans include credit card and overdraft checking accounts. Disclosures for open-end credit accounts differ substantially from those for closed-end credit.

Open-end credit involves a plan under which repeated extensions of credit are contemplated, often with a credit limit. Under an open-end plan the credit union may impose a finance charge on an outstanding unpaid balance. In addition, credit is generally made available as the consumers outstanding balance is repaid on the plan.
A line of credit is self-replenishing even though the plan has a fixed expiration date, as long as during the plan's existence the consumer may use the line, repay and reuse the credit. If the credit union elects to verify the credit information for security reasons, the plan is still considered open-end credit. Two basic types of disclosures are required:

- Those to be made before the first transaction on the account; and
- Those to be made on each periodic billing statement for transactions occurring during the period.

Subpart B of the regulation contains rules for disclosures for home-equity loans, credit and charge card accounts, and other open-end credit. Subpart B also covers rules for resolving billing errors, calculating annual percentage rates, credit balances, and advertising open-end credit. Special rules apply to credit card transactions only, such as certain prohibitions on the issuance of credit cards and restrictions on the right to offset a cardholder's indebtedness. Additional special rules apply to home-equity lines of credit, such as certain prohibitions against closing accounts or changing account terms.

Finance Charge (Open-End Credit)

Each finance charge imposed must be individually itemized. The aggregate total amount of the finance charge need not be disclosed. Some of the more important disclosure requirements under 226.6 follow.

Required Initial Disclosures: Disclosures must be reasonably understandable and readily noticeable.

- Finance charge;
- Periodic rate(s);
- Annual Percentage Rate(s) corresponding to disclosed periodic rate(s);
- Statement of billing rights;
- Charges (other than finance charges), or explanation of how the charge is determined;
- If a security interest has been or will be taken in property purchased under the plan, or in other property identified by item or type.

Initial disclosures must also disclose when and how a finance charge will be imposed, including:

- When finance charges begin to accrue.
- Whether there is any grace period for repayment without incurring a finance charge.
- Disclosure of each periodic rate used to compute the finance charge (there may be different rates for purchases versus cash advances). When different rates apply, the type of the transaction pertaining to each rate must be identified.
- The method used to determine the balance on which the finance charge will be computed.

- The method used to calculate the finance charge.

Finance Charge Resulting from Two or More Periodic Rates

Some credit unions 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 credit union 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

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.

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 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. 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.
    1. 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.

2. 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.
3. Interest, which is defined by state or other federal law, is not defined by Regulation Z.

- The payment schedule, which does not necessarily include only principal and interest (P + I) payments. 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.

Annual Percentage Rate (Open-End Credit) Accuracy Tolerance

The disclosed annual percentage rate (APR) on an open-end credit account is accurate if it is within one-eighth of 1 percentage point of the APR calculated under Regulation Z, §226.14.

Determination of APR

The regulation states two basic methods for determining the APR in open-end credit transactions. The first involves multiplying each periodic rate by the number of periods in a year. This method is used for disclosing:

- 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. In other words, it does not involve any particular finance charge or periodic balance. The second method is the "quotient" method used in computing the APR for periodic statements. [(226.14(c)(2)] This method refers to a composite APR when different periodic rates apply to different balances. This rate will differ from the corresponding APR if the credit union applies minimum, fixed, or transaction charges to the account during the cycle. If the finance charge is determined by applying one or more periodic rates to a balance, and does not include any of the charges just mentioned, the credit union may compute the APR using the quotient method.

Alternatively, the credit union may use the method of multiplying each periodic rate by the number of periods in the year for computing the corresponding APR. If the finance charge includes a minimum, fixed, or transaction charge, the credit union must use the appropriate variation of the quotient method.

The regulation also contains a computation rule for small finance charges. If the finance charge includes a minimum, fixed, or transaction charge, and the total finance charge for the cycle does not exceed 50 cents, the credit union may multiply each applicable periodic rate by the number of periods in a year to compute the APR. Optional calculation methods also are provided for accounts involving daily periodic rates. [(226.14(d)]

Subpart C—Closed-end Credit [§s 226.17 through 226.24]

Subpart C includes provisions for closed-end credit.. Closed-end credit plans include direct installment loans by financial institutions, purchased dealer paper, single payment (time) loans, mortgage loans, demand loans or any other credit arrangement that does not fall within the definition of open-end credit. Subpart C also contains disclosure rules for regular and variable rate loans, refinancings and assumptions, credit balances, calculating annual percentage rates, and advertising closed-end credit.

Finance Charge (Closed-End Credit)
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.

Construction Loans
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. Additional guidance for construction loans can be found within the regulation and staff commentary.

Annual Percentage Rate Accuracy Tolerance (Closed-End Credit)
Whichever method is used by the credit union, 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. Credit unions 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

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 §226.22(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 §226.22(a)(3).

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 is legally accurate, it would not be subject to reimbursement. Under Regulation Z, finance charge disclosures for open-end credit must be accurate. However, since closed-end credit transactions occur in many forms and may have numerous complexities, Regulation Z permits various finance charge accuracy tolerances for closed-end credit. Tolerances for the finance charge and other disclosures affected by any finance charge are generally $5 if the amount financed is less than or equal to $1,000 and $10 if the amount financed exceeds $1,000. For certain transactions consummated on or after September 30, 1995, those tolerances are superseded.

- Credit secured by real property or a dwelling (closed-end credit only):
  1. The disclosed finance charge is considered accurate if it does not vary from the actual finance charge by more than $100.
  2. Overstatements are not violations.
- Rescission rights after the three-business-day rescission period (closed end credit only):
  1. 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.
  2. 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 refinancings of residential mortgage transactions when the new loan is made at a different credit union. NOTE: This excludes high cost mortgage loans subject to 12 CFR 226.32, transactions in which there are new advances, and new consolidations.

Rescission rights in foreclosure: The disclosed finance charge is considered accurate if it does not vary from the actual finance charge by more than $35. Overstatements are not considered violations. NOTE: Normally, the finance charge tolerance for a rescindable transaction is either 0.5 percent of the credit transaction or, for certain refinancings, 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.

<u>Special Requirements</u>

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. 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 credit union's failure to disclose those values accurately can result in significant monetary damages to the credit union, either from a class action law suit or from a regulatory agency's order to reimburse consumers for violations of law. If an annual percentage rate 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 credit union.
- Upon discovery of the error, the credit union promptly discontinues use of that calculation tool for disclosure purposes.
- The credit union notifies the Federal Reserve Board in writing of the error in the calculation tool.

When a credit union claims a calculation tool was used in good faith, the credit union assumes a reasonable degree of responsibility for ensuring that the tool in question provides the accuracy required by the regulation. For example, the credit union might verify the results obtained using the tool by comparing those results to the figures obtained by using another calculation tool. The credit union 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.

Calculating the Annual Percentage Rate

The APR must be determined under one of the following:

- The actuarial method, which is defined by Regulation Z and explained in appendix J.
- The Federal Reserve's Regulation Z Annual Percentage Rate Tables 226.22(b).
- The accrual method, U.S. Rule.

Variable Rate Information

If the terms of the legal obligation allow the credit union, after consummation of the transaction, to increase the APR, the credit union 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 variable rate disclosure requirements under 226.19(b) follow.

- Booklet titled "Consumer Handbook on Adjustable Rate Mortgages" or suitable substitute (when secured by principal residence).
- The fact that the interest rate, payment, or term of the loan can change.

- The index or formula used in making adjustments and the source of information about the index or formula.
- How the interest rate and payment will be determined, including how the index is adjusted (such as by addition of a margin).
- A statement that the consumer should ask about the current margin and interest rate, or that the interest rate is discounted and the amount of discount.
- The frequency of interest rate and payment changes.
- Any rules relating to changes in index, interest rate, payment amount, and outstanding loan balance, including for example, an explanation of interest rate or payment limitations, negative amortization, and interest rate carryover.
- A 15-year historical example, using the most recent 15 years, based on a $10,000 loan, illustrating how payments and loan balance would have been affected by interest rate changes implemented according to the terms of the loan program. All significant loan program terms will be considered in the example.
- How the consumer may calculate the payments for the loan amount to be borrowed based on the most recent payment shown in the historical example.
- Maximum interest rate and payment for a $10,000 loan originated at the most recent interest rate shown in the historical example, assuming maximum periodic increases in rates and payments under the program; and the initial interest rate and payment for the loan.
- That the loan program contains a demand feature.
- The type of information provided in adjustment notices, and timing of the notices.
- A statement that the disclosure forms are available for the creditor's other variable-rate loan programs.

Amount Financed- 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, precomputed, 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 precomputed), 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.

Required Deposit

A required deposit, with certain exceptions, is one which the credit union 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.

Refinancings

Generally, when an obligation is satisfied and replaced by a new obligation 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, §226.20(a). The following transactions are not considered refinancings 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 credit union:

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

Subpart D Miscellaneous [§s 226.25 through 226.30]

Subpart D applies to both open-end and closed-end credit. It sets forth the duty of credit unions to retain evidence of compliance with the regulation. It also clarifies the relationship between the regulation and state law and requires credit unions to set and disclose a cap for variable rate transactions secured by a consumer's dwelling.

Use of Annual Percentage Rate in Oral Disclosures. [§226.26]

(a) Open-end credit. In an oral response to a consumer's inquiry about the cost of open-end credit, only the annual percentage rate or rates shall be stated, except that the periodic rate or rates also may be stated. If the annual percentage rate cannot be determined in advance because there are finance charges other than a periodic rate, the corresponding annual percentage rate shall be stated, and other cost information may be given.

(b) Closed-end credit. In an oral response to a consumer's inquiry about the cost of closed-end credit, only the annual percentage rate shall be stated, except that a simple annual rate or periodic rate also may be stated if it is applied to an unpaid balance. If the annual percentage rate cannot be determined in advance, the annual percentage rate for a sample transaction shall be stated, and other cost information for the consumer's specific transaction may be given.

Relationship to State Law

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. For example, a state law would be preempted if it required a credit union to include in the finance charge any fees that the federal law excludes, such as seller's points.
- Chapter 2, "Credit Transactions," which contains disclosure requirements, rescission rights, and certain credit card provisions. For example, a state law would be preempted if it required a credit union to use the terms "nominal annual interest rate" in lieu of "annual percentage rate."
- Chapter 3, "Credit Advertising," which contains consumer credit advertising rules and annual percentage rate oral disclosure requirements.

Conversely, state law provisions may be appropriate and are not preempted under federal law if they call for, without contradicting chapters 1, 2, or 3 of the TILA or the implementing §s 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.

Limitation on rates [§226.30]

A credit union shall include in any consumer credit contract secured by a dwelling and subject to the act and this regulation the maximum interest rate that may be imposed during the term of the obligation when:

- In the case of closed-end credit, the annual percentage rate may increase after consummation, or
- In the case of open-end credit, the annual percentage rate may increase during the plan.

Subpart E --Special Rules for Certain Home Mortgage Transactions [§s 226.31 through 226.33)]

Subpart E includes disclosure and other requirements for home mortgage transactions having rates or fees above a certain percentage or amount (closed-end credit only) and disclosure requirements for reverse mortgage transactions (open-end and closed-end credit).

Subpart F –Electronic Communication [§ 226.36)]

Subpart F allows creditors to deliver disclosures electronically if they obtain borrowers' consent in accordance with the Electronic Signatures in Global and National Commerce Act (E-Sign Act). In addition, the regulation allows creditors to provide disclosures in foreign languages. It does not affect any requirement imposed under this part other than a requirement that disclosures be in a paper form, and it does not affect the content or timing of disclosures. Electronic disclosures are subject to the regulation's format, timing and retainability rules and the clear and conspicuous standard.

<u>Clear and conspicuous standard</u>

A creditor must provide electronic disclosures using a clear and conspicuous format. Also in accordance with the E-Sign Act the creditor must:

- The credit must disclose the requirements for accessing and retaining disclosures in that format;
- The borrower must demonstrate the ability to access the information electronically and consent to electronic delivery.
- The creditor must provide the disclosures in accordance with the specified requirements.

<u>Timing and effective delivery when a borrower becomes obligated on-line</u>

When a creditor permits the borrower to consummate a closed-end transaction on-line, the borrower must be required to access the disclosures required under § 226.18 before becoming obligated. A link to the disclosures satisfies the timing rule if the borrower

cannot bypass the disclosures prior to becoming obligated. Or the creditor may use the option to automatically display the disclosures on the screen. The creditor is not required to confirm that the borrower has read the disclosures.

For disclosures that are not required to be separated and may be combined into the text of another document, the creditor may satisfy the requirement to provide the disclosures if the document appears automatically or via a nonbypassable link.

Timing and effective delivery for disclosures provided periodically

Disclosures provided by e-mail are timely based on when the disclosures are sent. Disclosures posted at an Internet web site such as periodic statements, or change-in-terms and other notices are timely when the creditor has made both disclosures available and sent a notice alerting the borrower that the disclosures are posted. For example, under § 226.9, creditors offering open-end plans must provide a change-in-terms notice to borrowers at least 15 days in advance of certain changes. For a change-in-terms notice posted on the Internet, a creditor must post both the notice and notify borrowers to its availability at least 15 days in advance of the change.

Retainability of disclosures

Creditors satisfy the requirement that disclosures be in a form that the borrower may keep if electronic disclosures are delivered in a format that is capable of being retained by printing or storing electronically. The format must also be consistent with the information required to be provided under section 101 (c)(1)(C)(i) of the E-Sign Act (15 U.S.C. 7001 (c)(1)(C)(i)) about the hardware and software requirements for accessing and retaining electronic disclosures.

Disclosures provided on creditor's equipment

A creditor that controls the equipment providing electronic disclosures to borrowers (for example, a computer terminal in the creditor's lobby) must ensure that the equipment satisfies the regulation's requirements to provide timely disclosures in a clear and conspicuous format and in a form that the borrower may keep.

Electronic address

A borrower's electronic address is an e-mail address that is not limited to receiving communications transmitted solely by the creditor.

Identifying accounts

A creditor may identify a specific account in a variety of ways and is not required to identify an account by reference to the account number.

90 day rule

The actual disclosures provided to a borrower must be available for at least 90 days, but the creditor has discretion to determine whether they should be available at the same location for the entire period.

E-mail returned as undeliverable

If an e-mail to the borrower (containing an alert notice or other disclosure) is returned undeliverable, the redelivery requirement is satisfied if the creditor sends the disclosure to a different e-mail address or postal address that the creditor has on file for the borrower. Sending the disclosures a second time to the same electronic address is not sufficient if the creditor has a different address on file.

Associated Risks

- Compliance risk can occur when the credit union fails to implement the necessary controls to comply with Regulation Z;
- Transaction risk can occur when the credit union does not have adequate internal controls in place and as a result suffers a loss;
- Reputation risk can occur when the credit union incurs fines and penalties or receives decreased member confidence as a result of failure to comply with Regulation Z; and
- Strategic risk occurs when the board of directors fails to perform necessary due diligence in reviewing existing and prospective products and services for compliance.

Additional Information

Refer to the Home Ownership and Equity Protection Act (HOEPA) for additional requirements on certain real estate transactions. Additional information is available on the Federal Reserve Board's website at http://www.federalreserve.gov/ .

TRUTH IN LENDING ACT (REGULATION Z)

OPERATIONAL REQUIREMENTS

Disclosures / Notices

Open-end Disclosures / Notices

Early Disclosures: Credit Card Applications and Solicitations [§ 226.5a].
The credit union must disclose the items listed under § 226.5a(b) on or with a solicitation or an application to open a credit or charge card account. Most of the disclosed items must be provided in a prominent location in the form of a table with headings, content, and format substantially similar to any of the applicable tables found at Appendix G of the regulation. The other disclosures must be provided either in the table or clearly and conspicuously elsewhere on or with the application or solicitation. Note special rules for disclosures in connection with:

- Direct-mail and electronic applications and solicitations § 226.5a(c)
- Telephone applications and solicitations § 226.5a(d)
- Applications and solicitations made available to the general public § 226.5a(e)

Early Disclosures: Home-Equity Plan Applications [§ 226.5b]
The credit union must provide:

- The disclosures set forth in § 226.5b(d) (grouped together and segregated from all unrelated information), and
- The home equity brochure referenced in § 226.5b(e) in connection with applications for open-end credit plans secured by the consumer's dwelling.

The disclosures and brochure must be provided at the time the application is furnished to the consumer, or no later than three business days after receiving a telephone application, an application from a magazine or other publication, or an application through an intermediary agent or broker.

Initial Disclosure Statement [§ 226.5(b)(1) and 226.6]
The credit union must provide the initial disclosure statement containing the items described in § 226.6 before the first transaction is made under the open-end credit plan.

Periodic Statement [§s 226.5(b)(2) and 226.7]
In connection with open-end credit transactions, the credit union must mail or deliver a periodic statement for each billing cycle ending with a debit or credit balance of more than $1 or on which a finance charge has been imposed. The periodic statement must be delivered at least 14 days prior to the date by which or the time period within which the new balance (or any portion thereof) must be paid to avoid additional finance charges.

The periodic statement must include the items specified in § 226.7, to the extent applicable.

Disclosures: Supplemental Credit Devices and Additional Features [§ 226.9(b)]
If a credit union adds a credit feature or furnishes a credit device on the same finance charge terms after 30 days following delivery of the initial disclosure statement, the credit union must disclose that it is for use in obtaining credit under the terms previously disclosed before the consumer uses the feature or device for the first time. If a credit feature is added or a credit device furnished, and the finance charge terms for the feature or device differ from the previously disclosed, the credit union must provide the applicable disclosures from § 226.6(a) before the consumer uses the new feature or device.

Change in Terms Notice [§ 226.9(c)(1) and (2)]
The credit union must provide a 15 day advance written notice to each consumer affected by a change in any term disclosed in the initial disclosure statement or an increase in the required minimum periodic payment. No notice is required in the case of late-payment charges, over-the-limit charges, consumer default or delinquency, or any other related occurrences detailed in § 226.9(c)(2).

Notice for Home-Equity Plans [§ 226.9(c)(3)]
If a credit union prohibits additional extensions of credit or reduces the credit limit applicable to a home-equity plan (based on § 226.5b(f)(3)(i) or (vi)), written notice of the action must be mailed or delivered to each affected consumer not later than three business days after the action is taken. The notice must contain specific reasons for the action, and if reinstatement of credit privileges must be requested by the consumer, the notice must state that fact.

Disclosures upon Renewal of Credit Card [§ 226.9(e)]
A card issuer that imposes any annual or other periodic fee for the renewal of a credit card account (including fees based on account activity or inactivity) must mail or deliver written notice of the renewal to the cardholder, containing the information and provided within time frame set forth in § 226.9(e).

Change in Credit Card Account Insurance Provider [§ 226.9(f)]
A card issuer must mail or deliver written notice of any intended change in the provider of insurance for repayment of all or part of the outstanding balance of an open-end credit card account not less than 30 days before the change occurs. The notice must include the items specified in § 226.9(f)(1), as applicable. The card issuer must also provide written notice after the change, including certain additional information specified in § 226.9(f)(2), as applicable. A combined notice may be provided if mailed or delivered not less than 30 days before the change.

Liability of Cardholder for Unauthorized Use [§ 226.12(b)]
A cardholder may not be held liability for unauthorized use of a credit card unless the card issuer has provided “adequate notice” of (1) the cardholder’s maximum potential

liability and (2) the means by which the card issuer may be notified of loss or theft of the card. The notice must state that the cardholder's liability will not exceed $50 (or a lesser amount) and that the cardholder may give oral or written notification. It must also describe a means of notification, such as a telephone number, an address, or both. "Adequate notice" means a printed notice that clearly lays out the pertinent facts so that the cardholder may reasonably be expected to have noticed it and understood its meaning. It may be given by any means reasonably assuring receipt by the cardholder.

Notification to Card Issuer Regarding Unauthorized Use [§ 226.12(b)(3)]
A cardholder is considered to have furnished notification to a card issuer when reasonable steps have been taken to provide the card issuer with the pertinent information about the loss, theft, or possible unauthorized use of a credit card. Notification may be given in person, by telephone, or in writing.

Billing Error Notice [§ 226.13(b)]
A consumer may assert that the occurrence of a "billing error" (see § 226.13(a) for specific definition) by providing a written notice that (1) is received by the credit union within 60 days after transmission of the periodic statement reflecting the error; (2) enables the credit union to identify the consumer's name and account number; and (3) indicates the perceived reasons that an error exists and the type, date and amount of the error.

Credit union Response to Billing Error Investigation [§ 226.13(c), (e), (f), and (g)]
The credit union must provide, within the required time periods, the appropriate notification(s) to the consumer in response to a billing error notice following a reasonable investigation. The type of notice(s) to be delivered depends upon whether the credit union determines that a billing error has occurred as asserted or whether a different billing error or no billing error has occurred.

Notice of Right to Rescind [§ 226.15]
In any transaction subject to rescission, the credit union must deliver two copies of the notice of the right to rescind to each consumer entitled to rescind which contains the information and is in the format specified in § 226.15(b).

Notice of Exercise of Right of Rescission [§ 226.15(a)]
To exercise the right to rescind, the consumer must notify the credit union of the rescission by mail, telegram, or other means of written communication within the specified time period.

Consumer's Waiver of Right to Rescind [§ 226.15(e)]
The consumer may modify or waive the right to rescind if the consumer determines that the credit extension is needed to meet a bona fide personal emergency. To modify or waive the right to rescind, the consumer must take the following action: provide the credit union a dated written statement that describes the emergency, specifically modifies or waives the right to rescind, and bears the signatures of all the consumers entitled to rescind.

Use of Annual Percentage Rate in Oral Disclosure [§ 226.26(a)]
In response to a consumer's inquiry about the cost of open-end credit, the credit union is allowed to state only the annual percentage rate(s), except that the periodic rate(s) also may be stated.

Closed-End Credit Disclosures [§s 226.17 and 18]
Prior to the consummation of a closed-end credit transaction, the credit union must provide the disclosures required by § 226.18 in a clear and conspicuous written form that the consumer may keep. The disclosures must be grouped together and may not contain any unrelated information.

Early Good Faith Estimates of Disclosures [§ 226.19(a)]
In a residential mortgage transaction subject to RESPA, the credit union must make good faith estimates of the disclosures required by § 226.18 prior to consummation or must mail or deliver them not later than three business days after receipt of the consumer's written application, whichever is earlier. Redisclosure is required at the time of consummation under certain circumstances described in paragraph (a)(2).

Disclosures for Certain Variable Rate Transactions [§ 226.19(b)]
If the APR may increase after consummation of a transaction secured by the consumer's principal dwelling with a term greater than one year, the credit union must provide, at the time of application or before the consumer pays a nonrefundable fee (whichever is earlier), the following information detailed in § 226.19(b): (1) the Consumer Handbook on Adjustable Rate Mortgages and (2) a loan program disclosure for each variable-rate program of interest to the consumer containing the information described in § 226.19(b)(2).

Disclosures for Refinancings [§ 226.20(a)]
New disclosures must be provided to a consumer in connection with any "refinancing." A refinancing occurs when an existing obligation previously subject to Subpart C of Regulation Z is satisfied and replaced by a new obligation undertaken by the same consumer.

Disclosures for Assumptions [§ 226.20(b)]
Prior to the occurrence of an "assumption," the credit union must make new disclosures to the subsequent consumer, based on the remaining obligation. An "assumption" occurs when a credit union expressly agrees in writing with a subsequent consumer to accept that consumer as a primary obligor on an existing residential mortgage transaction.

Notice of Right to Rescind [§ 226.23]
In a transaction subject to rescission, the credit union must deliver two copies of the notice of the right to rescind to each consumer entitled to rescind which contains the information and is in the format specified in § 226.23(b).

Notice of Exercise of Right of Rescission [§ 226.23(a)]

To exercise the right to rescind, the consumer must notify the credit union of the rescission by mail, telegram, or other means of written communication within the specified time period.

Consumer's Waiver of Right to Rescind [§ 226.23(e)]
The consumer may modify or waive the right to rescind if the consumer determines that the credit extension is needed to meet a bona fide personal emergency by taking the following action: provide the credit union a dated written statement that describes the emergency, specifically modifies or waives the right to rescind, and bears the signature of all the consumers entitled to rescind.

Use of Annual Percentage Rate in Oral Disclosure [§ 226.26(b)]
In response to a consumer's inquiry about the cost of closed-end credit, the credit union is allowed to state only the annual percentage rate, except that a simple annual rate or periodic rate may also be stated if it is applied to an unpaid balance.

Spanish language disclosures. [§ 226.27]
Disclosures required by Regulation Z may be made in a language other than English, provided that the disclosures are made available in English upon the consumer's request. This requirement for providing English disclosures on request shall not apply to advertisements subject to § 226.16 and 226.24 of Regulation Z. Also, if a creditor in Puerto Rico provides initial disclosures in Spanish, subsequent disclosures need not be in Spanish. For example, periodic statements and change-in-terms notices may be made in English.

Disclosures for Certain Closed-End and Reverse Mortgages [§ 226.31, 32 and 33]
Special disclosure requirements apply in the case of (i) certain closed-end home mortgages (where the APR or total points and fees payable by the consumer exceed a prescribed amount) as described in § 226.32 and (ii) reverse mortgages as defined in § 226.33. The content of the disclosures for these two types of mortgages is defined in §s 226.32 and 226.33, respectively, and the form, timing and other aspects of these disclosures are described in § 226.31.

The appendices to the regulation set forth model forms and clauses that credit unions may use when providing open-end and closed-end disclosures. The appendices also contain detailed rules for calculating the APR for open-end credit (appendix F) and closed-end credit (appendixes D and J). Official staff interpretations of the regulation are published in a commentary that is normally updated annually in March. Good faith compliance with the commentary protects credit unions from civil liability under the act. It is difficult to comply with Regulation Z without reference to and reliance on the commentary.

Written Programs / Documentation

Procedures for Employee Training and Compliance
A credit union must establish and maintain procedures to ensure its compliance with the regulation. It must also provide a statement of applicable portions of the procedures to

employees who perform tasks subject to the requirements of the regulation.

Recordkeeping

Record Retention [§226.25]

The credit union is required to retain evidence of compliance with the regulation (other than the advertising requirements of [§s 226.16 and 226.24)] for two years after the date the disclosures are required to be made or action is required to be taken. The record retention period may be extended in the event that enforcement proceedings are initiated against the institution.

Advertising [§ (226.24]

(a) Actually available terms. If an advertisement for credit states specific credit terms, it shall state only those terms that actually are or will be arranged or offered by the credit union.

(b) Advertisement of rate of finance charge. If an advertisement states a rate of finance charge, it shall state the rate as an ``annual percentage rate," using that term. If the annual percentage rate may be increased after consummation, the advertisement shall state that fact. The advertisement shall 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 annual percentage rate.

(c) Advertisement of terms that require additional disclosures.

(1) If any of the following terms are set forth in an advertisement, the advertisement shall meet the requirements of paragraph (c)(2) of this section:
(i) The amount or percentage of any down payment; or
(ii) The number of payments or period of repayment; or
(iii) The amount of any payment; or
(iv) The amount of any finance charge.

(2) An advertisement stating any of the terms in paragraph (c)(1) of this section shall state the following terms, as applicable: An example of one or more typical extensions of credit with a statement of all the terms applicable to each may be used.
(i) The amount or percentage of the down payment.
(ii) The terms of repayment.
(iii) The annual percentage rate, using that term, and, if the rate may be increased after consummation, that fact.

(d) Catalogs and multiple-page advertisements.

(1) If a catalog or other multiple-page advertisement gives information in a table or

schedule in sufficient detail to permit determination of the disclosures required by paragraph (c)(2) of this section, it shall be considered a single advertisement if:
(i) The table or schedule is clearly set forth; and
(ii) Any statement of the credit terms in paragraph (c)(1) of this section appearing anywhere else in the catalog or advertisement clearly refers to the page on which the table or schedule begins.

(2) A catalog or multiple-page advertisement complies with paragraph (c)(2) of this section if the table or schedule of terms includes all appropriate disclosures for a representative scale of amounts up to the level of the more commonly sold higher-priced property or services offered.

Enforcement / Liability

Administrative Enforcement Authority
The TILA authorizes the National Credit Union Administration to require credit unions 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. The NCUA has discretion to order account adjustments for certain 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.) TILA requires federal regulatory agencies to order financial institutions to reimburse consumers when an 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, or
- 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 credit union may be maintained against any assignee of the credit union if the violation is apparent on the face of the disclosure statement or other documents assigned, except where the assignment was involuntary.

Civil Liability [§226.1(e), 15 U.S.C. §1640]
If a credit union 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(s), and
- In a successful action, the cost of any legal action together with reasonable attorney's fees as determined by the court.

If it violates certain requirements of the TILA, the credit union also may be held liable for either of the following:

- In an individual action, twice the amount of the finance charge involved or, for closed-end credit secured by real property or a dwelling, not less than $200 or more than $2,000;
- In a class action, such amount as the court may allow. The total amount of recovery, however, cannot be more than $500,000 or 1 percent of the credit union's net worth, whichever is less.

Civil actions that may be brought against a credit union also may be maintained against any assignee of the credit union if the violation is apparent on the face of the disclosure statement or other documents assigned, except where the assignment was involuntary.

Criminal Liability [15 U.S.C. §1611]
Anyone who willingly and knowingly fails to comply with any requirement of the TILA may be fined not more than $5,000 or imprisoned not more than one year, or both.

Specific Defenses
Defense Against Civil, Criminal, and Administrative Actions. A credit union in violation of TILA may avoid liability by:

- Discovering the error before an action is brought against the credit union, or before the consumer notifies the credit union, in writing, of the error;
- Notifying the consumer of the error within 60 days of discovery; and
- 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 credit union to avoid a regulatory order to reimburse the borrower.

When a disclosure error occurs, the credit union is not required to re-disclose after a loan has been consummated or an account has been opened. If the credit union corrects a disclosure error by merely re-disclosing required information accurately, without adjusting the consumer's account, the credit union may still be subject to civil liability and an order to reimburse from its regulator. The circumstances under which a credit union 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 credit union 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 credit union is unable to produce evidence that explicitly indicates it has an internal controls program designed to ensure compliance.

The credit union’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.