FEDERAL RESERVE SYSTEM

12 CFR Part 226

[Regulation Z; Docket No. R-0942]

Truth in Lending

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule; official staff interpretation.

SUMMARY: The Board is publishing revisions to the official staff commentary to Regulation Z (Truth in Lending). The commentary applies and interprets the requirements of Regulation Z. The update provides guidance on issues relating to the treatment of certain fees paid in connection with mortgage loans. It addresses new tolerances for accuracy in disclosing the amount of the finance charge and other affected cost disclosures. In addition, the update discusses issues such as the treatment of debt cancellation agreements and a creditor's duties if providing periodic statements via electronic means.

DATES: This rule is effective February 28, 1997. Compliance is optional until October 1, 1997.

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SUPPLEMENTARY INFORMATION:

I. Background

The purpose of the Truth in Lending Act (TILA; 15 U.S.C. 1601 et seq.) is to promote the informed use of consumer credit by requiring disclosures about its terms and cost. The act requires creditors to disclose the cost of credit as a dollar amount (the finance charge) and as an annual percentage rate (the APR). Uniformity in creditors' disclosures is intended to assist consumers in comparison shopping. The TILA requires additional disclosures for loans secured by a consumer's home and permits consumers to rescind certain transactions that involve their principal dwelling. The act is implemented by the Board's Regulation Z (12 CFR Part 226). The Board's official staff commentary (12 CFR Part 226 (Supp. I)) interprets the regulation, and provides guidance to creditors in applying the regulation to specific transactions. The commentary is updated periodically to address significant questions that arise; it is a substitute for individual staff interpretations.

In November, the Board published proposed amendments to the commentary to Regulation Z (61 FR 60223, November 27, 1996). The Board received about 30 comments. Most of the comments were from financial institutions, mortgage lenders, insurance providers, and other creditors (or their representatives); about a half dozen were from consumer representatives and lawyers. Overall, commenters generally supported the proposed amendments. Views were mixed on a few comments, and some commenters expressed concerns about issues not addressed in the proposal. Except as discussed below, the commentary is being adopted as proposed; some technical suggestions or concerns raised by commenters are addressed. Compliance is optional until October 1, 1997, the effective date for mandatory compliance.

The revisions mainly incorporate guidance given in the supplementary information that accompanied September 1996 amendments to Regulation Z implementing the Truth in Lending Act Amendments of 1995 (Pub. L. 104-29, 109 Stat. 271). The rulemaking clarified the treatment of fees typically associated with real estate-related lending, and revised tolerances for finance charge calculations for loans secured by real estate or dwellings (61 FR 49237, September 19, 1996). It also addressed the treatment of fees charged in connection with debt cancellation agreements.

II. Commentary Revisions

Supplement I -- Official Staff Interpretations

Subpart A -- General

Section 226.4 -- Finance Charge

4(a) Definition

4(a)(1) Charges by Third Parties

Comment 4(a)(1)-1 illustrates the general rule that amounts charged by a third party are included in the finance charge if the creditor requires the use of a third party, even if the consumer may choose the service provider.

Comment 4(a)(1)-2 addresses the treatment of annuity premiums associated with some reverse mortgages. The proposal treated the cost of the premiums as a finance charge when the purchase of an annuity is effectively required incident to the credit. Commenters expressed concern about uncertainties that could result from such a test; the “effectively required” standard has been deleted for clarity.

4(a)(2) Special Rule; Closing Agent Charges

Comment 4(a)(2)-1 is revised and a new comment 4(a)(2)-2 is added to address commenters' requests for further guidance about the treatment of charges by third-party closing agents when the creditor requires the use of a closing agent. Comment 4(a)(2)-2 provides examples of the types of fees charged by a closing agent that may be excluded from the finance charge, even though the creditor requires the use of a closing agent.

4(a)(3) Special Rule; Mortgage Broker Fees

Two comments addressing the treatment of mortgage broker fees were proposed. These comments are adopted with some modification for clarity, and a third comment is added. Under the 1995 Amendments, mortgage broker fees paid by the borrower are finance charges unless otherwise excluded. Comment 4(a)(3)-1 clarifies that mortgage brokers' fees may be excluded from the finance charge if the fee would be excluded when charged by the creditor. To illustrate the rule, the comment discusses certain application fees as an example of fees charged by mortgage brokers that could be excluded from the finance charge.

New comment 4(a)(3)-2 addresses the scope of the special rule for mortgage broker fees. Commenters requested that the scope be clarified; some suggested defining the term "mortgage broker." Instead, the Board has clarified that the special rule for mortgage broker fees applies to consumer credit transactions secured by real property or a dwelling. The Board believes this interpretation carries out the purposes of the 1995 Amendments, and simplifies compliance by using existing definitions in the regulation rather than adding a new one.

Comment 4(a)(3)-3, redesignated from the proposal and revised for clarity, addresses the treatment of compensation paid by the creditor to a mortgage broker.

4(c) Charges Excluded From the Finance Charge

Paragraph 4(c)(5)

Comment 4(c)(5)-2, adopted substantially as proposed, addresses the treatment of finance charges paid by a noncreditor seller on a consumer's behalf before loan closing; it clarifies that disclosures should reflect the payment if the consumer is not legally bound to the creditor for the amount paid.

4(d) Insurance and Debt Cancellation Coverage

4(d)(3) Voluntary Debt Cancellation Fees

The comments are adopted as proposed, with minor revisions for clarity. Several commenters, including a credit insurance provider, disagreed with the Board's interpretation of section 226.4(d)(3), which in their view is not consistent with the TILA. These commenters objected to the proposed comments on the same grounds.

Comment 4(d)(3)-2 clarifies that although debt cancellation coverage and credit insurance are treated similarly for purposes of cost disclosures under the TILA, state law governs whether a creditor may represent that debt cancellation coverage is insurance. A provider of credit insurance commented that creditors should be permitted to disclose debt cancellation fees as insurance premiums only if the coverage is regulated by the state as insurance. Regulation Z does not provide a definition of insurance for purposes of the TILA, and under § 226.2(b)(3) the term's meaning is determined by state law -- which may or may not take account of the extent to which the particular product is regulated by the state. Consequently, the comments are adopted substantially as proposed.

4(e) Certain Security Interest Charges

Section 226.4(e) excludes certain security interest charges paid to public officials from the finance charge if the amounts are itemized and disclosed. A new § 226.4(e)(3) was added to implement a provision in the 1995 Amendments which excludes from the finance charge taxes levied on security instruments or on documents evidencing indebtedness that must be paid to record the security instrument. Comments 4(e)-1 (adopted substantially as proposed) and -2 are revised to reflect the recent amendment to § 226.4(e)(3).

Subpart B -- Open-end Credit

Section 226.5 -- General Disclosure Requirements

5(b) Time of Disclosures
5(b)(2) Periodic Statements
Paragraph 5(b)(2)(ii)

An addition to comment 5(b)(2)(ii)-3 is made to clarify that periodic statements may be provided electronically, for example, via home banking systems. Commenters generally supported the proposal and encouraged the Board to provide further guidance on how to adapt current rules to the way electronic disclosures may used. A review is now underway that will seek to adapt current rules under the Board's Truth in Lending and other consumer protection regulations to the way electronic disclosures may be provided and retained, responding to technological developments in the way financial service transactions are conducted via electronic means.

Subpart C -- Closed-end Credit

Section 226.17 -- General Disclosure Requirements

17(c) Basis of Disclosures and Use of Estimates
Paragraph 17(c)(2)(ii)

Comment 17(c)(2)(ii)-1 addresses the new rule applicable to the disclosure of per-diem interest charges. Under the rule, the disclosure of any numerical amount affected by the per-diem interest charge is considered accurate if it is based on the information known to the creditor at the time the disclosure is prepared, whether or not the disclosure of per-diem interest is accurate when it is received by the consumer. The comment clarifies that, in such cases, the resulting finance charge is considered accurate without regard to the tolerance for errors under § 226.18(d)(1). In response to requests for guidance, the comment clarifies that disclosures may be considered accurate under this rule without regard to whether they were labeled as estimates.

Section 226.18 -- Content of Disclosures

18(c) Itemization of Amount Financed

Comment 18(c)-4 is adopted substantially as proposed. Some commenters expressed concern that this comment imposed additional disclosure requirements. This is not the case. The comment is meant to streamline disclosure requirements for transactions that are also covered by Real Estate Settlement Procedures Act (RESPA) by allowing -- not requiring -- creditors to substitute the good faith estimate or the HUD-1 settlement statement for the itemization of the amount financed. Guidance is added regarding the format requirements for these disclosures.

A proposed revision to comment 18(c)(1)(iv)-2 responded to a proposal by the Department of Housing and Urban Development (HUD) to change the way that the amount collected at closing for escrow items is reflected on the HUD-1 for RESPA purposes (61 FR 46511, September 3, 1996). The Board is withdrawing the proposed revision given that HUD has not yet taken final action on its proposal.

Section 226.22 -- Determination of the Annual Percentage Rate

22(a) Accuracy of the Annual Percentage Rate
Paragraphs 22(a)(4) and 22(a)(5)

Section 226.22(a)(4) and 22(a)(5) provide APR tolerances for mortgage loans when the finance charge has been misstated but is considered accurate. The comments provide specific examples of these tolerances. Minor revisions have been made for clarity.

Section 226.23 -- Right of Rescission

23(h) Special rules for foreclosures
Paragraph 23(h)(1)(i)

Section 226.23(h), which implements section 125(i) of the TILA, contains special rescission rules that apply after a foreclosure action has been initiated. Section 226.23(h)(1) allows a consumer to rescind a loan in foreclosure if a mortgage broker fee that should have been included in the finance charge under the laws in effect at consummation was not included. Section 226.23(h)(2) contains a separate finance charge tolerance of $35 for loans in foreclosure; such loans may be rescinded if the finance charge was understated by more than $35. Comment 23(h)(1)(i)-1 is intended to clarify the relationship between these two provisions.

As proposed, the comment interpreted § 226.23(h)(1) to allow rescission if a mortgage broker fee was omitted from the finance charge entirely or if it was understated, without regard to the dollar amount involved. Under that interpretation, any finance charge understatement traceable to a misstatement of a mortgage broker fee would allow rescission of a loan in foreclosure; the $35 finance charge tolerance in § 226.23(h)(2) would not apply. Several commenters objected to this interpretation and expressed the view that the $35 finance charge tolerance should also apply to the rescission rights granted under § 226.23(h)(1)(i). They believed that the $35 tolerance in § 226.23(h)(2) provides the applicable rule for determining whether a mortgage broker fee has been included "in accordance with the laws and regulations in effect" at the time the loan was consummated. They noted that otherwise, creditors would be liable for inadvertent and technical errors--for example, if a mortgage broker fee was rounded down from fractional to whole dollar amounts. The commenters argued that this would be inconsistent with the purpose of the 1995 Amendments as a whole, which was to reduce lender liability for small technical errors.

Upon further analysis and after consideration of the comments received, a narrower interpretation of § 226.23(h)(1)(i) has been adopted. The Board believes that this narrower interpretation is consistent with the intent of section 125(i) of the TILA. The $35 tolerance in § 226.23(h)(2) reduces creditors' potential liability by replacing the $10 tolerance that applied before the 1995 Amendments became effective. Accordingly, comment 23(h)(1)(i)-1 clarifies that for loans in foreclosure, a right of rescission exists under § 226.23(h)(1)(i) only if the entire mortgage broker fee has been omitted from the finance charge. If the amount of a mortgage broker fee is misstated, the consumer's right to rescind is based on the rule in § 226.23(h)(2). A new comment 23(h)(2)-1 has been added to clarify that the $35 tolerance is based on the total finance charge and not its component charges.

Subpart E -- Special Rules for Certain Home Mortgage Transactions

Section 226.31 -- General Rules

31(d) Basis of Disclosures and Use of Estimates
31(d)(3) Per-diem Interest

Several commenters noted that a comment to paragraph 31(d)(3) like the comment to 17(c)(2)(ii) would be useful; a conforming comment has been added.

Section 33 -- Requirements for Reverse Mortgages

33(a) Definition
Paragraph 33(a)(2)

Comment 33(a)(2)-2, which addresses reverse mortgages, is adopted substantively as proposed.

List of Subjects in 12 CFR Part 226

Advertising, Banks, banking, Consumer protection, Credit, Federal Reserve System, Mortgages, Reporting and recordkeeping requirements, Truth in lending.

For the reasons set forth in the preamble, the Board amends 12 CFR Part 226 as follows:

PART 226 -- TRUTH IN LENDING (REGULATION Z)

1. The authority citation for part 226 continues to read as follows:

Authority: 12 U.S.C. 3806; 15 U.S.C. 1604 and 1637(c)(5).

2. In Supplement I to Part 226, under Introduction, the last sentence in paragraph 5. is revised to read as follows:

Supplement I--Official Staff Interpretations

Introduction

* * * * *

5. Comment designations. ***Comments to the appendices may be cited, for example, as Comment app. A-1.

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3. Supplement I to Part 226, under Section 226.2--Definitions, under paragraph 2(a)(25), is amended by removing the last two sentences of the second undesignated paragraph of paragraph 6.

4. In Supplement I to Part 226, under Section 226.4--Finance Charge, the following amendments are made:

a. Under 4(a) Definition., paragraphs 3. and 4. are removed and paragraphs 5. through 7. are redesignated as paragraphs 3. through 5., respectively, and new paragraphs 4(a)(1), 4 (a)(2), and 4(a)(3) are added after the end of the text of 4(a);

b. Under 4(b) Examples of finance charges., a new paragraph 4(b)(10) is added;

c. Under 4(c) Charges excluded from the finance charge., under paragraph 4(c)(5)., paragraph 2. is revised;

d. Under paragraph 4(d), the paragraph heading is revised, and a new paragraph 4(d)(3) is added; and

e. Under 4(e) Certain security interest charges., paragraphs 1.i. and 2. are revised.

The additions and revisions read as follows:

Subpart A -- General

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Section 226.4--Finance Charge

4(a) Definition.

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4(a)(1) Charges by third parties.

1. Choosing the provider of a required service. An example of a third-party charge included in the finance charge is the cost of required mortgage insurance, even if the consumer is allowed to choose the insurer.

2. Annuities associated with reverse mortgages. Some creditors offer annuities in connection with a reverse mortgage transaction. The amount of the premium is a finance charge if the creditor requires the purchase of the annuity incident to the credit. Examples include the following:

i. The credit documents reflect the purchase of an annuity from a specific provider or providers.

ii. The creditor assesses an additional charge on consumers who do not purchase an annuity from a specific provider.

iii. The annuity is intended to replace in whole or in part the creditor's payments to the consumer either immediately or at some future date.

4(a)(2) Special rule; closing agent charges.

1. General. This rule applies to charges by a third party serving as the closing agent for the particular loan. An example of a closing agent charge included in the finance charge is a courier fee where the creditor requires the use of a courier.

2. Required closing agent. If the creditor requires the use of a closing agent, fees charged by the closing agent are included in the finance charge only if the creditor requires the particular service, requires the imposition of the charge, or retains a portion of the charge. Fees charged by a third-party closing agent may be otherwise excluded from the finance charge under § 226.4. For example, a fee that would be paid in a comparable cash transaction may be excluded under § 226.4(a); a lump-sum fee for real-estate closing costs may be excluded under § 226.4(c)(7).

4(a)(3) Special rule; mortgage broker fees.

1. General. A fee charged by a mortgage broker is excluded from the finance charge if it is the type of fee that is also excluded when charged by the creditor. For example, to exclude an application fee from the finance charge under § 226.4(c)(1), a mortgage broker must charge the fee to all applicants for credit, whether or not credit is extended.

2. Coverage. This rule applies to charges paid by consumers to a mortgage broker in connection with a consumer credit transaction secured by real property or a dwelling.

3. Compensation by lender. The rule requires all mortgage broker fees to be included in the finance charge. Creditors sometimes compensate mortgage brokers under a separate arrangement with those parties. Creditors may draw on amounts paid by the consumer, such as points or closing costs, to fund their payment to the broker. Compensation paid by a creditor to a mortgage broker under an agreement is not included as a separate component of a consumer's total finance charge (although this compensation may be reflected in the finance charge if it comes from amounts paid by the consumer to the creditor that are finance charges, such as points and interest).

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4(b) Examples of finance charges.

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4(b)(10) Debt cancellation fees.

1. Definition. Debt cancellation coverage provides for payment or satisfaction of all or part of a debt when a specified event occurs. The term includes guaranteed automobile protection or "GAP" agreements, which pay or satisfy the remaining debt after property insurance benefits are exhausted.
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Paragraph 4(c)(5).
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2. Other seller-paid amounts. Mortgage insurance premiums and other finance charges are sometimes paid at or before consummation or settlement on the borrower's behalf by a noncreditor seller. The creditor should treat the payment made by the seller as seller's points and exclude it from the finance charge if, based on the seller's payment, the consumer is not legally bound to the creditor for the charge. A creditor who gives disclosures before the payment has been made should base them on the best information reasonably available.
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4(d) Insurance and debt cancellation coverage.
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4(d)(3) Voluntary debt cancellation fees.

1. General. Fees charged for the specialized form of debt cancellation agreement known as guaranteed automobile protection ("GAP") agreements must be disclosed according to § 226.4(d)(3) rather than according to § 226.4(d)(2) for property insurance.

2. Disclosures. Creditors can comply with § 226.4(d)(3) by providing a disclosure that refers to debt cancellation coverage whether or not the coverage is considered insurance. Creditors may use the model credit insurance disclosures only if the debt cancellation coverage constitutes insurance under state law.
* * * * *

4(e) Certain security interest charges.

1. Examples.

i. Excludable charges. Sums must be actually paid to public officials to be excluded from the finance charge under § 226.4(e)(1) and (3). Examples are charges or other fees required for filing or recording security agreements, mortgages, continuation statements, termination statements, and similar documents, as well as intangible property or other taxes even when the charges or fees are imposed by the state solely on the creditor and charged to the consumer (if the tax must be paid to record a security interest). (See comment 4(a)-5 regarding the treatment of taxes, generally.)

2. Itemization. The various charges described in § 226.4(e)(1) and (3) may be totaled and disclosed as an aggregate sum, or they may be itemized by the specific fees and taxes imposed. If an aggregate sum is disclosed, a general term such as security interest fees or filing fees may be used.
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5. In Supplement I to Part 226, under Section 226.5--General Disclosure Requirements, under Paragraph 5(b)(2)(ii)., paragraph 3. is revised to read as follows:
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Subpart B -- Open-End Credit

Section 226.5--General Disclosure Requirements
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5(b) Time of disclosures.
* * * * *

5(b)(2) Periodic statements.
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Paragraph 5(b)(2)(ii).
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3. Calling for periodic statements. The creditor may permit consumers to call for their periodic statements, but may not require them to do so. If the consumer wishes to pick up the statement and the plan has a free-ride period, the statement (including a statement provided by electronic means) must be made available in accordance with the 14-day rule.
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6. In Supplement I to Part 226, under Section 226.17--General Disclosure Requirements, the following amendments are made:

a. Under 17(c) Basis of disclosures and use of estimates., a new paragraph 17(c)(2)(ii) is added; and

b. Under 17(f) Early disclosures., paragraph 1. introductory text, 1.i., the last sentence of 1.ii. and 1.iii. is revised and a heading is added to paragraph 1.ii; and a new paragraph 17(f)(2) preceding 17(g) is added. The additions and revisions read as follows:
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Subpart C--Closed-End Credit

Section 226.17--General Disclosure Requirements
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17(c) Basis of disclosures and use of estimates.
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Paragraph 17(c)(2)(ii).

1. Per-diem interest. This paragraph applies to any numerical amount (such as the finance charge, annual percentage rate, or payment amount) that is affected by the amount of the per-diem interest charge that will be collected at consummation. If the amount of per-diem interest used in preparing the disclosures for consummation is based on the information known to the creditor at the time the disclosure document is prepared, the disclosures are considered accurate under this rule, and affected disclosures are also considered accurate, even if the disclosures are not labeled as estimates. For example, if the amount of per-diem interest used to prepare disclosures is less than the amount of per-diem interest charged at consummation, and as a result the finance charge is understated by $200, the disclosed finance charge is considered accurate even though the understatement is not within the $100 tolerance of § 226.18(d)(1), and the finance charge was not labeled as an estimate. In this example, if in addition to the understatement related to the per-diem interest, a $90 fee is incorrectly omitted from the finance charge, causing it to be understated by a total of $290, the finance charge is considered accurate because the $90 fee is within the tolerance in § 226.18(d)(1).
* * * * *

17(f) Early disclosures.

1. Change in rate or other terms. Redisclosure is required for changes that occur between the time disclosures are made and consummation if the annual percentage rate in the consummated transaction exceeds the limits prescribed in this section, even if the initial disclosures would be considered accurate under the tolerances in §§ 226.18(d) or 226.22(a). To illustrate:

i. General. A. If disclosures are made in a regular transaction on July 1, the transaction is consummated on July 15, and the actual annual percentage rate varies by more than ⅛ of 1 percentage point from the disclosed annual percentage rate, the creditor must either redisclose the changed terms or furnish a complete set of new disclosures before consummation. Redisclosure is required even if the disclosures made on July 1 are based on estimates and marked as such.

B. In a regular transaction, if early disclosures are marked as estimates and the disclosed annual percentage rate is within ⅛ of 1 percentage point of the rate at consummation, the creditor need not redisclose the changed terms (including the annual percentage rate).

ii. Nonmortgage loan. * * * (See § 226.18(d)(2) of this part.)

iii. Mortgage loan. At the time TILA disclosures are prepared in July, the loan closing is scheduled for July 31 and the creditor does not plan to collect per-diem interest at consummation. Consummation actually occurs on August 5, and per-diem interest for the remainder of August is collected as a prepaid finance charge. Assuming there were no other changes requiring redisclosure, the creditor may rely on the disclosures prepared in July that were accurate when they were prepared. However, if the creditor prepares new disclosures in August that will be provided at consummation, the new disclosures must take into account the amount of the per-diem interest known to the creditor at that time.
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Paragraph 17(f)(2).

1. Irregular transactions. For purposes of this paragraph, a transaction is deemed to be "irregular" according to the definition in footnote 46 of § 226.22(a)(3).
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7. In Supplement I to Part 226, under Section 226.18--Content of Disclosures, the following amendments are made:

a. Under 18(c) Itemization of amount financed., paragraph 4. is revised;

b. Under 18(d) Finance charge., a new paragraph 18(d)(2) is added; and

c. Under 18(n)., the paragraph heading is revised and a new paragraph 2. is added.

The additions and revisions read as follows:
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Section 226.18--Content of Disclosures
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18(c) Itemization of amount financed.
* * * * *

4. RESPA transactions. The Real Estate Settlement Procedures Act (RESPA) requires creditors to provide a good faith estimate of closing costs and a settlement statement listing the amounts paid by the consumer. Transactions subject to RESPA are exempt from the requirements of § 226.18(c) if the creditor complies with RESPA's requirements for a good faith estimate and settlement statement. The itemization of the amount financed need not be given, even though the content and timing of the good faith estimate and settlement statement under

RESPA differ from the requirements of §§ 226.18(c) and 226.19(a)(2). If a creditor chooses to substitute RESPA's settlement statement for the itemization when redisclosure is required under § 226.19(a)(2), the statement must be delivered to the consumer at or prior to consummation. The disclosures required by §§ 226.18(c) and 226.19(a)(2) may appear on the same page or on the same document as the good faith estimate or the settlement statement, so long as the requirements of § 226.17(a) are met.
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Section 226.18(d) Finance charge.
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18(d)(2) Other credit.

1. Tolerance. When a finance charge error results in a misstatement of the amount financed, or some other dollar amount for which the regulation provides no specific tolerance, the misstated disclosure does not violate the act or the regulation if the finance charge error is within the permissible tolerance under this paragraph.
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18(n) Insurance and debt cancellation.
* * * * *

2. Debt cancellation. Creditors may use the model credit insurance disclosures only if the debt cancellation coverage constitutes insurance under state law. Otherwise, they may provide a parallel disclosure that refers to debt cancellation coverage.
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8. In Supplement I to Part 226, under Section 226.19--Certain Residential Mortgage and Variable-Rate Transactions, under 19(a)(2) Redisclosure required., the first sentence of paragraph 1. is revised to read as follows:
* * * * *

Section 226.19--Certain Residential Mortgage and Variable-Rate Transactions
* * * * *

Paragraph 19(a)(2) Redisclosure required.

1. Conditions for redisclosure. Creditors must make new disclosures if the annual percentage rate at consummation differs from the estimate originally disclosed by more than ⅛ of 1 percentage point in regular transactions or ¼ of 1 percentage point in irregular transactions, as defined in footnote 46 of § 226.22(a)(3). * * *
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9. In Supplement I to Part 226, <u>Section 226.22--Determination of the Annual Percentage Rate</u>, is amended by adding new paragraphs 22(a)(4) and 22(a)(5) to read as follows:
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<u>Section 226.22--Determination of the Annual Percentage Rate</u>

<u>22(a) Accuracy of the annual percentage rate</u>.
* * * * *

<u>22(a)(4) Mortgage loans</u>.

1. <u>Example</u>. If a creditor improperly omits a $75 fee from the finance charge on a regular transaction, the understated finance charge is considered accurate under § 226.18(d)(1), and the annual percentage rate corresponding to that understated finance charge also is considered accurate even if it falls outside the tolerance of ⅛ of 1 percentage point provided under § 226.22(a)(2). Because a $75 error was made, an annual percentage rate corresponding to a $100 understatement of the finance charge would not be considered accurate.

<u>22(a)(5) Additional tolerance for mortgage loans</u>.

1. <u>Example</u>. This paragraph contains an additional tolerance for a disclosed annual percentage rate that is incorrect but is closer to the actual annual percentage rate than the rate that would be considered accurate under the tolerance in § 226.22(a)(4). To illustrate: in an irregular transaction subject to a ¼ of 1 percentage point tolerance, if the actual annual percentage rate is 9.00 percent and a $75 omission from the finance charge corresponds to a rate of 8.50 percent that is considered accurate under § 226.22(a)(4), a disclosed APR of 8.65 percent is within the tolerance in § 226.22(a)(5). In this example of an understated finance charge, a disclosed annual percentage rate below 8.50 or above 9.25 percent will not be considered accurate.
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10. In Supplement I to Part 226, <u>Section 226.23--Right of Rescission</u> is amended by adding new paragraphs 23(g)(2), and 23(h) to read as follows:
* * * * *

Section 226.23--Right of Rescission
* * * * *

Section 226.23(g) Tolerances for accuracy.

23(g)(2) One percent tolerance.

1. New advance. The phrase "new advance" has the same meaning as in comment 23(f)-4.

23(h) Special Rules for Foreclosures.

1. Rescission. Section 226.23(h) applies only to transactions that are subject to rescission under § 226.23(a)(1).

Paragraph 23(h)(1)(i).

1. Mortgage broker fees. A consumer may rescind a loan in foreclosure if a mortgage broker fee that should have been included in the finance charge was omitted, without regard to the dollar amount involved. If the amount of the mortgage broker fee is included but misstated the rule in section 226.23(h)(2) applies.

23(h)(2) Tolerance for disclosures.

1. General. This section is based on the accuracy of the total finance charge rather than its component charges.
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11. In Supplement I to Part 226, under Section 226.31--General Rules, the following amendments are made:

a. Under Paragraph 31(c)(1) paragraph 1. is redesignated as paragraph 1. under Paragraph 226.31(c)., and paragraph 2., under Paragraph 31 (c)(1) is redesignated as paragraph 1; and

b. Under Paragraph 31(d)(3), a new paragraph 1. is added.

The revisions and additions read as follows:

Section 226.31--General Rules
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31(d) Basis of disclosures and use of estimates.
* * * * *

31(d)(3) Per-diem interest.

1. Per-diem interest. This paragraph applies to the disclosure of any numerical amount (such as the finance charge, annual percentage rate, or payment amount) that is affected by the amount of the per-diem interest charge that will be collected at consummation. If the amount of per-diem interest used in preparing the disclosures for consummation is based on the information known to the creditor at the time the disclosure document is prepared, the disclosures are considered accurate under this rule, and affected disclosures are also considered accurate, even if the disclosures were not labeled as estimates. (See comment 17(c)(2)(ii)-1 generally.)
* * * * *

12. In Supplement I to Part 226, under Section 226.32--Requirements for Certain Closed-End Home Mortgages, the following amendments are made:

a. Under Paragraph 32(b)(1)(i)., paragraph 1. is revised; and

b. Under Paragraph 32(c)(3)., a new paragraph 2. is added.

The revisions and additions read as follows:
* * * * *

Section 226.32--Requirements for Certain Closed-End Home Mortgages
* * * * *

32(b) Definitions.
* * * * *

Paragraph 32(b)(1)(i).

1. General. Section 226.32(b)(1)(i) includes in the total "points and fees" items defined as finance charges under §§ 226.4(a) and 226.(4)(b). Items excluded from the finance charge under other provisions of § 226.4 are not included in the total "points and fees" under paragraph 32(b)(1)(i), but may be included in "points and fees" under paragraphs 32(b)(1)(ii) and 32(b)(1)(iii). Interest, including per-diem interest, is excluded from "points and fees" under § 226.32(b)(1).
* * * * *

32(c) Disclosures.
* * * * *

32(c)(3) Regular payment.
* * * * *

2. Balloon payments. If a loan with a term of five years or more provides for a balloon payment, the balloon payment must be disclosed. For a loan with a term of less than five years, a balloon payment is prohibited.
* * * * *

13. In Supplement I to Part 226, under Section 226.33--Requirements for Reverse Mortgages, under Paragraph 33(a)(2), in paragraph 2., the third and fourth sentences are revised and a new sentence is added at the end of the paragraph to read as follows:

Section 226.33--Requirements for Reverse Mortgages
* * * * *

33(a) Definition.
* * * * *

Paragraph 33(a)(2).

2. Definite term or maturity date.*** An obligation may state a definite maturity date or term of repayment and still meet the definition of a reverse-mortgage transaction if the maturity date or term of repayment used would not operate to cause maturity prior to the occurrence of any of the maturity events recognized in the regulation. For example, some reverse mortgage programs specify that the final maturity date is the borrower's 150th birthday; other programs include a shorter term but provide that the term is automatically extended for consecutive periods if none of the other maturity events has yet occurred. These programs would be permissible.
* * * * *

14. In Supplement I to Part 226, under APPENDICES G AND H--OPEN-END AND CLOSED-END MODEL FORMS AND CLAUSES, a new paragraph 2. is added to read as follows:
* * * * *

APPENDICES G AND H--Open-End and Closed-End Model Forms and Clauses
* * * * *

2. Debt cancellation coverage. The regulation does not authorize creditors to characterize debt cancellation fees as insurance premiums for purposes of this regulation. Creditors may provide a disclosure that refers to debt cancellation coverage whether or not the coverage is considered insurance. Creditors may use the model credit insurance disclosures only if the debt cancellation coverage constitutes insurance under state law.
* * * * *

15. In Supplement I to Part 226, under APPENDIX H--CLOSED-END MODEL FORMS AND CLAUSES, a new sentence is added to the end of paragraph 11. to read as follows:
* * * * *

APPENDIX H--Closed-End Model Forms and Clauses
* * * * *

11. Models H-8 and H-9. * * *The prior version of model form H-9 is substantially similar to the current version and creditors may continue to use it, as appropriate. Creditors are encouraged, however, to use the current version when reordering or reprinting forms.

By order of the Board of Governors of the Federal Reserve System, acting through the Secretary of the Board under delegated authority, February 28, 1997.

(signed)
Jennifer J. Johnson
Deputy Secretary of the Board