Regulation Z
Truth in Lending

Background
Regulation Z (12 CFR 226) implements the Truth in Lending Act (TILA) (15 USC 1601 et seq.), which was enacted in 1968 as title I of the Consumer Credit Protection Act (Pub. L. 90-321). Since its implementation, the regulation has been amended many times to incorporate changes to the TILA or to address changes in the consumer credit marketplace.

Regulation Z was first revised in 1970 to prohibit creditors from sending consumers unsolicited credit cards. Subsequent revisions to the regulation in the 1970s implemented billing dispute provisions of the Fair Credit Billing Act of 1974 and the Consumer Leasing Act of 1976.

During the 1980s, Regulation Z was changed significantly, first in connection with the Truth in Lending Simplification and Reform Act of 1980. In 1981, all consumer leasing provisions in the regulation were transferred to the Board’s Regulation M. During the late 1980s, Regulation Z was amended to implement the rate limitations for home-secured loans set forth in section 1204 of the Competitive Equality Banking Act of 1987 and to require disclosures for adjustable-rate mortgage loans. Other Regulation Z amendments implemented the Fair Credit and Charge Card Disclosure Act of 1988 and the Home Equity Loan Consumer Protection Act of 1988, which required disclosure of key terms at the time of application.

In the 1990s, Regulation Z was amended to implement the Home Ownership and Equity Protection Act of 1994, which imposed new disclosure requirements and substantive limitations on certain higher-cost closed-end mortgage loans and included new disclosure requirements for reverse mortgage transactions. The regulation was also revised to reflect the 1995 Truth in Lending amendments that dealt primarily with tolerances for loans secured by real estate and limitations on lenders’ liability for disclosure errors for these types of loans. Regulation Z amendments resulting from the Economic Growth and Regulatory Paperwork Reduction Act of 1996 simplified adjustable-rate mortgage disclosures.

Applicability
In general, Regulation Z applies to individuals and businesses that offer or extend credit, when all the following conditions are met:

- The credit is offered or extended to consumers
- The offering or extension of credit is done regularly (see the definition of “creditor” in section 226.2(a))
- The credit is subject to a finance charge or is payable by a written agreement in more than four installments
- The credit is primarily for personal, family, or household purposes

The regulation also includes special provisions for credit offered by credit card issuers and specific requirements for persons who are not creditors but who provide applications for home equity loans.

Organization of Regulation Z
The disclosure rules of Regulation Z differ depending on whether the credit is open-end (credit cards and home equity lines, for example) or closed-end (such as car loans and mortgages). Regulation Z is structured accordingly.

- **Subpart A**—Provides general information that applies to both open-end and closed-end credit transactions, including definitions, explanations of coverage and exemptions, and rules for determining which fees are finance charges
- **Subpart B**—Covers open-end credit, including home equity loans and credit and charge accounts; sets forth rules for providing disclosures, resolving billing errors, calculating annual percentage rates and credit balances, and advertising; describes special rules for credit card transactions (such as prohibitions on the issuance of credit cards and restrictions on the right to offset a cardholder’s indebtedness); and provides special rules for home equity lines of credit (such as prohibitions against closing accounts and changing account terms)
- **Subpart C**—Covers closed-end credit, including residential mortgage transactions, demand loans, and installment credit contracts (including direct loans by banks and purchased dealer paper); sets forth rules for disclosures related to regular and variable-rate loans, refinancings and assumptions, and credit balances; also gives rules for calculating annual percentage rates and advertising closed-end credit
- **Subpart D**—For both open- and closed-end credit, sets forth the duty of creditors to retain evidence of compliance with the regulation, clarifies the relationship between the regulation and state law, and requires creditors to set an
interest rate cap for variable-rate transactions secured by a consumer’s dwelling

- **Subpart E**—Requires additional disclosures for, sets limits on, and prohibits specific acts and practices in connection with certain home mortgage transactions having rates or fees above a certain percentage or amount; also sets forth disclosure requirements for reverse mortgage transactions (both open- and closed-end credit)

- **Appendixes**—Provide model forms and clauses that creditors may use when providing disclosures; detailed rules for calculating APRs for open- and closed-end credit; and instructions for computing the total annual loan cost rate for reverse mortgage transactions, along with tables giving assumed loan periods for those transactions

- **Official staff interpretations**—Published in a commentary normally updated annually, in March; include mandates concerning disclosures not necessarily explicit in the regulation and information on other actions required of creditors (Good faith compliance with the commentary protects creditors from civil liability under the act; it is virtually impossible to comply with the regulation without reference to, and reliance on, the commentary.)

Note: This chapter does not attempt to discuss all of Regulation Z, but rather highlights areas that have caused the most problems in relation to calculation of the finance charge and the annual percentage rate.

### General Information (Subpart A)

#### Purpose of the TILA and Regulation Z

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

- Protect consumers from inaccurate and unfair credit billing and credit card practices
- Provide consumers with rescission rights
- Provide for rate caps on certain dwelling-secured loans
- Impose limitations on home equity lines of credit and certain closed-end home mortgages

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

### Coverage and Exemptions (§§ 226.1–226.3)

Lenders must carefully consider several factors when deciding whether a loan requires Truth in Lending disclosures or is subject to other Regulation Z requirements. Broad coverage considerations are included in section 226.1(c) of the regulation, and relevant definitions appear in section 226.2. Coverage considerations are addressed in more detail in the commentary to the regulation.

The following transactions are exempt from Regulation Z under section 226.3:

- Credit extended primarily for a business, commercial, or agricultural purpose
- Credit extended to other than a natural person (including credit to government agencies or instrumentalities)
- Credit in excess of $25,000 not secured by real or personal property used as the consumer’s principal dwelling
- Public utility credit
- Credit extended by a broker–dealer registered with the Securities and Exchange Commission or the Commodity Futures Trading Commission involving securities or commodities accounts
- Home fuel budget plans
- Certain student loan programs

Footnote 4 in Regulation Z provides that if a credit card is involved, credit that is generally exempt from the requirements of Regulation Z (for example, credit for a business or agricultural purpose) is still subject to requirements that govern the issuance of credit cards and liability for their unauthorized use. (Credit cards must not be issued on an unsolicited basis, and if a credit card is lost or stolen, the cardholder must not be held liable for more than $50 for the unauthorized use of the card.)

When determining whether credit is for consumer purposes, the creditor must evaluate the following five factors:

- Information obtained from the consumer describing the purpose of the loan proceeds
  - A statement that the proceeds will be used for a vacation trip, for example, would indicate a consumer purpose.
  - If the consumer states that the loan has a mixed purpose (for example, that the pro-
ceeds will be used to buy a car that will be used for both 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 by the consumer will help the lender make that decision.

- A checked box indicating that the loan is for a business purpose could, absent any documentation showing the intended use of the proceeds, be insufficient evidence that the loan does not have a consumer purpose.

• The consumer’s primary occupation and how it relates to the use of the loan proceeds
  - The higher the correlation between the consumer’s occupation and the property purchased from the loan proceeds, the greater the likelihood that the loan has a business purpose. For example, proceeds used to purchase dental supplies for a dentist would indicate a business purpose.

• Personal management of the assets purchased from the loan proceeds
  - The less the borrower is personally involved in the management of the investment or enterprise purchased by the proceeds, the less likely the loan has a business purpose. For example, borrowing money 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 transaction, the more likely the loan has a business purpose. For example, a loan amount of $5,000,000 for a real estate transaction 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 less the income derived from the acquired property, the more likely the loan has a consumer purpose. For example, if the borrower has an annual salary of $100,000, receiving about $500 in annual dividends from the acquired property would indicate a consumer purpose.

The lender must evaluate all five factors before concluding that disclosures are not necessary. Normally, evidence suggested by a single factor is, by itself, insufficient to draw a conclusion about whether the transaction is covered by Regulation Z. The diagram “Coverage Considerations under Regulation Z” may be helpful in making the determination. In any case, the financial institution may choose to furnish disclosures to consumers. Disclosure under such circumstances does not control whether the transaction is covered but can ensure protection to the financial institution and compliance with the law.

Determination of the Finance Charge and the APR

Finance Charge (Open-End and Closed-End Credit) (§ 226.4)

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

Generally, the finance charge includes any charges or fees payable directly or indirectly by the consumer and imposed directly or indirectly by the financial institution either incident to or as a condition of an extension of consumer credit. For example, the finance charge on a loan always includes any interest charges and, often, other charges, such as points, transaction fees, or service fees.

Regulation Z provides examples, applicable to both open-end and closed-end credit transactions, of what must, must not, or need not be included in the disclosed finance charge (section 226.4(b)).

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

Calculation of the Finance Charge (Closed-End Credit)

One of the more complex tasks under Regulation Z is determining whether a charge associated with an extension of credit must be included in, or excluded from, the disclosed finance charge. The finance charge initially includes any charge that is, or will be, connected with a specific loan. Charges imposed by third parties are finance charges if the institution requires use of the third party. Charges imposed by settlement or closing agents are finance charges if the institution requires the specific service that gave rise to the charge and the charge is not otherwise excluded.

The “Finance Charges” diagram summarizes included and excluded charges and may be helpful in determining whether a loan-related charge is a finance charge.
Truth in Lending

Coverage Considerations under Regulation Z

Is the credit for personal, family, or household use? Yes No

Is the credit extended to a consumer? Yes No

Is the credit extended by a creditor? Yes No

Is the loan or credit plan secured by real property or by the consumer’s principal dwelling? Yes No

Is the amount financed or credit limit $25,000 or less? Yes No

Regulation Z does not apply, except the rules concerning issuance of and unauthorized-use liability for credit cards. (Exempt credit includes loans with a business or agricultural purpose and certain student loans. Credit extended to acquire or improve rental property that is not owner-occupied is considered business-purpose credit.)

Regulation Z does not apply. (Credit that is extended to a land trust is deemed to be credit extended to a consumer.)

The institution is not a “creditor” and Regulation Z does not apply unless at least one of the following tests is met:

1. The institution extends consumer credit regularly and
   a. The obligation is initially payable to the institution and
   b. The obligation either is payable by written agreement in more than four installments or is subject to a finance charge

2. The institution is a card issuer that extends closed-end credit that is subject to a finance charge or is payable by written agreement in more than four installments

3. The institution is a card issuer that extends open-end credit or credit that is not subject to a finance charge and is not payable by written agreement in more than four installments

For limited purposes, a person that honors a credit card may also be a creditor.

(Note: All persons, including noncreditors, must comply with the advertising provisions of Regulation Z.)

Regulation Z does not apply, but it may apply later if the loan is refinanced for $25,000 or less. If the principal dwelling is taken as collateral after consummation, rescission rights apply and, in the case of open-end credit, billing disclosures and other provisions of Regulation Z apply.
**Finance Charges**

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

### CHARGES ALWAYS INCLUDED

- **(A)** Interest
- Transaction fees
- Loan origination fees
- Consumer points
- Credit-guarantee insurance premiums
- Charges imposed on the creditor for purchasing the loan that are passed on to the consumer
- Discounts for inducing payment by means other than credit
- Mortgage broker fees
- Other examples: Fee for preparing TILA disclosures; real estate construction loan inspection fees; fees for post-consummation tax or flood insurance requirements; required credit life insurance charges

### CHARGES INCLUDED UNLESS CONDITIONS ARE MET

- **(B)** Premiums for credit life, accident and health, or loss-of-income insurance
- Debt-cancellation fees
- Premiums for property or liability insurance
- Premiums for vendor’s single interest (VSI) insurance
- Security interest charges (filing fees), insurance in lieu of filing fees, and certain notary fees
- Charges imposed by third parties
- Charges imposed by third-party closing agents
- Appraisal and credit-report fees

### CONDITIONS FOR EXCLUSION (Any loan)

- **(C)** Insurance not required, disclosures are made, and consumer authorizes
- Coverage not required, disclosures are made, and consumer authorizes
- Consumer selects insurance company and disclosures are made
- Insurer waives right of subrogation, consumer selects insurance company, and disclosures are made
- The fee is for lien purposes, is prescribed by law, is payable to a public official, and is itemized and disclosed
- Use of the third party is not required to obtain loan, and creditor does not retain the charge
- Creditor does not require and does not retain the fee for the particular service

### EXCLUDABLE CHARGES* (Residential mortgage transactions and loans secured by real estate)

- **(D)** Fees for preparing loan documents, mortgages, and other settlement documents
- Amounts required to be paid into escrow, if not otherwise included in the finance charge
- Notary fees
- Pre-consummation flood and pest inspection fees
- Appraisal and credit-report fees
- Fees for unanticipated late payments
- Seller’s points
- Participation or membership fees
- Discount offered by the seller to induce payment by cash or other means not involving the use of a credit card
- Interest forfeited as a result of interest reduction required by law
- Charges absorbed by the creditor as a cost of doing business

### CHARGES NEVER INCLUDED

- **(E)** Charges payable in a comparable cash transaction

*To be excludable, fees must be bona fide and reasonable.
• **Charges always included (col. A)—** Lists charges given in the regulation or commentary as examples of finance charges.

• **Charges included unless conditions are met (col. B)—** Lists charges that must be included in the finance charge unless the creditor meets specific disclosure or other conditions to exclude the charges from the finance charge.

• **Conditions for exclusion (col. C)—** Notes the conditions that must be met if the charges listed in column B may be excluded from the finance charge. Although most charges in column B may be considered part of the finance charge at the creditor’s option, third-party charges and application fees must be excluded from the finance charge if the relevant conditions are met; however, inclusion of appraisal and credit-report charges as part of the application fee is optional.

• **Excludable charges (col. D)—** Identifies fees or charges that may be excluded from the finance charge if they are bona fide and reasonable in amount and the credit transaction is secured by real property or is a residential mortgage transaction. For example, if a consumer loan is secured by a vacant lot or by commercial real estate, any appraisal fees connected with the loan may be excluded from the finance charge.

• **Charges never included (col. E)—** Lists charges given in the regulation as examples of charges that automatically are not finance charges (for example, fees for unanticipated late payments).

**Precomputed Finance Charges**

A prepaid finance charge is any finance charge that (1) is paid separately to the financial institution or to a third party, in cash or by check, before or at closing, settlement, or consummation of a transaction or (2) is 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 paid to such companies as the Mortgage Guaranty Insurance Company, 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 method. If reflected in the face amount of the debt instrument as part of the consumer’s obligation, finance charges that are not viewed as prepaid finance charges are treated as precomputed finance charges that are earned over the life of the loan.

**Accuracy Tolerances (Closed-End Credit) (§§ 226.18(d) and 226.23(h))**

The finance charge tolerances for closed-end credit provided by Regulation Z are for legal accuracy and should not be confused with those tolerances provided in the TILA for reimbursement under regulatory agency orders. As with disclosed APRs, if a disclosed finance charge is legally accurate, it is not subject to reimbursement.

Generally, tolerances for finance charge errors in a closed-end transaction are $5 if the amount financed is $1,000 or less and $10 if the amount financed exceeds $1,000 (see diagrams on following pages). For certain transactions consummated on or after September 30, 1995, the tolerances are different, as noted below:

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

- Rescission rights after the three-business-day rescission period (closed-end credit only):
  - 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.
  - 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 financial institution. (This category excludes high-cost mortgage loans subject to section 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.
– The consumer is entitled to rescind if a mortgage broker fee is not included as a finance charge.

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.

Neither the TILA nor Regulation Z provides any tolerances for finance charge errors in open-end credit disclosures. Open-end credit disclosures must be accurate.

Annual Percentage Rate (Closed-End Credit) (§ 226.22)

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 costs of various credit transactions.

The APR is a measure of the total 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 by the consumer. The disclosure of the APR is central to the uniform credit cost disclosure envisioned by the TILA.

The APR for closed-end credit must be disclosed as a single rate only, whether the loan has a single interest rate, a variable interest rate, a discounted variable interest rate, or graduated payments based on separate interest rates (step rates). Also, the APR must appear with the “segregated” disclosures—disclosures grouped together and not containing any information not directly related to the disclosures required under section 226.18.

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

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

The APR is a function of

- The amount financed, which is not necessarily equivalent to the loan amount
  – If the consumer must pay a separate 1 percent loan origination fee (a prepaid finance charge) on a $100,000 residential mortgage loan at closing, the loan amount is $100,000 but the amount financed is $100,000 less the $1,000 loan fee, or $99,000.
- The finance charge, which is not necessarily equivalent to the total interest amount
  – 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 this case is the sum of the interest on the loan (that is, the interest generated by the application of a percentage rate against the loan amount) plus the $25 credit-report fee.
  – If the consumer must pay a $25 credit-report fee for a home improvement loan secured by real property, the credit-report fee must be excluded from the finance charge. The finance charge in this case would be only the interest on the loan.
- Interest, which is defined by state or other federal law but not 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 would be $115.87, if all months are considered equal, and the amount financed
Truth in Lending

Closed-End Credit: Accuracy Tolerances for Finance Charges

Is this a closed-end credit TILA claim asserting rescission rights?

Yes

Is the rescission claim a defense to foreclosure action?

Yes

Is the transaction a refinancing?

Yes

Is the transaction a high-cost mortgage loan?*

Yes

The finance charge is considered accurate if it is not more than $5 above or below the exact finance charge in a transaction involving an amount financed of $1,000 or less, or not more than $10 above or below the exact finance charge in a transaction involving an amount financed of more than $1,000.

No

Does the refinancing involve a consolidation or new advance?

Yes

Finance charge tolerance is 1% of the loan amount or $100, whichever is greater. An overstated finance charge is not considered a violation.

No

Finance charge tolerance is $100 for understatements. An overstated finance charge is not considered a violation.

No

Finance charge tolerance is $200 for understatements. An overstated finance charge is not considered a violation.

No

Is the transaction secured by real estate or a dwelling?

Yes

Did the transaction originate before 9/30/95?

Yes

Finance charge tolerance is $35. An overstated finance charge is not considered a violation.

No

Finance charge tolerance is one-half of 1% of the loan amount or $100, whichever is greater. An overstated finance charge is not considered a violation.

No

Finance charge tolerance is 1% of the loan amount or $100, whichever is greater. An overstated finance charge is not considered a violation.

* See 15 USC 160(aa) and 12 CFR 226.32.
Closed-End Credit: Accuracy Tolerances for Overstated Finance Charges

- Is the loan secured by real estate or a dwelling?
  - No
  - Yes

- Is the amount financed more than $1,000?
  - No violation
  - No

- Is the disclosed finance charge, less $5, more than the correct finance charge?
  - No violation
  - Finance charge violation

- Is the disclosed finance charge, less $10, more than the correct finance charge?
  - No violation
  - Finance charge violation

No violation
Closed-End Credit: Accuracy and Reimbursement Tolerances for Understated Finance Charges

Is the loan secured by real estate or a dwelling?
- No
- Yes

Is the amount financed greater than $1,000?
- No
- Yes

Is the disclosed finance charge understated by more than $5?
- Yes
- No

Finance charge violation

Is the disclosed finance charge understated by more than $10?
- No
- Yes

Finance charge violation

Is the loan term more than 10 years?
- No
- Yes

Is the loan a regular loan?
- No
- Yes

Is the disclosed finance charge plus the finance charge reimbursement tolerance (based on a one-quarter of 1 percentage point APR tolerance) less than the correct finance charge?
- Yes
- No

Is the disclosed finance charge plus the finance charge reimbursement tolerance (based on a one-eighth of 1 percentage point APR tolerance) less than the correct finance charge?
- Yes
- No

No reimbursement

Subject to reimbursement
would be $2,500. If the consumer’s payments are increased $2.00 a month to pay a nonfinanced $50 loan fee over the life of the loan, the amount financed would remain at $2,500 but the monthly payment would increase to $117.87, the finance charge would increase $50, and there would be a corresponding increase in the APR. This would be the case whether or not state law defines the $50 loan fee as interest.

If the loan in the preceding example has 55 days to the first payment and the consumer prepays interest at consummation ($24.31 to cover the first 25 days), the amount financed would be $2,500 less $24.31, or $2,475.69. Although the amount financed is reduced because the amount available to the consumer at consummation is less, the time interval during which the consumer has use of the $2,475.69—55 days to the first payment—is unchanged. To ease creditor compliance, Regulation Z allows creditors to disregard certain minor irregularities in the first payment period (see section 226.17(c)(4)). In this case, however, because the first payment period exceeds the limitations of the regulation’s “minor irregularities” provisions, the first payment period of 55 days may not be treated as “regular.” In calculating the APR, the first payment period must not be reduced 25 days (that is, the first payment period may not be treated as one month).

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

Special Requirements for Calculating the Finance Charge and APR

Proper calculation of the finance charge and APR is very important. Regulation Z requires that the terms “finance charge” and “annual percentage rate,” when required to be disclosed with a corresponding amount or 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. Failure to disclose those values accurately can result in significant monetary damages to the creditor, either from a class action lawsuit or from a regulatory agency’s order to reimburse consumers for violations of law.

Footnote 45d to section 226.22 states that 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 financial institution
• Upon discovery of the error, the financial institution promptly discontinues use of that calculation tool for disclosure purposes
• The financial institution notifies the Federal Reserve Board in writing of the error in the calculation tool

When a financial institution claims that it used a calculation tool in good faith, it assumes a reasonable degree of responsibility for ensuring that the tool in question provides the accuracy required by the regulation. To check on the tool’s accuracy, the institution might verify the results obtained using the tool with figures obtained using a different calculation tool. It might also check 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.

Open-End Credit (Subpart B)

This discussion does not address all the requirements for open-end credit in the Truth in Lending Act and Regulation Z. Instead, it focuses on some of the more difficult issues presented in sections 226.5 through 226.16 of the regulation. Additional guidance is provided in the commentary for these sections.

Finance Charge (§ 226.6(a))

Each finance charge imposed must be individually itemized. An aggregate amount of the finance charge need not be disclosed.
Determining the Balance and Computing the Finance Charge

To compute the finance charge, the examiner must know how to determine the balance to which the periodic rate is applied. Common methods are the previous balance method, the daily balance method, and the average daily balance method.

- **Previous balance method**—The balance to which the periodic rate is applied is the balance outstanding at the start of the billing cycle. The periodic rate is multiplied by this balance to compute the finance charge.

- **Daily balance method**—The balance to which the periodic rate is applied is either the balance on each day in the billing cycle or the sum of the balances on each day in the cycle. If a daily periodic rate is multiplied by the balance on each day in the billing cycle, the finance charge is the sum of the products. If the daily periodic rate is multiplied by the sum of all the daily balances, the finance charge is the product.

- **Average daily balance method**—The balance to which the periodic rate is applied is the sum of the daily balances (either including or excluding current transactions) divided by the number of days in the billing cycle. The periodic rate is multiplied by the average daily balance to determine the finance charge. If the periodic rate is a daily rate, the product of the rate multiplied by the average balance is multiplied by the number of days in the cycle.

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

If the balance is determined without first deducting all credits given and payments made during the billing cycle, that fact, as well as the amounts of the credits and payments, must be disclosed.

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

- **A balance for each day in the billing cycle**—The daily periodic rate is multiplied by the balance on each day, and the sum of the products is the finance charge.

- **A balance for each day in the billing cycle on which the balance in the account changes**—The daily periodic rate is multiplied by the balance on each day, and the sum of the products is the finance charge, as above, but the statement shows the balance for only those days on which the balance changed.

- **The sum of the daily balances during the billing cycle**—The daily periodic rate is multiplied by the sum of all the daily balances in the billing cycle, and that product is the finance charge.

- **The average daily balance during the billing cycle**—If this balance is the one disclosed, the institution must explain somewhere on the periodic statement or in an accompanying document that the finance charge is or may be determined by multiplying the average daily balance by the number of days in the billing cycle rather than by multiplying the product by the daily periodic rate.

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

- **A balance for each day in the billing cycle**

- **A balance for each day in the billing cycle on which the balance in the account changed**

- **Two or more average daily balances**—If the balance is disclosed in this way, the institution must indicate on the periodic statement or in an accompanying document that the finance charge is or may be determined by (1) multiplying each of the average daily balances by the number of days in the billing cycle (or if the daily rate varies, multiplying the number of days that the applicable rate was in effect), (2) multiplying each of the results by the applicable daily periodic rate, and (3) summing the products.

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

Finance Charge Resulting from Two or More Periodic Rates

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

Annual Percentage Rate

**Accuracy Tolerance (§ 226.14)**

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

**Determining the APR**

Regulation Z describes two basic methods for determining the APR in open-end credit transactions. One method involves multiplying each periodic rate by the number of periods in a year. This method is used for disclosing

- The corresponding APR in 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
- The APR in oral disclosures

The corresponding APR is prospective. In other words, it is not based on the account’s actual outstanding balance and the finance charges that are imposed.

The other method is the quotient method, used in computing the APR for periodic statements. The quotient method reflects the annualized equivalent of the rate that was actually applied during a cycle. This rate, also known as the historical APR, will differ from the corresponding APR if the creditor 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 those charges (minimum, fixed, or transaction), the financial institution may compute the historical rate using the quotient method. In the quotient method, the total finance charge for the cycle is divided by the sum of the balances to which the periodic rates were applied, and the quotient (expressed as a percentage) is multiplied by the number of cycles in a year.

Alternatively, the financial institution may compute the historical APR using the method for computing the corresponding APR. In that method, each periodic rate is multiplied by the number of periods in one year. If the finance charge includes a minimum, fixed, or transaction charge, the institution must use the appropriate variation of the quotient method. When transaction charges are imposed, the financial institution should refer to appendix F to Regulation Z for computational examples.

Regulation Z 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 financial institution may multiply each applicable periodic rate by the number of periods in a year to compute the APR.

Regulation Z also provides optional calculation methods for accounts involving daily periodic rates (see section 226.14(d)).

**Calculating the APR for Periodic Statements**

*Note: Assume monthly billing cycles for each of the calculations.*

I. APR when finance charge is determined solely by applying one or more periodic rates
   A. Monthly periodic rates
      1. Monthly rate \( \times 12 = APR \)
      or
      2. \( \frac{\text{Total finance charge}}{\text{Applicable balance}} \times 12 = APR \)
   B. Daily periodic rates
      1. \( \frac{\text{Total finance charge}}{\text{Amount of applicable balance}} \times 365 = APR \)
      2. \( \frac{\text{Total finance charge}}{\text{Average daily balance}} \times 12 = APR \)
      or
      3. \( \frac{\text{Total finance charge}}{\text{Sum of balances}} \times 365 = APR \)

II. APR when finance charge includes a minimum, fixed, or other charge that is not calculated using a periodic rate (and does not include charges related to a specific transaction, such as a cash advance fee)
   A. Monthly periodic rates
      1. \( \frac{\text{Total finance charge}}{\text{Amount of applicable balance}} \times 12 = APR \)
   B. Daily periodic rates
      1. \( \frac{\text{Total finance charge}}{\text{Amount of applicable balance}} \times 365 = APR \)

---

1. If the applicable balance is zero, the APR cannot be determined.
2. See footnote 1.
3. Loan fees, points, or similar finance charges that relate to the opening of the account must not be included in the calculation of the APR.
4. See footnote 1.
5. See footnote 3.
2. The following may be used if at least a portion of the finance charge is determined by the application of a daily periodic rate. If not, use the formula above.
   a. (Total finance charge + Average daily balance) \times 12 = \text{APR}^6
   or
   b. (Total finance charge + Sum of balances) \times 365 = \text{APR}^7

C. Monthly and daily periodic rates
   1. If the finance charge imposed during the billing cycle does not exceed 50 cents for a monthly or longer billing cycle (or a prorated part of 50 cents for a billing cycle shorter than one month), the APR may be calculated by multiplying the monthly rate by 12 or the daily rate by 365.

III. If the total finance charge includes a charge related to a specific transaction (such as a cash advance fee), even if the total finance charge also includes any other minimum, fixed, or other charge not calculated using a periodic rate, then the monthly and daily APRs are calculated as follows: (Total finance charge + The greater of (1) the transaction amounts that created the transaction fees or (2) the sum of the balances and other amounts on which a finance charge was imposed during the billing cycle)\(^8\) multiplied by the number of billing cycles in a year (12) = \text{APR}^9

Closed-End Credit (Subpart C)
The information presented here does not provide a complete discussion of the closed-end credit requirements of the Truth in Lending Act. Instead, it is offered to clarify otherwise confusing terms and requirements. Refer to sections 226.17 through 226.24 of Regulation Z and related commentary for a more thorough understanding of the act.

Finance Charge (§ 226.17(a))
The total amount of the finance charge must be disclosed. Each finance charge imposed need not be individually itemized and must not be itemized with the segregated disclosures.

Annual Percentage Rate (§ 226.22)

Accuracy Tolerances
The disclosed APR on a closed-end transaction is considered accurate
   • If for regular transactions (including any single-advance transaction with equal payments and equal payment periods or transactions with an irregular first or last payment and/or an irregular first payment period), the APR is within one-eighth of 1 percentage point of the APR calculated under Regulation Z (section 226.22(a)(2))
   • If for irregular transactions (including multiple-advance transactions and other transactions not considered regular), the APR is within one-quarter of 1 percentage point of the APR calculated under Regulation Z (section 226.22(a)(3))
   • If for mortgage transactions, the APR is within one-eighth of 1 percentage point for regular transactions or one-quarter of 1 percentage point for irregular transactions and
     - The rate results from the disclosed finance charge and
     - The disclosed finance charge would be considered accurate under section 226.18(d)(1) or section 226.23(g) or (h) of Regulation Z (section 226.22(a)(4))

Note: An additional tolerance is granted for mortgage loans when the disclosed finance charge is calculated incorrectly but is considered accurate under section 226.18(d)(1) or section 226.23(g) or (h) of Regulation Z (section 226.22(a)(5)).

See the diagrams for more information on accuracy tolerances.

Construction Loans (§ 226.17(c)(6) and Appendix D)
Construction loans and certain other multiple-advance loans pose special problems in computing the finance charge and the APR. In many instances, the amount and dates of advances are not predictable with certainty because they depend on the progress of the work. Regulation Z provides that, for disclosure purposes, the APR and finance charge for such loans may be estimated.

A financial institution may, at its option, rely on the representations of other parties to acquire necessary information (for example, it might look to the consumer for the dates of advances). In addition, if any of the amounts or the dates of advances are unknown (even if some of them are known), the institution may, at its option, refer to appendix D to the regulation to make calculations and discl-
Closed-End Credit: Accuracy Tolerances for Overstated APRs

Is this a “regular” loan? (12 CFR 226, footnote 46)

No

Is the disclosed APR more than the correct APR by more than one-quarter of 1 percentage point?

Yes

No violation

No

Is the disclosed APR more than the correct APR by more than one-eighth of 1 percentage point?

Yes

No

Is the loan secured by real estate or a dwelling?

No

APR violation

Yes

Is the disclosed finance charge more than the correct finance charge?

Yes

Was the finance charge disclosure error the cause of the APR disclosure error?

No

APR violation

Yes

No violation

No violation
Closed-End Credit: Accuracy and Reimbursement Tolerances for Understated APRs

1. Is this a “regular” loan?
   - No
   - Yes

2. Is the disclosed APR understated by more than one-quarter of 1 percentage point?
   - Yes
   - No

3. Is the disclosed APR understated by more than one-eighth of 1 percentage point?
   - Yes
   - No

4. If Yes to questions 1 and 3, is the loan secured by real estate or a dwelling?
   - Yes
   - No

5. Is the finance charge understated by more than:
   - $100 if the loan originated on or after 9/30/95?
   - $200 if the loan originated before 9/30/95?
   - Yes
   - No

6. Was the finance charge disclosure error the cause of the APR disclosure error?
   - Yes
   - No

7. If Yes to questions 4 and 6, is the loan term greater than 10 years?
   - Yes
   - No

8. If Yes to questions 7 and 3, is the loan a “regular” loan?
   - Yes
   - No

9. Is the disclosed APR understated by more than one-quarter of 1 percentage point?
   - Yes
   - No

10. Is the disclosed APR understated by more than one-eighth of 1 percentage point?
    - Yes
    - No

11. If Yes to questions 9 and 10, is subject to reimbursement?
    - Yes
    - No
sures. The finance charge and payment schedule obtained by referring to appendix D may be used with volume 1 of the Board’s APR tables or with any other appropriate computation tool to determine the APR (the Board’s APR tables are available through the System publications catalog on the New York Reserve Bank’s web site). If the institution elects not to use appendix D, or if appendix D cannot be applied to a loan (for example, appendix D does not apply to a combined construction–permanent loan if the payments for the permanent loan begin during the construction period), the institution must make its estimates under section 226.17(c)(2) and calculate the APR using multiple-advance formulas.

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

In a transaction that finances the construction of a dwelling that may or will be permanently financed by the same financial institution, the construction–permanent financing phases may be disclosed in one of the following ways:

- As a single transaction, with one disclosure covering both phases
- As two separate transactions, with one disclosure for each phase
- As more than two transactions, with one disclosure for each advance and one for the permanent-financing phase

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

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

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

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

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

Calculating the Annual Percentage Rate (§ 226.22)

The APR must be determined under one of the following methods:

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

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

360-Day and 365-Day Years (§ 226.17(c)(3))

Confusion often arises over whether to use a 360-day or 365-day year in computing interest, particularly when the finance charge is computed by applying a daily rate to an unpaid balance. Many single-payment loans and loans payable on demand are in this category. Also in this category are loans that call for periodic installment payments.
Regulation Z does not require the use of one method of interest computation in preference to another (although state law may). It does, however, permit financial institutions to disregard the fact that months have different numbers of days when calculating and making disclosures. This means that financial institutions may base their disclosures on calculation tools that assume that all months have an equal number of days, even if their practice is to take account of the variations in months to collect interest. For example, an institution may calculate disclosures using a financial calculator based on a 360-day year with 30-day months when, in fact, it collects interest by applying a factor of 1/360 of the annual interest rate to actual days.

Disclosure violations may occur, however, when a financial institution applies a daily interest factor based on a 360-day year to the actual number of days between payments. In those situations, the institution must disclose the higher values of the finance charge, the APR, and the payment schedule resulting from this practice. For example, a 12 percent simple interest rate divided by 360 days results in a daily rate of 0.000333 percent. If no charges are imposed except interest and the amount financed is the same as the loan amount, applying the daily rate on a daily basis for a 365-day year on a $10,000 one-year, single-payment, unsecured loan results in an APR of 12.17% ($0.000333 \times 365 = 12.17$) and a finance charge of $1,216.67. There would be a violation if the APR were disclosed as 12 percent or the finance charge were disclosed as $1,200 (12% \times $10,000). However, if no other charges except interest are imposed, the application of a 360-day-year daily rate over 365 days on a regular loan would not result in an APR in excess of the one-eighth of 1 percentage point APR tolerance unless the nominal interest rate is greater than 9 percent. For irregular loans, with one-quarter of 1 percentage point APR tolerance, the nominal interest rate would have to be greater than 18 percent to exceed the tolerance.

Variable-Rate Loans (§ 226.18(f))

If the terms of the legal obligation allow the financial institution, after consummation of the transaction, to increase the APR, the financial institution must furnish the consumer with certain information on variable rates. Graduated-payment mortgages and step-rate transactions without a variable-rate feature are not considered variable-rate transactions. In addition, variable-rate disclosures are not applicable to rate increases resulting from delinquency, default, assumption, acceleration, or transfer of the collateral. Some of the more important transaction-specific variable-rate disclosure requirements under section 226.18 follow:

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

For variable-rate consumer loans that are not secured by the consumer’s principal dwelling or that are secured by the consumer’s principal dwelling but have a term of one year or less, creditors must disclose the circumstances under which the rate may increase, any limitations on the increase, the effect of an increase, and an example of the payment terms that would result from an increase (section 226.18(f)(1)).

For variable-rate consumer loans that are secured by the consumer’s principal dwelling and have a
maturity of more than one year, creditors must state that the loan has a variable-rate feature and that disclosures were previously given (section 226.18(f)(2)). Extensive disclosures about the loan program must be provided when consumers apply for such a loan (section 226.19(b)) and throughout the loan term when the rate or payment amount is changed (section 226.20(c)).

Payment Schedule (§ 226.18(g))

The disclosed payment schedule must reflect all components of the finance charge, including all scheduled payments to repay loan principal, interest on the loan, and any other finance charge payable by the consumer after consummation of the transaction. Any finance charge paid separately before or at consummation (for example, odd days’ interest) is not to be treated as part of the payment schedule; it is a prepaid finance charge and must be reflected as a reduction in the value of the amount financed.

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

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

If the instrument has no renewal conditions or the financial institution guarantees to renew the short-term loan at the consumer’s option or to renew the loan subject to conditions within the consumer’s control, the payment schedule must be disclosed using the shorter balloon-payment term. The short-term loan must be disclosed as a fixed-rate loan, unless it contains a variable-rate feature during the initial loan term.

Amount Financed (§ 226.18(b))

Definition

The amount financed is the net amount of credit extended for the consumer’s use. It should not be assumed that under the regulation, the amount financed is equivalent to the note amount, the proceeds, or the 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 (for example, an appraisal fee paid separately, in cash, on a real estate loan) need not be disclosed under Regulation Z and must not be included in the amount financed.

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

Required Deposit (§ 226.18(r))

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

Calculating the Amount Financed

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

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

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

Other Calculations

In the preceding example, the financial institution may treat the $10 service charge as a prepaid finance charge. If it does, the loan principal would be $5,010. The $5,010 loan principal does not include the $400 precomputed finance charge. The loan principal is increased by other amounts financed that are not part of the finance charge (the $25 credit-report fee) and reduced by any prepaid finance charges (the $50 loan fee and the $10 service charge withheld from the loan proceeds) to arrive at the same amount financed of $5,010 + $25 − $50 − $10 = $4,975.

Refinancings (§ 226.20)

When an obligation is satisfied and replaced by a new obligation to the original financial institution (or a holder or servicer of the original obligation) and is undertaken by the same consumer, it must be treated as a refinancing for which a complete set of new disclosures must be furnished. A refinancing may involve the consolidation of several existing obligations, disbursement of new money to the consumer, or the rescheduling of payments under an existing obligation. In any form, the new obligation must completely replace the earlier one to be considered a refinancing under Regulation Z. 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 (section 226.20(a)).

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

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

However, even if it is not accomplished by the cancellation of the old obligation and substitution of a new one, a new transaction subject to new disclosures results if the financial institution does either of the following:

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

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

Miscellaneous Provisions (Subpart D)

Civil Liability (TILA § 130)

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

- Actual damage
- The cost of any legal action together with reasonable attorney’s fees in a successful action

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

- In an individual action, twice the amount of the finance charge involved, but not less than $100
or more than $1,000. However, in an individual action relating to a closed-end credit transaction secured by real property or a dwelling, twice the amount of the finance charge involved, but not less than $200 or more than $2,000.

- In a class action, such amount as the court may allow. However, the total amount of recovery may not be more than $500,000 or 1 percent of the creditor’s net worth, whichever is less.

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

A creditor that fails to comply with the TILA’s requirements for high-cost mortgage loans may be held liable to the consumer for all finance charges and fees paid to the creditor. Any subsequent assignee is subject to all claims and defenses that the consumer could assert against the creditor, unless the assignee demonstrates that it could not reasonably have determined that the loan was subject to section 226.32 of Regulation Z.

Criminal Liability (TILA § 112)

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

Administrative Actions (TILA § 108)

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

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

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

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

Federal Reserve examiners follow the FFIEC’s interagency Regulation Z policy guide when determining the applicability and amount of any reimbursements. Although the policy guide appears to require reimbursement only in cases in which a pattern or practice was discovered, System policy requires banks to make reimbursements when isolated cases are discovered as well. Unlike the discovery of a pattern or practice of violations, which requires the bank to conduct a file search to determine the extent of the pattern or practice, the discovery of an isolated instance does not require a file search. Isolated violations are technical and nonsubstantive in nature, are not cited in the examination report, and may be communicated in an informal manner.

Relationship to State Law (TILA § 111)

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

- Preempted by federal law
- Appropriate under state law and not preempted by federal law
- Substituted in lieu of TILA and Regulation Z requirements

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

- Chapter 1, “General Provisions,” which contains definitions and acceptable methods for determining finance charges and annual percentage rates. For example, a state law would be preempted if it required a bank 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 bank to use the term “nominal annual interest rate” in lieu of “annual percentage rate.”
- Chapter 3, “Credit Advertising,” which contains rules for consumer credit advertising and requirements for the oral disclosure of annual percentage rates.
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 sections of Regulation Z, either of the following:

• Disclosure of information not otherwise required. A state law that requires disclosure of the minimum periodic payment for open-end credit, for example, would not be preempted because it does not contradict federal law.

• Disclosures more detailed than those required. A state law that requires itemization of the amount financed, for example, would not be preempted, unless it contradicts federal law by requiring the itemization to appear with the disclosure of the amount financed in the segregated closed-end credit disclosures.

Two preemption standards apply to TILA chapter 4. One applies to section 161 (Correction of Billing Errors) and 162 (Regulation of Credit Reports), the other to the remaining provisions of chapter 4 (sections 163–171).

State law provisions are preempted if they differ from the rights, responsibilities, or procedures contained in section 161 or 162 of the TILA. An exception is made, however, for state law that allows a consumer to inquire about an account and requires the bank to respond to such inquiry beyond the time limits provided by federal law. Such a state law would not be preempted for the extra time period.

State law provisions are preempted if they result in violations of sections 163 through 171 of chapter 4 of the TILA. For example, a state law that allows the card issuer to offset the consumer’s credit card indebtedness against funds held by the card issuer would be preempted, as it would violate section 226.12(d) of Regulation Z. Conversely, a state law that requires periodic statements to be sent more than fourteen days before the end of a free-ride period would not be preempted, as no violation of federal law is involved.

A bank, state, or other interested party may ask the Federal Reserve Board to determine whether state law contradicts chapters 1 through 3 of the TILA or Regulation Z. They may also ask if the state law is different from, or would result in violations of, chapter 4 of the TILA and the implementing provisions of Regulation Z. If the Board determines that a disclosure required by state law (other than a requirement relating to the finance charge, the annual percentage rate, or the disclosures required under section 226.32 of the regulation) is substantially the same in meaning as a disclosure required under the act or the regulation, generally, creditors in that state may make the state disclosure in lieu of the federal disclosure.

Special Rules for Certain Home Mortgage Transactions (Subpart E)

General Rules (§ 226.31)

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

Certain Closed-End Home Mortgages (§ 226.32)

The requirements of section 226.32 apply to a consumer credit transaction secured by the consumer’s principal dwelling in which either

• The APR at consummation will exceed by more than 8 percentage points for first-lien mortgage loans, or by more than 10 percentage points for subordinate-lien mortgage loans, the yield on Treasury securities having periods of maturity comparable to the loan’s maturity (as of the 15th day of the month immediately preceding the month in which the application for the extension of credit is received by the creditor)

• The total points and fees (see definition below) payable by the consumer at or before loan closing will exceed the greater of 8 percent of the total loan amount or a dollar amount that is adjusted annually on the basis of changes in the consumer price index (See staff commentary to section 226.32(a)(1)(ii) of Regulation Z for a historical list of dollar amount adjustments. For calendar year 2005, the dollar amount was $510.) (section 226.32(a)(1))

Exemptions

The following are exempt from section 226.32:

• Residential mortgage transactions (generally, purchase money mortgages)

• Reverse mortgage transactions subject to section 226.33 of Regulation Z

• Open-end credit plans subject to subpart B of the regulation

Points and Fees

Points and fees include the following:

• All items required to be disclosed under sections 226.4(a) and (b) of Regulation Z except interest or the time–price differential

• All compensation paid to mortgage brokers
• All items listed in section 226.4(c)(7) other than amounts held for future taxes, unless all of the following conditions are met:
  – The charge is reasonable
  – The creditor receives no direct or indirect compensation in connection with the charge
  – The charge is not paid to an affiliate of the creditor

• Premiums or other charges, paid at or before closing whether paid in cash or financed, for optional credit life, accident, health, or loss-of-income insurance, and other debt-protection or debt-cancellation products written in connection with the credit transaction (section 226.32(b)(1))

Reverse Mortgages (§ 226.33)

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

Specific Defenses—TILA Section 108

Defense against Civil, Criminal, and Administrative Actions

A financial institution in violation of the TILA may avoid liability by doing all of the following:

• Discovering the error before an action is brought against the institution, or before the consumer notifies the institution, in writing, of the error
• Notifying the consumer of the error within sixty days of discovery
• Making the necessary adjustments to the consumer’s account, also within sixty 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.)

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

An error is “discovered” if it is

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

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

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

Additional Defenses against Civil Actions

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

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

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

Statute of Limitations—TILA Sections 108 and 130

Civil actions may be brought within one year after the violation occurred. After that time, and if allowed by state law, the consumer may still assert the violation as a defense if a financial institution brings an action to collect the consumer’s debt. Criminal actions are not subject to the TILA one-year statute of limitations.

Regulatory administrative enforcement actions also are not subject to the one-year statute of limitations. However, enforcement actions under the FFIEC policy guide involving erroneously disclosed APRs and finance charges are subject to time limitations by the TILA. Those limitations range from the date of the most recent regulatory examination of the financial institution to as far back as 1969, depending on when the loan was made, when the violation was identified, whether the violation was a repeat violation, and other factors.

There is no time limitation on willful violations intended to mislead the consumer. The following summarize the various time limitations:

• For open-end credit, reimbursement applies to violations not older than two years.
Truth in Lending

• For closed-end credit, reimbursement is generally applied to loans with violations occurring since the immediately preceding examination.

Rescission Rights (Open-End and Closed-End Credit)—Sections 226.15 and 226.23

The TILA provides that for certain transactions secured by a consumer’s principal dwelling, the consumer has three business days after becoming obligated on the debt to rescind the transaction. The right of rescission allows the consumer time to reexamine the credit agreement and cost disclosures and to reconsider whether he or she wants to place his or her home at risk by offering it as security for the credit. Transactions exempt from the right of rescission include residential mortgage transactions (section 226.2(a)(24)) and refinancings or consolidations with the original creditor when no “new money” is advanced.

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

To rescind a transaction, the consumer must notify the creditor in writing by midnight of the third business day after the latest of three events: (1) consummation of the transaction, (2) delivery of material TILA disclosures, or (3) receipt of the required notice of the right to rescind. For purposes of rescission, business day means every calendar day except Sundays and legal public holidays (section 226.2(a)(6)). Material disclosures is defined in section 226.23(a)(3) to mean the required disclosures of the annual percentage rate, the finance charge, the amount financed, the total of payments, the payment schedule, and the disclosures and limitations referred to in sections 226.32(c) and 226.32(d).

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

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

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

1. To appraise the quality of the financial institution’s compliance management system for the Truth in Lending Act and Regulation Z
2. To determine the reliance that can be placed on the financial institution’s compliance management system, including internal controls and procedures performed by the person(s) responsible for monitoring the financial institution’s compliance review function for the Truth in Lending Act and Regulation Z
3. To determine the financial institution’s compliance with the Truth in Lending Act and Regulation Z
4. To initiate corrective action when policies or internal controls are deficient, or when violations of law or regulation are identified
5. To determine whether the institution will be required to make adjustments to consumer accounts under the restitution provisions of the act

EXAMINATION PROCEDURES

General Procedures

1. Obtain information pertinent to the area of examination from the financial institution’s compliance management system program (historical examination findings, complaint information, and significant findings from compliance reviews and audits).
2. Through discussions with management and review of the following documents, determine whether the financial institution’s internal controls are adequate to ensure compliance in the area under review. Identify procedures used daily to detect errors and violations promptly. Also, review the procedures used to ensure compliance when changes occur (for example, changes in interest rates, service charges, computation methods, and software programs).
   - Organization charts
   - Process flow charts
   - Policies and procedures
   - Loan documentation and disclosures
   - Checklists, worksheets, and review documents
   - Computer programs
3. Review compliance reviews and audit workpapers and determine whether

   a. The procedures used address all regulatory provisions (see “Transaction Testing” section, later in these procedures)
   b. Steps are taken to follow up on previously identified deficiencies
   c. The procedures used include samples that cover all product types and decision centers
   d. The work performed is accurate (by reviewing some transactions)
   e. Significant deficiencies, and the root cause of the deficiencies, are included in reports to management and the board
   f. Corrective actions are timely and appropriate
   g. The area is reviewed at an appropriate interval

Disclosure Forms

4. Determine whether the financial institution has changed any preprinted TILA disclosure forms or if there are forms that have not been previously reviewed for accuracy. If so, verify the accuracy of each preprinted disclosure by reviewing the following:
   - Note and/or contract forms (including those furnished to dealers)
   - Standard closed-end credit disclosures (§§ 226.17(a) and 226.18)
   - ARM disclosures (§ 226.19(b))
   - High-cost mortgage disclosures (§ 226.32(c))
   - Initial disclosures (§§ 226.6(a)–(d)) and, if applicable, additional home equity line of credit (HELC) disclosures (§ 226.6(e))
   - Credit card application and solicitation disclosures (§§ 226.5a(b)–(e))
   - HELC disclosures (§§ 226.5b(d) and 226.5b(e))
   - Statement of billing rights and change-in-terms notice (§ 226.9(a))
   - Reverse mortgage disclosures (§ 226.33(b))

Forms for Closed-End Credit

a. Determine that the disclosures are clear, conspicuous, grouped, and segregated. The terms “finance charge” and “APR” should be more conspicuous than other terms. (§ 226.17(a))
b. Determine that the disclosures include the following, as applicable: (§ 226.18)
   (1) Identity of the creditor
   (2) Brief description of the finance charge
   (3) Brief description of the APR
   (4) Variable-rate verbiage (§ 226.18(f)(1) or 226.18(f)(2))
   (5) Payment schedule
   (6) Brief description of the total of payments
   (7) Demand feature
   (8) For a credit sale, description of total sales price
   (9) Prepayment penalties or rebates
   (10) Late-payment amount or percentage
   (11) Description of security interest
   (12) Various insurance verbiage (§ 226.4(d))
   (13) Statement referring to the contract
   (14) Statement regarding assumption of the note
   (15) Statement regarding required deposits

c. Determine whether all variable-rate loans with a maturity of more than 1 year secured by a principal dwelling are given the following disclosures at the time of application: (§ 226.19)
   (1) Consumer handbook on adjustable-rate mortgages, or a substitute
   (2) Statement that interest rate payments and terms can change
   (3) The index or formula and a source of information
   (4) Explanation of the interest rate, payment determination, and margin
   (5) Statement that the consumer should ask for the current interest rate and margin
   (6) Statement that the interest rate is discounted, if applicable
   (7) Frequency of interest rate and payment changes
   (8) Rules relating to all changes
   (9) Either (1) a historical example, based on a $10,000 loan amount, illustrating how payments and the loan balance would have been affected by interest rate changes implemented according to the terms of the loan program over the past 15 years or (2) the initial and maximum interest rates and payments for a $10,000 loan, along with a statement that the periodic payment may substantially increase or decrease and a statement of a maximum interest rate and payment
   (10) Explanation of how to compute the loan payment, and an example
   (11) Demand feature, if applicable
   (12) Statement regarding the content and timing of adjustment notices
   (13) Statement that other variable-rate loan program disclosures are available, if applicable

d. Determine that the disclosures required for high-cost mortgage transactions clearly and conspicuously include the following items: (§ 226.32(c); see form H-16 in appendix H to Regulation Z)
   (1) The required statement “You are not required to complete this agreement merely because you have received these disclosures or have signed a loan application. If you obtain this loan, the lender will have a mortgage on your home. You could lose your home, and any money you have put into it, if you do not meet your obligations under the loan.”
   (2) Annual percentage rate
   (3) Amount of the regular monthly (or other periodic) payment and amount of any balloon payment. The regular payment should include amounts for voluntary items, such as credit life insurance or debt-cancellation coverage, only if the consumer has previously agreed to the amount. (See staff commentary to § 226.32(c)(3).)
   (4) For variable-rate loans, a statement that the interest rate may increase, and the amount of the single maximum monthly payment, based on the maximum interest rate allowed under the contract, if applicable
   (5) For mortgage refinancings, the total amount borrowed, as reflected by the face amount of the note; and if the amount borrowed includes premiums or other charges for optional credit insurance or debt-cancellation coverage, a statement to that effect (grouped together with the amount borrowed)

Forms for Open-End Credit

a. Determine that the initial disclosure statement is provided before the first transaction under the account and includes the following items, as applicable: (§ 226.6)
(1) Statement of when a finance charge would accrue and whether a grace period exists
(2) Statement of the periodic rates and the corresponding APR
(3) Explanation of the method of determining the balance on which the finance charge may be computed
(4) Explanation of how the finance charge would be determined
(5) Statement of the amount of any other charges
(6) Statement of the creditor's security interest in the property
(7) Statement of billing rights (§§ 226.12 and 226.13)
(8) Certain home equity plan information, if not provided with the application, in a form the consumer can keep (§ 226.6(e)(7))

b. Determine that the following credit card disclosures were made clearly and conspicuously on or with a solicitation or an application. Disclosures in 12-point type are deemed to comply with the requirements. See commentary to section 226.5a(a)(2)-1. The APR for purchases (other than an introductory rate that is lower than the rate that will apply after the introductory rate expires) must be in at least 18-point type. (§ 226.5a)

(1) APR for purchases, cash advances, and balance transfers, including penalty rates that may apply. If the rate is variable, the index or formula and the margin must be identified.
(2) Fee for issuance of the card
(3) Minimum finance charge
(4) Transaction fees
(5) Length of the grace period
(6) Balance-computation method
(7) Statement that charges incurred by using the charge card are due when the periodic statement is received

Note: Items 1–7 must be provided in a prominent location in the form of a table. The following items (8–10) may be included in the same table or clearly and conspicuously elsewhere in the same document. An explanation of specific events that may result in the imposition of a penalty rate must be placed outside the table, with an asterisk inside the table (or other means) directing the consumer to the additional information.

(8) Cash-advance fees
(9) Late-payment fees
(10) Fees for exceeding the credit limit
c. Determine that the disclosure of items 1–7 in “b,” above, are made orally for creditor-initiated telephone applications and pre-approved solicitations. Also, determine for applications or solicitations made to the general public that the card issuer makes one of the optional disclosures. (§§ 226.5a(d) and 226.5a(e))
d. Determine that the following home equity information was provided clearly and conspicuously at the time of application: (§ 226.5b)

(1) Home equity brochure
(2) Statement that the consumer should retain a copy of the disclosure
(3) Statement of the time the specific terms are available
(4) Statement that terms are subject to change before the plan opens
(5) Statement that the consumer may receive a full refund of all fees
(6) Statement that the consumer’s dwelling secures the credit
(7) Statement that the consumer could lose the dwelling
(8) Statement of the creditor’s right to change, freeze, or terminate the account
(9) Statement that information about conditions for adverse action is available upon request
(10) Statement of payment terms, including the length of the draw and repayment periods, how the minimum payment is determined, the timing of payments, and an example based on $10,000 and a recent APR
(11) A recent APR imposed under the plan and a statement that the rate does not include costs other than interest (fixed-rate plans only)
(12) Itemization of all fees to be paid to the creditor
(13) Estimate of any fees payable to third parties to open the account and a statement that the consumer may receive a good-faith itemization of third-party fees
(14) Statement regarding negative amortization, as applicable
(15) Statement of transaction requirements
(16) Statement that the consumer should consult a tax advisor regarding the deductibility of interest and charges under the plan

(17) For variable-rate home equity plans, disclosures including
i. That the APR, payment, or term may change
ii. That the APR excludes costs other than interest
iii. The index and its source
iv. How the rate will be determined
v. That the consumer should request information on the current index value, margin, discount, premium, or APR
vi. That the initial rate is discounted, and the duration of the discount, if applicable
vii. Frequency of APR changes
viii. Rules relating to changes in the index, APR, and payment amount
ix. Lifetime rate cap and any annual caps, or that there is no annual limitation
x. The minimum payment requirement, using the maximum APR, and when the maximum APR may be imposed
xi. A table, based on a $10,000 balance, reflecting all significant plan terms
xii. That rate information will be provided on or with each periodic statement

e. Determine when the last statement of billing rights was furnished to customers and whether the institution used the short-form notice with each periodic statement. (§ 226.9(a))
f. Determine that the notice of any change in terms was provided 15 days prior to the effective date of the change. (§ 226.9(b))
g. Determine that items 1–7 in “b,” above, are disclosed when the account is renewed. This disclosure must also state how and when the cardholder may terminate the credit to avoid paying the renewal fee. (§ 226.9(e))
h. Determine that a statement regarding the maximum interest rate that may be imposed during the term of the obligation is made for any loan for which the APR may increase during the plan. (§ 226.30(b))

Forms for Reverse Mortgages
(Both Open- and Closed-End)

a. Determine that the disclosures required for reverse mortgage transactions are substantially similar to the model form in appendix K to Regulation Z and include the following items:

(1) A statement that the consumer is not obligated to complete the reverse mortgage transaction merely because he or she has received the disclosures or signed an application

(2) A good-faith projection of the total cost of the credit expressed as a table of "total annual loan cost rates," including payments to the consumer, additional creditor compensation, limitations on consumer liability, assumed annual appreciation, and the assumed loan period

(3) An itemization of loan terms, charges, the age of the youngest borrower, and the appraised property value

(4) An explanation of the table of total annual loan cost rates

Note: Forms that include or involve current transactions, such as change-in-terms notices, periodic billing statements, rescission notices, and billing-error communications, should be verified for accuracy when the file review worksheets are completed.

Timing of Disclosures

5. Review financial institution policies, procedures, and systems to determine, either separately or when completing the actual file review, whether the applicable disclosures listed below are furnished when required by Regulation Z. Take into account products that have different features, such as closed-end loans or credit card accounts that are fixed or variable rate.

a. Credit card application and solicitation disclosures—On or with the application (§ 226.5a(b))

b. HELC disclosures—At the time the application is provided or within 3 business days under certain circumstances (§ 226.5b(b))

c. Open-end credit initial disclosures—Before the first transaction is made under the plan (§ 226.5b(1))

d. Periodic disclosures—At the end of a billing cycle if the account has a debit or credit balance of $1 or more or if a finance charge has been imposed (§ 226.5(b)(2))
e. Statement of billing rights—At least once a year (§ 226.9(a))

f. Supplemental credit devices—Before the first transaction under the plan (§ 226.9(b))

g. Open-end credit change in terms—15 days prior to the effective change date (§ 226.9(c))

h. Finance charge imposed at time of transaction—Prior to imposing any fee (§ 226.9(d))

i. Disclosures upon renewal of credit or charge card—30 days or 1 billing cycle, whichever is less, before the delivery of the periodic statement on which the renewal fee is charged. Alternatively, notice may be delayed until the mailing or delivery of the periodic statement on which the renewal fee is charged to the accounts if the notice meets certain requirements. (§ 226.9(e))

j. Change in credit account insurance provider—Certain information 30 days before the change in provider occurs, and certain information 30 days after the change in provider occurs. The institution may provide a combined disclosure 30 days before the change in provider occurs. (§ 226.9(f))

k. Closed-end credit disclosures—Before consummation (§ 226.17(b))

l. Disclosures for certain closed-end home mortgages—3 business days prior to consummation (§ 226.31(c)(1))

m. Disclosures for reverse mortgages—3 days prior to consummation of a closed-end credit transaction or prior to the first transaction under an open-end credit plan (§ 226.31(c)(2))

n. Disclosures for adjustable-rate mortgages—At least once each year during which an interest rate adjustment is implemented without an accompanying payment change, and at least 25, but no more than 120, calendar days before a new payment amount is due, or in accordance with other variable-rate subsequent-disclosure regulations issued by a supervisory agency (§ 226.20(c))

Transaction Testing

Note: When verifying APR accuracies, use the OCC’s APR calculation model or other acceptable calculation tool.

Advertising

7. Sample advertising copy, including any Internet advertising, since the previous examination and verify that the terms of credit are specific. If triggering terms are used, determine that the required disclosures are made. (§§ 226.16 and 226.24)

For advertisements for closed-end credit, determine,

• If a rate of finance charge was stated, that it was stated as an APR
• If an APR will increase after consummation, that a statement to that effect is made

Closed-End Credit

8. For each type of closed-end loan being tested, determine the accuracy of the disclosures by comparing the disclosures with the contract and other financial institution documents. (§ 226.17)

9. Determine whether the required disclosures were made before consummation of the transaction, and ensure the presence and accuracy of the items below, as applicable. (§ 226.18)

a. Amount financed

b. Itemization of the amount financed (RESPA good-faith estimate may be substituted)

c. Finance charge

d. APR

e. Variable-rate verbiage, as follows, for loans not secured by a principal dwelling or loans with terms of 1 year or less:

(1) Circumstances that permit a rate increase

(2) Limitations on the increase (periodic or lifetime)

(3) Effects of the increase

(4) Hypothetical example of new payment terms

f. Payment schedule, including amount, timing, and number of payments

g. Total of payments

h. Total sales price (credit sale)

i. Description of security interest

Record Retention

6. Review the financial institution’s record-retention practices to determine whether evidence of compliance (for other than the advertising requirements) is retained for at least 2 years after the disclosure was required to be made or other action was required to be taken. (§ 226.25)
j. Credit life insurance premium is included in the finance charge, unless all three of the following conditions are met:
   (1) Insurance is not required
   (2) Premium for the initial term is disclosed
   (3) Consumer signs or initials an affirmative written request for the insurance

k. Property insurance available from the creditor is excluded from the finance charge if the premium for the initial term of the insurance is disclosed

l. Required deposit

10. Determine, for adjustable-rate mortgage loans that are secured by the borrower’s principal dwelling and have maturities of more than 1 year, that the required early and subsequent disclosures are complete, accurate, and timely. Early disclosures required by section 226.19(a) are verified during the closed-end credit forms review. Subsequent disclosures should include the items below, as applicable: (§ 226.20(c))
   a. Current and prior interest rates
   b. Index values used to determine current and prior interest rates
   c. Extent to which the creditor has foregone an increase in the interest rate
   d. Contractual effects of the adjustment (new payment and loan balance)
   e. Payment required to avoid negative amortization

   Note: The accuracy of the adjusted interest rates and indexes should be verified by comparing them with the contract and with early disclosures. Refer to the “Additional Variable-Rate Testing” section of these examination procedures.

11. Determine, for each type of closed-end rescindable loan being tested, whether 2 copies of the rescission notice are provided to each person whose ownership interest is or will be subject to the security interest. The rescission notice must disclose the following items: (§ 226.23(b))
   a. Security interest taken in the consumer’s principal dwelling
   b. Consumer’s right to rescind the transaction
   c. How to exercise the right to rescind, with a form for that purpose, stating the address of the creditor’s place of business
   d. Effects of rescission
   e. Date the rescission period expires

12. Ensure that funding was delayed until the rescission period expired. (§ 226.23(c))

13. Determine if the institution has received any requests to waive the 3-day right to rescind since the previous examination. If applicable, test rescission waivers. (§ 226.23(e))

14. Determine whether the maximum interest rate in the contract is disclosed for any adjustable-rate consumer credit contract secured by a dwelling. (§ 226.30(a))

Open-End Credit

15. For each open-end credit product tested, determine the accuracy of the disclosures by comparing the disclosures with the contracts and other financial institution documents. (§ 226.5(c))

16. Review the financial institution’s policies, procedures, and practices to determine whether it provides appropriate disclosures for creditor-initiated direct mail applications and solicitations to open charge card accounts, telephone applications and solicitations to open charge card accounts, and applications and solicitations made available to the general public to open charge card accounts. (§§ 226.5a(b)–(d))

17. Determine, for all home equity plans with a variable rate, that the APR is based on an independent index. Further, ensure that home equity plans are terminated or terms are changed only if certain conditions exist. (§ 226.5b(f))

18. Determine that if any consumer rejected a home equity plan because a disclosed term changed before the plan was opened, all fees were refunded. Verify that nonrefundable fees were not imposed until 3 business days after the consumer received the required disclosures and brochure. (§§ 226.5b(g) and 226.5b(h))

19. Review consecutive periodic billing statements for each major type of open-end credit activity offered (overdraft and home equity lines of credit, credit card programs, and so forth). Determine whether disclosures were calculated accurately and are consistent with the initial disclosure statement furnished in connection with the accounts (or any subsequent change-in-terms notice) and the underlying contractual terms governing the plan(s). The periodic statement must disclose the following items, as applicable: (§ 226.7)
   a. Previous balance
   b. Identification of transactions
   c. Dates and amounts of any credits
   d. Periodic rates and corresponding APRs; for variable-rate plans, that the periodic rates may vary
   e. Balance on which the finance charge is
computed, and an explanation of how the balance is determined
f. Amount of the finance charge, with an itemization of each of the components of the finance charge
g. Annual percentage rate
h. Itemization of other charges
i. Closing date and balance
j. Payment date, if there is a “free ride” period
k. Address for notice of billing errors
20. Verify that the institution credits a payment to an open-end account as of the date of receipt. (§ 226.10)
21. Determine how the institution handles credit balances. Specifically, if an account’s credit balance is in excess of $1, the institution must take the following actions: (§ 226.11)
a. Credit the amount to the consumer’s account
b. Refund any part of the remaining credit balance within 7 business days from receiving a written request from the consumer
c. Make a good-faith effort to refund the amount of the credit to a deposit account of the consumer if the credit remains for more than 6 months
22. Review samples of billing-error-resolution files and correspondence from consumers asserting a claim or defense against the financial institution for a credit card dispute regarding property or services. Verify the following: (§§ 226.12 and 226.13)
a. Credit cards are issued only upon request
b. Liability for unauthorized credit card use is limited to $50
c. Disputed amounts are not reported as delinquent unless remaining unpaid after the dispute has been settled
d. Offsetting credit card indebtedness is prohibited
e. Errors are resolved within two complete billing cycles
23. Determine, for each type of open-end rescindable loan being tested, that two copies of the rescission notice are provided to each person whose ownership interest is or will be subject to the security interest and follow procedures 11, 12, and 13 in the section “Closed-End Credit.”

Additional Variable-Rate Testing
24. Verify that when accounts were opened or loans were consummated, the loan contract terms were recorded correctly in the financial institution’s calculation systems (for example, its computer). Determine the accuracy of the following recorded information:
a. Index value
b. Margin and method of calculating rate changes
c. Rounding method
d. Adjustment caps (periodic and lifetime)
25. Using a sample of periodic disclosures for open-end variable-rate accounts (for example, home equity accounts) and closed-end rate-change notices for adjustable-rate mortgage loans,
a. Compare the rate-change date and rate on the credit obligation with the actual rate-change date and rate imposed.
b. Determine that the index disclosed and imposed is based on the terms of the contract (Example: The weekly average of 1-year Treasury constant maturities, as of 45 days before the change date). (§§ 226.7(g) and 226.20(c)(2))
c. Determine that the new interest rate is correctly disclosed by adding the correct index value with the margin stated in the note, plus or minus any contractual fractional adjustment. (§§ 226.7(g) and 226.20(c)(1))
d. Determine that the new payment disclosed (section 226.20(c)(4)) was based on an interest rate and loan balance in effect at least 25 days before the payment change date (consistent with the contract). (§ 226.20(c))

Certain Home Mortgage Transactions
26. Determine whether the financial institution originates consumer credit transactions subject to subpart E of Regulation Z, specifically, certain closed-end home mortgages (high-cost mortgages (section 226.32) and reverse mortgages (section 226.33)).
27. Examiners may use the worksheet at the end of these examination procedures as an aid in identifying and reviewing high-cost mortgages.
28. Review both high-cost and reverse mortgages to ensure that
a. Required disclosures are provided to consumers in addition to, not in lieu of, the disclosures contained in other subparts of Regulation Z (§ 226.31(a))
b. Disclosures are clear and conspicuous, in writing, and in a form that the consumer can keep (§ 226.31(b))
c. Disclosures are furnished at least 3 business days prior to consummation of a mortgage transaction covered by section 226.32 or a closed-end reverse mortgage transaction (or at least 3 business days prior to the first transaction under an open-end reverse mortgage) (§ 226.31(c))

d. Disclosures reflect the terms of the legal obligation between the parties (§ 226.31(d))

e. The institution abides by the disclosure rules for multiple consumers and multiple creditors. If the obligation involves multiple consumers, the disclosures may be provided to any consumer who is primarily liable on the obligation. However, for rescindable transactions, the disclosures must be provided to each consumer who has the right to rescind. If the transaction involves more than one creditor, only one creditor should provide the disclosures. (§ 226.31(e))

f. The APR is accurately calculated and disclosed in accordance with the requirements and within the tolerances allowed in section 226.22 (§ 226.31(g))

29. For high-cost mortgages (section 226.32), ensure that

a. In addition to other required disclosures, the creditor gives the following at least 3 business days prior to consummation (see the model disclosure in appendix H-16):

1) Notice containing the prescribed language (§ 226.32(c)(1))

2) Annual percentage rate (§ 226.32(c)(2))

3) Amount of regular loan payment and amount of any balloon payment (§ 226.32(c)(3))

4) For variable-rate loans, a statement that the interest rate and monthly payment may increase, and the amount of the single maximum monthly payment allowed under the contract (§ 226.32(c)(4))

5) For mortgage refinancings, the total amount the consumer will borrow (the face amount), and if this amount includes premiums or other charges for optional credit insurance or debt-cancellation coverage, that fact. This disclosure is to be treated as accurate if the disclosed face amount is within $100 of the actual amount. (§ 226.32(c)(5))

6) A new disclosure is required if subsequent to providing the additional disclosure but prior to consummation, there are changes in any terms that make the disclosures inaccurate. For example, if a consumer purchases optional credit insurance and, as a result, the monthly payment differs from the payment previously disclosed, redisclosure is required and a new 3-day waiting period applies. (§ 226.31(c)(1)(ii))

7) If a creditor provides new disclosures by telephone when the consumer initiates a change in terms, then at consummation (§ 226.31(c)(1)(ii))

- The creditor must provide new written disclosures and both parties must sign a statement that these new disclosures were provided by telephone at least 3 days prior to consummation.

8) If a consumer waives the right to a 3-day waiting period to meet a bona fide personal financial emergency, the consumer’s waiver must be a dated written statement (not a preprinted form) describing the emergency and bearing the signature of all entitled to the waiting period (a consumer may waive only after receiving the required disclosures and prior to consummation). (§ 26.31(c)(1)(iii))

b. High-cost mortgage transactions do not include any of the following terms:

1) Balloon payment (if the term is less than 5 years, with exceptions) (§§ 226.32(d)(1)(i) and 226.32(d)(1)(ii))

2) Negative amortization (§ 226.32(d)(2))

3) Advance payments from the proceeds of more than two periodic payments (§ 226.32(d)(3))

4) Increased interest rate after default (§ 226.32(d)(4))

5) A rebate of interest, arising from a loan acceleration due to default, that is calculated by a method less favorable than the actuarial method (§ 226.32(d)(5))

6) Prepayment penalties (but permitted in the first 5 years if certain conditions are met) (§§ 226.32(d)(6) and 226.32(d)(7))

7) A due-on-demand clause permitting the creditor to terminate the loan in advance of maturity and accelerate the balance, with certain exceptions (§ 226.32(d)(8))

c. The creditor is not engaged in the following
acts and practices for high-cost mortgages:

1. **Home improvement contracts**—Paying a contractor under a home improvement contract from the proceeds of a mortgage unless certain conditions are met (§ 226.34(a)(1))

2. **Notice to assignee**—Selling or otherwise assigning a high-cost mortgage without furnishing the required statement to the purchaser or assignee (§ 226.34(a)(2))

3. **Refinancing within 1 year of extending credit**—Within 1 year of making a high-cost mortgage loan, a creditor may not refinance any high-cost mortgage loan to the same borrower into another high-cost mortgage loan that is not in the borrower’s interest. This restriction also applies to assignees that hold or service the high-cost mortgage loan. Commentary to section 226.34(a)(3) has examples that apply the refinancing prohibition and address “borrower’s interest.”

4. **Consumer’s ability to repay**—Engaging in a pattern or practice of extending high-cost mortgages based on the consumer’s collateral without regard to repayment ability, including the consumer’s current and expected income, current obligations, and employment. A violation is presumed if there is a pattern or practice of making such mortgage loans without verifying and documenting the consumer’s repayment ability.

   A. A creditor may consider any expected income of the consumer, including
      i. Regular salary or wages
      ii. Gifts
      iii. Expected retirement payments
      iv. Income from self-employment

   B. Equity income that would be realized from the collateral may not be considered.

   C. Creditors may verify and document a consumer’s income and obligations through any reliable source that provides the creditor with a reasonable basis for believing that there are sufficient funds to support the loan. Reliable sources include
      i. Credit reports
      ii. Tax return

iii. Pension statements

iv. Payment records for employment income

D. If a loan transaction includes a discounted introductory rate, the creditor must consider the consumer’s ability to repay on the basis of the nondiscounted or fully indexed rate.

Note: Commentary to section 226.34(a)(4) contains guidance on income that may be considered, on “pattern or practice,” and on “verifying and documenting” income and obligations.

30. Ensure that the creditor does not structure a home-secured loan as an open-end plan (“spurious open-end credit”) to evade the requirements of Regulation Z. See staff commentary to section 226.34(b) for factors to be considered.

### Administrative Enforcement

31. If there is noncompliance involving understated finance charges or understated APRs subject to reimbursement under the FFIEC Policy Guide on Reimbursement, continue with procedure 32.

32. Document the date on which the administrative enforcement of the TILA policy statement would apply for reimbursement purposes by determining the date of the preceding examination.

33. If the noncompliance involves indirect (third-party paper) disclosure errors and affected consumers have not been reimbursed,

   a. Prepare comments, discussing the need for improved internal controls, to be included in the report of examination.

   b. Notify your supervisory office for follow up with the regulator that has primary responsibility for the original creditor.

   If the noncompliance involves direct credit,

   c. Make an initial determination as to whether the violation is a pattern or practice.

   d. Calculate the reimbursement for the loans or accounts in an expanded sample of the identified population.

   e. Estimate the total impact on the population based on the expanded sample.

   f. Inform management that reimbursement may be necessary under the law and the FFIEC policy guide, and discuss all substantive facts, including the sample loans and calculations.
g. Inform management of the financial institution’s options, under section 130 of the TILA, for avoiding civil liability and of its option under the policy guide and section 108(e)(6) of the TILA for avoiding a regulatory agency’s order to reimburse affected borrowers.
Truth in Lending: Examination Objectives and Procedures

**HIGH-COST-MORTGAGE (§ 226.32) WORKSHEET**

Borrower’s name ___________________________ Loan number ___________________________

<table>
<thead>
<tr>
<th>COVERAGE</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>Is the loan secured by the consumer’s principal dwelling? (§§ 226.2(a)(19) and 226.32(a)(1))</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

If the answer is No, STOP HERE

<table>
<thead>
<tr>
<th>Is the loan for the following purpose?</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Residential mortgage transaction (§ 226.2(a)(24))</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2 Reverse mortgage transaction (§ 226.33)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3 Open-end credit plan (Subpart B) (Note prohibition against structuring loans as open-end plans to evade sections 226.32–226.34(b))</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

If the answer is Yes in Box 1, 2, or 3, STOP HERE. If No, continue to Test 1.

**TEST 1: CALCULATION OF APR**

<table>
<thead>
<tr>
<th>A Disclosed APR</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>B Treasury security yield of comparable maturity</strong></td>
<td></td>
</tr>
<tr>
<td>Obtain the Treasury constant maturities yield from the Board’s H.15 statistical release, “Selected Interest Rates” (on the Board’s web site (<a href="http://www.federalreserve.gov/releases/h15/data.htm">www.federalreserve.gov/releases/h15/data.htm</a>), the “Business” links display daily yields). Use the yield that has the maturity most comparable to the loan term and is from the 15th day of the month that immediately precedes the month of the application. If the 15th is not a business day, use the yield for the business day immediately preceding the 15th. If the loan term is exactly halfway between two published security maturities, use the lower of the two yields. Note: Creditors may use the interest rates in the H.15 release or the actual auction results. See staff commentary to Regulation Z for further details. (§ 226.32(a)(1)(i))</td>
<td></td>
</tr>
<tr>
<td><strong>C Treasury security yield of comparable maturity (from Box B)</strong></td>
<td></td>
</tr>
<tr>
<td>Plus: 8 percentage points for first-lien loan or 10 percentage points for subordinate-lien loan</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>D Is Box A greater than Box C?</td>
<td></td>
</tr>
</tbody>
</table>

If Yes, the transaction is a high-cost mortgage. If No, continue to Test 2.
HIGH-COST MORTGAGE (§ 226.32) WORKSHEET—continued

TEST 2: CALCULATION OF POINTS AND FEES

STEP 1: Identify all charges paid by the consumer at or before loan closing

<table>
<thead>
<tr>
<th>Fee</th>
<th>Fee</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loan points</td>
<td></td>
</tr>
<tr>
<td>Mortgage broker fee</td>
<td></td>
</tr>
<tr>
<td>Loan service fees</td>
<td></td>
</tr>
<tr>
<td>Required closing agent/third-party fees</td>
<td></td>
</tr>
<tr>
<td>Required credit insurance</td>
<td></td>
</tr>
<tr>
<td>Private mortgage insurance</td>
<td></td>
</tr>
<tr>
<td>Life-of-loan charges (flood, taxes, etc.)</td>
<td></td>
</tr>
<tr>
<td>Any other fees considered finance charges</td>
<td></td>
</tr>
<tr>
<td>Subtotal</td>
<td></td>
</tr>
</tbody>
</table>

B Certain non-finance charges under section 226.4(c)(7)

Include fees paid by consumers only if the amount of the fee is unreasonable, the creditor receives direct or indirect compensation from the charge, or the charge is paid to an affiliate of the bank. (See the example in section 226.32(b)(1)(ii) of the commentary for further explanation.)

<table>
<thead>
<tr>
<th>Fee</th>
<th>Fee</th>
</tr>
</thead>
<tbody>
<tr>
<td>Title examination</td>
<td></td>
</tr>
<tr>
<td>Title insurance</td>
<td></td>
</tr>
<tr>
<td>Property survey</td>
<td></td>
</tr>
<tr>
<td>Document preparation charge</td>
<td></td>
</tr>
<tr>
<td>Credit report</td>
<td></td>
</tr>
<tr>
<td>Appraisal</td>
<td></td>
</tr>
<tr>
<td>Fee for “initial” flood hazard determination</td>
<td></td>
</tr>
<tr>
<td>Pest inspection</td>
<td></td>
</tr>
<tr>
<td>Any other fees not considered finance charges</td>
<td></td>
</tr>
<tr>
<td>Subtotal</td>
<td></td>
</tr>
</tbody>
</table>

C Premiums or other charges for optional credit life, accident, health, or loss-of-income insurance or debt-cancellation coverage

Subtotal

D Total points and fees: Add subtotals for Boxes A, B, and C
# HIGH-COST MORTGAGE (§ 226.32) WORKSHEET—continued

## TEST 2—continued

### STEP 2: Determine the total loan amount for cost calculation (§ 226.32(a)(1)(ii))

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
</table>
| **A** | Determine the amount financed (§ 226.18(b))  
Principal loan amount  
Plus: Other amounts financed by the lender (not already included in the principal and not part of the finance charge)  
Less: Prepaid finance charges (§ 226.2(a)(23))  
**EQUALS**: Amount financed  
**B** | Deduct costs included in the points and fees under sections 226.32(b)(1)(iii) and (iv) (Step 1, Box B and Box C) that are financed by the creditor  
**C** | Total loan amount (Step 2, Box A minus Box B) |

### STEP 3: Perform high-fee cost calculation

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
</table>
| **A** | 8 percent of the total loan amount (from Step 2, Box C)  
**B** | Annual adjustment amount (§ 226.32(a)(1)(ii))  
1999 $441  
2000 $451  
2001 $465  
2002 $480  
2003 $488  
2004 $499  
2005 $510  
2006 $528  
(Use the dollar amount corresponding to the year of the loan’s origination.)  
**C** | Total points and fees (from Step 1, Box D)  
Yes | No  
In Step 3, does Box C exceed the greater of Box A or Box B?  
If Yes, the transaction is a high-cost mortgage. If No, the transaction is not a high-cost mortgage under Test 2.