

FEDERAL RESERVE BANK
OF NEW YORK

At Cir. No. 8206
October 24, 1977

REGULATION Z
PROPOSED STATEMENT OF INTERAGENCY ENFORCEMENT POLICY

*To the Chief Executive Officers of All State Member Banks
in the Second Federal Reserve District:*

The Board of Governors of the Federal Reserve System, in conjunction with the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Home Loan Bank Board, and the National Credit Union Administration, has issued for comment a proposed statement of interagency policy regarding uniform guidelines for the enforcement of Regulation Z, "Truth in Lending."

Enclosed is a copy of the joint press release, dated October 18, 1977, issued by the five regulatory agencies, together with a copy of the proposed statement of interagency enforcement policy.

Comments on the proposed statement of interagency policy should be submitted by November 21 to Interagency Enforcement Policy -- Regulation Z, Comptroller of the Currency, Washington, D. C. 20219, or to the Consumer Affairs Division of this Bank.

PAUL A. VOLCKER,
President.



FEDERAL RESERVE

press release

AT-8206

This release has been issued on behalf of the following Federal regulatory agencies:
Comptroller of the Currency
Federal Deposit Insurance Corporation
Federal Home Loan Bank Board
National Credit Union Administration
Board of Governors, Federal Reserve System

For immediate release

October 18, 1977

Uniform guidelines for the enforcement of the Truth in Lending law and its regulatory rules were proposed for public comment today by the five Federal agencies that regulate banks, thrift institutions and credit unions.

Comment should be sent by November 21, 1977 to Interagency Enforcement Policy -- Regulation Z, Washington, D.C. 20219.

The joint notice of the proposed guidelines said they are intended to "promote improved and uniform enforcement of the Truth in Lending Act through corrective action, including reimbursement, for borrowers who have been overcharged or otherwise harmed by violations of the Act."

The Truth in Lending Act was passed in 1968, and, at the direction of Congress, the Federal Reserve Board wrote rules -- Regulation Z -- to implement it. The Act calls for disclosure of the true costs of credit extended for consumer purchases.

The Truth in Lending Act was the first of a dozen Federal consumer credit protection laws enacted in the last decade. These acts, and regulations spelling out their meaning and what may and may not be done under them, have created a new body of law so large and complex that provision of standard criteria for their enforcement has become necessary.

Consequently, the five Federal agencies have joined in proposing uniform guidelines for enforcement of Truth in Lending and Regulation Z

and they expect to issue further enforcement guidelines for other consumer credit protection laws and regulations.

The agencies joining in today's proposal are the Board of Governors of the Federal Reserve System, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Home Loan Bank Board and the National Credit Union Administration.

In a statement accompanying their enforcement proposals the agencies said:

"It is felt that coordination among the agencies is desirable in order to bring about uniformity in the administrative actions that will be taken when violations of the Act are detected....It is administratively impossible to fashion an appropriate remedy for every type of violation. The guidelines...outline the corrective action the agencies intend to require when violations...have caused measurable monetary injury to customers.... It should be emphasized that it will continue to be the policy of the enforcing agencies that...prospective correction of any violation will be required -- that is, creditors will be required to take whatever action is necessary to insure that the violation does not recur....

"The guidelines are not intended to substitute for...administrative authority any of the agencies has to enforce the Act, nor are they intended to foreclose the customer's right to bring civil action to recover for violations of the Act."

The agencies said willful and knowing violations will be brought to the attention of the Department of Justice. The guidelines may be modified by the agencies to be responsive to specific circumstances, and they will be reviewed and modified as continued special examinations of financial

institutions for compliance with the consumer credit protection laws yields more information.

"In all cases," the joint statement added, "the financial condition of the creditor and the cost of corrective action will be considered in applying the guidelines."

In connection with a number of their proposals, the agencies cited specific questions on which they would particularly like to have comment.

In part, the guidelines propose corrective actions that would be required when violations of key provisions of the Act are discovered. These guidelines are listed, beginning with Guideline 4, under the heading Corrective Action for Specific Violations. They include:

Violations Involving Improper Disclosure of the Annual Percentage Rate or Finance Charge (total cost of credit to a customer) (No. 4):

The agencies distinguish several types of violations involving the Annual Percentage Rate (APR) and the finance charge. They are:

1. Where the APR is understated^{1/} and the finance charge is either correct or not disclosed:
 - The creditor would be allowed to charge no more for the credit than the understated APR indicates, and must take action to ensure this.
2. Where no APR is disclosed and the finance charge is either correct or not disclosed:

Alternate 1: The creditor would calculate what APR is actually being charged and take action to ensure that the customer does not pay more than that, reduced by one-quarter of one per cent in the case of a first mortgage loan or one per cent in all other cases.

^{1/} "Understatement" of the APR or finance charge means an APR or finance charge that is less than what the customer is actually paying, resulting in an overcharge. See definitions Nos. 18 and 19 in the guidelines.

Alternate 2: Whatever rate is disclosed on the loan note or conditional sales contract would be considered the "disclosed" APR and the customer could be charged no more than that.

3. Where the APR is correctly disclosed but the finance charge is understated, the creditor would be required to pay the difference between the actual and the understated finance charge to the customer.
4. Where both the APR and the finance charge are understated, the creditor would be required to take the corrective action appropriate to whichever of the understatements caused the largest overcharge.
5. No reimbursement would be required when no finance charge is disclosed and the APR is correct. The agencies feel that customers are more likely to be misled by misstatement of the finance charge than by no disclosure of it.

Additionally, the agencies proposed three types of actions for correcting an understated APR. These are:

- A lump sum rebate and reduction of the amount of each remaining payment;
- Reducing the number of remaining payments;
- Reducing the amount of each remaining payment.

The agencies said each of these is administratively feasible and all would lower the actual rate paid by the customer to the level of the understated APR.

Violations Involving the Improper Disclosure of Credit Life, Accident, Health or Loss of Income Insurance(No. 5). The Act allows premiums for such insurance to be excluded from the Finance Charge if the customer is clearly and conspicuously informed that the insurance is optional. If the customer wants the insurance, the customer must sign and date an affirmative statement to that effect. The agencies proposed that if there is no written disclosure that the insurance is voluntary it should be treated as having been required, and its cost must be included in the finance charge.

If the disclosure was made but the cost of the insurance was not stated or the customer did not sign a statement saying it was desired, the agencies proposed that the customer should be given another chance to accept or reject the insurance. If the customer wants to cancel the insurance, the creditor would be required, under alternative proposals, to (1) refund some or (2) all of the premiums paid. The agencies said their alternative proposals for partial or entire refunds were made in light of the facts that even if the customer in the end rejects the insurance, some benefits were received while it was in force.

Other guidelines constitute proposed general policies, dealing with such matters as the difference in treatment of intentional and unintentional violations, how far back in time corrective action should reach and minimum amounts for which correction should be required.

Intentional Violations (No. 1):

The agencies defined intentional violations as (1) those an enforcing agency can reasonably determine to have been knowingly committed, permitted or approved by a creditor's managerial personnel or board of directors, or (2) a violation that an enforcing agency determines to have

resulted, (a) from a deliberate or sustained ignorance of, or indifference to, the law on the part of the creditor's management, including the board of directors, or (b) a deliberate or sustained omission concerning, or misrepresentation of, the requirements of the Act in the creditor's policies and procedures.

All intentional violations resulting in an overcharge would require corrective action, regardless of the dollar amount involved.

Unintentional Violations (No. 2):

(1) All unintentional violations resulting in an overcharge would require corrective action if the overcharge, or the estimated average overcharge per customer, is one dollar or more.

(2) Where the overcharge or estimated average for a type or class of loan is determined to be less than one dollar:

A -- Generally, no corrective action is to be required.

If, however, in the discretion of the agencies, the aggregate amount is considered substantial, a corrective action may be required.

B -- Corrective action is to be required

in the case of any customer accounts identified in a sampling of the creditor's practices as having been overcharged by one dollar or more.

In a discussion section following Guideline No. 2 the agencies said they were trying to strike a balance between harm to the customer and cost of corrective action programs to creditors who violate Truth in Lending requirements unintentionally. "Therefore," they said, "the agencies propose that in cases of unintentional violations, if an examiner, by sampling or some other

technique, detects a type or a class of loan for which the overcharge is one dollar or more, corrective action will be ordered for that type or class of loans. Creditors...will be given the right to produce their own average overcharge estimates."

Period for which Corrective Action is Required (No. 3):

Alternate Proposal 1: Corrective action shall be required for all violations since July 1, 1969 (date when Truth in Lending became effective).

Alternate Proposal 2: Corrective action would be required for all violations within the scope of the Guidelines occurring within one year prior to the date of examination of a creditor by an enforcing agency.

In discussing these alternatives the agencies said they have determined that the statute of limitations for civil remedies in the Truth In Lending Act does not control administrative enforcement of the Act, such as proposed under the Guidelines. However, they said, they are concerned about requiring creditors to take corrective action for violations back to 1969 since retroactive enforcement has only recently been required by the agencies. On the other hand, they said, they recognize that any time limitation will cut off some customers from relief for losses.

The statement of the agencies, and their proposed guidelines, are attached.

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DEPARTMENT OF THE TREASURY
COMPTROLLER OF THE CURRENCY

Regulation Z

JOINT NOTICE OF PROPOSED STATEMENT OF ENFORCEMENT POLICY

AGENCIES: The Board of Governors of the Federal Reserve System, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Home Loan Bank Board, and the National Credit Union Administration

ACTION: Proposed Statement of interagency enforcement policy - Regulation Z.

SUMMARY: This proposed statement of enforcement policy sets forth uniform guidelines which the Board of Governors of the Federal Reserve System, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Home Loan Bank Board, and the National Credit Union Administration propose to use to enforce the Truth in Lending Act and Regulation Z. It is intended that specific, standardized guidelines will promote improved and uniform enforcement of the Truth in Lending Act through corrective action, including reimbursement for borrowers who have been overcharged or otherwise harmed by violations of the Act. Realizing the value of public participation in the formulation of these guidelines, the agencies are requesting comments on these guidelines and have designated specific issues for comment.

DATES: Comments must be received on or before November 21, 1977 (30 days from publication in the Federal Register).

ADDRESSES: Written comments should be addressed to:

Interagency Enforcement Policy - Regulation Z
Washington, D. C. 20219

FOR FURTHER INFORMATION CONTACT: Mark Medvin, Federal Reserve Board, 202-452-2412; Thomas Vartanian, Comptroller of the Currency, 202-447-1884; Peter M. Kravitz, Federal Deposit Insurance Corporation, 202-389-4427; Harry W. Quillian, Federal Home Loan Bank Board, 202-376-3556; Harry J. Blaisdell, National Credit Union Administration, 202-254-8760.

SUPPLEMENTARY INFORMATION: This document is intended as a statement of the guidelines that the federal regulatory agencies involved propose to use in enforcing the Truth-in-Lending Act and Regulation Z.

It is felt that coordination among the agencies is desirable in order to bring about uniformity in the administrative actions that will be taken when violations of the Act are detected. To that end, the agencies have developed a set of proposed policy guidelines for measuring and correcting the conditions resulting from certain violations of the Truth in Lending Act.

It is administratively impossible to fashion an appropriate remedy for every type of violation. The guidelines which follow outline the corrective action that the agencies intend to require when violations which have caused measurable monetary injury to customers are discovered. It should be emphasized that it will continue to be the policy of the enforcing agencies that, whenever any violation of the Act is detected, prospective correction of the violation will be required--that is, creditors will be required to take whatever action is necessary to insure that the violation does not recur. For example, a creditor which is found to be using forms that do not comply with the type size requirements will be required to obtain new forms which do comply. These guidelines, however, are intended to address the most serious types of violations, those which result in overcharges to customers. Based upon the expertise and experience acquired by the various agencies through examinations of lending institutions throughout the country and investigations of consumer complaints, several substantive violations which cause measurable damage to customers have been identified, and guidelines for correcting the conditions resulting from these violations are proposed.

These guidelines are not intended to substitute for any other administrative authority that any of the agencies has to enforce the Act, nor are they intended to foreclose the customer's right to bring a civil action to recover for violations of the Act. Further, where apparently willful and knowing violations are found, the agencies will notify the Department of Justice. The guidelines serve only to reflect the enforcement policies of the agencies and to specify the actions which the agencies feel are appropriate to correct the conditions resulting from violations which cause overcharges to customers. As guidelines, they may be modified in the discretion of the agency so as to be more responsive to specific or unique circumstances which may exist. As new examination data concerning the extent and type of violations are received, the guidelines will be reviewed and revised as appropriate. In all cases, the financial condition of the creditor and the cost of corrective action will be considered in applying the guidelines.

This statement of enforcement policy is proposed to announce formally and to solicit public comment on the course which the federal regulatory agencies involved propose to follow in enforcement actions. It is hoped that the publication of

this proposed general statement of policy will promote uniformity of enforcement and provide notice to consumers and creditors of the type of action that can be expected when violations resulting in overcharges are found. Comments are requested on the entire proposal and specifically on the designated issues.

AUTHORITY

These guidelines are proposed pursuant to the enforcement authority contained in 15 U.S.C. 1607 and 12 U.S.C. 1818(b) in the cases of the Federal Reserve Board, the Federal Deposit Insurance Corporation, and the Comptroller of the Currency, pursuant to 15 U.S.C. 1607 and 12 U.S.C. 1464(d)(2) and 1730(e) in the case of the Federal Home Loan Bank Board, and pursuant to 15 U.S.C. 1607 and 12 U.S.C. 1786(e)(1) in the case of the National Credit Union Administration.

DRAFTING INFORMATION: The principal drafters of this document were Mark Medvin, Federal Reserve Board; Roberta Boylan, Comptroller of the Currency; Peter M. Kravitz, Federal Deposit Insurance Corporation.

PROPOSED STATEMENT

In consideration of the foregoing, the following statement of enforcement policy is proposed:

STATEMENT OF ENFORCEMENT POLICY

DEFINITIONS

1. "Act" means the Truth-in-Lending Act, 15 U.S.C. 1601 et seq., and Regulation Z, 12 CFR 226.
2. "Actuarial method based on scheduled payments" means a method of computing rebates of unearned finance charges in which the ratio of interest earned in a given period of time to the amount of the principal owed during that time is constant; the scheduled payment is allocated first to interest earned and the remainder is used to reduce principal.
3. "Annual percentage rate (APR)" means "annual percentage rate" as defined in 12 CFR 226.2(g).
4. "Corrective action" means a course of conduct to be undertaken by a creditor at the direction of an enforcing

agency to correct the conditions resulting from past violations of the Act.

5. "Creditor" means a "creditor" as defined in 12 CFR 226.2(s) and which is supervised by an enforcing agency.
6. "Customer" means "customer" as defined in 12 CFR 226.2(u)
7. "Enforcing agency" means the Board of Governors of the Federal Reserve System, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Home Loan Bank Board, and the National Credit Union Administration.
8. "Estimated average overcharge" means the average amount each customer is overcharged for a specific violation within the scope of these guidelines, based on a sampling of similar types or classes of loan accounts by an examiner of an enforcing agency.
9. "Finance charge" means "finance charge" as defined in 12 CFR 226.2(w).
10. "Intentional violation" means 1) any violation which an enforcing agency can reasonably determine to have been knowingly committed, permitted or approved by managerial personnel or the board of directors of a creditor; or 2) a violation which, in the determination of an enforcing agency, resulted from a deliberate or sustained ignorance of or indifference to the requirements of the Act on the part of a creditor's management, including the board of directors, or a deliberate or sustained omission concerning or misrepresentation of the requirements of the Act in the creditor's policies and procedures.
11. "Lump sum method" means a method of adjustment for determining the amount that will be returned to a customer when a loan has been paid in full; the amount will be calculated in accordance with the maturity reduction method.
12. "Lump sum/payment reduction method" - means a method of adjustment under which a cash payment equal to the amount the customer has overpaid (including time value) will be returned to the customer and the remaining payments on the loan will be reduced to the level at which they would have been had the payments been computed at the understated APR at the outset.
13. "Maturity reduction method" - means a method of adjustment under which a loan will be restructured to reduce the number of payments that the customer is required to make to pay off the loan so that the customer will not pay at a rate in excess of the understated APR.
14. "Method of adjustment" - means a calculation to determine

the adjustment necessary to correct overcharges resulting from APR violations.

15. "Overcharge" means a charge imposed by the creditor in excess of charges disclosed or required to be disclosed in accordance with 12 CFR 226 and as computed in accordance with these guidelines.

16. "Payment reduction method" means a method of adjustment under which the amount of each remaining payment on the loan will be lowered so that the customer will not pay at a rate in excess of the understated APR.

17. "Reimbursement" means corrective action involving monetary adjustment for overcharges for other than APR violations.

18. "Understated APR" means a disclosed APR, rounded to the next higher one-eighth of one percent, which is less than the APR calculated in accordance with the Act.

19. "Understated finance charge" means a finance charge disclosed at a dollar amount which is less than the finance charge calculated in accordance with the Act.

20. "Violation" means a violation of the Act.

GENERAL POLICIES

1. INTENTIONAL VIOLATIONS

All intentional violations of the Act by a creditor which result in an overcharge shall require corrective action regardless of the dollar amount of the overcharge.

2. UNINTENTIONAL VIOLATIONS

(a) All unintentional violations which result in overcharges shall require corrective action if the overcharge or the estimated average overcharge per customer is one dollar or more.

(b) If the overcharge or the estimated average overcharge per customer for a type or class of loans is determined to be less than one dollar, no corrective action shall be required except as provided in paragraph (c) unless, in the discretion of the agency, the aggregate amount of all overcharges is considered substantial.

Alternate paragraph (b):

(b) If the overcharge or the estimated average overcharge for a type or class of loans is less than one dollar, no corrective action shall be required except as provided in paragraph (c).

(c) Where the estimated average overcharge for a type or class of loans is less than one dollar, any customer accounts

identified in the sample which have been overcharged by one dollar or more shall be subject to corrective action.

DISCUSSION

In many cases, the costs involved in the corrective action may be far greater than the amount of monetary damage suffered by the customer. The agencies believe that the imposition of a corrective action program on a creditor who had unintentionally violated the law may be unnecessary where there is negligible harm to any customer. Therefore, the agencies propose that, in cases of unintentional violations, if an examiner, by sampling or some other technique, detects a type of loan (e.g. mortgage, installment, open-end) or a class within that type of loan (e.g., all loans involving amounts financed greater than \$1,000) for which the overcharge or the estimated average overcharge is \$1 or more, corrective action will be ordered for that type or class of loans. Further, to afford creditors the opportunity to confirm or rebut the accuracy of estimated average overcharges they will be given the right to produce their own average overcharge estimates.

When estimated average overcharges are less than \$1 per customer but the total of all overcharges is substantial, it may not be equitable to allow the creditor to keep amounts to which it is not entitled. It has been suggested that, in these cases, each agency may exercise its discretion to order the creditor to use such amounts in a manner which would further the purposes of the Truth in Lending Act.

It should be noted that, where estimated average overcharges are less than \$1, any account in the sample which has been identified as having been overcharged \$1 or more should be reimbursed since the cost of identifying those accounts and computing the overcharge has already been incurred.

The agencies have advanced the estimated average overcharge proposal under the assumption that the costs involved in requiring corrective action for amounts less than \$1 would probably outweigh the benefits of such action and would be unnecessarily burdensome when the violation was unintentional. In the case of intentional violations, however, corrective action should presumably always be ordered because the creditor has inflicted financial harm upon its customers.

In distinguishing between intentional and unintentional violations of the Act, the agencies do not mean to equate "intentional" violations as defined in these guidelines with "willful and knowing" violations as defined in 15 U.S.C. 1611. However, if, in the determination of the agencies, an intentional violation was committed willfully and knowingly, the matter will be referred to the Department of Justice.

Designated Issues

1. Is one dollar a reasonable minimum estimated average overcharge amount to trigger corrective action for unintentional violations of the Act?
2. Where the estimated average overcharge is less than the amount that would trigger corrective action, but the total

of all overcharges is substantial, should corrective action be ordered? If so, in what form?

3. PERIOD FOR WHICH CORRECTIVE ACTION IS REQUIRED

Corrective action shall be required for all violations within the scope of these guidelines occurring since July 1, 1969. Alternate guideline 3.

3. PERIOD FOR WHICH CORRECTIVE ACTION IS REQUIRED

Corrective action shall be required for all violations within the scope of these guidelines occurring within one year prior to the date of the examination by the enforcing agency.

Discussion

The agencies have considered the time period for which corrective action will be required. One proposal is that corrective action should be required for all violations within the scope of the guidelines since 1969 when the Act became effective. Another proposal is that the creditor only be required to take corrective action for violations occurring within one year prior to the date of examination to maintain consistency with the one-year statute of limitations for Truth-in-Lending civil actions.

The enforcing agencies have concluded that the statute of limitations for civil remedies in the Act does not control administrative enforcement of the Act. The agencies are concerned, however, about the desirability of requiring creditors to take corrective action for violations occurring as far back as 1969 since retroactive corrective action has only recently been imposed by the agencies. On the other hand, it is recognized that a corrective action program which addresses violations occurring within any limited time frame will provide no relief for some customers who have suffered harm as a result of a violation.

Designated Issue

3. Should corrective action be required for violations occurring since July 1, 1969, when the Act became effective, or should it be limited to violations occurring within one year prior to the date of examination? Is any other time period appropriate? Should a longer time period be specified for long-term obligations (e.g. real estate loans) than for short-term obligations (e.g. auto loans).

CORRECTIVE ACTION FOR SPECIFIC VIOLATIONS

4. VIOLATIONS INVOLVING THE IMPROPER DISCLOSURE OF THE APR OR FINANCE CHARGE

(a) Where there is an understated APR and the finance charge is either correct or not disclosed, the creditor shall take corrective action to insure that the customer's true cost of credit does not exceed the understated APR.

(b) Where no APR is disclosed and the finance charge is either correct or not disclosed, the creditor shall calculate the APR it charged the customer and shall take corrective action to insure that the customer's true cost of credit does not exceed the actual APR reduced by one-quarter of one percent in the case of first lien real estate transactions, and one percent in all other consumer credit transactions.

Alternate paragraph (b):

(b) Where no APR is disclosed and the finance charge is either correct or not disclosed, the rate disclosed on the note or conditional sales contract evidencing the transaction will be considered the "disclosed APR"; the creditor shall calculate the APR it charged the customer and shall take corrective action to insure that the customer's true cost of credit does not exceed the "disclosed APR". If no rate is disclosed on the note, the creditor shall calculate the APR it charged the customer and shall take corrective action to insure that the customer's true cost of credit does not exceed the actual APR reduced by one-quarter of one percent in the case of first lien real estate transactions, and one percent in all other consumer credit transactions.

(c) Where there is an understated finance charge and the APR is correct, the creditor shall reimburse the overcharge which is the difference between the actual and the understated finance charge.

(d) Where no finance charge is disclosed and the APR is properly disclosed, no reimbursement is required.

(e) Where there is an understated finance charge and an understated APR, the creditor shall take appropriate corrective action for the larger overcharge.

(f) Corrective action for understated APR violations will be made by a method of adjustment as defined in the guidelines.

Discussion

1. APR Violations

One of the most important items of information furnished to a borrower under the Truth-in-Lending Act is the Annual Percentage Rate (APR). The APR is a term of art which is described in 12 CFR 226.5. Essentially, it represents the true cost of the credit extended and reflects not only the rate of interest but also the total of certain other costs which the customer must pay as a condition of the extension of credit. Congress intended that the uniform disclosure of a rate would enable borrowers to shop for and compare consumer credit costs and make informed credit decisions.

Where the creditor discloses a rate but actually charges a higher rate, the affected accounts must be adjusted. For the purpose of calculating the adjustment, the disclosed APR will be rounded to the next higher one-eighth of one percent and termed the "understated APR". This tolerance recognizes the flexibility suggested by the rounding provisions found in 15 U.S.C. 1606 and 12 CFR 226.5 and would not unfairly discriminate against creditors which try to disclose the exact APR as a service to their customers rather than utilize the method of rounding permitted by the Act and Regulation Z to disclose less precise rates.

Where the creditor discloses no APR to the customer, a serious breach of the creditor's responsibility under the Act has occurred. Technically, while it may be said that since no APR was disclosed, none can be charged, the agencies feel that that would be a windfall to customers and a severe hardship to creditors. On the other hand, those creditors who fail to make such important disclosures should be treated at least as severely as those who did make disclosures, even though inaccurately. Consequently, the agencies propose that in such a situation the actual APR should be computed and the creditor should be required to adjust affected accounts to reflect an APR which is lower than the actual APR by certain specified margins. Those specified margins will be based on a comprehensive data base compiled by the agencies after a review of a sufficient number of examination reports to determine typical APR disclosure inaccuracies found in various types of credit transactions. Based upon information which the agencies now have, it is proposed that the actual APR charged on first lien real estate mortgages should be reduced by one-quarter of one percent since that appears to be the most common margin of APR disclosure error. Further, until an even more comprehensive data base can be established through further examinations, all other credit transactions will be corrected by a reduction of one percent in the actual APR.

An alternate proposal is to consider the rate disclosed on the contract or note as the "disclosed APR" and to require corrective action if the actual APR is higher.

Another alternative, to adjust the APR and lower the finance

charge to the lowest rate which was available in the market area at the time the loan was made, under the assumption that the customer might have obtained credit at another institution which provided that lower APR if the customer had been given the tools to shop for that credit, was not included in the proposal because adequate rate information on local markets is not readily available.

2. Specific Methods of Adjustment
for APR Violations.

When the disclosed APR is less than the APR actually being charged, an adjustment of the loan will be required in order to bring the rate actually being charged down to the understated APR. Simply reimbursing the difference between the APR charged and the understated APR will not accomplish this goal since the effect of the overcharge increases as the length of time between the inception of the loan and the error adjustment date increases. The agencies have considered a number of methods of adjustment. Some are attractive for policy reasons but are administratively unacceptable because formulas and programs to enable creditors to make the adjustments are extremely difficult to develop and use. Three adjustment methods,^{1/} all of which have the effect of lowering the actual rate paid by the customer to the understated APR and are administratively feasible, are proposed. The dollar adjustments for each method vary because the time periods over which the total adjustments will be made are different. The proposed methods are:

(1) Lump sum/payment reduction

The remaining payments on the loan would be reduced to the level at which they would have been had the payments initially been computed on the basis of the understated APR, and a lump sum money adjustment equal to the amount that the customer has overpaid (including time value) would be returned to the customer.

Example: On a 12-month loan having an amount financed of \$1,000 and calling for 12 payments of \$100, where a \$120 total overcharge has been found and six payments have been made, the customer would receive \$61.83 in cash and each remaining payment would be reduced to \$90. The dollar adjustment to the customer under this method is \$121.83.

(2) Maturity Reduction

The loan would be restructured in such a way as to reduce the number (not the amount) of required payments. The amount of each

^{1/} The lump sum method defined in the guideline is proposed only for loans that have been paid in full. It incorporates the maturity reduction method.

payment in the revised schedule (except the last) will remain the same as in the past.

Example: A loan having an amount financed of \$1,000 and requiring 12 payments of \$100 per month would be adjusted to require only 10 payments of \$100 per month and one payment of \$72.05 if the total overcharge resulting from an understated APR is \$120. The dollar adjustment to the customer under this method is \$127.95.

(3) Payment Reduction

The amount of each remaining payment on the loan would be lowered so that the total finance charge does not exceed that permitted by the revised payment schedule and the understated APR.

Example: On a 12-month loan having an amount financed of \$1,000 and calling for 12 payments of \$100, where a \$120 total overcharge has been found after six payments have been made, each remaining payment would be reduced to \$79.25. The dollar adjustment to the customer under this method is \$124.50.

It is anticipated that, because of cost and administrative factors, only one adjustment method will be adopted. After a determination has been made as to the method of adjustment that will be required, technical assistance will be available from the agencies to creditors for making adjustments for APR violations.

The agencies recognize that all methods will require adjustments to the creditor's records and notification of changes to customers.

3. Finance Charge Violations

The agencies recognize that customers may be misled by understated finance charges even though the disclosed APR is accurate. In such situations, adjustment of the finance charge will be required. Reimbursement will be made by repaying to the customers the difference between the actual and disclosed finance charge.

Where the correct APR has been disclosed, but there is no disclosure of the finance charge, the agencies have considered various standards for corrective action. Although the finance charge is an integral part of the disclosure requirements, the Act assumes that its reflection in the APR is the essential tool contemplated by the disclosures. In all transactions subject to the Act the APR must be disclosed; however, in certain transactions no finance charge disclosure is required. Further, the agencies feel that misstating the finance charge is more likely to mislead a customer than omitting that disclosure, particularly since the finance charge can normally

be computed from the other disclosures. Consequently, where the APR is correct and there is no disclosure of the finance charge, the agencies propose that no corrective action be required.

Designated Issues

4. Which method of adjustment (i.e., the "maturity reduction method", "the payment reduction method", or "the lump sum/payment reduction method") is preferable? Is any other method preferable?

Commentors should address: (1) any accounting problems associated with the various methods, (2) whether more than one adjustment method should be adopted, (3) if more than one method is adopted, who should determine which method to use (customer/bank/enforcing agency), and (4) the costs associated with the various options.

5. VIOLATIONS INVOLVING THE IMPROPER DISCLOSURE OF CREDIT LIFE, ACCIDENT, HEALTH OR LOSS OF INCOME INSURANCE.

(a) If the creditor has not disclosed to the customer in writing that credit life, accident, health, or loss of income insurance is optional, the insurance shall be treated as having been required by the creditor and improperly excluded from the finance charge. The overcharge will result from an understated finance charge and, possibly, an understated APR. The creditor shall take appropriate corrective action for the larger overcharge. The insurance will remain in effect.

(b) If the creditor has disclosed to the customer in writing that credit life, accident, health or loss of income insurance is optional, but there is either no signed insurance option or no disclosure of the cost of the insurance, the creditor shall be required to send a written notice to the affected customers disclosing the cost of the insurance and notifying them that the insurance is optional and may be cancelled within 45 days to obtain a full refund of all premiums charged. If the creditor receives no response within 45 days, the insurance will remain in effect and no further corrective action will be required.

Alternate paragraph (b):

(b) If the creditor has disclosed to the customer in writing that credit life, accident, health or loss of income insurance is optional but there is either no signed insurance option or no disclosure of the cost of the insurance, the creditor shall be required to send a written notice to the affected customers disclosing the cost of the insurance and notifying them that the insurance is optional and may be cancelled within 45 days to obtain a partial refund of premiums charged. If the creditor receives no response within 45 days, the insurance will remain in effect and no further corrective action will be

required.

Discussion

The Act requires that premiums for credit life, accident, health, or loss of income insurance written in connection with any credit transaction be included in the finance charge unless the customer is clearly and conspicuously advised in writing that the insurance is optional. If the insurance is desired, the customer must sign and date an affirmative statement to that effect after having received written disclosure of the cost of the insurance. These requirements are imposed to insure that premiums which are excluded from the calculation of the cost of credit are voluntarily incurred by the customer.

Since voluntariness is the basis for excluding the insurance premiums from the finance charge, the agencies believe that if there is no written disclosure that the insurance is voluntary it should be treated as having been required and, therefore, improperly excluded from the finance charge. Corrective action will be ordered as discussed in the section on APR violations or in the section on understated finance charges, depending on which method is more beneficial to the customer.

If the optional nature of the insurance was disclosed in writing but either 1) the cost was not disclosed or 2) the customer did not sign the insurance option blank, the agencies believe that the creditor should be required to write to and inform the customer that the insurance was optional, disclose its cost, and offer to cancel the insurance if requested. In cases where the customer expresses a desire to cancel, the creditor should be required to refund some or all of the premiums paid. On the one hand, the customer has received benefit from the insurance coverage during the period it was in effect; on the other hand, the customer did not want the insurance. Alternate courses of corrective action are set forth in the guidelines.

If the required insurance authorization is signed but not dated, no corrective action need be taken since the lack of date disclosure is deemed to be of little significance in establishing whether the insurance was optional.

Designated Issue

5. Where the proposed guidelines require notice to customers that credit life, accident, health or loss of income insurance was optional and may be cancelled, should the entire premium be reimbursed if the customer cancels? If not, on what basis should a partial reimbursement be made?

6. VIOLATIONS INVOLVING THE IMPROPER DISCLOSURE OF PROPERTY

INSURANCE, INCLUDING VENDOR'S SINGLE INTEREST INSURANCE

(a) If a creditor has not included the property insurance premium in the finance charge when required by 12 CFR §226.4(a)(6), corrective action will not be required.

(b) If an insurer providing vendor's single interest insurance has not waived its right of subrogation against the customer and the premium has been excluded from the finance charge, the creditor shall indemnify the customer for any loss incurred as a result of a subrogation action by the insurer.

Discussion

The agencies believe that if property insurance is improperly excluded from the finance charge, the resulting situation should not be treated as an overcharge. Even required property insurance is excludable from the finance charge if the creditor discloses the cost of the insurance if purchased through the creditor and that the customer has the option to select the insurer. Based upon the agencies' review of examinations conducted up to this point, the agencies have not found evidence of abuse in this area as there is with credit life insurance. However, the agencies believe that borrowers might be harmed if the insurer has not waived its right of subrogation against the customer when vendor's single interest insurance is required since the insurer may sue the customer for amounts it paid to the creditor. Consequently, in that situation, creditors would be required to establish procedures to indemnify customers for any harm caused by that failure where the insurance has been improperly excluded from the finance charge.

7. VIOLATIONS CONCERNING PREPAYMENT PENALTIES AND REBATES

(a) Where the finance charge is computed on the outstanding balance and the creditor has not disclosed a prepayment penalty, none can be collected and those already collected are overcharges which shall be reimbursed.

(b) Where the finance charge is computed on the outstanding balance and the creditor has charged a prepayment penalty in excess of that disclosed, the difference is an overcharge which shall be reimbursed.

(c) Where the finance charge is precomputed and there is neither a disclosure that no rebates of unearned finance charges will be made nor a disclosure of the method of computing the rebates, the failure to rebate unearned finance charges is an overcharge. The amount of reimbursement shall be the rebate of unearned finance charges in the event of early payment of the obligation as specified under state law; if state law is silent, the actuarial method based on scheduled payments shall be used to determine the amount of the reimbursement.

(d) Where the finance charge is precomputed and a method of

computing rebates of unearned finance charges has been disclosed but the actual rebate is less favorable to the customer, the difference between the actual and the disclosed rebate is an overcharge which shall be reimbursed.

Discussion

Regulation Z, 12 CFR 226.8(b)(7), requires that the method of rebating unearned finance charges be disclosed, and if no rebate will be given, that fact must be disclosed. The regulation also requires disclosure of the amount of any pre-payment penalties (12 CFR 226.8(b)(6)). The guideline is self-explanatory.

8. VIOLATIONS CONCERNING LATE FEES

(a) Where a creditor has disclosed the amount of late fees to be imposed in the event of late payment, any late fees collected in excess of those disclosed are overcharges which shall be reimbursed.

(b) Where a creditor has not disclosed the amount of late fees to be imposed in the event of late payment, none can be imposed and those already collected are overcharges which shall be reimbursed.

Discussion

The guideline is self-explanatory.

9. ITEMIZATION OF MISCELLANEOUS FEES AND CHARGES

If a creditor has not itemized and disclosed the charges found in 12 CFR 226.4(b) and has not included them in the finance charge as required by that section, the resulting disclosure violation, by itself, shall not constitute an overcharge and corrective action shall not be required.

Discussion

Regulation Z, 12 CFR 226.4(b), lists certain miscellaneous charges which may be excluded from the finance charge if they are itemized and disclosed to the customer. The agencies believe that if the charges are not itemized and disclosed, and are excluded from the finance charge, the resulting violation is only of a technical nature. The customer's ability to shop is not impaired since comparability of the APR and finance charge is not destroyed; the nature of the violation does not justify requiring corrective action.

PUBLICATION FOR COMMENT

The Administrative Procedure Act does not require notice

and solicitation of comment in connection with the establishment of statements of enforcement policy or guidelines (5 U.S.C. 553(b)), and it permits them to become effective immediately (5 U.S.C. 553(d)). However, in consideration of the agencies' desire to solicit public participation on these issues, they have elected to afford an opportunity for comment on these proposed guidelines. Comments should be addressed to: Interagency Enforcement Policy-Regulation Z, Washington, D. C. 20219.

Dated:

Stephen S. Gardner
Vice Chairman of the
Board of Governors of the
Federal Reserve System

Dated:

John G. Heimann
Comptroller of the Currency

Dated:

George A. Le Maistre
Chairman, Federal Deposit
Insurance Corporation

Dated:

Robert H. McKinney
Chairman, Federal Home
Loan Bank Board

Dated:

Lawrence Connell Jr.
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Credit Union Administration