



Reimbursable Violations of the Truth in Lending Act

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TO: CHIEF EXECUTIVE OFFICER AND COMPLIANCE OFFICER

SUBJECT: *Reimbursable Violations of the Truth in Lending Act*

The Federal Deposit Insurance Corporation (FDIC) is providing additional guidance to bank management on how to prevent violations of the Truth in Lending Act and its implementing regulation, Regulation Z. These violations have the potential to expose an institution to civil liability and require adjustments to the accounts of individual consumers.

Because of the statutory requirements of the Truth in Lending Act, the FDIC (as well as the other federal banking agencies) has little supervisory latitude to negotiate settlements involving reimbursements. See FIL-19-97, dated March 10, 1997, "Requests for Relief from Reimbursement under the Truth in Lending Act."

There are two distinct areas we would like to highlight where examiners have occasionally discovered reimbursable violations. The first involves the disclosure of credit life insurance when it is written in connection with a credit transaction. The second involves the incorrect usage of Appendix D in making disclosures for multiple advance construction loans.

Credit Life Disclosures

A violation occurs when an institution fails to provide required disclosures on insurance policies written in connection with credit transactions. Some institutions incorrectly assume that if insurance is not categorized as "credit life" insurance by state law, the disclosures in §226.4(d) of Regulation Z do not apply.

The provisions of §226.4(d) apply to the premiums for credit life, accident, health, or loss-of-income insurance as well as debt cancellation coverage.

If a term insurance policy is written in connection with a credit transaction and the institution is the beneficiary of the policy directly (or indirectly through assignment by the beneficiary), the product should be treated as credit life. The institution must then provide the proper disclosures to the consumer or it must include the premium in calculating the finance charge.

Regulation Z requires that the premium for insurance written in connection with a credit transaction be included in the finance charge unless **all three** of the following requirements are met:

- A written disclosure that the purchase of the insurance is optional and is not required by the creditor;
- The premium for the initial term of insurance coverage is disclosed; and

- The consumer signs or initials an affirmative written request for the insurance after receiving the previous disclosures.

A number of violations of §226.4(d) requirements have occurred because the institution failed to obtain the customer's affirmative written request indicating that the insurance coverage was desired. Having the customer complete an application to the insurance company for the insurance is not a substitute for obtaining the customer's affirmative request for insurance. At a minimum, a "yes" or "no" box should be checked to indicate the customer's request. Violations have also been cited because the institution failed to disclose the amount of the premium for the initial term of the insurance.

Multiple Advance Construction Loans

In interim construction financing involving multiple advances, Appendix D to Regulation Z may be used to estimate the interest portion of the finance charge and calculate the annual percentage rate (APR). Appendix D uses an approximation based on the premise that only one-half of the money is outstanding for 100 percent of the time. Improper use of Appendix D may result in understated APRs, which, if outside of the permissible tolerances, will require reimbursement to the consumer.

In some interim construction financing, inclusion of the inspection fees within the title preparation or title insurance costs has resulted in reimbursements to the consumer because the fees were not identified as a finance charge. The Federal Reserve Board's "Truth in Lending Official Staff Commentary to Regulation Z §226.4(a)" states that inspection and handling fees for the staged disbursement of construction loan proceeds are to be considered as finance charges.

Here are some suggestions to assist banks in avoiding the more common reimbursement pitfalls involving the requirements of §226.4(d) and in using Appendix D properly:

- Provide training for employees who prepare disclosures to ensure they are aware of the more common pitfalls and know how to avoid them. Knowledge of the types of fees that are considered finance charges is critical in making correct disclosures. Refer to the Official Staff Commentary for §226.4, which provides examples of what should and should not be included as a finance charge. When preparing disclosures for multiple advance construction loans, refer to the instructions in Appendix D and the associated Official Staff Commentary.
- Develop procedures for the compliance officer/auditor to periodically verify the accuracy of disclosed rates and finance charges. Test the processing system and/or calculation tools whenever changes are made to the bank's loan processing system through vendor updates, purchases of new services, or conversions. When the bank introduces new loan programs, verify the accuracy of the disclosures.
- Develop an ongoing internal compliance review system to monitor transactions for compliance.

When violations are discovered that require reimbursement to consumers, FDIC examiners use the "Joint Statement of Policy on Administrative Enforcement of the Truth in Lending Act" to establish the corrective action period. For loans involving closed-end credit, the corrective action

period has generally been from the current examination back to the "immediately preceding examination." The banking agencies had uniformly taken the position that compliance with the requirements of the Truth in Lending Act and Regulation Z would have been reviewed during the "immediately preceding examination." However, courts have recently held that "immediately preceding examination," means the examination of any type conducted immediately prior to the current examination, including examinations in which no review of compliance with the Truth in Lending Act was conducted. The banking agencies have directed their supervisory staff to implement the policy as enunciated by the courts. Guidance has been transmitted by each of the agencies to its examination and supervision staff regarding this change in policy. The Federal Financial Institutions Examination Council's (FFIEC) Consumer Compliance Task Force recently approved the attached question and answer guide on the appropriate time period for taking retrospective corrective action when reimbursable violations are discovered. However, once the violation has been brought to the attention of bank management, intervening examinations of any kind will not relieve the bank of the responsibility for taking corrective action.

For further information, please contact your FDIC Division of Compliance and Consumer Affairs (DCA) Regional Office on the attached list or one of the following FDIC staff members:

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Attachments:

[Interagency Questions and Answers Regarding Corrective Action Time Periods Under the Truth in Lending Act Policy Guide\(January 1998\)](#)

[FDIC Regional Offices](#) (7 kb, [PDF help](#) or [hard copy](#))

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