Proposed Rules

Federal Register
Vol. 51, No. 151
Wednesday, August 6, 1986

This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

FEDERAL RESERVE SYSTEM

12 CFR Part 226

[Reg. Z; Docket No. R-0577]

Truth in Lending; Right of Rescission

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Proposed rule.

SUMMARY: The Board is proposing to revise Regulation Z (Truth in Lending) regarding the right of rescission in closed-end credit transactions. A consumer has the right to rescind an extension of credit in most transactions in which a consumer's principal dwelling serves as security for a credit obligation, with the exception of purchase money residential mortgage loans, certain refinancings by the same creditor, and other narrowly defined transactions. The proposed amendment to Regulation Z would create a new limited exemption under which the right of rescission would not apply to an extension of credit by a new creditor that replaces a transaction secured by the consumer's principal dwelling where (1) no new advances of money are made to the consumer, (2) the annual percentage rate on the new obligation is not subject to increase after consummation and is the same as or lower than the annual percentage rate on the obligation being replaced, and (3) the new transaction does not have a balloon payment feature.

DATE: Comments must be received on or before September 10, 1986.

ADDRESS: Comments should be mailed to William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, Washington, DC 20551, or delivered to the 20th Street courtyard entrance, 20th Street, between C Street and Constitution Avenue, NW., Washington, DC, between 8:45 a.m. and 5:15 p.m. weekdays. Comments should include a reference to Docket No. R-0577. Comments may be inspected in Room B-1122 between 8:45 a.m. and 5:15 p.m. weekdays.

FOR FURTHER INFORMATION CONTACT: Adrienne Hurt or Leonard Chanin, Staff Attorneys, (202) 452-3867 or (202) 452-3667, Division of Consumer and Community Affairs, or Earnestine Hill or Dorothea Thompson, Telecommunications Device for the Deaf at (202) 452-3544, Board of Governors of the Federal Reserve System, Washington, DC 20551.

SUPPLEMENTARY INFORMATION:

Background

Section 125 of the Truth in Lending Act (TILA) provides that consumers have the right to rescind certain credit transactions in which a security interest is taken in the consumer's principal dwelling. The right of rescission was established to provide consumers an opportunity to reexamine their credit contracts and cost disclosures in order to reconsider their decision to place an important asset—the home—at risk by offering it as security for the credit extension. The rescission period runs for three business days ending on midnight of the third business day following consummation, delivery of material Truth in Lending disclosures, or delivery to the consumer of the notice of the right to rescind, whichever occurs last. Under § 226.23 of Regulation Z, which implements the act's rescission provision, a creditor is prohibited from performing services or disbursing funds, other than in escrow, during the rescission period. A consumer may waive the right to rescind where the consumer has a bona fide personal financial emergency.

With the substantial increase recently in consumer applications to refinance mortgages, primarily to take advantage of declining interest rates, the Board has received several inquiries and complaints about the effect of the TILA rescission provisions on refinancings.[1] Some consumers have complained of the inconvenience of not being allowed to receive the proceeds of a loan before the rescission period expires. The major complaint raised by consumers is that of having to pay "double interest." This situation occurs when finance charges on the new loan accrue prior to disbursement of the funds (a permissible practice is allowed under state law), while finance charges continue to accrue on the existing obligation until it is paid. In other cases the inability to obtain the loan proceeds to pay off an existing Federal Housing Administration (FHA) loan by an impending due date may result in the payment of extra charges by the consumer on the existing FHA loan for an additional month. (FHA permits lenders to charge interest to the end of the month where an obligation is not paid in full by the installation due date.) This situation may occur when the loan closing on the refinancing occurs near the payment due date of the existing FHA loan.

Most of the questions from creditors relate to compliance with the TILA rescission provisions. There also have been inquiries whether the Board could revise the rules for waiving the right of rescission where a consumer is refinancing a residential mortgage loan. Others have asked the Board to consider profiding special rules for refinancings or exempting refinancings from all or portions of the rescission rules.

Proposed Amendments

In response to the inquiries and complaints, the Board has considered whether the refinancings now covered by the rescission rules are the type of transactions in which the consumer needs the right of rescission. Both the act and the regulation exempt from the right of rescission purchase money residential mortgage transactions, certain refinancings by the same creditor of obligations already secured by the consumer's principal dwelling, and other narrowly defined transactions. The Board now proposes to expand the category of transactions that would be exempt. Under the proposal the right to rescind would not apply to an extension of credit by a new creditor that replaces a transaction secured by the consumer's principal dwelling, provided that no new advances of money are made to the consumer and the annual percentage rate (APR) for the new obligation is the same as or lower than the APR for the obligation being replaced.

The proposed exemption for refinancings by a new creditor would be limited in two additional ways to help

[1] Although the term 'refinancing" in § 226.23 of Regulation Z refers only to new transactions by the same creditor that had made the original extension of credit, the term in this discussion refers to a transaction by any creditor that satisfies and replaces an existing obligation.

ensure that the consumer receives the right of rescission when the consumer's home is at greater risk. First, it would not apply to any refinancing with a variable rate feature. Thus, a consumer would retain the right to rescind an extension of credit secured by the home where the APR may increase after consummation. Second, a refinancing with a balloon payment feature would not be exempt from the right of rescission, even if the transaction had the same or a lower APR than the existing extension of credit.

The Board believes the exemption it proposes to add to the regulation is consistent with the purpose of the act because consumers are not taking on a higher level of debt in these refinancings than in their existing obligations, and because the likelihood of default on their new obligations is not increased. First, the exemption would apply only to extensions of credit in which the consumer does not receive additional funds that would increase the consumer's security risk, and would cover only those refinancings in which the consumer obtains the same or a lower annual percentage rate. Second, the exemption would not apply to any refinancing with a variable rate or balloon payment feature. Although these features are not necessarily disadvantageous to consumers, they may, in some cases, increase consumers' chances of defaulting on their loans and losing their homes. The Board believes that these restrictions on the new exemption appropriately limit it to refinancings in which the right of rescission is not necessary.

There may be other situations in which a refinancing satisfies the criteria for exemption in the proposal but where the protections of the act should be retained because a consumer would be placing the home at greater risk—for example, when the new loan is payable on demand. On the other hand, it is arguable that the criteria that limit the exemption to refinancings that have the same or lower APRs are unnecessary. For example, a consumer may refinance an existing loan at a higher APR to extend the term, thereby reducing the amount of the monthly payment obligations. In such cases the new loan does not necessarily place the consumer's house at greater risk even though the APR is higher on the refinancing. In addition to the issue of whether all the criteria are needed, the Board recognizes that the criteria might be defined differently to exempt more types of refinancings from the right of rescission. For example, the definition of a balloon payment feature could be modified.

The Board is therefore soliciting comment on whether the conditions included in the proposal are necessary, whether they should be revised, and whether other criteria should be added to the proposal. The Board particularly requests comment on whether the proposed exemption should be limited to refinancings that meet all of the following conditions:

- The annual percentage rate for the new transaction is the same as or lower than the annual percentage rate for the existing transaction
- The annual percentage rate for the new transaction is not subject to increase after consummation
- The new extension of credit has a balloon payment feature.

Definition of New Money in a Refinancing

Section 226.23(f)(2) of Regulation Z exempts refinancings by the same creditor from the right of rescission where no "new money" is advanced to the consumer. (See also commentary provision 226.23(f)(2)–4.) The regulation treats as new money the difference between the new "amount financed" and the unpaid principal balance plus any earned unpaid finance changes on the obligation being refinanced. Sometimes a consumer who is not receiving additional advances may finance costs associated with the closing of a refinancing, such as attorney's fees, title examination fees and insurance premiums, instead of paying them in cash or check prior to or at consummation. These charges, which are not finance charges under § 226.4, are added to the old debt to arrive at the new amount financed. Under the present rule in § 226.23(f)(2), the new transaction is rescindable to the extent of these charges. The proposed amendment to Regulation Z, new § 226.23(f)(3), also has a provision that would exempt from the right of rescission extensions of credit by new creditors in which no new money is advanced to the customer. The Board is requesting comment on whether, as provided in the proposed regulatory language, the definition of new money should be revised to provide that the right of rescission would not apply even if the creditor finances the costs associated with the closing of the new transaction. For example, if the old debt (the outstanding principal balance plus the earned finance charge) is $75,000 and the new amount financed is $75,500, with the $500 being attributable to title examination fees and insurance premiums, the right of rescission would not apply under the proposed revisions. On the other hand if the new amount financed in $80,500, with the additional $5,000 to be provided to the consumer for home repairs, the consumer would have the right to rescind. If the refinancing is with the same creditor and the consumer rescinds, rescission would be effective as to $5,000. If the new extension of credit is with a different creditor and the consumer rescinds, rescission would be effective as to the entire $80,500.

The Board solicits comment on three specific questions relating to its definition of new money, which would apply to the current exemption in § 226.23(f)(2) as well as the proposed exemption, new § 226.23(f)(3):

- Do creditors ordinarily finance costs such as attorney's fees, title examination fees, insurance premiums and similar closing charges (which are not finance charges), or are such costs normally paid in cash or check by the consumer prior to or at consummation?
- What is the average cost of these charges?
- Do consumers need the right of rescission in refinancings in which these charges are financed by the creditor?

Comments Requested

Interested persons are invited to submit written comments on the proposed amendments. Because prompt resolution of these matters is essential and in the public interest, the comment period is for 30 days. The comment period ends on September 10.

Regulatory analysis

The proposed revisions to the rescission provisions in Regulation Z would reduce the number of transactions for which creditors would need to provide consumers with a notice of their rescission rights and an opportunity to rescind. Therefore, it appears that creditors, including small entities, would not incur any additional costs as a result of the proposed changes.

List of Subjects in 12 CFR Part 226

Advertising; Banks; Banking; Consumer protection; Credit; Federal Reserve System; Finance; Penalties; Truth in lending.

Text of Proposed Revisions

Certain conventions have been used to highlight the proposed revisions. New language is shown inside bold-faced arrows, while language that would be deleted is set off with brackets. Pursuant to authority granted in section 105(a) of the Truth in Lending Act, 15 U.S.C. 1604(a) the Board proposes to amend

Regulation Z (12 CFR Part 226) as follows:

PART 226—[AMENDED]

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

Authority: Sec. 105, Truth in Lending Act, as amended by sec. 605, Pub. L. 96–221, 94 Stat. 170 (15 U.SC. 1604 et seq.).

3. Section 226.23 is proposed to be amended by revising (f)(2), adding new (f)(3) and republishing the introductory text of (f) to read as follows:

§ 226.23 Right of rescission.

* * * * *

(f) *Exempt transactions.* The right to rescind does not apply to the following:

* * *

(2) A refinancing or consolidation by the same creditor of an extension of credit already secured by the consumer's principal dwelling. If the new amount financed exceeds the unpaid principal balance►, ◄[plus] any earned unpaid finance charge on the existing debt, ►and amounts attributed solely to the costs of the refinancing or consolidation, ◄this exemption applies only to the existing debt and its security interest.

►(3) An extension of credit (other than one made by the same creditor) that replaces an existing transaction already secured by the consumer's principal dwelling if

(i) The new amount financed does not exceed the unpaid principal balance, any earned unpaid finance charges on the existing transaction, and amounts attributed solely to the costs of the new extension of credit,

(ii) The annual percentage rate for the new extension of credit is not subject to increase after consummation and is the same as or lower than the annual percentage rate for the existing transaction, and

(iii) The final payment in the new extension of credit is not more than three times greater than any other payment in that transaction.◄

* * * * *

2. § 226.23, paragraphs (f)(3)—(5) would be redesignated as § 226.23(f)(4)—(6), respectively.

By order of the Board of Governors of the Federal Reserve System August 1, 1986.

William W. Wiles,

Secretary of the Board.

[FR Doc. 86–17694 Filed 8–5–86; 8:45 am]

BILLING CODE 6210–01–M

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Office of the Assistant Secretary for Housing—Federal Housing Commissioner

24 CFR Part 203

[Docket No. R–86–1297; FR–2214]

Mortgage and Loan Insurance Programs; Nonentitlement to Distributive Shares in the Event of Foreclosure

AGENCY: Office of the Assistant Secretary for Housing—Federal Housing Commissioner, HUD.

ACTION: Proposed rule.

SUMMARY: This proposed rule would revise 24 CFR Part 203 to describe circumstances under which a mortgagor would not be entitled to receive a share of the participating reserve account (§ 203.423). If the mortgage is foreclosed and title to the property is conveyed to a person or an entity other than the Federal Housing Commissioner, no distributive share will be payable.

Comment due date: October 6, 1986.

FOR FURTHER INFORMATION CONTACT: Fred W. Pfaender, Director, Single Family Servicing Division, Room 9176, Department of Housing and Urban Development, 451 Seventh Street, SW., Washington, DC 20410–8000. Telephone (202) 755–6672. (This is not a toll-free number.)

SUPPLEMENTARY INFORMATION: At present, 24 CFR 203.423 states that a mortgagor is permitted to receive a share of the participating reserve account if the contract of insurance is terminated by conveyance to a person or entity other than the Commissioner, by prepayment of the mortgage, or by voluntary agreement between the mortgagor and the mortgagee with approval of the Commissioner.

The Department believes that under some circumstances the above-referenced regulation unfairly allows a mortgagor who has defaulted on his or her mortgage obligation to receive a share of the participating reserve account, when the mortgage is foreclosed, simply because title is not conveyed to the Commissioner and a mortgage insurance claim is not filed. The Department believes that mutuality benefits should be linked to successful completion of the mortgagor's obligations as a debtor—not merely to whether an insurance claim is filed. Under this proposed rule, a mortgagor default leading to foreclosure would end the mortgagor's entitlement to a distributive share.

The Department's proposal to deny a mortgagor a distributive share of the participating reserve is consistent with section 205(d) of the National Housing Act which states that no mortgagor or mortagee of any mortgage insured under section 203 shall have any vested right in a credit balance in any such account.

The restrictions contained in this rule would only be applied to mortgage insurance contracts for which conditional commitments have been issued on or after the effective date of the rule. (In the case of the Single Family Direct Endorsement program, the rule would only be applied to applications for mortgage insurance endorsement where the property appraisal report is signed by the mortgagee's approved underwriter on or after the effective date of the rule.)

On January 10, 1985, HUD published a proposed rule (50 FR 1233) (FR–1927) which would revise Part 203 by allowing mortgagees to submit claims for the payment of mortgage insurance benefits on foreclosed single family properties without conveying title to the foreclosed properties to the Secretary. Today's proposed rule (FR–2214), when published as final, will incorporate these revisions if the final version of FR–1927 is published in the **Federal Register** first.

This proposed rule does not constitute a "major rule" as that term is defined in section 1(b) of the Executive Order on Federal Regulation issued by the President on February 17, 1981. Analysis of the proposed rule indicates that it does not (1) have an annual effect on the economy of $100 million or more; (2) cause a major increase in costs or prices for consumers, individual industries, Federal, State or local government agencies, or geographic regions; or (3) have an significant adverse effect on competition, employment, investment productivity, innovation, or on the ability of United States-based enterprises to compete with foreign-based enterprises in domestic or export markets.

A Finding of No Significant Impact with respect to the environment has been made in accordance with HUD regulations in 24 CFR Part 50 that implement section 102(2)(C) of the National Environmental Policy Act of 1969, 42 U.S.C. 4332. The Finding of No Significant Impact is available for public inspection and copying during regular business hours in the Office of the Rules Docket Clerk, Room 10276, 451 Seventh Street SW., Washington, DC 20410.

Under 5 U.S.C. 605(b) (the Regulatory Flexibility Act), the Undersigned hereby certifies that this rule would not have a significant economic impact on a