32(d) Limitations

32(d)(1)(i) Balloon Payment

The statute and regulation prohibit the use of balloon payments for mortgages covered by § 226.32 that have a term of less than five years. For such loans, the repayment schedule must fully amortize the outstanding principal balance through "regular periodic payments." The proposed comment provides guidance on the definition of ''regular periodic payments.''

32(d)(2) Negative Amortization

Proposed comment 32(d)(2)-1 clarifies that the prohibition against including negative amortization in a mortgage covered by § 226.32 does not extend to increases in the principal balance unrelated to the payment schedule, such as an increase related to the purchase of force-placed insurance.

32(d)(4) Increased Interest Rate

Proposed comment 32(d)(4)-1 clarifies that a rate increase in a variable-rate transaction is not prohibited by the act or regulation, even if the rate increases after the consumer has defaulted on the obligation.

32(d)(5) Rebates

Section 226.32(d)(5) restricts how creditors may calculate refunds of interest when a mortgage loan subject to this section is accelerated due to a consumer's default. The proposed comment clarifies that this restriction applies to refunds of interest only, and not to refunds of other items such as origination fees or points. In addition, the proposed comment clarifies that the refund calculation includes odd-days interest, regardless of when it is paid.

32(d)(7) Prepayment Penalty Exception

Proposed comment 32(d)(7)-1 provides guidance on calculating a consumer's debt-to-income ratio. Proposed comment 32(d)(7)-2 clarifies that verification of employment satisfies the regulation's requirement that the creditor obtain "payment records for employment income."

32(e) Prohibited Acts and Practices 32(e)(1) Repayment Ability

For mortgage loans subject to § 226.32, the regulation prohibits creditors from engaging in a pattern or practice of extending such credit based on the consumer's collateral without regard to the consumer's repayment ability, including the consumer's current and expected income, current obligations, and employment. Proposed comment 32(e)(1)-1 provides guidance

on determining the consumer's repayment ability. The comment clarifies that creditors may rely on the same information provided by the consumer in connection with $\S 226.32(d)(7)$, or other information, including information about unverified income.

Section 226.33—Requirements for Reverse Mortgages

The U.S. Department of Housing and Urban Development (HUD) has modified its software regarding reverse mortgages originated under the Home Equity Conversion Mortgage (HECM) program to conform with the requirements and the terminology used for reverse mortgages under Regulation Z and the appendices to the regulation. (The HECM program has been temporarily suspended, pending the reauthorization of funding by the Congress.) For example, HUD's software now allows creditors to use the initial interest rate, rather than the "expected interest rate," in calculating the total annual loan cost rate for a variable-rate transaction. Although creditors may find HUD's software helpful in meeting the disclosure requirements under Regulation Z, they should first take steps to verify the accuracy of the software, including any instructions, before using it. Neither HUD nor the Board provides a "safe harbor" to creditors regarding use of this software.

33(a) Definition

Proposed comment 33(a)-1 addresses an implication relative to the definition of a reverse mortgage transaction under the regulation. If a transaction structured as a reverse mortgage loan is a recourse transaction (that is, one that imposes personal liability on the consumer for the difference between the loan balance at maturity and the value of the property), it is not a reverse mortgage under § 226.33. Thus, if the transaction is also closed-end, and the annual percentage rate or the points and fees assessed in the transaction exceed those specified in § 226.32(a)(1), the transaction is covered by § 226.32. Such transactions may not generally contain a balloon payment or negative amortization (both of which are found in reverse mortgages by definition). Open-end credit plans are exempt from the provisions of § 226.32(a).

33(c)(2) Payments to Consumer

Proposed comment 33(c)(2)-1provides guidance where the legal obligation of a reverse mortgage transaction includes a benefit, such as a "death benefit," in which a payment to the consumer's estate (or a credit to the

outstanding loan balance) will be made upon the occurrence of an event (for example, the consumer's death within a certain period of time).

III. Form of Comment Letters

Comment letters should refer to Docket No. R-0903, and, when possible, should use a standard courier typeface with a type size of 10 or 12 characters per inch. This will enable the Board to convert the text to machine-readable form through electronic scanning, and will facilitate automated retrieval of comments for review. Also, along with an original document in paper form, commenters are encouraged to submit their comments on 3½ inch or 5¼ inch computer diskettes in any IBMcompatible DOS-based format.

List of Subjects in 12 CFR Part 226

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

Certain conventions have been used to highlight the proposed revisions to the regulation. New language is shown inside bold-faced arrows, while language that would be deleted is set off with bold-faced brackets. Comments are numbered to comply with new Federal Register publication rules.

For the reasons set forth in the preamble, the Board proposes to amend 12 CFR part 226 as follows:

PART 226—TRUTH IN LENDING (REGULATION Z)

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

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

- 2. In supplement I to Part 226, under section 226.4—Finance Charge, the following amendments would be made:
- 1. Under 4(a) Definition., a new paragraph 8. would be added; and
- 2. Under 4(d) Insurance., paragraph 5. would be revised.

The additions and revisions read as follows:

Supplement I—Official Staff Interpretations

Subpart A—General *

Section 226.4—Finance Charge

4(a) Definition.

fl 8. Treatment of Debt Cancellation Agreements. Some creditors may require debt cancellation agreements while others may offer them as an option. In the case of motor