Robert A. Burgess
*SUPERINTENDENT*

Harry W. Giddinge
*Deputy Superintendent*

DEPARTMENT OF PROFESSIONAL AND FINANCIAL REGULATION
**BUREAU OF CONSUMER CREDIT PROTECTION**
(207)289-3731

ADVISORY RULING #91

RE: Miscellaneous Truth-in-Lending disclosure issues in real estate transactions.

A creditor has posed these questions concerning its disclosure obligations under Maine's truth-in-lending provisions in certain real estate transactions.

1. In a consumer buydown must the interest earned on funds held in escrow, if applied to the monthly payment obligation, be included in the Finance Charge and Total of Payments?

The creditor presented a hypothetical to illustrate the question, which will be simplified to aid comprehension in this discussion. A loan is bought down by $1500 for two years. The buydown funds, paid by the consumer at closing, are placed in an escrow account earning 5¼%. Because the escrow account is expected to generate $100 in interest over the two-year period it is drawn upon , the consumer in actuality only pays $1400 at closing. Must the $100 in interest earned on the account be included as part of the Finance Charge and the Total of Payments?

The answer to the question depends upon how the creditor chooses to characterize, and ultimately disclose, the transaction. The loan product in questions is know as a "pledged account mortgage." Section 226.18(r)(2) of the Commentary to Regulation Z declares that such mortgages may be disclosed as either a "consumer buydown" or as a "required deposit."

Disclosed as a consumer buydown, the escrowed funds would have to be shown as a prepaid finance charge (See §226.17-(c)(4) of the Commentary). The Commentary does not describe how any interest on the account should be disclosed. However, in the Bureau's view such interest, where it is intended to be applied in full toward the buydown obligation, is a finance charge and should be so disclosed. It should be disclosed as total part of the finance charge, but not as part of the prepaid finance charge. The prepaid finance charge should only include that amount which the consumer actually paid at closing. Because the $100 interest is a finance charge and is included in the Total Finance Charge, it necessarily will be included in the Total of Payments.

If the escrowed funds are disclosed as a "required deposit" they do not have to be included in the Finance Charge, Annual Percentage Rate and Total of Payments in this example because the escrow account earns "at least 5 percent interest per year" (§226.18(r)(4) of the Commentary). In lieu of including such funds in the required disclosures, §226.18(r) requires a "statement that the annual percentage rate does not reflect the effect of the required deposit." Appendix H-7 of Regulation offers a model disclosure clause for this purpose.

2. How should an "interest credit," designed to lessen prepaid finance charges at closing, be disclosed?

In this hypothetical the creditor offers a plan in which prepaid finance charges can be lessened to the consumer through the device of an "interest credit." In situations where a loan closes within the first ten days of a month, a credit for interest from the first day of the month to the date of closing would be given to the consumer at closing. A full month's interest and principal would then be due on the first day of the month following closing. This plan offers the consumer the advantage of reducing or eliminating pre-paid finance charges at closing and thereby reducing overall up-front closing costs.

For example, assume an amount borrowed of $50,000, at 10% over 20 years. Further assume daily interest accrual of $15. If the loan closed on May 8th the consumer would normally have to prepay 23 days of interest, or $345 and his next payment would be due July 1. Under the hypothetical, however, the consumer would receive an interest credit of $120 (8 x 15) but would be required to make his first full payment on June 1. Under such a plan, how should the $120 be disclosed.

The $120 "credit" should be reflected in the note amount of funds borrowed, increasing it to $50,120. The amount financed should remain at $50,000 and the Finance Charge should be increased by $120. In effect, the lender has lent $50,120 to the customer, although he has use of only $50,000, the amount financed. Because the Amount Financed and the Finance Charge are mutually exclusive for disclosure purposes, the $120 not revealed in the Amount Financed must be included in the Finance Charge.

3. What is "consummation of the transaction" under State law for purposes of triggering the right of rescission under §226.23 of Regulation Z-2.

"Consummation" is defined by Regulation Z (§226.2(a)(13)) as "the time that a consumer becomes contractually obligated on a credit transaction." When a consumer becomes so bound is not defined in the regulation, however. The Commentary to §226.2(a)(13) provides that when consummation occurs is to be determined under state law, but does opine that a "contractual commitment agreement...that under applicable state law binds the consumer to the credit terms would be consummation."

No Maine cases were found addressing when consummation occurs. However, several New York and Federal cases have determined that consummation occurs when credit is "proffered" and it is accepted, "irrespective of the time of performance of the contract itself," Gramatan Home Investors Corp. v. Mack, 421 N.Y.S. 2d 124, 126 (1979); Postow v. OBA Federal S & L Ass'n, 627 F. 2d 1370 (1980); and that acceptance of a commitment letter ("a commitment letter to make a loan is an enforceable contract and in order for such a commitment contract to exist, it is only necessary that the lender and borrower concur as to the essential terms of the future mortgage transaction") is consummation, Murphy v. Empire of America FSA, 583 F. Supp, 1563, 1565 (1984).

In the Bureau's view as long as a commitment letter is sufficiently explicit in its terms to encompass the offer to lend and invites a response that is given by the borrower as prescribed, a binding contract exists and consummation for purposes of §226.23 has occurred, regardless of when the actual signing of the note and mortgage takes place. (See, 17 CJS Contracts §§41(g), 359(A)

(1963); Restatement (Second) of Contracts, §§24, 50(1).) If the rescission notice required under §226.24(b), and all material disclosures, have been given the three day rescission period begins to run on the first business day following that date.

/s/ Robert A. Burgess
Robert A. Burgess
Superintendent