NATIONAL CREDIT UNION ADMINISTRATION
Washington, D.C. 20456

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Office of General Counsel

Robert C. Pyfer, Vice President
Governmental & Community Relations
Montana Credit Union Network
1236 Helena Avenue
Helena, MT 59601

Dear Mr. Pyfer:

This is in response to your letter concerning whether Federal credit unions ("FCU's") may accrue interest during the three day rescission period under Regulation Z.

You enclosed a copy of an article appearing in CUNA's Regulatory Monitor that discussed a recent opinion from this Office on the issue. Pursuant to Regulation Z , with respect to both closed- and open-end credit, when a consumer rescinds, he shall not be liable for any finance charge. (See Section 226.15(d)(1) of Regulation Z, 12 C.F.R. §226.15(d)(1), for open-end credit, and Section 226.23(d)(1) of Regulation Z, 12 C.F.R. §226.23(d)(1), for closed-end credit.) As noted in your letter, the Official Staff Commentary to Regulation Z states that a "creditor may . . . accrue finance charges during the delay period." (See Comment 3 to Section 226.15(c) of Regulation Z referring to open-end credit.) The same comment appears under the section addressing the right of rescission for closed-end credit. (See Official Staff Comment 3 to Section 226.23(c) of Regulation Z.)

Regulation Z does not preclude a creditor from accruing finance charges during the three-day rescission period in either closed-end or open-end credit plans. However, such accrued finance charge can not be collected if the borrower rescinds the transaction pursuant to Regulation Z.

Neither the FCU Act nor the National Credit Union Administration ("NCUA") Rules and Regulations address the issue of whether interest can accrue during the three-day rescission period. Section 5040.5.1.4 of the Accounting Manual for Federal Credit Unions does address the issue. A copy of Section 5040.5.1.4 is enclosed. This section states that interest begins to accrue when the loan proceeds are disbursed. It goes on to state that the proceeds will not be disbursed until it is determined that the borrower will not rescind under Regulation Z. Please note that this section cites Section 226.9 of Regulation Z.

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Section 226.9 was the old version of Regulation Z addressing the right of rescission for both open-and closed-end credit. The old version of Regulation Z did not contain an official interpretation on accruing finance charges during the rescission period as does the current version. Section 226.9(d) did state that "when a customer exercises his right to rescind . . . he is not liable for any finance or other charge. . . ." We previously addressed Section 5040.5.1.4 of the Accounting Manual and concluded that the issue of whether or not interest can accrue during the rescission period was a matter that may vary in different jurisdictions (i.e., a matter of state law).

Subsequent to the publication of Section 5040.5.1.4 of the Accounting Manual, a specific preemption section was written into NCUA's lending regulation. The preemption provision expressly provides that any state laws purporting to limit or affect amounts of finance charges are preempted. (See Section 701.21(b)(1) of NCUA's Rules and Regulations, 12 C.F.R. §701.21(b)(1).) It is our opinion that included within the parameters of the "amounts of finance charge" is the matter of when a finance charge begins to accrue (i.e., during the three-day rescission period). Hence, state laws attempting to regulate accrual of finance charges during the rescission period would be preempted.

In light of the Official Commentary to Regulation Z that allows for accrual of a finance charge during the rescission period, the preemption of state law limits on finance charges in NCUA's lending regulation, and the fact that Section 5040.5.1.4 of the Accounting Manual predates both the Official Commentary to Regulation Z and the preemption section of our lending regulation, we have reevaluated our former opinion. It is now our opinion that each FCU may determine for itself whether or not to accrue finance charges during the three-day rescission period. This issue would not be governed by state law. It is specifically preempted by Section 701.21(b)(1) of the NCUA Rules and Regulations. Section 5040.5.1.4 of the Accounting Manual will be revised to reflect this change. If the borrower rescinds the transaction, the accrued finance charge can not be collected.

I hope that we have been able to clear up any remaining questions on this issue.

Sincerely,

STEVEN R. BISKER
Assistant General Counsel

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Enclosure

5040.5.1.2 30-DAY MONTH METHOD (360-DAY YEAR)

This method may be advantageous for those credit unions which make loans based upon monthly repayment terms, or fractions or multiples of monthly repayment terms. The most popular of these repayment terms is the loan calling for payments on the same date each month; other terms call for payments semimonthly, bimonthly, quarterly, semiannually or annually. If factors are developed to aid in computing interest on the basis of a 30-day month, they must be based on 360 days (30 days times 12 months).

When applying the 30-day month method, each month is considered to have 30 days regardless of the actual number of days in the month. For instance, under this method March is considered to have 30 days even though it actually has 31 days. If payments are made on the same date each month, one month's interest is charged regardless of whether the month that has elapsed actually had 28, 29, 30 or 31 days.

When a payment is made before a full month has elapsed, interest is charged for the exact number of days (based on the 30-day month). As an example, if a payment was made on March 12 and the next payment is made on April 5, interest would be charged for 23 days ($^{23}/_{30}$ths) (31st of March is not counted).

When more than one full month has elapsed since the previous payment, interest is charged for the full month(s), plus the additional days (computed similar to the instructions in the previous paragraph). As an example, if a payment on a loan was made on March 29 and the next payment is made on June 4, interest would be charged for two full months (March 30 to May 29), plus five days (May 30, June 1, 2, 3, 4) (31st of May not counted) or ($^{65}/_{30}$ths).

5040.5.1.3 GRACE PERIOD

To ease the task of computing interest, the board of directors may permit a grace period of up to seven days following the due date of each payment. No late charges or additional interest charges are assessed if the payment due is received during that period. For a grace period for credit cards, refer to Section 6030.1.

5040.5.1.4 ACCRUAL OF INTEREST

Interest on a loan will begin to accrue upon the disbursement of the loan proceeds. Where the borrower's principal residence (or property which is expected to be used as the borrower's principle residence) is to serve as security for a loan (except for related first mortgage loans), the loan proceeds will not be disbursed until it is determined that the borrower does not intend to rescind the transaction as provided by Section 226.9 of Regulation Z. When loan drafts are involved, the question arises whether a credit union incurs a liability at the time authorization is issued for a draft to be drawn upon it or whether no liability exists until the draft is accepted. The influencing factors are of a legal nature and may vary in different jurisdictions; the credit union is advised to seek advice from its attorney in determining when the draft becomes a loan and when the interest begins to accrue.

5040.5.2 METHODS OF CALCULATING INTEREST

5040.5.2.1 UNITED STATES RULE — SIMPLE INTEREST

Under the United States Rule, a loan payment must first be applied to the accumulated interest up to the date of the payment. Any remainder is then credited as a deduction from the principal; successive interest is computed from a declining unpaid balance each time a loan payment is made. If a payment is not sufficient to meet the simple interest which has accrued during the elapsed payment period, such shortfall of interest will be met from subsequent payment or payments. If a loan payment is insufficient to cover the interest due, the balance of the interest is not added to the principal so as to produce interest.

5040.5.2.1.1 LEVEL PAYMENT

This method of repaying a loan involves payment of equal installments of principal and interest over the life of the loan. As the loan matures, payments to principal become greater as interest charges become smaller. The following procedure will be used to determine the amount of level payment:

(1) Determine the amount of the loan

(2) Choose the number of months to be allowed for payment