

of interest!

A timely digest of regulatory changes, specialized reports and important information for the consumer finance industry.

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STUDENT LENDERS TURN TO CARLETON TO DEVELOP NEW SOFTWARE SOLUTIONS

Carleton's suite of software solutions continues to grow due to ever emerging challenges in the financial industry. But Carleton is uniquely poised to work with clients to develop new solutions to these challenges. One example of this can be seen in the product the company recently developed for the student loan segment of the lending industry.

The final regulations considered prepaid fees and capitalized interest Original Issue Discount (OID).

New Solution Requested

A group of student loan lenders turned to Carleton to help them develop a solution for this new requirement. Our work with these lenders resulted in a remarkably efficient and flexible software module tool that helps them properly deal with re-yielding events such as the assessment of prepaid fees during the interim and repayment periods, frequent capitalization of interest, and introduction of borrower benefits programs during the life of the loan. These are only a few of the many contingent situations and events that the Carleton module will properly take into account while tracking the total yield.

Carleton's IRS interest reporting software has been integrated directly into the loan processing systems of multiple private student lenders as well as third party software providers that service student lending.

The Carleton Calculation Module assists student lenders in tracking the amount to be reported to borrowers as the total yield (OID + QSI) in Box 1 on form 1098E according to the IRS regulations.

Continued on page 3

Providers of student loans in particular have been faced with significant changes in the last several years, so they turned to Carleton for help.

IRS Interest Reporting Requirements

In 2004, the United States Department of the Treasury and the Internal Revenue Service (IRS) issued final regulations relating to the deduction for interest paid on student loans. Student loan lenders were subsequently required to report paid interest to borrowers. The definition of interest included certain prepaid fees such as origination fees and guarantee fees, as well as capitalized interest.

quotes & calcs

PUBLISHER'S NOTEBOOK

Many companies in the financial industry are being challenged every time you look around these days. Carleton, in fact, was faced with a special challenge in the education finance arena, but it was one we were more than happy to accept. When approached by a consortium of private student loan lenders to help them with some complex calculations, we rolled up our sleeves and developed a unique software solution. You can find out more about our assistance with the student lending process in our cover feature.

In this issue of our newsletter, you'll also read about our expanded suite of software developed specifically for the mortgage industry. This new module allows mortgage lenders to compute and disclose any type of mortgage financing.

Jeff Buysse, our director of research, tackles the problem of how to account for time when calculating payments in "From our research department." He'll explain why sometimes "30 days" is not a month.

And when it comes to state laws, there is never a lack of changes. In this issue we provide you with compliance updates for the states of Indiana and South Carolina. Indiana's new regulations regarding that state's Credit Code take effect July 1, as do South Carolina's changes to the Consumer Protection Code.

If you have questions about any of the information presented in *of interest*, don't hesitate to call us at 800-433-0090. And if you would prefer to receive this newsletter electronically, merely send us your e-mail address and we'll put you on the list to receive the digital version. Just send your request to ofinterest@carletoninc.com and we'll take it from there.

Thanks for your interest.

INSIDE

WHEN "30 DAYS" IS NOT A MONTH
Making sure your calculations do not assume or presume

2

COMPLIANCE UPDATE
Upcoming changes in the states of Indiana and South Carolina

3

SUITE OF SOFTWARE SOLUTIONS EXPANDS WITH SMARTCALCS FOR MORTGAGES
New module automates tedious aspects of mortgage origination

4



Serving consumer lending and credit insurance providers with full-service, one-stop solutions.

WHEN “30 DAYS” IS NOT A MONTH

from our research dept. ...

Carleton's Speaking Engagements:

“Managing Rates and Profits”

National Institute of Consumer Credit Management
June 5, 2008

Marquette University,
Milwaukee, Wis.

The American Financial Services Association Education Foundation is sponsoring this training program for finance company managers. Jeff Buysse, Carleton's director of research, will be the featured instructor along with Andrew Morrison, executive vice president of Sun Loan Company. This session will focus on factors that affect the profitability of product lines along with alternative methods of developing rate and revenue calculations.

By Jeff Buysse – Director of Research

A main theme re-visited often in this space is that clear communication is vital to understanding the concepts and details of consumer finance mathematics. For better or worse, terminology rules.

We've often said that using “APR” in place of “interest rate” muddies the water and can misdirect our attention when we're trying to solve a problem. The same goes for the phrase “30 days.” Many people use “30 days” to describe a transaction's first time interval from the date of loan to the first scheduled payment date without fully considering its implications. Is it the same as a month?

To those of us needing preciseness, clearly defined rules and definitions are essential to achieving that sometimes elusive goal of “the right payment.” How we think about and describe time is a case in point.

Our 365 day Gregorian calendar, with its 12 months having varying numbers of days, plays havoc with algorithms and logic. The Gregorian year isn't evenly divisible by either 12 or 30.

One of the major assumptions made in computing payments for a loan or a credit sale is that following the first payment date all subsequent payments will fall on that same date every month. Any “irregularities” occur during the time from the contract date/closing date to the scheduled first payment date. This is often the critical element that causes a payment calculation from one system or tool to be different from that on a different system.

Of course, when you are in the software business and producing calculations and disclosures, the acid test of your numbers is when the client runs a transaction on the “old” system and then runs the same numbers through your system and, gasp, the payments don't match! Which payment then is “wrong”?

In most cases probably neither. However, the method chosen (and there are many to select from) to recognize time intervals is one of the prime factors that create different payments for identical data.

Take for example the payment associated with a simple transaction involving a prospective client:

- \$5,000 principal amount, 12% interest rate, 36 monthly payments
- The Date of Contract is June 1, 2008
- The 1st Scheduled Payment Date is July 1, 2008

The resulting payment computed by Carleton is \$166.07. That value is arrived at by the most basic and generic of day counting methods that assumes every interval is one month which is equal to 1/12 of a year. This day counting method is often referred to as “360/360”, “unit-period”, and at Carleton we call it Month and Day/360. This is the same payment you would compute on any Texas Instrument or Hewlett Packard financial calculator.

The unit of time between two like dates (i.e. the 1st to the 1st) is 1/12 of a year. If the period in question is longer than one calendar

month, then the concept of “extra days”, often called “odd days”, is introduced and any days in excess of one month accrue interest at 1/360 of the annual rate.

The client ran the same transaction on the “old” system and the result was the same \$166.07. So far, so good.

One of the tests we perform to make sure we cover all the potential bases is to run a second example that is also exactly one calendar month to the first payment date but that is a differing number of calendar days. In this set of examples, we used:

- The Date of Contract is July 1, 2008
- The 1st Scheduled Payment Date is August 1, 2008
- The Carleton module once again returned a payment of \$166.07.

The “old” system returned a payment of \$166.12, not only different but higher than the payment we computed, meaning more interest was being accrued.

After reassuring the client that the \$166.07 was indeed an accurate payment, and based on the specifications they submitted, we began to investigate the disclosures from the existing system.

What we found was a disclosure value of 1 in the “odd days” box on the system output screen. Here was a clue. The system was recognizing “30 days” as a period and thus, July 1st to July 31st was being counted as one “monthly period” and August 1st was counted as an “extra” day.

This scenario is part of our testing regimen for just that reason. It helps highlight and illustrate the potential differences that can

occur between systems because of day counting methods. Maybe it's just me, and my Carleton training, but I'd have a hard time convincing an auditor/examiner that the interest charge from July 1st to August 1st has just accrued more than one month's interest especially so when a “month” is the declared computing period for the calculations.

Much of the confusion, and most likely the origin of the mind-set, comes from mis-

construing the day counting language in Appendix J of Regulation Z. Never mind that Appendix J is a blueprint for the computation of the APR disclosure value; (that's another sermon on the difference between disclosure values and computation values for another day) the concepts are often mimicked and the algorithms manipulated to solve for a payment. I have no doubt that quite often over the last 27 years a software developer has been handed Appendix J and been instructed “here's your formula” to find the payment.

Section 226.22 (b)(3)(iv) states “all months shall be considered equal” in the instructions for determining a Reg. Z unit-period. Section 226.22 (b)(5)(ii) spells out determining the “Fed Calendar” “odd days” and says to take the number of days and “divide by 30”.



Continued on page 4

Student Lenders Turn ...

Continued from page 1

Truth-in-Lending Act (TILA) Annual Percentage Rate Calculations for Multi-Advance, Multi-Payment Student Loans

Student lending provides a more difficult challenge than standard loans when it comes to Annual Percentage Rate disclosures. Understanding a proper TILA Annual Percentage Rate for a multi-advance student loan is difficult enough without having to figure out how to compute it. This complexity and the need for compliant disclosures are the reasons why several lending companies came to Carleton to develop a new solution.

At the request of a consortium of private student loan lenders, Carleton created a new SmartCalcs Student Loan APR software module that these companies integrated into their lending systems to accurately compute TILA disclosures. This software solution allowed the lenders to embed this callable subroutine within their existing loan system to compute the APR. Carleton has also provided consulting services to assist in evaluating the compliance of the TILA disclosures.

"Carleton has been a good friend to the student loan industry," says Walter Witthof, senior vice president of Iowa Student Loan. "They have a well-earned reputation within the education finance business as a solution-providing company that brings value to any discussion regarding the mathematics of finance and programming — particularly as these areas relate to calculation of the APR and paid interest reporting."

Carleton can provide any lender with the comfort and security of knowing their APR disclosures are precise and accurate regardless of how complex the transaction. In fact, Carleton was a member of the Industry Advisory Panel that helped create Appendix J of Regulation Z in 1969. In order to further enhance our capabilities and resources, Carleton acquired Financial Publishing Company (FPC) in 1996. FPC was founded in 1896, and, together with Carleton, have been providing accurate, precise APR values since Truth-in-Lending's inception in 1969.

If you have any questions or concerns about your current level of compliance with Truth-In-Lending disclosures, call Carleton's sales department at 800-433-0090.

Effective State Changes

compliance update

INDIANA

The dollar amount brackets and ceilings relating to maximum charges in the Indiana Credit Code will be adjusted and increased by 10% of the original amounts on July 1, 2008. The new maximum rate structures will be:

Supervised Loans and Retail Credit Sales:

The greater of:

- (A)
 - 36% of the amount financed up to \$1,050 plus
 - 21% of the excess to \$3,500 plus
 - 15% of the remainder

or

- (B)
 - 21% Simple Interest
 - The maximum delinquency charge for both loans and sales will become \$17.50
 - The minimum credit service charge and loan finance charge will become \$42.00
 - The July 1, 2008 increase will bring the dollar adjustments to 350% of the original amounts
 - The minimum amount financed for property insurance coverage will be \$1,050



SOUTH CAROLINA

The Department of Consumer Affairs has adjusted the amounts in the Consumer Protection Code that are subject to change on July 1st of each even-numbered year. The increase is equal to 10% of the original amounts in the Code. The new dollar brackets are effective July 1, 2008 until June 30, 2010.

The maximum amounts for consumer leases, credit sales or consumer loans will increase to the following:

	Effective 7/1/08	Currently in effect
Maximum Loan/Sale/Lease	\$82,500	\$77,500
Maximum Delinquency Charge	\$16.50	\$15.50
Minimum Delinquency Charge	\$6.60	\$6.20
Maximum Loan Terms	\$930/\$3,100	\$930/\$3,100



The following information is presented by the Carleton Research Department. In order to keep our customers abreast of what is happening in the consumer credit and credit insurance industries, the following law changes have been compiled for your review. Please check to see if any of the listed changes will impact your operations.

CARLETON TO SPONSOR CIMRO CONFERENCE

Carleton once again is proud to be a sponsor for this year's CIMRO conference. Ken Solnoky will be representing Carleton as a sponsor and exhibitor at the organization's 16th annual event. The conference will be held June 22-24 at the Omni Interlocken Hotel in Broomfield, Colo.

CIMRO is an acronym for Credit Industry Marketing Representative Organization. It is a formal gathering of credit insurance (including debt cancellation and debt suspension products) and bank marketing personnel for the purpose of sharing strategies, trends, products and methodologies.

There is a synergistic value achieved through the group's interaction in discussing the industry's opportunities and challenges. A forum with open communication is feasible because credit insurance operations don't compete for customers like their respective financial institutions.

"As a sponsor of CIMRO, Carleton has made available to CIMRO members software applications and services that help promote and market payment protection products as well as make the lending process more efficient," says Art Criden of Wachovia Insurance and a past CIMRO chairman. "Carleton has been a great supporter of our organization for many, many years."

For more information on this year's conference and registration, log on to www.CIMRO.org or call Ken Solnoky at Carleton 800-433-0090 ext 241.



SUITE OF SOFTWARE SOLUTIONS EXPANDS WITH SMARTCALCS FOR MORTGAGES

Carleton and its subsidiary, Financial Publishing, have been selling mortgage software for many years. The company recently developed a new module – SmartCalcs for Mortgages, so its family of LoanSmart software solutions is more robust than ever. This parameter driven software automates those tedious aspects of mortgage origination that are prone to error. Just as Carleton is known for the compliant nature of our consumer lending software, SmartCalcs for Mortgages is in compliance with Regulation Z, RESPA and other federal and state lending regulations.

In 1996, Carleton purchased Financial Publishing Company (FPC). One of the primary reasons for acquiring FPC (which was founded in 1896) was because of the wealth of experience they had in the mortgage lending industry. This new module is a direct result of the products that FPC has developed over the years. While SmartCalcs for Mortgages may be a new product, the software code, calculations and disclosures capabilities have been thoroughly tested over the years.

SmartCalcs for Mortgages allows you to compute and disclose conventional, FHA and VA loans as well as calculate full and half amount construction loans including interest reserve and PMI premiums with optional actual-day interest. With the new software you can also disclose construction and construction-to-permanent financing loans for any type of mortgage, including ARMs.

Other benefits of this software include the ability to compute monthly FHA insurance and traditional PMI loans, and compute automatic PMI termination at any LTV. It also allows you to choose from a variety of mortgage types including fixed, ARMs, buydowns, graduated payment, equal payment, monthly payment and biweekly payment.

To learn more about SmartCalcs for Mortgages or any of our other software products, please call Carleton's sales department at 800-433-0090.

WHEN "30 DAYS" IS NOT A MONTH *Continued from page 2*

Paraphrasing, what these two sections lay out is the general concept that all months shall have 30 days and the rate for one day will be 1/360th of the annual rate.

Unfortunately, translating Appendix J language to mean "a month is 30 days" is simply incorrect. The first "month" of the year would run from January 1st to January 31st (30 days), the second month from January 31st to March 1st, the third from March 1st to March 31st, and so on through the year. If the phrase "a month is 30 days" were accurate, how

do we account for the missing 5 days in the actual calendar?

Analyzing the payments that result from a particular system requires understanding the parameters and settings that drive those payment calculations. Like any logical conclusion or result, if the premise underlying the argument is faulty, the end result will follow suit. Make sure your calculations rest on sound principles and not on poorly defined assumptions and presumptions.



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