

RULES and REGULATIONS

FEDERAL RESERVE SYSTEM

12 CFR Part 226

Reg. Z; TIL-1
FR Doc. 85-7883
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Truth in Lending; Official Staff
Commentary Update

Wednesday, April 3, 1985

AGENCY: Board of Governors of the
Federal Reserve System.

ACTION: Final official staff
interpretation.

SUMMARY: The Board is publishing in final form changes to the official staff commentary to Regulation Z (Truth in Lending). The commentary applies and interprets the requirements of Regulation Z and is a substitute for individual staff interpretations of the regulation. The revisions address a variety of questions that have arisen about the regulation concerning such matters as the assumption provision, surcharges, discounted variable-rate disclosures, and implementation of the statutory change to the open-end right of rescission.

EFFECTIVE DATE: April 1, 1985, but
reliance optional until October 1, 1985.

FOR FURTHER INFORMATION

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SUPPLEMENTARY INFORMATION:

(1) General. Effective October 13, 1981, an official staff commentary (TIL-1, Supp. I to 12 CFR Part 226) was published to interpret Regulation Z (12 CFR Part 226). The commentary is designed to provide guidance to creditors in applying the regulation to specific transactions. The commentary is updated periodically to address significant questions that arise.

There have been three general updates so far--the first in September 1982 (47 FR 41338), the second in April 1983 (48 FR 14882), and the third in April 1984 (49 FR 13482). There was also a limited update concerning fees for the use of automated teller machines, which was adopted in October 1984 (49 FR 40560). This notice contains the fourth general update, which was proposed for comment on December 4, 1984 (49 FR 47406). The changes are effective on April 1, 1985. Although creditors are free to rely on the provisions as of that date and are protected if they do so, they need not follow the revisions until October 1, 1985, the uniform effective date provided for in section 105(d) of the revised Truth in Lending Act.

(2) Explanation of revisions. Following is a brief description of the revisions to the commentary and how they differ, if at all, from those proposed:

Subpart A--General

Section 226.2 Definitions and Rules of Construction.

2(a) Definitions.

2(a)(15) "Credit Card".

Comment 2(a)(15)-2 is revised to make clear that certain types of access devices that are used at wholesale petroleum distribution terminals--whether or not credit is involved--are not considered credit cards under Regulation Z. The comment has been revised from the proposal to address points raised by the commenters. First, language has been added to clarify that devices other than cards would also be excluded from the regulation's credit card definition if those devices in fact served the purpose described in the comment. The Comment also has been modified to indicate that, in order to come within the terms of the exclusion, the device need not be required both to gain access to the facility and also to obtain the petroleum products.

2(a)(17) "Creditor".

Paragraph 2(a)(17)(i).

Comment 2(a)(17)(i)-8 is added to explain how the numerical tests for determining who is a "creditor" should be applied to loans made by employee savings plans. It provides that the numerical test should be applied to the plan as a whole rather than to the individual account. The final comment has been revised from the proposal to make clear that it does not apply to plans in which the participants' accounts constitute individual trusts.

2(a)(20) "Open-End Credit".

Comment 2(a)(20)-5 is revised to correct a potential contradiction caused by the language "specific approval for each extension." Because "verification" of credit information--which is permissible under the open-end credit definition--necessarily involves "approval" if a credit extension is not denied after verifying the credit information, the "specific approval" language may have been confusing. The revised provision, therefore, does not contain that language. The comment continues to mean, however, that, while creditors may verify credit information on an open-end credit plan before authorizing additional credit extensions, they may not undertake activities such as requiring a new application for each additional credit extension, without jeopardizing a program's status as an open-end credit plan.

Section 226.4 Finance Charge.

4(a) Definition.

The first sentence of comment 4(a)-3 is revised to clarify which charges by third parties are excluded from the finance charge. The revision makes clear that, in order to be excluded, the charge must be imposed on the consumer and the creditor must not retain the charge. The final comment has been reworded from the proposal to make it easier to read and understand.

Subpart B--Open-End Credit

Section 226.7 Periodic Statement.

7(h) Other Charges.

Comment 7(h)-4 is added to make clear that, in disclosing "other charges" on the periodic statement, creditors have the flexibility to disclose them individually or as a total, as long as the charges are still itemized and identified by type.

Section 226.9 Subsequent Disclosure Requirements.

9(d) Finance Charge Imposed at Time of Transaction.

Comment 9(d)-1 is totally rewritten since the ban on credit card surcharges expired on February 27, 1984. Section 226.9(d) requires the disclosure of the amount of any finance charge, such as a credit card surcharge, that is imposed by a person other than the card issuer on a consumer for using a credit card. Revised comment 9(d)-1 makes clear that such finance charges must be disclosed to consumers prior to their being committed to purchasing property or services.

The final comment has been revised from the proposal to more clearly reflect the regulatory requirement to disclose the amount of the surcharge. In addition, at the suggestion of several commenters, the examples that were in the supplementary information to the proposal are now included in the comment. More detailed guidance on the disclosure requirements for surcharges may prove necessary in the future should surcharges continue to be permitted.

Section 226.12 Special Credit Card Provisions.

12(a) Issuance of Credit Cards.

Paragraph 12(a)(1).

Comment 12(a)(1)-8 is added to make clear that card issuers may issue, without a specific request from the consumer, a personal identification number (PIN) to existing cardholders, provided the PIN cannot be used by itself to obtain credit. The example given in the final comment has been revised from the proposal to clarify that the PINs might be issued to allow existing credit cards to be used at electronic terminals at point-of-sale, as well as at ATMs. (For a discussion of PIN issuance for use with existing debit cards, see question 5-4.5 in the update to the official staff commentary to Regulation E, published elsewhere in this Federal Register issue.)

Section 226.15 Right of Rescission.

15(a) Consumer's Right to Rescind.

Paragraph 15(a)(1).

Comment 15(a)(1)-2 is revised to reflect the amendment to the Truth in Lending Act in Pub. L. 98-479 which permanently exempts from the right of rescission individual transactions made on an open-end line of credit in accordance with a previously established credit limit.

References

Reference to section 205 of Pub. L. 98-479 is added to the References section to reflect the permanent exemption from the right of rescission for individual credit extensions made on an open-end credit line.

Subpart C--Closed-End Credit

Section 226.17 General Disclosure

Requirements.

17(a) Form of Disclosures.

Paragraph 17(a)(1).

Comment 17(a)(1)-5 is revised to clarify that other conditions of assumption, in addition to the currently-allowed reference to a due-on-sale clause, may be briefly reflected in the assumption policy disclosure under § 226.18(q).

17(b) Time of Disclosures.

Comment 17(b)-2, regarding conversion of open-end to closed-end credit, is expanded to address the question of the basis for disclosures when an open-end plan is converted to a variable-rate closed-end transaction. The revision makes clear that, where closed-end disclosures are delayed in accordance with the comment, the disclosures should reflect the rate in effect at the time of conversion.

Section 226.18 Content of Disclosures.

18(f) Variable Rate.

Comment 18(f)-5 is revised to add recent federal adjustable rate mortgage regulations to the list of variable rate regulations for which footnote 43 to § 226.18(f) may be used. Creditors making disclosures in accord with the rules issued by the Department of Housing and Urban Development (49 FR 23580) need not make the variable rate disclosures required by § 226.18(f). Comment 18(f)-5 is also revised to reflect a new citation to the variable rate regulation of the Federal Home Loan Bank Board. The revision is technical and reflects no substantive change in the

comment.

Comment 18(f)-8 is revised to clarify the application of the discounted variable rate rules to some types of variable rate transactions. A paragraph is added to explain that transactions in which the only difference between the initial rate and the index rate at consummation results from a change in the index are not discounted transactions. Material also is added to address plans that have a built-in delay between index changes and implementation of those changes. In calculating a composite annual percentage rate for these plans, creditors may use an index value within a certain period before consummation. Finally, premium loans are specifically referenced, and editorial changes are made to clarify some of the explanatory material.

18(k) Prepayment.

Comment 18(k)-2 is revised to delete the example regarding student loans with loan fees, in order to make the comment more consistent with comment 18(k)-3. Comment 18(k)-2 illustrates transactions that may require disclosures under both § 226.18(k)(1), regarding penalties for prepayment of simple interest transactions, and § 226.18(k)(2), regarding rebates for prepayment of precomputed transactions. Comment 18(k)-3 clarifies that prepaid finance charges do not require rebate disclosures. Since loan fees in student loans are normally prepaid finance charges, the continued use of that type of transaction as an example of a loan requiring a rebate disclosure is inappropriate and may cause confusion. The deletion of the example is a technical revision and does not affect the substance of either comment.

18(q) Assumption Policy.

Comment 18(q)-1 is revised to clarify the disclosure required when uncertainty exists as to the assumability of the obligation. Under the revision, the uncertain nature of a future assumption should be reflected in the disclosure, in order to more adequately inform consumers.

Section 226.23 Right of Rescission.

23(f) Exempt Transactions.

Comment 23(f)-8 is added to clarify the application of the right of rescission to close-end credit transactions arising from the conversion of an open-end credit account. Where consummation of both the closed-end and open-end credit occurs at the time the consumer enters into the open-end agreement, the closed-end disclosures may be delayed until conversion, as provided by comment 17(b)- 2. Comment 23(f)-8 makes clear that, if the creditor has previously complied with the rescission requirements on the open-end account, no new right of rescission applies on the conversion of an account secured by the consumer's principal dwelling.

List of Subjects in 12 CFR Part 226

Advertising, Banks, banking, Consumer protection, Credit, Federal Reserve System, Finance, Penalties, Truth in lending.

PART 226--[AMENDED]

(3) Text of revisions. The revisions to the commentary (TIL-1, Supplement I to 12 CFR Part 226) read as follows:

Supplement I--Official Staff Commentary--TIL-1

SUBPART A--General

Section 226.2 Definitions and Rules of Construction

2(a) Definitions

2(a)(15) "Credit Card"

2. Examples. Examples of credit cards include:

A card that guarantees checks or similar instruments, if the asset account is also tied to an overdraft line or if the instrument directly accesses a line of credit

A card that accesses both a credit and an asset account (that is, a debit-credit card)

An identification card that permits the consumer to defer payment on a purchase

An identification card indicating loan approval that is presented to a merchant or to a lender, whether or not the consumer signs a separate promissory note for each credit extension

In contrast, credit card does not include, for example:

A check guarantee or debit card with no credit feature or agreement, even if the creditor occasionally honors an inadvertent overdraft.

Any card, key, plate, or other device that is used in order to obtain petroleum products for business purposes from a wholesale distribution facility or to gain access to that facility, and that is required to be used without regard to payment terms.

2(a)(17) "Creditor"

Paragraph 2(a)(17)(i)

8. Loans from employee savings plans. Some employee savings plans permit participants to borrow money up to a certain percentage of their account balances. Unless each participant's account is an individual trust, the numerical tests should be applied to the plan as a whole rather than to the individual accounts, even if the loan amount is determined by reference to the balance in an individual account and the repayments are credited to the individual account.

2(a)(20) "Open-End Credit"

5. Reusable line. The total amount of credit that may be extended during the existence of an open-end plan is unlimited because available credit is generally replenished as earlier advances are repaid. A line of credit is self-replenishing even though the plan itself has a fixed expiration date, as long as during the plan's existence the consumer may use the line, repay, and reuse the credit. The creditor may verify credit information such as the consumer's continued income and employment status or information for security purposes. This criterion of unlimited credit distinguishes open-end credit from a series of advances made pursuant to a close-end credit loan commitment.

Section 226.4 Finance Charge

4(a) Definition

3. Charges by third parties. Charges imposed on the consumer by someone other than the creditor for services not required by the creditor are not finance charges, as long as the creditor does not

retain the charges.

For example:

A fee charged by a loan broker to a consumer, provided the creditor does not require the use of a broker (even if the creditor knows of the loan broker's involvement or compensates the broker)

A tax imposed by a state or other governmental body on the credit transaction that is payable by the consumer (even if the tax is collected by the creditor)

Subpart B--Open-End Credit

Section 226.7 Periodic Statement

7(h) Other Charges

4. Itemization--types of "other charges". Each type of "other charge" (such as late payment charges, over-the-credit-limit charges, ATM fees that are not finance charges, and membership fees) imposed during the cycle must be separately itemized; for example, disclosure of only a total of "other charges" attributable to both an over-the-credit-limit charge and a late payment charge would not be permissible. "Other charges" of the same type may be disclosed, however, individually or as a total. For example, three ATM fees of \$1 may be listed separately or as \$3.

Section 226.9 Subsequent Disclosure Requirements

9(d) Finance Charge Imposed at Time of Transaction

1. Disclosure prior to imposition. A person imposing a finance charge at the time of honoring a consumer's credit card must disclose the amount of the charge, or an explanation of how the

charge will be determined, prior to its imposition. This must be disclosed before the consumer becomes obligated for property or services that may be paid for by use of a credit card. For example, disclosure must be given before the consumer has dinner at a restaurant, stays overnight at a hotel, or makes a deposit guaranteeing the purchase of property or services.

Section 226.12 Special Credit Card Provisions

12(a) Issuance of Credit Cards

Paragraph 12(a)(1)

8. Unsolicited issuance of PINs. A card issuer may issue personal identification numbers (PINs) to existing credit cardholders without a specific request from the cardholders, provided the PINs cannot be used alone to obtain credit. For example, the PINs may be necessary if consumers wish to use their existing credit cards at automated teller machines or at merchant locations with point-of-sale terminals that require PINs.

Section 226.15 Right of Rescission

15(a) Consumer's Right to Rescind

Paragraph 15(a)(1)

2. Exceptions. Although the consumer generally has the right to rescind with each transaction on the account, section 125(e) of the act provides an exception: the creditor need not provide the right to rescind at the time of each credit extension made under an open-end credit plan secured by the consumer's principal dwelling to the extent that the credit extended is in accordance with a

previously established credit limit for the plan. This limited rescission option is available whether or not the plan existed prior to the effective date of the act.

References

Statute: Sections 113, 125, 130, and the Housing and Community Development Technical Amendments Act of 1984, Sec. 205 (Pub. L. 98-479).

1981 Changes: Section 226.15 reflects the statutory amendments of 1980, providing for a limited right of rescission when individual credit extensions are made in accordance with a previously established credit limit for an open-end credit plan. The 1980 amendments provided that this limited rescission right be available for a three-year trial period. However, Pub. L. 98-479 now permanently exempts such individual credit extensions from the right of rescission.

Subpart C--Closed-End Credit

Section 226.17 General Disclosure Requirements

17(a) Form of Disclosures

Paragraph 17(a)(1)

5. Directly related. The segregated disclosures may, at the creditor's option, include any information that is directly related to those disclosures. Directly related information includes, for example, the following:

A statement that a due-on-sale clause or other conditions on assumption are contained in the loan document. For example, the disclosure given under §

226.18(q) may state, "Someone buying your home may, subject to conditions in the due-on-sale clause contained in the loan document, assume the remainder of the mortgage on the original terms."

17(b) Time of Disclosure

2. Converting open-end to closed-end credit. If an open-end credit account is converted to a closed-end transaction under a written agreement with the consumer, the creditor must provide a set of closed-end credit disclosures before consummation of the closed-end transaction. If consummation of the closed-end transaction occurs at the same time as the consumer enters into the open-end agreement, the closed-end credit disclosures may be given at the time of conversion. If disclosures are delayed until conversion and the closed-end transaction has a variable-rate feature, disclosures should be based on the rate in effect at the time of conversion. (See the commentary to § 226.5 regarding conversion of closed-end to open-end credit.)

Section 226.18 Content of Disclosures

18(f) Variable Rate

5. Other variable-rate regulations. Transactions in which the creditor is required to comply with and has complied with variable-rate regulations of other federal agencies are exempt from the requirements of § 226.18(f), by virtue of footnote 43. Those variable-rate regulations include the adjustable mortgage loan instrument regulation issued by the Federal Home Loan Bank Board (12 CFR 545.33), the adjustable-rate mortgage regulation issued by the Comptroller of the Currency (12 CFR

Part 29) and the adjustable-rate mortgage regulations issued by the Department of Housing and Urban Development (24 CFR Parts 203 and 234). The exception in footnote 43 is also available to creditors that are required by state law to comply with the federal variable-rate regulations noted above and to creditors that are authorized by title VIII of the Depository Institutions Act of 1982 (Pub. L. 97-320) to make loans in accordance with those regulations. Creditors using this exception should comply with the timing requirements of those regulations rather than the timing requirements of Regulation Z in making the variable-rate disclosures.

8. Discounted variable-rate transactions. In some variable-rate transactions, creditors may set an initial interest rate that is not determined by the index or formula used to make later interest rate adjustments. Typically, this initial rate charged to consumers is lower than the rate would be if it were calculated using the index or formula. However, in some cases the initial rate may be higher. In a discounted transaction, for example, a creditor may calculate interest rates according to a formula using the six-month Treasury bill rate plus a 2 percent margin. If the Treasury bill rate at consummation is 10 percent, the creditor may forego the 2 percent spread and charge only 10 percent for a limited time, instead of setting an initial rate of 12 percent.

When creditors use an initial interest rate that is not calculated using the index or formula for later rate adjustments, the disclosures should reflect a composite annual percentage rate based on the initial rate for as long as it is charged and, for the remainder of the term, the

rate that would have been applied using the index or formula at the time of consummation. The rate at consummation need not be used if a contract provides for a delay in the implementation of changes in an index value. For example, if the contract specifies that rate changes are based on the index value in effect 45 days before the change date, creditors may use the index value in effect not more than 45 days before consummation in calculating a composite annual percentage rate. The effect of the multiple rates must also be reflected in the calculation and disclosure of the finance charge, total of payments, and payment schedule. If a loan contains a rate or payment cap that would prevent the initial rate or payment, at the time of the first adjustment, from changing to the rate determined by the index or formula at consummation, the effect of that rate or payment cap should be reflected in the disclosures.

Because these transactions involve irregular payment amounts, an annual percentage rate tolerance of 1/4 of 1 percent applies, in accordance with section § 226.22(a)(3) of the regulation. Examples of discounted variable-rate transactions include:

--A 30-year loan for \$100,000 with no prepaid finance charges and rates determined by the Treasury bill rate plus 2 percent. Rate and payment adjustments are made annually. Although the Treasury bill rate at the time of consummation is 10 percent, the creditor sets the interest rate for one year at 9 percent, instead of 12 percent according to the formula. The disclosures should reflect a composite annual percentage rate of 11.63 percent based on 9 percent for one year and 12 percent for 29 years. Reflecting those two rate levels, the

payment schedule should show 12 payments of \$804.62 and 348 payments of \$1,025.31. The finance charge should be \$266,463.32 and the total of payments \$366,463.32.

--Same loan as above, except with a 2 percent rate cap on periodic adjustments. The disclosures should reflect a composite annual percentage rate of 11.53 percent based on 9 percent for the first year, 11 percent for the second year, and 12 percent for the remaining 28 years. Reflecting those three rate levels, the payment schedule should show 12 payments of \$804.62, 12 payments of \$950.09, and 336 payments of \$1,024.34. The finance charge should be \$265,234.76, and the total of payments \$365,234.76.

--Same loan as above, except with a 7 1/2 percent cap on payment adjustments. The disclosures should reflect a composite annual percentage rate of 11.64 percent, based on 9 percent for one year and 12 percent for 29 years. Because of the payment cap, five levels of payments should be reflected. The payment schedule should show 12 payments of \$804.62, 12 payments of \$864.97, 12 payments of \$929.86, 12 payments of \$999.60, and 312 payments of \$1,070.03. The finance charge should be \$277,037.96, and the total of payments \$377,037.96.

This paragraph does not apply to variable-rate loans in which the initial interest rate is set according to the index or formula used for later adjustments, but is not set at the value of the index or formula at consummation. For example, if a creditor commits to an initial rate based on the formula on a date prior to consummation, but the index has moved during the period between that time and consummation, a creditor should base its disclosures on the initial rate.

18(k) Prepayment

2. Rebate-penalty disclosure. A single transaction may involve both a precomputed finance charge and a finance charge computed by application of a rate to the unpaid balance (for example, mortgages with mortgage-guarantee insurance). In these cases, disclosures about both prepayment rebates and penalties are required. Sample form H-15 in appendix H illustrates a mortgage transaction in which both rebate and penalty disclosures are necessary.

18(q) Assumption Policy

1. Policy statement. In many mortgages, the creditor cannot determine, at the time disclosure must be made, whether a loan may be assumable at a future date on its original terms. For example, the assumption clause commonly used in mortgages sold to the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation conditions an assumption on a variety of factors such as the creditworthiness of the subsequent borrower, the potential for impairment of the lender's security, and execution of an assumption agreement by the subsequent borrower. In cases where uncertainty exists as to the future assumability of a mortgage, the disclosure under § 226.18(q) should reflect that fact. In making disclosures in such cases, the creditor may use phrases such as "subject to conditions," "under certain circumstances," or "depending on future conditions." The creditor may

provide a brief reference to more specific criteria such as a due-on-sale clause, although a complete explanation of all conditions is not appropriate. For example, the disclosure may state, "Someone buying your home may be allowed to assume the mortgage on its original terms, subject to certain conditions, such as payment of an assumption fee." See comment 17(a)(1)-5 for an example for a reference to a due-on-sale clause.

Section 226.23 Right of Rescission

23(f) Exempt Transactions

8. Converting open-end to closed-end credit. Under certain state laws, consummation of a closed-end credit transaction may occur at the time a consumer enters into the initial open-end credit agreement. As provided in the commentary to § 226.17(b), closed-end credit disclosures may be delayed under these circumstances until the conversion of the open-end account to a closed-end transaction. In accounts secured by the consumer's principal dwelling, no new right of rescission arises at the time of conversion, assuming that the right of rescission was previously provided on the open-end account pursuant to § 226.15.

Board of Governors of the Federal Reserve System, March 28, 1985.

William W. Wiles,

Secretary of the Board.