

FEDERAL RESERVE BANK OF DALLAS

DALLAS, TEXAS 75222

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REGULATION Z

Revised Pamphlet of Amendments and Interpretations

To All Banks, Other Creditors and Others
Concerned in the Eleventh Federal Reserve District:

The Board of Governors of the Federal Reserve System has revised the pamphlet containing the amendments and interpretations of Regulation Z issued during the period September 12, 1969 to August 31, 1973.

A copy of the pamphlet is enclosed.

Yours very truly,

P. E. Coldwell,

President

Enclosure

Board of Governors
of the
Federal Reserve System

TRUTH IN LENDING
AMENDMENTS TO
TRUTH IN LENDING ACT
and
AMENDMENTS AND INTERPRETATIONS
of
REGULATION Z

This pamphlet contains the 1970 credit card amendments to the Truth in Lending Act and all amendments and interpretations of Regulation Z issued during the period September 12, 1969 to August 31, 1973.

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**TRUTH IN LENDING
AMENDMENTS TO TRUTH IN LENDING ACT**

Effective October 26, 1970, the Truth in Lending Act is amended to include the following additional provisions relating to credit cards:

Section 103 of the Truth in Lending Act (82 Stat. 146) is amended by redesignating subsections (j), (k), and (l) as subsections (p), (q), and (r), respectively, and by adding after subsection (i) the following:

(j) The term "adequate notice", as used in section 133, means a printed notice to a cardholder which sets forth the pertinent facts clearly and conspicuously so that a person against whom it is to operate could reasonably be expected to have noticed it and understood its meaning. Such notice may be given to a cardholder by printing the notice on any credit card, or on each periodic statement of account, issued to the cardholder, or by any other means reasonably assuring the receipt thereof by the cardholder.

(k) The term "credit card" means any card, plate, coupon book or other credit device existing for the purpose of obtaining money, property, labor, or services on credit.

(l) The term "accepted credit card" means any credit card which the cardholder has requested and received or has signed or has used, or authorized another to use, for the purpose of obtaining money, property, labor, or services on credit.

(m) The term "cardholder" means any person to whom a credit card is issued or any person who has agreed with the card issuer to pay obligations arising from the issuance of a credit card to another person.

(n) The term "card issuer" means any person who issues a credit card, or the agent of such person with respect to such card.

(o) The term "unauthorized use", as used in section 133, means a use of a credit card by a person other than the cardholder who does not have actual, implied, or apparent authority for such use and from which the cardholder receives no benefit.

The Truth in Lending Act (82 Stat. 146) is amended by adding after section 131 the following sections:

§ 132. Issuance of credit cards

No credit card shall be issued except in response to a request or application therefor. This prohibition does not apply to the issuance of a credit card in renewal of, or in substitution for, an accepted credit card.

§ 133. Liability of holder of credit card

(a) A cardholder shall be liable for the unauthorized use of a credit card only if the card is an accepted credit card, the liability is not in excess of \$50, the card issuer gives adequate notice to the cardholder of the potential liability, the card issuer has provided the cardholder with a self-addressed, prestamped notification to be mailed by the cardholder in the event of the loss or theft of the credit card, and the unauthorized use occurs before the cardholder has notified the card issuer that an unauthorized use of the credit card has occurred or may occur as the result of loss, theft, or otherwise. Notwithstanding the foregoing, no cardholder shall be liable for the unauthorized use of any credit card which was issued on or after the effective date of this section, and, after the expiration of twelve months following such effective date, no cardholder shall be liable for the unauthorized use of any credit card regardless of the date of its issuance, unless (1) the conditions of liability specified in the preceding sentence are met, and (2) the card issuer has provided a method whereby the user of such card can be identified as the person authorized to use it. For the purposes of this section, a cardholder notifies a card issuer by taking such steps as may be reasonably required in the ordinary course of business to provide the card issuer with the pertinent information whether or not any particular officer, employee, or agent of the card issuer does in fact receive such information.

(b) In any action by a card issuer to enforce liability for the use of a credit card, the burden of proof is upon the card issuer to show that the use was authorized or, if the use was unauthorized, then the burden of proof is upon the card issuer to show that the conditions of liability for the unauthorized use of a credit card, as set forth in subsection (a), have been met.

(c) Nothing in this section imposes liability upon a cardholder for the unauthorized use of a credit card in excess of his liability for such use under other applicable law or under any agreement with the card issuer.

(d) Except as provided in this section, a card-

holder incurs no liability from the unauthorized use of a credit card.

§ 134. Fraudulent use of credit card

Whoever, in a transaction affecting interstate or foreign commerce, uses any counterfeit, fictitious, altered, forged, lost, stolen, or fraudulently obtained credit card to obtain goods or services, or both, having a retail value aggregating \$5,000 or more, shall be fined not more than \$10,000 or imprisoned not more than five years, or both.

The table of contents of Chapter 2 of the Truth in Lending Act is amended by adding at the end thereof the following:

132. Issuance of credit cards.

133. Liability of holder of credit card.

134. Fraudulent use of credit card.

The amendments to the Truth in Lending Act made by this title become effective as follows:

(1) Section 132 of such Act takes effect upon the date of enactment of this title.

(2) Section 133 of such Act takes effect upon the expiration of 90 days after such date of enactment.

(3) Section 134 of such Act applies to offenses committed on or after such date of enactment.

* * * * *

(See corresponding Amendments to Regulation Z (§ 226.13) at page 11.)

**TRUTH IN LENDING
AMENDMENTS TO REGULATION Z**

Effective January 25, 1971, section 226.1 is amended as follows:

**SECTION 226.1—AUTHORITY, SCOPE,
PURPOSE, ETC.**

(a) **Authority, scope and purpose.** (1) This Part comprises the regulations issued by the Board of Governors of the Federal Reserve System pursuant to Title I (Truth in Lending Act) and Title V (General Provisions) of the Consumer Credit Protection Act, as amended (15 U.S.C. § 1601 et seq.). Except as otherwise provided herein, this Part applies to all persons who in the ordinary course of business regularly extend, or offer to extend, or arrange, or offer to arrange, for the extension of consumer credit as defined in paragraph (k) of § 226.2, and to all persons who issue credit cards.

(2) This Part implements the Act, the purpose of which is to assure that every customer who has need for consumer credit is given meaningful information with respect to the cost of that credit which, in most cases, must be expressed in the dollar amount of finance charge, and as an annual percentage rate computed on the unpaid balance of the amount financed. Other relevant credit information must also be disclosed so that the customer may readily compare the various credit terms available to him from different sources and avoid the uninformed use of credit. This Part also implements the provision of the Act under which a customer has a right in certain circumstances to cancel a credit transaction which involves a lien on his residence. Advertising of consumer credit terms must comply with specific requirements, and certain credit terms may not be advertised unless the creditor usually and customarily extends such terms. This Part also contains prohibitions against the issuance of unsolicited credit cards and limits on the cardholder's liability for unauthorized use of a credit card. Neither the Act nor this Part is intended to control charges for consumer credit, or interfere with trade practices except to the extent that such practices may be inconsistent with the purpose of the Act.

(b) **Administrative enforcement.** (1) As set forth more fully in section 108 of the Act, administrative enforcement of the Act and this Part with respect to certain creditors and credit card issuers is assigned to the Comptroller of the Currency,

Board of Directors of the Federal Deposit Insurance Corporation, Federal Home Loan Bank Board (acting directly or through the Federal Savings and Loan Insurance Corporation), Administrator of the National Credit Union Administration, Interstate Commerce Commission, Civil Aeronautics Board, Secretary of Agriculture, and Board of Governors of the Federal Reserve System.

(2) Except to the extent that administrative enforcement is specifically committed to other authorities, compliance with the requirements imposed under the Act and this Part will be enforced by the Federal Trade Commission.

(c) **Penalties and liabilities.** Section 112 of the Act provides for criminal liability for willful and knowing failure to comply with any requirement imposed under the Act and this Part, and section 130 of the Act provides for civil liability on the part of any creditor who fails to disclose any information required under Chapter 2 of the Act and under the corresponding provisions of this Part. Section 134 provides for criminal liability for the fraudulent use of a credit card to obtain goods or services having a retail value aggregating \$5,000 or more. Pursuant to section 108 of the Act, violations of the Act or this Part constitute violations of other Federal laws which may provide further penalties.

Effective November 1, 1973, section 226.2(u) is amended as follows:

**SECTION 226.2—DEFINITIONS AND RULES
OF CONSTRUCTION**

* * * * *

(u) **"Periodic rate"** means a percentage rate of finance charge which is or may be imposed by a creditor against a balance for a period. (See also § 226.5(a)(3).)

Effective June 1, 1973, section 226.5(a)(3) is amended as follows:

**SECTION 226.5—DETERMINATION OF
ANNUAL PERCENTAGE RATE**

(a) **General Rule—open end credit accounts.**

* * * * *

(3) Where the finance charge imposed during the billing cycle is or includes

(i) any minimum, fixed, or other charge not due to the application of a periodic rate, other

than a charge with respect to any specific transaction during the billing cycle, by dividing the total finance charge for the billing cycle by the amount of the balance(s) to which applicable and multiplying the quotient (expressed as a percentage) by the number of billing cycles in a year; or

(ii) any charge with respect to any specific transaction during the billing cycle (even if the total finance charge also includes any other minimum, fixed, or other charge not due to the application of a periodic rate), by dividing the total finance charge imposed during the billing cycle by the total of all balances and other amounts on which any finance charge was imposed during the billing cycle without duplication and multiplying the quotient (expressed as a percentage) by the number of billing cycles in a year,^{5a} except that the annual percentage rate shall not be less than the largest rate determined by multiplying each periodic rate imposed during the billing cycle by the number of periods in a year; or

(iii) any minimum, fixed, or other charge not due to the application of a periodic rate and the total finance charge imposed during the billing cycle does not exceed 50 cents for a monthly or longer billing cycle, or the pro rata

part of 50 cents for a billing cycle shorter than monthly, at the creditor's option, by multiplying each applicable periodic rate by the number of periods in a year, notwithstanding the provisions of subdivisions (i) and (ii) of this subparagraph.

SECTION 226.6—GENERAL DISCLOSURE REQUIREMENTS

Effective November 1, 1973, section 226.6(a) is amended as follows:

(a) **Disclosures: general rule.** The disclosures required to be given by this Part shall be made clearly, conspicuously, in meaningful sequence, in accordance with the further requirements of this section, and at the time and in the terminology prescribed in applicable sections. Except with respect to the requirements of § 226.10, where the terms "finance charge" and "annual percentage rate" are required to be used, they shall be printed more conspicuously than other terminology required by this Part and all numerical amounts and percentages shall be stated in figures and shall be printed in not less than the equivalent of 10 point type, .075 inch computer

^{5a} In determining the denominator of the fraction under §226.5(a)(3)(ii) no amount will be used more than once when adding the sum of the balances to which periodic rates apply to the sum of the amounts financed to which specific transaction charges apply. In every case the full amount of transactions to which specific transaction charges apply shall be included in the denominator. Other balances or parts of balances shall be included according to the manner of determining the balance to which a periodic rate is applied, as illustrated in the following examples of accounts on monthly billing cycles:

1. Previous balance—none.

A specific transaction of \$100 occurs on first day of the billing cycle. The average daily balance is \$100. A specific transaction charge of 3% is applicable to the specific transactions. The periodic rate is 1½% applicable to the average daily balance. The numerator is the amount of the finance charge, which is \$4.50. The denominator is the amount of the transaction (which is \$100), plus the amount by which the balance to which the periodic rate applies exceeds the amount of specific transactions (such excess in this case is 0), totaling \$100.

The annual percentage rate is the quotient (which is 4.5%) multiplied by 12 (the number of months in a year). *i.e.*, 54%

2. Previous balance—\$100.

A specific transaction of \$100 occurs at midpoint of the billing cycle. The average daily balance is \$150. A specific transaction charge of 3% is applicable to the specific transaction. The periodic rate is 1½% applicable to the average daily balance. The numerator is the amount of finance charge which is \$5.25. The denominator is the amount of the transaction (which is \$100), plus the amount by which the balance to which the periodic rate

applies exceeds the amounts of specific transactions (such excess in this case is \$50), totaling \$150.

As explained in example 1, the annual percentage rate is $3.5\% \times 12 = 42\%$.

3. If, in example 2, the periodic rate applies only to the previous balance, the numerator is \$4.50 and the denominator is \$200 (the amount of the transaction, \$100, plus the balance to which only the periodic rate is applicable, the \$100 previous balance). As explained in example 1, the annual percentage rate is $2.25\% \times 12 = 27\%$.

4. If, in example 2, the periodic rate applies only to an adjusted balance (previous balance less payments and credits) and the customer made a payment of \$50 at midpoint of billing cycle, the numerator is \$3.75 and the denominator is \$150 (the amount of the transaction, \$100, plus the balance to which only the periodic rate is applicable, the \$50 adjusted balance). As explained in example 1, the annual percentage rate is $2.5\% \times 12 = 30\%$.

5. Previous balance—\$100

A specific transaction (check) of \$100 occurs at the midpoint of the billing cycle. The average daily balance is \$150. The specific transaction charge is 25 cents per check. The periodic rate is 1½% applied to the average daily balance. The numerator is the amount of the finance charge, which is \$2.50 and includes the 25 cents check charge and the \$2.25 resulting from the application of the periodic rate. The denominator is the full amount of the specific transaction (which is \$100) plus the amount by which the average daily balance exceeds the amount of the specific transaction (which in this case is \$50), totaling \$150. As explained in example 1, the annual percentage rate would be $1\frac{3}{4}\% \times 12 = 20\%$.

type, or elite size typewritten numerals, or shall be legibly handwritten.

* * * * *

Effective December 31, 1971, section 226.6 is amended by the addition of paragraph (l) as follows:

(1) **Leap year.** Any variance in the amount of any finance charge, payment, percentage rate, or other term required under this Part to be disclosed, or stated in any advertisement, which occurs by reason of the addition of February 29 in each leap year, may be disregarded, and such term may be disclosed or stated without regard to such variance.

Effective June 1, 1973, sections 226.7(a)(4), 226.7(b)(5) and (6), and 226.7(c) are amended as follows:

SECTION 226.7—OPEN END CREDIT ACCOUNTS—SPECIFIC DISCLOSURES

(a) Opening new account.

* * * * *

(4) Where one or more periodic rates may be used to compute the finance charge, each such rate, the range of balances to which it is applicable, and the corresponding annual percentage rate determined by multiplying the periodic rate by the number of periods in a year.^{6a}

^{6a} A creditor imposing minimum charges is not required to adjust the disclosure of the range of balances to which each periodic rate would apply in order to reflect the range of the balances below which the minimum charge applies. If a creditor does not impose a finance charge when the outstanding balance is less than a certain amount, the creditor is not required to disclose that fact or the balance below which no such charge will be imposed.

* * * * *

(b) Periodic statements required.

* * * * *

(5) Each periodic rate, using the term "periodic rate" (or "rates"), that may be used to compute the finance charge (whether or not applied during the billing cycle), the range of balances to which it is applicable, and the corresponding annual percentage rate determined by multiplying the periodic rate by the number of periods in a year. The words "corresponding annual percentage rate," "corresponding nominal annual percentage rate," "nominal annual percentage rate" or "annual percentage rate" (or "rates") may be used to describe

the corresponding annual percentage rate. The requirements of § 226.6(a) of this Part with respect to disclosing the term "annual percentage rate" more conspicuously than other required terminology shall not be applicable to the disclosure made under this subparagraph, although such term (or words incorporating such term) may, at the creditor's option, be shown as conspicuously as the terminology required under subparagraph 6 of this paragraph. Where a minimum charge may be applicable to the account, the amount of such minimum charge shall be disclosed.^{9a}

(6) When a finance charge is imposed during the billing cycle, the annual percentage rate or rates determined under § 226.5(a) using the term "annual percentage rate" (or "rates").

^{9a} A creditor imposing minimum charges is not required to adjust the disclosure of the range of balances to which each periodic rate would apply in order to reflect the range of the balances below which the minimum charge applies. If a creditor does not impose a finance charge when the outstanding balance is less than a certain amount, the creditor is not required to disclose that fact or the balance below which no such charge will be imposed.

* * * * *

(c) **Location of disclosures.** The disclosures required by paragraph (b) of this section shall be made on the face of the periodic statement, except that, at the creditor's option:

(1) Itemization of the amount and date of each extension of credit (or the date such extension of credit was debited to the account) required to be disclosed under paragraph (b)(2) of this section and itemization of the amount of the "credits" disclosed under paragraph (b)(3) of this section, and of the amount of any finance charge required to be disclosed under paragraph (b)(4) of this section, may be made on the reverse side of the periodic statement or on a separate accompanying statement(s), provided that the totals of such respective amounts are disclosed on the face of the periodic statement; and

(2) The disclosures required under paragraph (b)(5) and (b)(8) of this section, except the balance on which the finance charge was computed, may be made on the reverse side of the periodic statement or on the face of a single supplemental statement which shall accompany the periodic statement.

(3) If the creditor exercises any of the options provided under this paragraph, the face of the periodic statement shall contain one of the following notices, as applicable: "NOTICE: See reverse

side for important information” or “NOTICE: See accompanying statement(s) for important information” or “NOTICE: See reverse side and accompanying statement(s) for important information,” and the disclosures shall not be separated so as to confuse or mislead the customer or obscure or detract attention from the information required to be disclosed.

* * * * *

*Effective April 5, 1971, section 226.7(e) is amended as follows:

(e) **Change in terms.** Not later than 15 days prior to the beginning date of the billing cycle in which any change is to be made in the terms previously disclosed to the customer of an open end credit account, the creditor shall mail or deliver a written disclosure of such change to each customer required to be furnished a statement under paragraph (b) of this section. Such disclosure shall be mailed or delivered to each other customer who subsequently activates his account not later than the date of mailing or delivery of the next required billing statement on his account. However, if the periodic rate or rates, or any minimum, fixed, check service, transaction, activity, or similar charge is increased, the creditor shall mail or deliver a written disclosure of such increase to each customer at least 15 days prior to the beginning date of the billing cycle in which the increase is imposed on his account. No notice is necessary if the only change is a reduction in the minimum periodic payment, periodic rate or rates, or in any minimum, fixed, check service, transaction, activity, or similar charge applicable to the account.

**Supersedes amendment issued October 23, 1970*

SECTION 226.8—CREDIT OTHER THAN OPEN END—SPECIFIC DISCLOSURES

Effective January 1, 1974, section 226.8(b)(7) is amended as follows:

(b) Disclosures in sale and non-sale credit.

* * * * *

(7) Identification of the method of computing any unearned portion of the finance charge in the event of prepayment in full of an obligation which includes precomputed finance charges and a statement of the amount or method of computa-

tion of any charge that may be deducted from the amount of any rebate of such unearned finance charge that will be credited to an obligation or refunded to the customer. If the credit contract does not provide for any rebate of unearned finance charges upon prepayment in full, this fact shall be disclosed.

* * * * *

Effective November 6, 1969, section 226.8 is amended by the addition of paragraph (p) as follows:

(p) **Agricultural credit—information not determinable.** (1) In any transaction subject to this section, if the amount or date of any advance or payment in connection with an extension of credit for agricultural purposes under a written agreement is to be determined by production, seasonal needs, or similar operational factors, and is not determinable at the time of execution of the agreement, disclosures may be made at the creditor's option in accordance with this paragraph, provided the use of this paragraph is not for the purpose of circumvention or evasion of this Part.

(2) If a creditor elects to make disclosures under this paragraph, he shall disclose the following items in accordance with § 226.8(a), which shall constitute compliance with the requirements of § 226.8, and under § 226.9(a) shall constitute “all other material disclosures required under this Part”:

- (i) The method of computing the amount of the finance charge including an identification of each component thereof in accordance with § 226.4;
- (ii) Any item required to be disclosed under § 226.8(b)(3) which is determinable at the time the disclosures are required to be made under this paragraph;
- (iii) The disclosures, as applicable, required under § 226.8(b)(4), (5), (6), and (7) and the items described in § 226.8(e)(1) and (2);
- (iv) The disclosures, as applicable, required under § 226.8(o)(1), (2), (3), (4), (5), (8), and (9).

(3) Disclosures made pursuant to subparagraph (2)(i), (ii), and (iii) of this paragraph need be made only on the agreement or on a separate statement as specified in § 226.8(a).

(4) If a creditor making disclosures pursuant to this paragraph transmits a periodic billing statement of the type described in paragraph (n) of

vided the disclosure required under paragraph (b) of this section was made at the time the security interest was acquired by the creditor or at any time prior to the first advance made on or following the effective date of this Part, or

(ii) Paragraph (p) of § 226.8 under a written agreement, provided the disclosure required under paragraph (b) of this section was made at the time the written agreement was executed by the customer.

SECTION 226.10—ADVERTISING CREDIT TERMS

Effective November 1, 1973, sections 226.10(c) and 226.10(d) are amended as follows:

* * * *

(c) **Advertising of open end credit.** No advertisement to aid, promote, or assist directly or indirectly the extension of open end credit may set forth any of the terms described in paragraph (a) of § 226.7, the Comparative Index of Credit Cost, or that a specified downpayment or periodic payment is required (either in dollars or as a percentage), the period of repayment or any of the following items, unless it also clearly and conspicuously sets forth all the following items in terminology prescribed under paragraph (b) of § 226.7:

(1) An explanation of the time period, if any, within which any credit extended may be paid without incurring a finance charge.

(2) The method of determining the balance upon which a finance charge may be imposed.

(3) The method of determining the amount of the finance charge, including the determination of any minimum, fixed, check service, transaction, activity, or similar charge, which may be imposed as a finance charge.

(4) Where one or more periodic rates may be used to compute the finance charge, each corresponding annual percentage rate determined by multiplying the periodic rate by the number of periods in a year and, where there is more than one corresponding annual percentage rate, the range of balances to which each is applicable.¹⁵

¹⁵ A creditor imposing minimum charges is not required to adjust the disclosure of the range of balances to which each rate would apply in order to reflect the range of the balances below which the minimum charge applies. If a creditor does not impose a finance charge when the outstanding balance is less than a certain amount, the creditor is not required to disclose that fact or the balance below which no such charge will be imposed.

(d) **Advertising of credit other than open end.** No advertisement to aid, promote, or assist directly or indirectly any credit sale including the sale of residential real estate, loan, or other extension of credit, other than open end credit, subject to the provisions of this Part, shall state.

(1) The rate of the finance charge except as an "annual percentage rate," using that term. No other rate of finance charge may be stated, except that:

(i) where the total finance charge includes, as a component, interest computed at a simple annual rate, the simple annual rate may be stated in conjunction with, but not more conspicuously than, the annual percentage rate, or

(ii) where the finance charge is computed solely by the application of a periodic rate to an unpaid balance, the periodic rate may be stated in conjunction with, but not more conspicuously than, the annual percentage rate.

(2) That no downpayment is required, or the amount of the downpayment or of any instalment payment required (either in dollars or as a percentage), the dollar amount of any finance charge, the number of instalments or the period of repayment, or that there is no charge for credit, unless it also clearly and conspicuously sets forth all of the following items in terminology prescribed under § 226.8:

(i) the cash price or the amount of the loan, as applicable.

(ii) in a credit sale, the amount of the downpayment required or that no downpayment is required, as applicable.

(iii) the number, amount, and due dates or period of payments scheduled to repay the indebtedness if the credit is extended.

(iv) the amount of the finance charge expressed as an annual percentage rate. The exemptions from disclosure of an annual percentage rate permitted in paragraph (b)(2) of § 226.8 shall not apply to this subdivision.

(v) except in the case of the sale of a dwelling or a loan secured by a first lien on a dwelling to purchase that dwelling, the deferred payment price in a credit sale, or the total of payments in a loan or other extension of credit which is not a credit sale, as applicable.

* * * *

Effective April 5, 1971, section 226.10(e) is added as follows:

(e) **Advertising of FHA Section 235 financing.** Any advertisement to aid, promote, or assist directly or indirectly the sale of residential real estate under Title II, Section 235, of the National Housing Act (12 U.S.C. 1715z) shall clearly identify those credit terms which apply to the assistance program and, except as provided in this paragraph, comply with the provisions of paragraph (d) of this section. No such advertisement shall state:

(1) the amount of any payment scheduled to repay the indebtedness without stating the family size and income level applicable to that amount.

(2) any rate of a finance charge, or the amount of the finance charge, expressed as an annual percentage rate based on the assistance. The annual percentage rate exclusive of the assistance may be stated, but is not required.

Effective January 25, 1971, section 226.12 is amended as follows:

*SECTION 226.12—EXEMPTION OF
CERTAIN STATE REGULATED
TRANSACTIONS

(a) **Exemption for State regulated transactions.** In accordance with the provisions of Supplements II and IV to Regulation Z, any State may make application to the Board for exemption of any class of transactions within that State from the requirements of Chapter 2 of the Act and the corresponding provisions of this Part: *Provided, That*

(1) Under the law of that State, that class of transactions is subject to requirements substantially similar to those imposed under Chapter 2 of the Act and the corresponding provisions of this Part; and

(2) There is adequate provision for enforcement.

(b) **Procedures and criteria.** The procedures and criteria under which any State may apply for the determination provided for in paragraph (a) of this section are set forth in Supplement II to Regulation Z with respect to disclosure and rescission requirements (§§ 121–131 of Chapter 2) and Supplement IV with respect to the prohibition of the issuance of unsolicited credit cards and the

liability of the cardholder for unauthorized use of a credit card (§§ 132–133 of Chapter 2).

(c) **Civil liability.** In order to assure that the concurrent jurisdiction of Federal and State courts created in section 130(e) of the Act shall continue to have substantive provisions to which such jurisdiction shall apply, and generally to aid in implementing the Act with respect to any class of transactions exempted pursuant to paragraph (a) of this section and Supplement II, the Board pursuant to sections 105 and 123 hereby prescribes that:

(1) No such exemptions shall be deemed to extend to the civil liability provisions of sections 130 and 131; and

(2) After an exemption has been granted, the disclosure requirements of the applicable State law shall constitute the disclosure requirements of this Act, except to the extent that such State law imposes disclosure requirements not imposed by this Act. Information required under such State law with the exception of those provisions which impose disclosure requirements not imposed by this Act shall, accordingly, constitute the "information required under this Chapter" (Chapter 2 of the Act) for the purpose of section 130(a).

(d) **Exemptions granted.** Exemptions granted by the Board to particular classes of credit transactions within specified States are set forth in Supplement III to Regulation Z.

**Supersedes amendment issued March 12, 1970*

Effective January 25, 1971, section 226.13 (as amended effective December 15, 1972) is added as follows:

SECTION 226.13—CREDIT CARDS—
ISSUANCE AND LIABILITY

(a) **Supplemental definitions applicable to this section.** In addition to the definitions set forth in § 226.2, as applicable, the following definitions apply to this section:

(1) **"Accepted credit card"** means any credit card which the cardholder has requested or applied for and received, or has signed, or has used, or has authorized another person to use for the purpose of obtaining money, property, labor, or services on credit. Any credit card issued in renewal of, or in substitution for, an accepted credit

card becomes an accepted credit card when received by the cardholder whether such card is issued by the same or a successor card issuer.

(2) **"Adequate notice"** means a printed notice to a cardholder which sets forth the pertinent facts clearly and conspicuously so that a person against whom it is to operate could reasonably be expected to have noticed it and understood its meaning.

(3) **"Card issuer"** means any person who issues a credit card, or the agent of such person with respect to such card.

*(4) **"Cardholder"** means any person to whom a credit card is issued for personal, family, household, agricultural, business, or commercial purposes, or any person who has agreed with the card issuer to pay obligations arising from the issuance of a credit card to another person for such purposes.

(5) **"Credit"** means the right to defer payment of debt, incur debt and defer its payment, or to obtain money, property, labor or services and defer payment therefor.

(6) **"Credit card"** means any card, plate, coupon book, or other single credit device existing for the purpose of being used from time to time upon presentation to obtain money, property, labor, or services on credit.

(7) **"Unauthorized use"** means the use of a credit card by a person other than the cardholder

(i) who does not have actual, implied, or apparent authority for such use, and

(ii) from which the cardholder receives no benefit.

*(b) **Issuance of credit cards.** Regardless of whether a credit card is to be used for personal, family, household, agricultural, business or commercial purposes, no credit card shall be issued to any person except:

(1) In response to a request or application therefor, or

(2) As a renewal of, or in substitution for, an accepted credit card whether such card is issued by the same or a successor card issuer.

*(c) **Conditions of liability of cardholder.** A cardholder shall be liable for unauthorized use of each credit card issued only if,

(1) The credit card is an accepted credit card;

(2) Such liability does not exceed the lesser of \$50 or the amount of money, property, labor, or services obtained by such use prior to notification of the card issuer pursuant to paragraph (f) of this section;

(3) The card issuer has given adequate notice to the cardholder of his potential liability on the credit card or within two years preceding the unauthorized use; and

(4) The card issuer has provided the cardholder with an addressed notification requiring no postage to be paid by the cardholder which may be mailed by the cardholder in the event of the loss, theft, or possible unauthorized use of the credit card.

(d) **Other conditions of liability.** In addition to the conditions of liability in paragraph (c) of this section, no cardholder shall be liable for the unauthorized use of any credit card which was issued after January 24, 1971, and, regardless of the date of its issuance, after January 24, 1972, no cardholder shall be liable for the unauthorized use of any credit card, unless the card issuer has provided a method whereby the user of such card can be identified as the person authorized to use it, such as by signature, photograph, or fingerprint on the credit card or by electronic or mechanical confirmation.

(e) **Notice to cardholder.** The notice to cardholder pursuant to paragraph (c)(3) of this section may be given by printing the notice on the credit card, or by any other means reasonably assuring the receipt thereof by the cardholder. An acceptable form of notice must state that liability shall not exceed \$50 (or any lesser amount), that notice of loss, theft, or possible unauthorized use may be given orally or in writing, and the name and address of the party to receive the notice. It may include any additional information which is not inconsistent with the provisions of this section. An example of an acceptable notice is as follows:

"You may be liable for the unauthorized use of your credit card [*or other term which describes the credit device*]. You will not be liable for unauthorized use which occurs after you notify [*name of card issuer or his designee*] at [*address*] orally or in writing of loss, theft, or possible unauthorized use. In any case liability shall not exceed [*insert \$50 or any lesser amount under other applicable law or under any agreement with the cardholder*]."

* Amended December 15, 1972.

(f) **Notice to card issuer.** For the purposes of this section, a cardholder notifies a card issuer by taking such steps as may be reasonably required in the ordinary course of business to provide the card issuer with the pertinent information with respect to loss, theft, or possible unauthorized use of any credit card, whether or not any particular officer, employee, or agent of the card issuer does, in fact, receive such notice or information. Irrespective of the form of notice provided under paragraph (c) (4) of this section, at the option of the cardholder, notice may be given to the card issuer or his designee in person or by telephone or by letter, telegram, radiogram, cablegram, or other written communication which sets forth the pertinent information. Notice by mail, telegram, radiogram, cablegram, or other written communication shall be considered given at the time of receipt or,

whether or not received, at the expiration of the time ordinarily required for transmission, whichever is earlier.

(g) **Action to enforce liability.** In any action by a card issuer to enforce liability for the use of a credit card, the burden of proof is upon the card issuer to show that the use was authorized or, if the use was unauthorized, then the burden of proof is upon the card issuer to show that the conditions of liability for the unauthorized use of a credit card, as set forth in paragraphs (c) and (d) of this section, have been met.

(h) **Effect on other applicable law or agreement.** Nothing in this section imposes liability upon a cardholder for the unauthorized use of a credit card in excess of his liability for such use under other applicable law or under any agreement with the card issuer.

**TRUTH IN LENDING
INTERPRETATIONS OF REGULATION Z**

SECTION 226.1

**SECTION 226.101—USE OF “ANNUAL
PERCENTAGE RATE” IN ORAL
COMMUNICATIONS**

Under § 226.1(a)(2), a stated purpose of the Truth in Lending Act and Regulation Z is to assure that every customer who has need for consumer credit is given meaningful information with respect to the cost of that credit so that he may readily compare the various credit terms available to him from different sources and avoid the uninformed use of credit. Under § 226.6(a), a creditor is required to make disclosures using certain prescribed terminology, including the “annual percentage rate.” The question arises as to the propriety of a creditor quoting annual rates other than “annual percentage rate” in response to consumer inquiries about the cost of credit, where such other rates could not be used in an advertisement under the proscriptions of § 226.10.

The Truth in Lending Act and Regulation Z are intended to facilitate “shopping” between competitive credit plans. If a customer inquires about the cost of credit and the creditor responds by quoting an add-on or discount rate, he may mislead the customer since the use of such rates is prohibited in consumer credit advertising and such rates are significantly lower than the annual percentage rate which must be shown on the creditor’s disclosure statement. The quotation of these rates can frustrate the stated purpose of the Act and prevent the customer from making an informed use of credit.

In response to any oral inquiry by a customer about the cost of credit, a creditor when quoting annual rates should use only those rates permitted to be used in advertisements under § 226.10. Irrespective of the method used by the creditor to compute finance charges, the annual rate of the creditor’s total finance charges should be quoted only in terms of the “annual percentage rate.”

6/29/73

SECTION 226.3

**SECTION 226.302—CREDIT FOR BUSINESS
OR COMMERCIAL PURPOSES—MORE
THAN 4 FAMILY UNITS**

Under § 226.3(a), extensions of credit for business or commercial purposes, other than agricultural purposes, are not subject to Regulation Z. The question arises as to whether an extension of credit relating to a dwelling (as defined in § 226.2(p)) which contains more than 4 family housing units is an extension of credit of business or commercial purposes.

Credit extended to an owner of a dwelling containing more than 4 family housing units for the purpose of acquiring, financing, refinancing, improving, or maintaining that dwelling is an extension of credit for business or commercial purposes.

1/28/70

SECTION 226.4

***SECTION 226.404—PREMIUMS FOR
VENDOR’S SINGLE INTEREST
INSURANCE REQUIRED BY CREDITOR**

The question arises whether charges or premiums for single interest insurance (Vendor’s Single Interest Insurance) written in connection with a credit transaction may be excluded from the finance charge under § 226.4(a)(6) if the insurer waives subrogation.

If the insurer waives all right of subrogation against the customer in a single interest policy of insurance against loss of or damage to property (which may include coverage for skip, concealment, conversion, and embezzlement) written in connection with a credit transaction, and the creditor complies with the requirements of § 226.4(a)(6), charges or premiums for such insurance may be excluded from the amount of the finance charge on that transaction. However, if the insurer does not so waive subrogation in such

policy of insurance, the charges or premiums shall be included in the finance charge.

1/28/70

**Supersedes interpretation § 226.404 issued 8/1/69*

SECTION 226.405 (Not included in this pamphlet—issued 9/11/69.)

SECTION 226.406—SELLER'S POINTS AND DISCOUNTS UNDER REGULATION Z

Section 226.4(a) of Regulation Z includes in the finance charge any charge "payable directly or indirectly by the customer, and imposed directly or indirectly by the creditor as an incident to or as a condition of the extension of credit. . ." The question arises as to the proper treatment of discounts paid by the seller, including points imposed on the seller by the lender in connection with a real estate transaction.

Under the general rule in § 226.4(a), any such discount, to the extent it is passed on to the buyer through an increase in the selling price, must be included in the finance charge. However, as a practical matter, it may be difficult to determine whether or not a discount paid by the seller in connection with a real estate transaction has been, in fact, passed along to the customer as a part of the purchase price of the property. The same situation may exist in other cases, for example, those in which the creditor sells at a discount obligations payable in more than four instalments.

The Board has concluded that in any such transaction coming within its administrative enforcement authority, where seller's points or discounts were, in fact, passed along to the customer or buyer and the amount thereof was not disclosed as a finance charge, the Board will take such action as may be appropriate in the circumstances. However, it will not attempt to prescribe rules creating a presumption that all discounts or points are passed on to the customer or buyer and hence must be included in the finance charge in any particular class of transaction. On the other hand, the inclusion of seller's points or discounts in the finance charge will be acceptable to the Board as a correct disclosure under Regulation Z.

This position relates only to the Board's administrative enforcement procedures and it is not intended in any way to restrict or prejudice the

rights of any customer or buyer to bring an action under sections 130 and 131 of the Act where he has reason to believe he is or was required to pay directly or indirectly a finance charge imposed directly or indirectly by the creditor of the transaction and the amount of that finance charge was not disclosed to him.

10/23/70

SECTION 226.407—CHARGES FOR MEMBERSHIP IN OPEN END CREDIT PLAN

A credit card issuer charges the cardholder an annual fee for membership in the credit plan and for issuance of a credit card for use in conjunction with the plan. The payment of the fee is required as a condition of membership in the plan, whether or not the cardholder uses his card for the purpose of obtaining credit. The question arises whether these fees are finance charges under § 226.4(a) of Regulation Z.

Since such fees are imposed as a qualification of membership in the plan and for the issuance of a credit card, and not as incident to or as a condition of any specific extension of credit, they do not fall within the definition of a "finance charge" under § 226.4(a) of Regulation Z.

8/12/71

SECTION 226.5

SECTION 226.506—DAILY PERIODIC RATE; COMPUTATION OF THE ANNUAL PERCENTAGE RATE

Under §§ 226.5(a)(1)(ii), (3)(i), and (3)(ii), the quotient used in computing the annual percentage rate in open end credit accounts must be multiplied "by the number of billing cycles in a year". The question arises as to the method which should be used to compute the annual percentage rate under those sections where a daily periodic rate (or rates) is used.

In any open end credit account to which the provisions of §§ 226.5(a)(1)(ii) or 226.5(a)(3)(i) apply, where all or a portion of the finance charge is determined by the application of one or

more daily periodic rates, the annual percentage rate may be determined (1) by dividing the total finance charge by the average of daily balances and multiplying the quotient by the number of billing cycles in a year, or alternatively (2) by dividing the total finance charge by the sum of the daily balances and multiplying the quotient by 365.

In any open end credit account to which the provisions of § 226.5(a)(3)(ii) apply, where a portion of the finance charge is determined by application of one or more daily periodic rates, the phrase "sum of the balances" in footnote 5a shall also mean the "average of daily balances".

6/1/73

SECTION 226.7

SECTION 226.702 is incorporated into section 226.7(c) effective June 1, 1973, and is revoked effective that date.

*SECTION 226.703—FINANCE CHARGE BASED ON AVERAGE DAILY BALANCE IN OPEN END CREDIT ACCOUNTS

Section 226.7(b)(8) requires that periodic statements for open end accounts shall disclose, among other things, "The balance on which the finance charge was computed, and a statement of how that balance was determined." In some instances, creditors compute a finance charge on the average daily balance by application of a monthly periodic rate. In such case, this information is adequately disclosed if the statement gives the amount of the average daily balance on which the finance charge was computed, and also states how the balance is determined. In other instances, the finance charge is computed on the balance each day by application of a daily periodic rate and such charges are accumulated and debited to the account in a single amount for the billing cycle. The question arises whether the periodic statement must show for each day of the billing cycle a balance on which a finance charge was computed.

If a daily periodic rate is used, the balance to which it is applicable shall be stated as follows:

(1) A balance for each day in the billing cycle; or

(2) A balance for each day in the billing cycle on which the balance in the account changes; or

(3) The sum of the daily balances during the billing cycle; or

(4) The average daily balance during the billing cycle in which case the creditor shall state on the face of the periodic statement, its reverse side, or on an enclosed supplement wording to the effect that the average daily balance is or can be multiplied by the number of days in the billing cycle and the periodic rate applied to the product to determine the amount of the finance charge.

6/21/72

**Supersedes interpretation § 226.703 issued 5/5/69.*

SECTION 226.704 is incorporated into section 226.5(a)(3) effective June 1, 1973, and is revoked effective that date.

SECTION 226.705—OPEN END CREDIT— CHANGE IN THE METHOD OF DETERMINING THE BALANCE ON WHICH FINANCE CHARGES ARE COMPUTED

The creditor of an open end credit account plan desires to change his method of determining the balance on which finance charges are computed from a method in which payments and credits made during the billing cycle are not deducted in determining such balance to a method in which such payments and credits are deducted in determining such balance. This change results in a reduction in finance charges to the customer, where full payment of the account is deferred. The question arises whether notice of such change is required to be sent to customers of open end credit accounts under § 226.7(e), since that section also provides that prior notice is not required if the only change is a reduction in the "periodic rate or rates, or in any minimum, fixed, check service, transaction, activity, or similar charge applicable to the account."

Where a creditor changes his method of determining the balance on which finance charges are computed from a method in which payments and credits made during the billing cycle are not deducted in determining such balance, to a method in which such payments and credits are deducted

in determining such balance, § 226.7(e) requires no prior notice of such change in terms, provided no other changes in terms applicable to the account are made simultaneously which would require § 226.7(e) notification.

7/29/71

SECTION 226.706—OPEN END CREDIT— ALLOCATION OF PAYMENTS

Section 226.7(a)(2) provides that before the first transaction is made on any open end credit account, the creditor must disclose “the method of determining the balance upon which a finance charge may be imposed.” Section 226.7(b)(8) requires the creditor to disclose on the periodic statement “the balance on which the finance charge was computed, and a statement of how that balance was determined.” The question is raised whether these provisions require a creditor to provide a description of the manner in which payments or other credits are applied to various portions of the balance or balances on which finance charges are computed.

In disclosing the method of determining the balance(s) upon which finance charges are computed, it is not necessary to show the method of allocating payments or other credits. For example, explanation of the manner in which payments or credits may be applied to late charges, overdue balances, finance charges, insurance premiums or other portions of balances is not required. Similarly, explanation of the method of allocating such payments between cash advance and purchase portions of the account is not required. Such explanations in many cases involve lengthy and complex descriptions which may unduly complicate disclosures.

Explanation of the allocation method may be made by creditors where it can be done in conformity with § 226.6(c) which authorizes additional information or explanations as long as they are not stated, utilized, or placed so as to mislead or confuse the customer or contradict, obscure, or detract attention from the required disclosures.

6/21/72

SECTION 226.707—DISCLOSURES— VARIABLE PERIODIC RATES

Under the terms of some open end credit plans the periodic rates of finance charges and corre-

sponding annual percentage rates are tied to a fluctuating base rate, for example, the “prime rate.” Consequently, both the periodic rates and annual percentage rates may change from time to time with changes in the base rate. The question arises as to the proper disclosure, if any, which should be made under § 226.7(a)(4), § 226.7(b)(5), § 226.7(b)(6), § 226.7(e) and § 226.10(c)(4) in connection with such plans.

Where any creditor’s open end credit plan provides that the account is subject to variations in any periodic rate of finance charge, the creditor need not comply with § 226.7(e) with respect to any prospective change in any periodic rate or corresponding annual percentage rate applicable to the account, *provided* that in connection with the disclosures made pursuant to paragraph 226.7(a)(4) the creditor has disclosed that such rates are subject to change, the conditions under which such rates may be changed, and, if applicable, the maximum and minimum limits of such rates. The requirements of § 226.7(b)(5) and § 226.10(c)(4) may be complied with by similarly disclosing the method of computing the periodic or annual percentage rates which are subject to variation. In disclosing an annual percentage rate or rates under § 226.7(b)(6) where there have been variations during the billing cycle, the computations as specified in § 226.5(a)(1)(ii), § 226.5(a)(2), § 226.5(a)(3)(i) or § 226.5(a)(3)(ii), as applicable, should be used.

11/2/72

SECTION 226.8

*SECTION 226.811—RENEWALS OF NOTES

Any renewal of an extension of credit providing for payment of the full principal sum on a specified date shall not be considered a refinancing under § 226.8(j), and no disclosures need be made in connection with such renewal, provided:

(i) All disclosures required under this Part were made in connection with the original extension of credit or a prior renewal thereof;

(ii) The amount of the renewal does not exceed the amount of the unpaid balance plus any accrued and unpaid finance charge;

(iii) The annual percentage rate (or rates) previously disclosed is not increased; and

(iv) The period for which renewal is made does not exceed by more than 4 days the period of the extension of credit for which disclosures were made.

In instances in which disclosures are required to be made and renewal is made by mail, the creditor may not know whether the customer will reduce his obligation by a payment on principal or, if reduced, the amount of that reduction. The question arises as to what disclosures should be made by mail to the customer in these circumstances.

If the creditor knows the amount of the principal payment, all disclosures should be made on the basis of the resulting new amount financed. If, however, the creditor does not know whether the customer will reduce his original obligation, or if so, by how much, he should disclose on the assumption that there will be no reduction. In such circumstances, at the creditor's option, he may make one or more additional disclosures based on one or more examples of graduated principal reduction. For example, if a single payment note for \$1,000 at 7% is proposed to be renewed for \$1,000 at 8% for 3 months, in addition to the other required disclosures, the creditor should disclose an amount financed of \$1,000 with a finance charge of \$20, and may, in addition, disclose that with a principal payment of \$300 the amount financed would be \$700 with a finance charge of \$14, and with a principal payment of \$500 the amount financed would be \$500 with a finance charge of \$10.

1/28/70

**Supersedes interpretation § 226.811 issued 8/1/69*

SECTION 226.812—ADVANCES UNDER OPEN END REAL ESTATE MORTGAGES FOR AGRICULTURAL PURPOSES

Under § 226.8(p) disclosures are permitted in connection with certain extensions of credit for agricultural purposes which may involve advances under an open end real estate mortgage or similar lien. Section 226.8(j) in part treats advances for agricultural purposes under an open end real estate mortgage or similar lien. The question

arises as to the respective application of these paragraphs to such advances.

If an extension of credit involving multiple advances, whether or not under an open end mortgage, meets the tests of § 226.8(p), disclosures need only be made prior to consummation of the credit transaction and need not be made at the time of each individual advance, even though such advance for agricultural purposes may not meet the tests in § 226.8(j). Conversely, extensions of credit for agricultural purposes involving advances under an open end real estate mortgage or similar lien which do not meet the tests for disclosure under § 226.8(p) are subject to the relevant provisions of § 226.8(j) dealing with such advances.

11/6/69

SECTION 226.813—DISCLOSURES ON MULTIPLE ADVANCE LOANS

In connection with construction and other multiple advance loans under § 226.8(i), which are payable in a single sum or permanently financed by the same creditor at maturity of the construction phase with interest only payable up to such maturity, and in which either the amount or date of an advance is not determinable, the question arises whether a method might be utilized to estimate the information to be disclosed under § 226.8(b)(2) and (3) and (d)(3).

In such cases, at the creditor's option, required information may be estimated and disclosed as follows:

(1) The following mathematical equations based upon assumed continuous advances may be utilized in estimating the amount of the interest component of the finance charge and the annual percentage rate by substituting the appropriate numerical amounts for the following symbols in the equations:

(i) Symbols

- L = Amount of loan commitment.
- r = Stated annual interest rate expressed as a decimal figure.
- n = Number of interest payments to be made to maturity.
- m = Number of interest periods (unit-periods) in 1 year.
- P = Total amount of any prepaid finance charge under § 226.8(e).
- B = Amount of any required deposit balance under § 226.8(e).

(ii) If interest is computed from the date of each advance on only the amounts advanced:

$$\text{Estimated annual percentage rate} = \frac{nrL + 2mP}{n(L - 2P - 2B)}$$

$$\text{Estimated interest finance charge} = \frac{nrL}{2m}$$

(iii) If interest is computed on the full amount of the commitment without regard for the dates of disbursements or actual amounts disbursed:

$$\text{Estimated annual percentage rate} = \frac{2nrL + 2mP}{n(L - 2P - 2B)}$$

$$\text{Estimated interest finance charge} = \frac{nrL}{m}$$

(2) If the equations under subdivision (ii) of paragraph (1) are utilized, the amounts of any required interest payments during the construction phase may be omitted in making the disclosure required under § 226.8(b)(3); however, if the equations under subdivision (iii) of paragraph (1) are utilized, then the amount of each scheduled interest payment shall be disclosed as required under § 226.8(b)(3).

(3) In the case of a combination construction loan and permanent financing provided by the same creditor:

(i) The amount of interest finance charge to be paid prior to the due date of the first amortization payment shall be estimated as prescribed under subdivisions (ii) or (iii) of paragraph (1) as the case may be and shall be treated as pre-paid finance charge for computational purposes; and

(ii) Estimation of the annual percentage rate shall be made without regard to the number of interest only payments to be made, assuming the first payment period to be that interval between the date the finance charge begins to accrue and the date the first amortization payment is due.

(4) Disclosures made in accordance with this interpretation, when made along with the other disclosures required under § 226.8(b) and (d), shall constitute "all other material disclosures required under this Part" referred to under § 226.9(a):

Example I

A \$20,000 construction loan commitment on which the precise dates or amounts of advances

are not determinable. The obligation bears a stated 6% interest rate and interest is to be paid monthly on the amounts advanced, and the total of the amounts advanced under the commitment plus any unpaid interest is due and payable at the end of nine months from the date the finance charge begins to accrue. There is a loan fee of 1% (\$200), but there is no required deposit balance. Substituting these terms for the symbols, the equations become:

$$\frac{(9 \times .06 \times 20,000) + (2 \times 12 \times 200)}{9 \times [(20,000 - (2 \times 200))]} =$$

.0884 or 8.84% or 8¾% estimated annual percentage rate.

$$\frac{9 \times .06 \times 20,000}{2 \times 12} = \frac{450 \text{ or } \$450 \text{ estimated interest finance charge component of the finance charge.}}{}$$

If the terms stated in the example were changed so that interest would be computed on the full amount of the commitment from the date the finance charge begins to accrue without regard for the dates of disbursements or actual amounts of funds disbursed, the equations under (iii) above become:

$$\frac{(2 \times 9 \times .06 \times 20,000) + (2 \times 12 \times 200)}{9 \times [(20,000 - (2 \times 200))]} =$$

.1497 or 14.97% or 15% estimated annual percentage rate.

$$\frac{9 \times .06 \times 20,000}{12} = \frac{900 \text{ or } \$900 \text{ estimated interest finance charge component of the finance charge. This interest would be payable in 9 monthly payments of } \$100 \text{ each.}}{}$$

Example II

A \$20,000 construction loan followed by permanent financing in same amount. Six per cent interest. One point loan fee. Nine months to maturity of construction phase. Nine months payments of interest only during construction phase. Twenty-year maturity on permanent financing to be amortized in 240 equal monthly payments including interest and principal.

From mortgage amortization tables:

Amortization of a \$20,000 6% 20-year loan in 240 equal monthly payments including interest and principal requires each monthly payment to be \$143.29.

Total of 240 payments =	
	240 × \$143.29 = \$34,389.60
Subtract amount of	
loan principal	\$20,000.00
Interest finance charge on	
permanent financing	\$14,389.60
Add: Estimated interest finance	
charge on construction	
phase (pursuant to sub-	
division (ii))	450.00
Add: Loan fee 1 point	200.00
Estimated finance charge	\$15,039.60

(If the interest on the construction phase is computed on the full amount of the commitment for the full time to maturity without regard for the dates of disbursements or actual amounts disbursed pursuant to subdivision (iii), the estimated interest finance charge for the construction phase would be \$900.00 which would result in a total estimated finance charge of \$15,489.60.)

Loan fee 1 point prepaid finance charge	\$ 200.00
For computational purposes consider interest to be paid on construction phase as prepaid (not to be disclosed as prepaid)	\$ 450.00
Total amount treated as prepaid finance charge for computational purposes	\$ 650.00

	Computational Purposes	Disclosure Purposes
Amount of loan	\$20,000	\$20,000
Deduct total of estimated finance charge treated as prepaid	\$ 650	
Deduct actual amount of prepaid finance charge		\$ 200
Estimated amount financed for computational purposes	\$19,350	
Amount financed to be disclosed		\$19,800

Adjust first payment period (period of construction loan plus period from maturity date of construction loan to due date of first amortization payment) by dividing the period of the construction loan by 2 and adding the period of time between the maturity date of the construction loan and the date the first amortization payment is due.

9 months divided by 2 = 4½ months plus 1 month = 5½ months

From Appendix A (page A2) of Volume I of the Board's Annual Percentage Rate Tables, read across to 5 months and on the line below opposite 15 days (½ month) read +9.0. This adjustment should be added to the number of regular amortization payments to determine the number of payments in utilizing the Annual Percentage Rate Tables:

240 monthly payments + adjustment 9.0 = 249

Following the directions on page 1 of Volume I: Estimated finance charge \$15,039.60 × 100 = \$1,503,960 which should be divided by the estimated amount financed for computational purposes:

\$1,503,960 ÷ 19,350 = \$77.72 estimated finance charge per \$100 of estimated amount financed for computational purposes.

Refer to page 309M of Volume I, read down number of payments column to 249; read across to 78.71 (which is nearest to \$77.72 computed above), and read up to 6.25% which is the estimated annual percentage rate to be disclosed.

In the example where the interest on the construction phase is computed on the full amount of the commitment without regard for the dates of advances or actual amounts advanced, the estimated finance charge per \$100 of amount financed is \$81.96. On page 309M of Volume I, read down to the 249th payment line and across to 82.39 which is the nearest amount to \$81.96, and read up to 6.50% which is the estimated annual percentage rate to be disclosed.

1/28/70

**SECTION 226.814—PREMIUMS FOR
INSURANCE ADDED TO AN
EXISTING BALANCE**

Subsequent to the consummation of a consumer credit transaction the customer may wish to purchase optional insurance in connection with the obligation. Typically, mortgage life and disability insurance may be offered to the customer at some date after consummation under a plan in which the lender will advance the amount of the premium due and add that amount to the existing unpaid balance of the obligation. Generally, each instalment on the original obligation paid during the period before the next premium is due will be

increased proportionately to liquidate the amount of the additional advance plus any finance charge. Additional advances are made automatically for renewal premiums as they become due unless the borrower requests discontinuance of the coverage. The question arises as to the required disclosures.

In such cases the insurance agreement may be considered a single separate transaction, and the disclosures required under § 226.8, at the creditor's option, need be made only prior to the time the agreement is executed and only with respect to the amount of the initial advance. For example, a mortgage life and disability insurance plan in which the annual premium advanced was \$145 repayable in 12 monthly instalments of \$12.61 added to the regular monthly mortgage payments would be disclosed as an "amount financed" of \$145, a "finance charge" of \$6.32, and a "total of payments" of \$151.32. Additional disclosures as applicable under § 226.8 would, of course, be made. If, as in some cases, only a portion of the advance is liquidated during the premium period with the remainder payable at the end of the mortgage contract, the creditor would likewise calculate the amount of finance charge which would accrue on the advance until paid in full.

In some cases the advance is secured by a security interest in real property which is used or expected to be used as the principal residence of the customer. In those cases the premium advance agreement is rescindable under § 226.9, and notice of the right of rescission provided in § 226.9(b) need only be given at the time the agreement is executed. Subsequent advances for renewal premiums are not subject to the right of rescission.

1/28/70

SECTION 226.815—DISCLOSURE FOR DEMAND LOANS

Section 226.8(b)(3) requires a creditor to disclose the number, amount and due dates or periods of payments scheduled to repay an extension of credit other than open end and, in appropriate cases, the total of payments. The question arises as to how these requirements should be met in the case of demand loans.

Section 226.4(g) provides that for the purpose of calculating the finance charge and annual per-

centage rate, demand loans are considered to have a one-half year maturity unless the obligation is alternatively payable upon a stated maturity, in which case the stated maturity shall be used.

In order to comply with the requirements of § 226.8(b)(3), if no alternative maturity date is specified, the creditor need disclose only the due dates or periods of payments of all scheduled interest payments for the first one-half year. In such cases, the creditor need not disclose the number, amounts or total of payments or identify any balloon payment. Effective May 1, 1970, creditors shall disclose the fact that the obligation is payable on demand.

If an alternative maturity date is specified, all disclosures required under § 226.8(b)(3) shall be made, using that date.

1/28/70

SECTION 226.816—MORTGAGES WITH DEMAND FEATURES

In some cases real estate mortgages are written for a stated period, for example one year, with the provision that they shall be payable on demand after expiration of that period, provided that until such demand is made the principal and interest shall be paid in scheduled periodic instalments until paid in full. The obligation is thus payable according to a specified amortization schedule subject to the holder's right to demand payment after the stated period.

The question arises whether the creditor may make disclosures based on the specified amortization schedule or whether disclosures must be made on the basis of the maturity established by the expiration of the stated period.

In such cases the creditor may make disclosures based on the specified amortization schedule, provided he discloses clearly and conspicuously that the obligation is payable on demand after the stated period together with the fact that disclosures are made on the basis of the specified amortization schedule. Otherwise, disclosures shall be based upon the earliest date demand for payment in full may be made under the terms of the mortgage showing the unpaid balance due at that time as a "balloon payment."

The disclosure requirements of this interpretation shall become effective May 1, 1970.

1/28/70

SECTION 226.817—REDUCTION IN ANNUAL PERCENTAGE RATE

Section 226.8(j) specifies that if any existing extension of credit is refinanced, such transaction shall be considered a new transaction subject to the disclosure requirements of Regulation Z. The question arises as to whether a reduction in the annual percentage rate applicable to an existing extension of credit, when no other credit terms are changed, constitutes a refinancing under § 226.8(j).

When no other credit terms are changed, a reduction in the annual percentage rate applicable to an existing extension of credit does not constitute a refinancing under § 226.8(j), and no disclosures are required.

3/31/70

SECTION 226.818—REFUND OF UNEARNED FINANCE CHARGE; PREPAYMENT PENALTY

Under § 226.8(b)(7) a creditor must provide an identification of the method of computing any unearned portion of the finance charge in the event of prepayment of an obligation, as well as a statement of the amount or method of computation of any charge that may be deducted from the amount of any rebate. Section 226.8(b)(6) requires the creditor to provide "a description of any penalty charge that may be imposed by the creditor or his assignee for prepayment of the principal of the obligation. . . ." A question arises whether the computation of certain rebates of unearned finance charges on contracts with pre-computed finance charges involves a "prepayment penalty." A second question concerns the disclosures required to identify the method of computing any finance charge rebate.

Section 226.8(b)(6) relates only to charges assessed in connection with obligations which do *not* involve precomputed finance charges included in the obligation. It applies to transactions in which the finance charge is computed from time to time by application of a rate to the unpaid principal balance. Prepayment penalties which require disclosure under this section (which principally arise in connection with prepayment of real estate mortgages) occur when the obligor in such a transaction is required to pay separately an additional amount for paying all or part of the

obligation before maturity. On the other hand, § 226.8(b)(7) is designed to encompass the disclosures necessary with regard to the prepayment of an obligation involving precomputed finance charges which are included in the face amount of the obligation. Therefore, although in a precomputed obligation the finance charge rebate to a customer may be less when calculated according to the "Rule of 78's," "sum of the digits," or other method than if calculated by the actuarial method, such difference does not constitute a penalty charge for prepayment that must be described pursuant to § 226.8(b)(6).

Section 226.8(b)(7) requires "identification" of the rebate method used on precomputed contracts. Many State statutes provide for rebates of unearned finance charges under methods known as the "Rule of 78's" or "sum of the digits" or other methods. In view of the fact that such statutory provisions involve complex mathematical descriptions which generally cannot be condensed into simple accurate statements, and which if repeated at length on disclosure forms could detract from other important disclosures, the requirement of rebate "identification" is satisfied simply by reference by name to the "Rule of 78's" or other method, as applicable.

4/30/73

SECTION 226.819—PREPAID FINANCE CHARGES; ADD-ONS AND DISCOUNTS

Sections 226.8(c)(6), 226.8(d)(2) and 226.8(e)(1) require that certain finance charges be disclosed as "prepaid finance charges." They also require that such prepaid finance charges be excluded or deducted from the credit extended in arriving at the "amount financed." The question arises whether add-on, discount or other pre-computed finance charges which are reflected in the face amount of the debt instrument as part of the customer's obligation, but which are excluded from the "amount financed," must be labeled as "prepaid" finance charges.

The concept of prepaid finance charges was adopted to insure that the "amount financed" reflected only that credit of which the customer had the actual use. Precomputed finance charges which are included in the face amount of the obligation are not the type contemplated by the "prepaid" finance charge disclosure concept. Although such precomputed finance charges are not

to be included in the "amount financed," they need not be regarded as finance charges "paid separately" or "withheld by the creditor from the proceeds of the credit extended" within the meaning of § 226.8(e) to require labeling "prepaid" under §§ 226.8(c)(6) and 226.8(d)(2). They are "finance charges," of course, to be disclosed under §§ 226.8(c)(8) and 226.8(d)(3).

8/23/73

SECTION 226.9

*SECTION 226.903—REFINANCING AND INCREASING—DISCLOSURES AND EFFECTS ON THE RIGHT OF RESCISSION

In some cases the creditor of an obligation will refinance that obligation at the request of a customer by permitting the customer to execute a new note, contract, or other document evidencing the transaction under the terms of which one or more of the original credit terms, including the maturity date of the obligation, are changed. Except as provided in § 226.811, such refinancing constitutes a new transaction, and all disclosures

required under § 226.8 must be made. The question arises as to whether that transaction is subject to the right of rescission under § 226.9 where the obligation is already secured by a security interest in real property which is used or expected to be used as the principal residence of that customer.

If the amount of such new transaction does not exceed the amount of the unpaid balance plus any accrued and unpaid finance charge on the existing obligation, § 226.9 does not apply to the transaction.

If, however, such new transaction is for an increased amount, that is, for an amount in excess of the amount of the unpaid balance plus any accrued and unpaid finance charge on the existing obligation, § 226.9 applies to the transaction. However, such right of rescission applies only to such excess and does not affect the existing obligation (or related security interest) for the unpaid balance plus accrued unpaid finance charge.

If a transaction is refinanced by a creditor other than the creditor of the existing obligation, the entire transaction is subject to § 226.9.

1/28/70

**Supersedes interpretation § 226.903 issued 6/20/69*