

# FEDERAL RESERVE BANK OF DALLAS

DALLAS, TEXAS 75222

Circular No. 80-232  
December 9, 1980

## REGULATION Z - TRUTH IN LENDING

### Revision of Proposed Regulation

TO ALL MEMBER BANKS, OTHER CREDITORS  
AND OTHERS CONCERNED IN THE  
ELEVENTH FEDERAL RESERVE DISTRICT:

The Board of Governors of the Federal Reserve System issued a second draft revision of its Regulation Z, which implements the Truth in Lending Act, and asked for comment on the proposal through January 19, 1981. The new proposals are a complete restructuring and further simplification of proposals originally issued May 5, 1980, taking into account comment received on the May proposals. All comments on the revision must be received on or before January 19, 1981; comments received after that date cannot be considered.

The Board proposed the revisions to carry out the objectives of the Truth in Lending Simplification and Reform Act, which became law on March 31, 1980. The revised Regulation Z will become effective when adopted in final form not later than April 1, 1981. The Act is to become fully effective on April 1, 1982.

In making the proposal, the Board set forth five principles for simplification of Regulation Z. These are: (1) the Regulation should contain precise, simple rules - based on enforceable obligations - as opposed to principles that create ambiguity and require additional regulatory clarification, (2) tolerances and disclosures should be more flexible and the use of estimates should be increased, (3) emphasis should be on disclosures relevant to credit decision making, (4) burdens not justified by substantial consumer benefit should be eliminated, and (5) the Regulation should give creditors some flexibility to tailor disclosures to their own credit plans. The current proposal is 40% shorter than the existing Regulation and 20% shorter than the earlier proposals. The current proposal focuses mainly on everyday types of transactions. It also contains a number of sample forms that can be relied upon to prevent civil liability when properly used.

A summary of the proposals as set out in the Federal Reserve Board Press Release dated November 28, 1980, a summary page from the Federal Register notice of the Board's proposals, a list of questions on which the Board wishes particularly to receive comment, and a summary of the principal new proposals are printed on the following pages. The Board is mailing, to all who commented on its May proposals, the full proposed simplified Regulation Z and related forms. The full text of the revision appears in the Federal Register dated Friday, December 5, 1980. For those who do not have access to the Federal Register, a copy of the text may be obtained from the Board of Governors or the Federal Reserve Bank of Dallas.

Questions regarding Regulation Z should be directed to the Consumer Affairs Section of our Bank Supervision and Regulations Department, Ext. 6171.

Sincerely yours,  
Robert H. Boykin  
First Vice President

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Banks and others are encouraged to use the following incoming WATS numbers in contacting this Bank: 1-800-442-7140 (intrastate) and 1-800-527-9200 (interstate). For calls placed locally, please use 651 plus the extension referred to above.

# FEDERAL RESERVE press release



For immediate release

November 28, 1980

The Federal Reserve Board today issued revised proposals for simplifying its Regulation Z, which implements the Truth in Lending, Fair Credit Billing and Consumer Leasing acts.<sup>1/</sup>

The Board requested comment by January 19, 1981.

The Board's proposals are a complete overhaul, restructuring and further simplification of proposals made in May taking into account comment received on the May proposals.

The proposals are being made under the terms of the Truth in Lending Simplification and Reform Act<sup>2/</sup> which became law in March. The Simplification Act, which the Board requested that Congress enact, requires that simplified implementing regulations be in effect by April 1, 1981. The proposals reflect also work undertaken, prior to passage of the Simplification Act, by the Board and the Federal Reserve Bank of Atlanta to rewrite Regulation Z as part of the Board's Regulatory Improvement Program. Under this program the Federal Reserve System is examining all Board regulations to modernize, simplify, shorten and put into plain language Federal Reserve rules in all fields in which the System has regulatory responsibilities.

The Board proposed -- and grouped its revisions of Regulation Z accordingly -- five principles for simplification. These are:

First, the regulation should contain precise, simple rules--based

<sup>1/</sup> Contained in Title I of the Consumer Credit Protection Act, as amended.  
<sup>2/</sup> Title VI of the Depository Institutions Deregulation and Monetary Control Act of 1980.

on enforceable obligations--as opposed to principles that create ambiguity and require additional regulatory clarification.

Second, tolerances in disclosures should be more flexible and the use of estimates should be increased.

Third, the emphasis should be on disclosures relevant to credit decision making.

Fourth, burdens not justified by substantial consumer benefit should be eliminated.

Fifth, the regulation should give creditors some flexibility to tailor disclosures to their own credit plans.

As part of its simplification effort, the Board is proposing a number of sample forms that can be relied upon when properly used.

There is attached a brief description grouped under the simplification principles proposed by the Board, of the principal proposed new changes in Regulation Z, compared with current requirements of the Regulation, together with statements of reasons for proposing these changes.

The Board noted, in making its proposals, that three basic problems hinder shortening and simplification of Regulation Z:

- 1) The scope of the original Truth in Lending Act of 1969, which called only for disclosures to consumers of the true costs of borrowing, has been expanded to cover also the issuance of credit cards and liability for their loss, resolution of billing errors and disclosures of the conditions of consumer leases. The underlying statute also provides protection for consumers from endangering their financial interest in their homes, conditions for purchasing credit life insurance and rights for consumers who receive shoddy merchandise when they use a bank credit card.

- 2) Over the years, the Board has issued some 50 interpretations of the Regulation, and the staff has written some 1,500 interpretive letters, many of which are relied upon legally by creditors. Much of this material will be dealt with in a commentary to be issued at a later time, but part of it must be included in the revised Regulation.
- 3) Over the years also, credit has become much more complicated. It takes various forms, such as revolving credit and closed-end credit; it may be payable on demand or in installments of various kinds; insurance may or may not be required; credit may be extended only upon application in person, or by mail or by telephone, and such variants must be covered by the Regulation.

Despite these difficulties, the current proposal is 40 percent shorter than the existing Regulation and the formal interpretations of it (and 20 percent shorter than the May proposals). This has been achieved mainly by focusing on common, everyday types of transactions, and not trying to cover every conceivable situation in the huge, almost endlessly complicated and diverse field of credit. It is the Board's belief that in the interests of having a more understandable, serviceable and shorter regulation and disclosure statement both consumers and creditors will be willing to forego disclosures or provisions that, essentially are tailored to fit particular situations applying to few consumers or transactions.

In this respect, the Board said:

The simplification effort should produce positive consumer benefits. By eliminating the less significant regulatory material disclosures will be easier to understand and therefore more useful in common, everyday transactions. Reduction of detail should also help direct enforcement of the law toward substance rather than technicalities. Major simplification should reduce the volume of nonproductive litigation, improve acceptance of consumer credit protection regulation and, to the extent this occurs, encourage voluntary compliance.

The Board welcomes comment on any part of its proposals, but asks, in particular, for comment on the principal proposed changes, and on the questions listed in Attachment 2.

The Board is mailing to all who commented on its May proposals the full proposed simplified Regulation Z, and related forms. These are available upon request from the Reserve Banks.

Attachments

1. Summary page from the Federal Register Notice of the Board's proposals.
2. A list of questions on which the Board wishes particularly to receive comment.
3. A summary of the Board's principal new proposals.

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Proposed Rulemaking

Federal Reserve System

[12 CFR Part 226]

[Reg. Z; Docket No. R-0288]

TRUTH IN LENDING

Revision of Regulation Z

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Proposed rule.

SUMMARY: The Board is proposing for public comment a second complete revision of Regulation Z (Truth in Lending), to implement amendments to the Truth in Lending Act adopted by Congress in March 1980 (Title VI of the Depository Institutions Deregulation and Monetary Control Act, Public Law 96-221). That act becomes effective on April 1, 1982, but requires the Board to have implementing regulations in place by April 1, 1981. The Board published a first draft for comment on May 5, 1980 (45 FR 29702) and has now revised the proposal on the basis of the comments received and its own analysis.

DATE: Comments must be received by January 19, 1981.

ADDRESS: Comments may be mailed to the Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551, or delivered to Room B-2223, 20th and Constitution Avenue, N.W., Washington, D.C., between 8:45 a.m. and 5:15 p.m. weekdays. Comments received should refer to docket number R-0288. To insure consideration, comments must be received by the Board by the close of the official comment period. To facilitate analysis, comments on separate sections of the regulation should be made on separate pages. Comments may be inspected in Room B-1122 between 8:45 a.m. and 5:15 p.m. weekdays.

FOR FURTHER INFORMATION CONTACT: The following attorneys in the Division of Consumer and Community Affairs, Board of Governors, Federal Reserve System, Washington, D.C. 20551, at (202) 452-2412, (202) 452-3667, or (202) 452-3867:

§§ 226.1,3	Beth Morgan	§§ 226.17	Denise Rechter
226.2	Denise Rechter	226.18	Beth Morgan
226.4	Gerald Hurst		Claudia Yarus
226.5-11	Ruth Amberg	226.19, 20, 23	Susan Werthan
	Jesse Filkins	226.21, 22, 24	Rugenia Silver
	Stan Mabbitt	Subpart D	Barbara Ranagan
226.12	John Wood		Steve Zeisel
226.13	Barbara Ranagan	Subpart E	Lynn Goldfaden
226.14	Stan Mabbitt		Susan Werthan
226.15	Ruth Amberg	Appendices	Gerald Hurst
			Denise Rechter

Questions on Which the Board Particularly  
Requests Comment

Definitions

1. Should a creditor be defined as any person that made more than 25 credit extensions in the preceding year (5 in the case of transactions secured by a dwelling), assuming the other requirements of the definition are met? (§ 226.2)
2. If credit is extended without a finance charge, should a written agreement to repay in more than four installments be required in order for the credit-extender to be considered a creditor? (§ 226.2)
3. Should required deposit balances be eliminated from the regulation, meaning that any required deposits or investments would not be taken into account in making Truth in Lending disclosures? As an alternative, should required deposit balances be taken into account only if they are above a certain percentage of the amount financed? (§ 226.2)
4. Should consummation, the time by which closed-end credit disclosures normally must be given, be defined as the time when the consumer becomes contractually liable on the obligation under applicable law? (§ 226.2)
5. Should a security interest be defined more narrowly than under the current regulation, to exclude a number of incidental property interests such as accessions, accessories and interests in insurance and unearned insurance proceeds? (§ 226.2)

6. Should downpayments be defined to include a deferred portion of the downpayment (so-called "pick-up payments")? (§ 226.2)

#### Exemptions

7. Should loans that are extended by a trust be exempt from the regulation? (§ 226.3)

#### Finance Charge

8. Should a tolerance be provided for calculating and disclosing the finance charge, similar to the margin of error already provided for the annual percentage rate? (§ 226.4)
9. Should an application fee be considered a finance charge? (§ 226.4)
10. Should a fee for membership or participation in a credit plan be exempt from the finance charge, so long as the fee is not tied to a particular credit extension? (§ 226.4)
11. Should a fee for reconveyance in a realty transaction be excluded from the finance charge? (§ 226.4)
12. Should sellers points in a realty transaction be excluded from the finance charge in all cases? (§ 226.4)
13. Should the cost of credit life or property insurance to be excluded from the finance charge be permitted to be disclosed on a unit-cost basis? (§ 226.4)



Open-End Credit Provisions

14. Unlike the current regulation and the May proposal, but in accordance with the statute, this proposal does not require disclosure on the initial disclosure statement of ~~the~~ minimum payment. Is it necessary to require such a disclosure under Truth in Lending or is such information routinely provided?
15. What disclosures should be made in connection with variable rate open-end plans? (§ 226.6 and 226.7)
16. How should the annual percentage rate disclosure be handled when a finance charge is imposed during a billing cycle but there is no balance on the account? (§ 226.7)
17. Should the proposal limit the applicability of the change in terms notice requirement? (§ 226.9)
18. Does the proposal's streamlining of the prompt crediting of payments requirement afford adequate consumer protection?
19. Should the proposal address the applicability of the issuance and liability rules to authorized users of credit cards?
20. Where the regulation provides relief to creditors for inadvertent collection action or for reporting a consumer's account as delinquent after receiving a billing error notice, are there operational problems in the regulation's requiring a creditor to redress the inadvertent action? (§ 226.13(d) and (4))
21. Does the proposal's automatic debit provision adequately protect consumers when asserting billing errors? (§ 226.13(d)(5))

22. When should the consumer have the right to rescind under an open-end plan in which a security interest is taken in the consumer's principal dwelling? (§ 226.16)

Closed-End Credit Disclosures

23. Should a creditor base its disclosures only on the legally-enforceable agreement with the consumer, even if there is an informal or "side" understanding of the terms that is different from the legal obligation? (§ 226.17)
24. Should loans involving multiple advances be disclosable either by treating all of the advances as a single transaction or by disclosing each advance as a separate transaction? (§ 226.17)
25. Should creditors providing construction loans with permanent financing be permitted to give separate disclosures for each phase as an alternative to treating both phases as a single transaction? (§ 226.17)
26. When a creditor makes early disclosure of credit terms based on the best information available at that time, should the creditor be required to provide new disclosures when an event occurs before consummation that makes the previous disclosures inaccurate? (§ 226.17)
27. Should the number of items that must be disclosed as part of the amount financed explanation be reduced? (§ 226.18)

28. Should creditors in residential mortgage transactions with variable rate clauses be required to provide examples of the effects of an increase in the rate? (§ 226.18)
29. Should renegotiable rate mortgages be considered variable rate transactions? (§ 226.18)
30. Should the special rules for residential mortgage transactions subject to the Real Estate Settlement Procedures Act (RESPA) be revised in the following ways:
  - (1) Define "written application" for Truth in Lending purposes in the same way as that term is defined under RESPA?
  - (2) If new disclosures are required because the annual percentage rate is beyond the tolerance, require redisclosure of only the changed terms?
  - (3) Combine the good faith estimate of settlement costs under RESPA and the amount financed explanation under Truth in Lending into one form, such as the model form in § G(4) of Appendix G? (§ 226.19)
31. Should a refinancing requiring new Truth in Lending disclosures be defined only as a transaction that extinguishes and replaces an existing obligation? (§ 226.20)
32. Should the assumption of an obligation require new Truth in Lending disclosures only when the obligation assumed is a residential mortgage transaction? (§ 226.20)

Annual Percentage Rate

33. Should a wider tolerance be provided for annual percentage rate calculations and disclosures in closed-end credit transactions involving irregular payment schedules or multiple advances? (§ 226.22)

Right of Rescission

34. Should the right of rescission be waived whenever the customer determines that the extension of credit is needed to meet a bona fide personal financial emergency, in contrast to the requirement in the current regulation that the emergency endanger persons or property? (§ 226.23)

Consumer Leases

35. Should the renegotiation of a consumer lease require new leasing disclosures only when the existing lease is satisfied and replaced by a new consumer lease? (§ 226.26)

Model Forms

36. Should the model disclosure forms and clauses for credit and lease transactions, which if used properly would assure compliance with the regulation, be required or expanded in any way? Should model forms be provided for other specific types of transactions? (Appendices)

### Simplification Principles and Specific New Proposals

The regulation should contain precise, simple rules as opposed to principles that create ambiguity and require additional regulatory clarification.

<u>Current Requirement</u>	<u>Proposed Change</u>	<u>Reasons</u>
1. The regulation applies to "creditors" who "in the ordinary course of business regularly extend or arrange for the extension of consumer credit."	"Creditor" defined as person who extends credit more than 25 times a year (or more than 5 times in the case of transactions secured by a dwelling).	To avoid the imprecision of "ordinary course of business" and "regularly extends" and the need for further regulatory material.
2. Credit where there is no finance charge is covered if it is payable by agreement in more than four installments. This has been deemed to include <u>informal</u> arrangements.	Coverage limited to <u>written</u> agreements. Coverage is limited to <u>written</u> agreements, unless a finance charge is involved. All agreements involving a finance charge continue to be covered.	To exclude informal arrangements not involving a finance charge, such as those frequently made by doctors, dentists, small tradesmen and others as an accommodation to their customers.
3. Disclosures must be made prior to "consummation" of the credit transaction which may be when the customer has an "economic incentive" to go forward with the transaction.	"Consummation" would occur only when the consumer becomes <u>contractually</u> liable.	To reduce uncertainty over the timing of required disclosures.
4. Disclosures must be made on the basis of the "understanding" between the parties, even if at variance from the legal obligation.	Disclosures based on the legally enforceable obligation.	To avoid uncertainties produced by disclosure based upon informal terms of repayment.
5. "Points" paid by the <u>seller</u> in a real estate transaction must be included in the finance charge if paid, indirectly, by the purchaser through an increase in purchase price.	Exclude <u>seller's</u> points from the finance charge in all cases. Points paid by the buyer of the house would continue to be disclosed as part of the finance charge.	To avoid difficulty in knowing whether purchase prices have been specifically increased to cover seller's points. Also, to simplify disclosures.

Tolerances in disclosures should be more widely available.

<u>Current Requirement</u>	<u>Proposed Change</u>	<u>Reasons</u>
1. The disclosed finance charge must be accurate to the penny.	Incorporate the 1/8 of 1% tolerance already provided for the APR into the finance charge disclosure.	To ease the burden of finance charge calculations and remove liability for slight errors.

<u>Current Requirement</u>	<u>Proposed Change</u>	<u>Reasons</u>
2. In irregular transactions, although certain APR tolerances are permitted, these are limited to several slight irregularities and have no application to the majority of complex transactions.	Provide a tolerance of 1/4 of 1% for any transactions involving multiple advances or irregular payments.	To reduce regulatory complexity and calculation difficulties.
3. Even though creditors have provided good faith disclosures before consummation, if an item changes before consummation, no matter how slight, full redisclosure is required.	No new disclosures required once good faith estimates given except in certain real estate transactions.	To help effectuate the credit shopping goals by promoting earlier disclosures.

Emphasis should be on disclosures relevant to credit decisionmaking.

<u>Current Requirement</u>	<u>Proposed Change</u>	<u>Reasons</u>
1. A change in the original terms of an obligation is generally considered a "refinancing" requiring all new disclosures.	Limit the concept of refinancing to the complete replacement of an existing transaction with a new one.	To remove a source of many letters, interpretations, and special rules.
2. New disclosures required when any consumer credit transaction is assumed by another customer.	New disclosures required only in assumption of residential mortgage transaction.	To limit redisclosure responsibilities to those assumptions in which consumer is most likely to compare credit sources.
3. Extended disclosures of security interests and other terms relevant to post-consummation events like default and prepayment.	Elimination of disclosure details such as whether security interest applies to "after-acquired" property.	To remove unnecessary technical material that does not aid credit-shopping, complicates disclosures and causes unproductive litigation

Burdens not justified by substantial consumer benefit should be eliminated.

<u>Current Requirement</u>	<u>Proposed Change</u>	<u>Reasons</u>
1. Unusual transactions which may have aspects of credit, but which do not lend themselves to disclosures without complex rules, are covered--for example, pawn shop transactions, layaway plans, letters of credit, and utility "budget plans."	Exclude these transactions from coverage.	To remove a source of unnecessary regulatory detail and burden in situations where disclosures are not particularly meaningful.
2. The three-day right of rescission where a home is used as security (which requires that no funds be disbursed during the period) may be waived only if the delay "will jeopardize welfare, health, or safety or endanger property."	Waiver may be made simply if consumer determines there is a "bona fide personal financial emergency" (the statutory language).	To allow customers to obtain their money promptly (for example, from a second mortgage). Protection from overreaching is still provided since the use of pre-printed forms to request a waiver is prohibited.
3. Certain minor disclosures are required with specified language--e.g. "pickup payment," "balloon payment," "trade-in."	Deletion of requirements.	To omit detail with no substantive loss to consumers.
4. Consumer deposits in the nature of compensating balances (called "required deposit balances") must be taken into consideration in APR calculations and separately itemized and disclosed.	Consider excluding any consideration of "required deposit balances," at least below a certain amount where there would be little impact on APR.	To remove a source of complicated regulatory language, disclosures, and mathematical calculations that add very little to accuracy of credit cost disclosures.

The regulation should give creditors some flexibility to tailor disclosures to their own credit plans.

<u>Current Requirement</u>	<u>Proposed Change</u>	<u>Reasons</u>
1. In certain transactions with variable rates, a hypothetical example of the effect of a 1/4 of 1% increase in the rate is required.	The terms in the example may be designed by the creditor.	To allow creditors to design an example which best reflects their own terms.

<u>Current Requirement</u>	<u>Proposed Change</u>	<u>Reasons</u>
2. Where there are advances under a closed-end credit line, the dates of the advances must be estimated and a single disclosure made.	The creditor may either treat the arrangement as a single transaction or, alternatively, make disclosures for each draw under the line.	To recognize that individual circumstances, best known to the creditor, may make one disclosure or the other more meaningful and easier to compute.
3. A single integrated disclosure is required for construction loans involving advances during construction and a set amortization schedule after construction is completed.	At the creditor's option, allow transaction to be divided into two segments for disclosure--one for the construction phase and one for the amortization.	To remove need for complicated calculations required to integrate construction advances with amortization schedule, where separate disclosures may also be useful to consumers.
4. Specific rules apply for treatment of "cash rebates" from the creditor or the manufacturer.	At the creditor's option, cash rebates need not be incorporated into disclosures.	To avoid necessity for complex rules covering great variety of cash rebate situations.
5. In credit advertising an example of a specific payment schedule must be shown.	Creditors are given more flexibility in showing terms of repayment in ads.	To allow creditor to determine most appropriate way to describe its own plan.