FEDERAL RESERVE BANK
OF DALLAS

WILLIAM H. WALLACE
FIRST VICE PRESIDENT
AND CHIEF OPERATING OFFICER

DALLAS, TEXAS 75222

April 16, 1987

Circular 87-29

TO: The Chief Executive Officer of all
member banks and others concerned in
the Eleventh Federal Reserve District

SUBJECT

Final revisions to the official staff commentaries relating to consumer credit protection regulations

DETAILS

The Board of Governors of the Federal Reserve System has adopted final changes to the official staff commentary for three of its consumer credit protection regulations -- Regulation B (Equal Credit Opportunity), Regulation E (Electronic Fund Transfers), and Regulation Z (Truth in Lending).

ATTACHMENTS

The Board's press release and the material as published in the Federal Register are attached.

MORE INFORMATION

Questions should be directed to Sharon Sweeney (Regulation B), John Rogers (Regulation E), and David Dixon (Regulation Z) of this Bank's Legal Department at (214) 651-6228.

Sincerely yours,

William H. Wallace

FEDERAL RESERVE press release

For immediate release April 1, 1987

The Federal Reserve Board has adopted final changes to the official staff commentaries to its Regulations B (Equal Credit Opportunity), E (Electronic Fund Transfers), and Z (Truth in Lending).

The major changes to the Regulation B official staff commentary pertain to notification regarding denial of an incomplete application and data collection requirements for monitoring purposes.

The revisions to the Regulation E official staff commentary address systems for paying government benefits by means of electronic terminals; coverage of dividend or interest payments on securities; restrictions on payments to third parties from money market deposit accounts; and the practice of including promotional material on ATM or POS receipts.

The update to the Regulation Z official staff commentary clarifies provisions affecting disclosures for refinancing transactions and the right of rescission. In addition, the update clarifies the exception from the finance charge for participation or membership fees and the prohibition against offsetting a consumer's credit card indebtedness with funds from a deposit account held with a credit card issuer.

The changes to the commentaries are attached.

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Attachments

FEDERAL RESERVE SYSTEM

12 CFR Part 202

[Reg. B; EC-1]

Equal Credit Opportunity; Official Staff Commentary Update

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final official staff interpretation.

SUMMARY: The Board is publishing in final form revisions to the official staff commentary to Regulation B (Equal Credit Opportunity). The commentary applies and interprets the requirements of Regulation B and is a substitute for individual staff interpretations of the regulation. The revisions address questions that have arisen about the regulation, and include new material and changes in existing material

EFFECTIVE DATE: April 1, 1987.

FOR FURTHER INFORMATION CONTACT: Adrienne Hurt or Leonard Chanin, Staff Attorneys, Division of Consumer and Community Affairs, at (202) 452-3867 or 452-3667; for the hearing impaired *only*, Telecommunications Device for the Deaf, Earnestine Hill or Dorothea Thompson at (202) 452-3544, Board of Governors of the Federal Reserve System, Washington, DC 20551.

SUPPLEMENTARY INFORMATION: (1) *General.* The Equal Credit Opportunity Act (15 U.S.C 1691 *et seq.*) makes it unlawful for creditors to discriminate in any aspect of a credit transaction on the basis of race, color, religion, national origin, sex, marital status, age, receipt of public assistance, or the exercise of rights under the Consumer Credit Protection Act. This statute is implemented by the Board's Regulation B (12 CFR Part 202).

On November 20, 1985, an official staff commentary interpreting the regulation was published along with the final rule revising Regulation B (50 FR 48018). The commentary is designed to provide general guidance to creditors in applying the regulation to specific transactions.

Periodic updates provide the vehicle for additional staff interpretations that may be necessary as new questions arise (although each unique situation cannot be individually addressed in the commentary). This notice contains the first update, which was proposed for comment on December 2, 1986 (51 FR 43371). The revisions are effective on April 1, 1987.

(2) *Explanation of revisions.* Following is a brief description of the revisions to the commentary:

Section 202.2—Definitions.

2(f) Application

A cross reference to comment 9(a)(1)-(3) has been added to comment 2(f)-5. Comment 2(f)-5 is a general statement of a creditor's duty to exercise reasonable diligence in obtaining information from applicants or third parties in connection with an application for credit. Because a creditor may deny an application on the basis of incompleteness, the new cross reference helps clarify the relationship between this comment and the treatment of incomplete applications.

2(z) Prohibited Basis

Editorial changes have been made to the first and second sentences of

comment 2(z)–1 for clarity. No substantive change is intended.

Section 202.3—Limited Exceptions for Certain Classes of Transactions.

3(a) Public-Utilities Credit

New comment 3(a)–3 has been added to explain that only telephone companies that are regulated by or that file certain information with a government unit qualify for the public utilities exceptions available under § 202.3(a)(2). The words "required to" were deleted in the final comment to conform to the regulation.

Section 202.9—Notifications.

9(a) Notification of Action Taken, ECOA Notice, and Statement of Specific Reasons

Paragraph 9(a)(1)

New comment 9(a)(1)–3 has been added to explain that a creditor may deny an application missing information from the applicant on the basis of incompleteness. Existing comments 9(a)(1)–3 through 9(a)(1)–6 are redesignated as comments 9(a)(1)–4 through 9(a)(1)–7, respectively.

Section 202.13—Information For Monitoring Purposes.

13(a) Information to Be Requested

New comment 13(a)–5 has been added to address transactions not covered by the data collection requirements of § 202.13(a). Based on suggestions made by commenters, the final comment clarifies that the test for determining whether an application is covered by § 202.13(a) focuses on the purpose of the transaction. For example, second mortgages and open-end home equity lines obtained primarily for a purpose other than the purchase or refinancing of an applicant's principal residence are not covered by § 202.13(a). Existing comment 13(a)–5 is redesignated as comment 13(a)–6.

Appendix B—Model Application Forms

Comments 1 and 2 to Appendix B have been revised to address the proper use of two mortgage application forms issued in October 1986 by the Federal Home Loan Mortgage Corporation (FHLMC) and the Federal National Mortgage Association (FNMA). The two forms—FHLMC 65/FNMA 1003 and FHLMC 703/FNMA 1012—contain a section for collecting the monitoring information required by section 202.13. The forms do not, however, differentiate between transactions that are covered by § 202.13(a), which limits data collection to applications for credit primarily for the purchase or refinancing of an applicant's principal residence, and other transactions in which collection is required for certain creditors by an enforcement agency under the substitute monitoring provisions of § 202.13(d). The residential loan application is typically used for second mortgages as well as the more limited class of mortgage loans covered by § 202.13(a) of the regulation, for example.

Revised comments 1 and 2 provide that creditors which are governed solely by § 202.13(a) should delete, strike, or modify the "Information for Government Monitoring Purposes" section when using the FHLMC/FNMA forms in transactions in which they are not permitted to collect the information. Other creditors may use the forms as issued in compliance with their enforcement agency's substitute monitoring program.

List of Subjects in 12 CFR Part 202

Banks; Banking; Civil rights; Consumer protection; Credit; Federal Reserve System; Marital status discrimination; Minority groups; Penalties; Religious discrimination; Sex discrimination; Women.

(3) *Text of revisions.* The revisions to the commentary (12 CFR Part 202, Supp. I) read as follows:

PART 202—[AMENDED]

Supplement I—Official Staff Commentary

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Section 202.2—Definitions.

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2(f) Application.

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5. *Completed Application—diligence requirement.* The regulation defines a completed application in terms that give a creditor the latitude to establish its own information requirements. Nevertheless, the creditor must act with reasonable diligence to collect information needed to complete the application. For example, the creditor should request information from third parties, such as a credit report, promptly after receiving the application. If additional information is needed from the applicant, such as an address or telephone number needed to verify employment, the creditor should contact the applicant promptly. (But see comment 9(a)(1)–3, which discusses the creditor's option to deny an application on the basis of incompleteness.)

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2(z) Prohibited basis.

1. *Persons associated with applicant.* "Prohibited basis" as used in this regulation refers not only to certain characteristics—the race, color, religion, national origin, sex, marital status, or age—of an applicant (or officers of an applicant in the case of a corporation) but also to the characteristics of individuals with whom an applicant is affiliated or with whom the applicant associates. This means, for example, that under the general rule stated in § 202.4, a creditor may not discriminate against an applicant because of that person's personal or business dealings with members of a certain religion, because of the national origin of any persons associated with the extension of credit (such as the tenants in the apartment complex being financed), or because of the race of other residents in the neighborhood where the property offered as collateral is located.

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Section 202.3—Limited Exceptions for Certain Classes of Transactions.

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3(a) Public utilities credit.

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3. *Telephone companies.* A telephone company's credit transactions qualify for the exceptions provided in § 202.3(a)(2) only if the company is regulated by a government unit or files the charges for service, delayed payment, or any discount for prompt payment with a government unit.

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Section 202.9—Notifications

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9(a) Notification of Action Taken, ECOA Notice, and Statement of Specific Reasons.

Current comments 9(a)(1)–3 through 9(a)(1)–6 are redesignated comments 9(a)(1)–4 through 9(a)(1)–7, respectively.

* * * * *

Paragraph 9(a)(1)

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3. *Incomplete application—denial for incompleteness.* When an application is incomplete regarding matters that the applicant can complete and the creditor lacks sufficient data for a credit decision, the creditor may deny the application giving as the reason for denial that the application is incomplete. The creditor has the option, alternatively, of providing a notice of incompleteness under § 202.9(c).

Section 202.13—Information For Monitoring Purposes

Current comment 13(a)–5 is redesignated 13(a)–6.

13(a) Information to Be Requested

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5. *Transactions not covered.* The information collection requirements of § 202.13(a) apply to applications for credit primarily for the purchase or refinancing of a dwelling that is or will become the applicant's principal residence. Therefore, applications for home equity lines and other applications for credit secured by the applicant's principal residence but made primarily for a purpose other than the purchase or refinancing of the principal residence (such as loans for home improvement and debt consolidation) are not

subject to the information collection requirements of § 202.13(a).

Appendix B—Model Application Forms

1. *FHLMC/FNMA form—residential loan application.* The residential loan application form (FHLMC 65/FNMA 1003), including supplemental form (FHLMC 65A/FNMA 1003A), prepared by the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association and dated October 1986, complies with the requirements of this regulation in some transactions but not others because of the form's section on "Information for Government Monitoring Purposes." Creditors that are governed by § 202.13(a) of the regulation (which limits collection to applications primarily for the purchase or refinancing of the applicant's principal residence) should delete, strike, or modify the data collection section on the form when using it for transactions not covered by § 202.13(a) to assure that they do not collect the information. Creditors that are subject to more extensive collection requirements by a substitute monitoring program under § 202.13(d) may use the form as issued, in compliance with the substitute program.

2. *FHLMC/FNMA form—home-improvement loan application.* The home-improvement and energy loan application form (FHLMC 703/FNMA 1012), prepared by the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association and dated October 1986, complies with the requirements of the regulation for some creditors but not others because of the form's section on "Information for Government Monitoring Purposes." Creditors that are governed by § 202.13(a) of the regulation (which limits collection to applications primarily for the purchase or refinancing of the applicant's principal residence) should delete, strike, or modify the data collection section on the form when using it for transactions not covered by § 202.13(a) to assure that they do not collect the information. Creditors that are subject to more extensive collection requirements by a substitute monitoring program under § 202.13(d) may use the form as issued, in compliance with that substitute program.

Board of Governors of the Federal Reserve System, March 31, 1987.

William W. Wiles,

Secretary of the Board.

[FR Doc. 87-7409 Filed 4-2-87; 8:45 am]

BILLING CODE 6210-01-M

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12 CFR Part 205

[Reg. E; EFT-2]

Electronic Fund Transfers; Official Staff Commentary Update

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final official staff interpretation.

SUMMARY: The Board is publishing revisions to the official staff commentary to Regulation E (Electronic Fund Transfers). The commentary applies and interprets the requirements of Regulation E and is a substitute for individual staff interpretations of the regulation. The revisions represent final action on proposed changes published for comment in December 1986.

EFFECTIVE DATE: April 1, 1987.

FOR FURTHER INFORMATION: Contact Sharon Bowman or Heather Hansche, Staff Attorneys, Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, Washington, DC 20551, (202) 452-2412. For the hearing-impaired *only*, Telecommunication Device for the Deaf (TDD), Earnestine Hill or Dorothea Thompson, (202) 452-3544.

SUPPLEMENTARY INFORMATION: (1) *General.* The Electronic Fund Transfer Act (15 U.S.C. 1693 *et seq.*) governs any transfer of funds that is electronically initiated and that debits or credits a consumer's account. This statute is implemented by the Board's Regulation E (12 CFR Part 205). Effective September 24, 1981, an official staff commentary (EFT-2, Supp. II to 12 CFR Part 205) was published to interpret the regulation. The commentary is designed to provide guidance to financial institutions in applying the regulation to specific situations. The commentary is updated periodically to address significant questions that arise. There have been four updates so far. The proposed version of this fifth update was published for comment on December 3, 1986 (51 FR 43615); this notice contains the final version.

(2) *Revisions to Commentary.* Four of the questions included in this document—questions 2-12.6, 3-3.6, 7-11.5, and 9-3.5—are new. Question 2-12.6 addresses systems for paying government benefits, such as public assistance, by means of electronic terminals; it clarifies that since the benefits are not disbursed from an account established by or in the control of the recipient, Regulation E does not apply. Question 3-3.6 concerns the regulation's coverage of dividend or interest payments on securities; it has been modified from the proposed version to avoid indicating that such payments are necessarily "preauthorized" transfers.

Question 7-11.5 deals with the Regulation D restrictions on payments to third parties from money market deposit accounts; it describes the circumstances under which the institution would be required by Regulation E to disclose those restrictions. Question 9-3.5 addresses the practice of including promotional material on ATM or POS receipts, and is adopted without change from the proposed version.

The remaining two questions—questions 9-36 and 11-11.5—are revisions of existing commentary provisions; the new material deals with the treatment of cash-back and cash-only transactions at merchant point-of-sale terminals. These have been adopted without change from the proposed versions.

List of Subjects in 12 CFR Part 205

Banks, banking; Consumer protection; Electronic fund transfers; Federal Reserve System; Penalties.

Text of Revisions

The revisions to the Official Staff Commentary on Regulation E (EFT-2, Supp. II to 12 CFR Part 205) read as follows:

§ 205.2 Definitions and rules of construction.

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Q 2-12.6: *Fund transfer—electronic payment of government benefits.* A recipient of government benefits, such as public assistance or food stamps, receives the benefits from an automated teller machine or a staffed electronic terminal. For example, the recipient presents an identification card to a clerk, the card is run through an electronic terminal, the recipient's identity is verified by some means (such as a photograph, personal identification number, or signature), and the benefits are given in the form of cash, food stamps, or food items. The benefits are disbursed from an account of the governmental entity paying the benefits, not an account established by or in the control of the consumer. Are these transactions subject to Regulation E?

A: No, since there is no debit or credit to a consumer asset account. (See questions 2-4 and 2-12.) (Section 205.2(b) and (g))

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§ 205.3 Exemptions.

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Q 3-3.6: *Payment of dividends or interest on securities.* A payment of interest or dividends on securities is made by electronic fund transfer into a consumer's account. The payment may be made, for example, by a discount brokerage firm into an account at an affiliated depository institution or, for government securities, by a Federal Reserve Bank into the consumer's account at a depository institution. Is the transfer covered by Regulation E?

A: Yes. The securities exemption does not apply since there is no purchase or sale of securities. (Section 205.3(c))

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§ 205.7 Initial Disclosure of Terms and Conditions.

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Q 7-11.5: *Restrictions on certain deposit accounts.* Regulation D imposes restrictions

on the number of payments to third parties that may be made from a money market deposit account (whether made by electronic or nonelectronic means). If an institution chooses to implement the restrictions by refusing to execute transfers that would exceed the limit, must it disclose the restrictions under Regulation E as limitations on the frequency of electronic fund transfers?

A: Yes, limitations on account activity that restrict the consumer's ability to make electronic fund transfers must be disclosed to the consumer as part of the Regulation E disclosures. (Section 205.7(a)(4))

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§ 205.9 Documentation of transfers.

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Q 9-3.5: *Receipts—inclusion of promotional material.* A financial institution uses receipts on which there is promotional material (such as discount coupons for food items at restaurants). Is the printing of such promotional material on receipts prohibited by the regulation?

A: No. The regulation does, however, mandate that the required receipt information be set forth clearly; this may be achieved, for example, by separating it from the promotional material. In addition, a consumer must not be required to surrender the receipt (or that portion containing the required disclosures) in order to take advantage of a promotion. (Section 205.9(a))

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Q 9-36: *Receipts/periodic statements—type of transfer.* What degree of specificity is required on terminal receipts and periodic statements for the type of transfer?

A: Common descriptions are sufficient. There is no prescribed terminology, although some examples are contained in the regulation. On periodic statements, it is enough simply to show the amount of the transfer in the debit or the credit column if other information on the statement (such as a terminal location or third-party name) enables the consumer to identify the type of transfer. When a consumer obtains cash from a merchant at a POS terminal in addition to purchasing goods, or obtains cash only, it is not necessary to differentiate the transaction from one involving only the purchase of goods. (See question 9-27.) (Section 205.9(a)(3) and (b)(1)(iii))

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§ 205.11 Procedures for resolving errors.

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Q 11-11.5: *POS debit-card transactions.* The deadlines for investigating errors are extended for all transfers resulting from POS debit-card transactions, regardless of whether an electronic terminal is involved. For purposes of these deadlines, what types of transactions can be viewed as POS debit-card transactions?

A: POS debit-card transactions include all debit card transactions at merchants' point-of-sale terminals, including those for cash only. (Transactions at ATMs, however, are not POS transactions even though the ATM may be in a merchant location.) POS debit-card transactions generally take place at merchant locations but also include mail and telephone orders of goods or services involving a debit card. (Section 205.11(c)(4))

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Board of Governors of the Federal Reserve System, March 30, 1987.

William W. Wiles,

Secretary of the Board.

[FR Doc. 87-7498 Filed 4-2-87; 8:45 am]

BILLING CODE 6210-01-M

Rules and Regulations

Federal Register
Vol. 52, No. 65
Monday, April 6, 1987

FEDERAL RESERVE SYSTEM

12 CFR Part 226

[Reg. Z; TIL-1]

Truth in Lending; Official Staff Commentary Update

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final official staff interpretation.

SUMMARY: The Board is publishing in final form changes to the official staff commentary to Regulation Z (Truth in Lending). The commentary applies and interprets the requirements of Regulation Z and is a substitute for individual staff interpretations of the regulation. The revisions address a variety of questions that have arisen about the regulation, and include new material and changes in existing material.

As a result of the increased use of home-equity lines of credit and second mortgage loans, partly due to the new limitations on the deductibility of non-business interest expenses under the revised federal tax laws, the Board has received a number of inquiries concerning real estate-secured extensions of credit. These questions are addressed by several revisions, one of which clarifies the rules that apply when a creditor adds a security interest in the consumer's principal dwelling to a transaction that was previously exempt from the regulation.

The update includes a variety of other revisions including clarification of the

exception from the finance charge for participation or membership fees under § 226.4(c)(4), and clarification of the prohibition against offsetting a consumer's credit card indebtedness with funds from a deposit account held with a credit card issuer under § 226.12(d).

DATES: Effective April 1, 1987, but compliance optional until October 1, 1987.

FOR FURTHER INFORMATION: Contact the following attorneys in the Division of Consumer and Community Affairs at (202) 452-3667 or (202) 452-3867:

Open-end—Kathleen Brueger, Heather Hansche, Susan Kraeger

Closed-end—Sharon Bowman, Leonard Chanin, Adrienne Hurt, Thomas Noto

For the hearing impaired *only*, Telecommunications Device for the Deaf (TDD), Earnestine Hill or Dorothea Thompson at (202) 452-3544, Board of Governors of the Federal Reserve System, Washington, DC 20551.

SUPPLEMENTARY INFORMATION:

(1) General

The Truth in Lending Act (15 U.S.C. 1601 *et seq.*) governs consumer credit transactions and is implemented by the Board's Regulation Z (12 CFR Part 226). Effective October 13, 1981, an official staff commentary (TIL-1, Supp. I to 12 CFR Part 226) was published to interpret the regulation. The commentary is designed to provide guidance to creditors in applying the regulation to specific transactions. The commentary is updated periodically to address significant questions that arise. There have been five general updates so far. This notice contains the sixth general update, which was proposed for comment on December 2, 1986 (51 FR 43372). The changes are effective on April 1, 1987. Although creditors are free to rely on the provisions as of that date and are protected if they do so, they need not follow the revisions until October 1, 1987.

(2) Revisions

The following is a brief description of the revisions to the commentary:

Subpart A—General

Section 226.2—Definitions and Rules of Construction— 2(a) Definitions—2(a)(20) "Open-End Credit". Comment 2(a)(20)-4 is amended to further clarify that an open-end credit plan may exist even though the creditor does not normally impose a finance charge, provided the creditor has the right to impose a finance charge from time to time on the outstanding balance.

Section 226.3—Exempt Transactions— 3(b) Credit Over $25,000 Not Secured by Real Property or a Dwelling—Comment 3(b)-2 is amended to clarify that an open-end credit plan which was exempt from the regulation's coverage under § 226.3(b) becomes subject to the regulation when a security interest is taken in any real property, or in personal property used or expected to be used as the consumer's principal dwelling. As a result, creditors must give the consumer an initial disclosure statement reflecting the current account terms at the time such security interest is taken, and comply with the other provisions of the regulation applicable to open-end credit. If the security interest that is taken is in the consumer's principal dwelling, the creditor must also give the consumer the right to rescind the security interest.

Comment 3(b)-3 is amended to correct the reference to the $25,000 limitation and to add a reference to the consumer's principal dwelling in the first sentence. In addition, the caption "Refinanced obligations" has been changed to "Closed-end credit—subsequent changes" to more closely parallel the language used in the caption for the preceding comment on open-end credit. The revisions clarify the rule that disclosures for previously exempt closed-end credit transactions are required only when the existing obligation is satisfied and replaced by a new obligation. A cross reference to the commentary to § 226.23(a)(1), which discusses the right of rescission when a security interest in a consumer's principal dwelling is added to a previously exempt transaction, has also been added to the comment.

Section 226.4—Finance Charge—4(c) Charges Excluded from the Finance Charge—*Paragraph 4(c)(4).* Comment 4(c)(4)-1 is amended and a new comment 4(c)(4)-2 is added to clarify the types of charges that may be treated as participation or membership fees, and thus excluded from the finance charge. Specifically, comment 4(c)(4)-1 is amended to make clear that a one-time charge imposed when an account is opened, such as a loan origination fee, may not be treated as a participation fee. Comment 4(c)(4)-2 is added to make clear that fees based on either the degree of account activity or on the amount of credit available under the plan (such as a fee based on a percentage of the credit limit) are not participation fees and, if imposed, must be treated as finance charges.

Subpart B—Open-End Credit

Section 226.5—General Disclosure Requirements—5(b) Time of Disclosures—*5(b)(1) Initial disclosures.* Comment 5(b)(1)-1 is revised to make clear that, in general, the initial disclosure statement must be provided to the consumer before the consumer pays any fees or charges under the plan, including real estate charges of the type excluded from the finance charge in § 226.4(c)(7). However, the comment would continue to allow imposition of an application fee (§ 226.4(c)(1)) or membership fee (§ 226.4(c)(4)) prior to giving the initial disclosure statement; any membership fee imposed before the initial disclosures are given must be refunded if the consumer rejects the plan.

Section 226.6—Initial Disclosure Statement—6(b) *Other Charges*—Comment 6(b)-1 is amended by adding examples of the types of real estate charges included in § 226.4(c)(7). In addition, taxes and filing or notary fees excluded from the finance charge under § 226.4(e) are deleted as examples of an "other charge" in comment 6(b)-1, and comment 6(b)-2 is amended to include them as examples of what is not an "other charge." Since taxes and filing or notary fees excluded from the finance charge under § 226.4(e) must be itemized and disclosed, it is unnecessary to specifically require them to be treated as "other charges" in order to ensure that they are disclosed to the consumer. The creditor has the option of either itemizing and disclosing these fees separately under § 226.4(e), or including the fees as part of the initial disclosure statement as an "other charge" under § 226.6(b). Under either option, the creditor may disclose the amount of the fees or, alternatively, an explanation of how the amount will be determined.

6(c) *Security Interests.* Comments 6(c)-2 and 6(c)-4 are revised to take into account the Board's Credit Practices Rule, Subpart B of Regulation AA, 12 CFR Part 227, and the credit practices rules of the Federal Trade Commission and the Federal Home Loan Bank Board, 16 CFR Part 444 and 12 CFR Part 535, respectively. These rules declare it an unfair or deceptive act or practice for creditors to take or enforce a nonpurchase money, nonpossessory security interest in "household goods," as that term is defined by the rules. Some state laws also limit the availability of security interests in household goods. Comments 6(c)-2 and 6(c)-4 have been supplemented with parenthetical statements designed to alert creditors to the existence of these restrictions, rather than deleting the references to "household appliances" and "household goods" altogether, as was originally proposed.

Section 226.7—Periodic Statement—
7(f) *Amount of Finance Charge.* A new comment 7(f)–8 is added to clarify that finance charges assessed at the time an account is opened must be disclosed on the periodic statement if they are financed under the plan.

7(h) *Other Charges.* Comment 7(h)–1 is amended to make clear that creditors may disclose real estate-related charges excluded from the finance charge under § 226.4(c)(7) as a single amount with a term such as "closing costs" on the periodic statement, if the charges were itemized and described by the same term on the initial disclosure. Creditors may continue, however, to disclose these charges on the initial disclosure statement by explaining how the charge will be determined (see § 226.6(b)).

Section 226.12—Special Credit Card Provisions—12(d) Offsets by Card Issuer Prohibited—Paragraph 12(d)(2). Comment 12(d)(2)–1 is revised to clarify that the security interest exception to the prohibition on offsetting a cardholder's indebtedness against funds on deposit with the card issuer does not include a security interest that is the functional equivalent of the right of offset. Therefore, security interests granted by language routinely included in credit card agreements are not within the exception. For the exception to apply, there must be some affirmative indication that the consumer is aware that a security interest is a condition for an account (or for more favorable terms on an account) and specifically intends to grant the security interest. In addition, to qualify for the exception, a security interest in the consumer's deposit account must be obtainable and enforceable by creditors generally. The revised comment eliminates the examples at the end of the previous comment since they are now incorporated in the requirements discussion.

Section 226.15—Right of Rescission—15(c) Delay of Creditor's Performance. Comment 15(c)–1 is amended to clarify that a creditor is not prohibited from disbursing funds during the rescission period when property subject to the right to rescind is added as security under an existing open-end credit plan.

Comment 15(c)–3 is revised to clarify that the examples of actions a creditor may take during the rescission period are permissible actions provided they are not prohibited by state law or other requirements. In addition, the caption "Permissible actions" has been changed to "Actions during the delay period." These revisions were prompted by the fact that some creditors mistakenly believed that the regulation authorized the accrual of finance charges during the rescission period, even when state law does not permit the practice. The revisions make it clear that the regulation neither authorizes nor prohibits the listed actions.

Subpart G—Closed-End Credit

Section 226.18—Content of Disclosures—18(g) Payment Schedule—Paragraph 18(g)(2). Comment 18(g)(2)–1 is reVised to incorporate a discussion of transactions in which interest and principal payments occur at different intervals. The revision clarifies that a creditor may disclose the two series of payments separately and use an abbreviated payment schedule for the interest payments. The revision also makes clear that this option is available for transactions in which interest and principal payments are scheduled on the same, as well as on different, dates of the month.

18(m) *Security Interest*—Comment 18(m)–2, addressing disclosure of nonpurchase money security interests, is revised to reflect the existence of the Board's Credit Practices Rule, Subpart B of Regulation AA, 12 CFR Part 227, and the credit practices rules of the Federal Trade Commission, 16 CFR Part 444, and the Federal Home Loan Bank Board, 12 CFR Part 535. These rules declare it an unfair or deceptive act or practice for creditors to take or enforce a nonpossessory, nonpurchase money security interest in "household goods," as that term is defined by the rules. Some state laws also limit the availability of security interests in household goods. Comment 18(m)–2 has therefore been supplemented with a parenthetical statement designed to alert creditors to the existence of these restrictions.

Rather than deleting the reference to "household goods" altogether, as was originally proposed, an additional example has been provided: "certain household items." Some creditors have expressed reluctance, in light of the credit practices rules, to use the term "household goods." Accordingly, the additional term has been provided in comment 18(m)–2 as an alternative means of describing this type of property.

*Section 226.20—Subsequent Disclosure Requirements—*20(a) *Refinancing—Paragraph 20(a)(2).* The discussion in comment 20(a)(2)–1 on what qualifies as a corresponding change in the payment schedule is deleted as a result of the addition of comment 20(a)(2)–2.

Comment 20(a)(2)–2 is added to clarify what is a corresponding change in the payment schedule that would not require new disclosures. The addition also makes clear that a reduction in the annual percentage rate accompanied by an increase in the term of the original obligation is an event requiring new disclosures.

Section 226.23—Right of Rescission—
23(a) *Consumer's Right to Rescind—Paragraph 23(a)(1).* Comment 23(a)(1)–5 is modified to clarify the circumstances in which the addition of a security interest to an existing obligation is rescindable. The revised comment makes clear that if a security interest in the consumer's principal dwelling is added to a transaction that was previously exempt from the regulation (because it was credit over $25,000 not secured by real property or a principal dwelling), the consumer has the right to rescind the addition of that security interest even if the existing obligation is not satisfied and replaced by a new obligation. Finally, the term "preexisting" has been replaced by "existing" for consistency of terminology.

23(c) *Delay of Creditor's Performance*—Comment 23(c)–3 is revised to clarify that the examples of actions a creditor may take during the rescission period are permissible actions provided they are not prohibited by state law or other requirements. In addition, the caption "Permissible actions" has been changed to "Actions during the delay period" to reflect a more neutral statement of the subject of the comment. These revisions were prompted by the fact that some creditors mistakenly believed that the regulation authorized the accrual of finance charges during the rescission period, even if state law prohibited such a practice. The revisions make it clear that the regulation neither authorizes nor prohibits the listed actions.

23(f) *Exempt Transactions*—In December, the Board adopted an amendment to Regulation Z to redefine what constitutes a new advance of money to a consumer for purposes of the rescission exemption for refinancings with the original creditor. Under the amendment, a new advance of money to a consumer would no longer include amounts attributed solely to the costs of the refinancing. Comment 23(f)–4 has been changed to incorporate the revised definition of a new advance of money in a refinancing with the original creditor and to further explain what amounts are included and excluded when determining what constitutes a new advance. In a refinancing, if the new "amount financed" exceeds the unpaid principal balance, any earned unpaid finance charges on the existing debt, and the amounts attributable solely to

the costs of the refinancing, the consumer has the right of rescission as to the difference. Final comment 23(f)–4 differs from the proposal in that it explains that in determining whether there is a new advance in a refinancing, creditors may rely on the information stated in the latest Truth in Lending disclosure given to the consumer. Thus, for example, if the actual dollar amount of refinancing costs determined at the time a loan closes differs from that reflected in the latest Truth in Lending disclosure, the creditor may rely on the amounts contained in the disclosure in determining whether there is a new advance in the refinancing. A minor editorial change has also been made in the first sentence of this comment to clarify that a consolidation is a type of refinancing: no substantive change is intended.

Appendix D—Multiple-Advance Construction Loans

Comment Appendix D–5 is added to explain the way in which "interest reserves" for multiple-advance construction loans should be treated when a creditor uses appendix D to calculate the annual percentage rate and disclosures. The final comment provides that regardless of the amount of the interest reserve, it is not treated as a prepaid finance charge. The comment explains that if the consumer is permitted to make interest payments as they become due, the interest reserve should be disregarded in the disclosures and calculations under appendix D. The comment also provides, however, that if a creditor automatically deducts the interest payments from the interest reserve rather than allow the consumer to make the interest payments as they become due, the estimated interest must reflect the fact that interest will accrue on the interest payments as well as the other loan proceeds. The comment explains how to account for that accrual.

List of Subjects in 12 CFR Part 226

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

Pursuant to authority granted in section 105 of the Truth in Lending Act (15 U.S.C. 1604 as amended), the Board amends the official staff commentary to Regulation Z (12 CFR Part 226 Supp. I) as follows:

1. Authority Citation

The authority citation for Part 226 continues to read:

Authority: Sec. 105, Truth in Lending Act, as amended by sec. 605, Pub. L. 96–221, 94 Stat. 170 (15 U.S.C. 1604 *et seq.*).

PART 226—[AMENDED]

2. Text of Revisions

The commentary (TIL–1, Supplement I to 12 CFR Part 226) is amended by revising comments 2(a)(20)–4, 3(b)–2, 3(b)–3, and 4(c)(4)–1; by adding comment 4(c)(4)–2; by revising the first sentence of comment 5(b)(1)–1; by revising the third bulleted paragraph and removing the fourth bulleted paragraph of comment 6(b)–1; by adding a new bulleted paragraph at the end of comment 6(b)–2; by revising comment 6(c)–2; by adding parenthetical material at the end of comment 6(c)–4; by adding new comment 7(f)–8; by adding a new second sentence to comment 7(h)–1; by revising comment 12(d)(2)–1; by adding two new sentences at the end of comment 15(c)–1; by revising the heading and second sentence of comment 15(c)–3; by revising comments 18(g)(2)–1, 18(m)–2, 20(a)(2)–1; by adding comment 20(a)(2)–2; by revising comments 23(a)(1)–5, 23(c)–3, and 23(f)–4; and by adding comment app. D–5, to read as follows:

Supplement I—Official Staff Interpretations

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Subpart A—General

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Section 226.2—Definitions and Rules of Construction

2(a) Definitions

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

* * * * *

4. *Finance charge on an outstanding balance.* The requirement that a finance charge may be computed and imposed from time to time on the outstanding balance means that there is no specific amount financed for the plan for which the finance charge, total of payments, and payment schedule can be calculated. A plan may meet the definition of open-end credit even though a finance charge is not normally imposed, provided the creditor has the right, under the plan, to impose a finance charge from time to time on the outstanding balance. For example, in some plans, such as certain "china club" plans, a finance charge is not imposed if the consumer pays all or a specified portion of the outstanding balance within a given time period. Such a plan could meet the finance charge criterion, if the creditor has the right to impose a finance charge, even though the consumer actually pays no finance charges during the existence of the plan because the consumer takes advantage of the option to pay the balance (either in full or in installments) within the time necessary to avoid finance charges.

* * * * *

Section 226.3—Exempt Transactions

* * * * *

3(b) Credit Over $25,000 Not Secured by Real Property or a Dwelling.

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2. *Open-end credit.* An open-end credit plan is exempt under § 226.3(b) (unless secured by real property or personal property used or expected to be used as the consumer's principal dwelling) if either of the following conditions is met

- The creditor makes a firm commitment to lend over $25,000 with no requirement of additional credit information for any advances.
- The initial extension of credit on the line exceeds $25,000.

If a security interest is taken at a later time in any real property, or in personal property used or expected to be used as the consumer's principal dwelling, the plan would no longer be exempt. The creditor must comply with all of the requirements of the regulation including, for example, providing the consumer with an initial disclosure statement. If the security interest being added is in the consumer's principal dwelling, the creditor must also give the consumer the right to rescind the security interest. (See the commentary to § 226.15 concerning the right of rescission.)

3. *Closed-end credit—subsequent changes.* A closed-end loan for over $25,000 may later be rewritten for $25,000 or less, or a security interest in real property or in personal property used or expected to be used as the consumer's principal dwelling may be added to an extension of credit for over $25,000. Such a transaction is consumer credit requiring disclosures only if the existing obligation is satisfied and replaced by a new obligation made for consumer purposes undertaken by the same obligor. (See the commentary to § 226.23(a)(1) regarding the right of rescission when a security interest in a consumer's principal dwelling is added to a previously exempt transaction.)

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Section 226.4—Finance Charge

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4(c) Charges Excluded from the Finance Charge

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Paragraph 4(c)(4)

1. *Participation fees—periodic basis.* The participation fees mentioned in § 226.4(c)(4) do not necessarily have to be formal membership fees, nor are they limited to credit card plans. The provision applies to any credit plan in which payment of a fee is a condition of access to the plan itself, but it does not apply to fees imposed separately on individual closed-end transactions. The fee may be charged on a monthly, annual, or other periodic basis; a one-time, non-recurring fee imposed at the time an account is opened is not a fee that is charged on a

periodic basis, and may not be treated as a participation fee.

2. *Participation fees—exclusions.* Minimum monthly charges, charges for non-use of a credit card, and other charges based on either account activity or the amount of credit available under the plan are not excluded from the finance charge by § 226.4(c)(4). Thus, for example, a fee that is charged and then refunded to the consumer based on the extent to which the consumer uses the credit available would be a finance charge. (See the commentary to § 226.4(b)(2).)

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Subpart B—Open-End Credit

Section 226.5—General Disclosure Requirements

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5(b) Time of Disclosures—5(b)(1) Initial Disclosures

1. *Disclosure before the first transaction.* The rule that the initial disclosure statement must be furnished "before the first transaction" requires delivery of the initial disclosure statement before the consumer becomes obligated on the plan. For example, the initial disclosures must be given before the consumer makes the first purchase, receives the first advance, or pays any fees or charges under the plan other than an application fee or refundable membership fee (see below). * * *

* * * * *

Section 226.6—Initial Disclosure Statement

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6(b) Other Charges

1. *General; examples of other charges.* Under § 226.6(b), significant charges related to the plan (that are not finance charges) must also be disclosed. For example: * * *

• Charges imposed in connection with real estate transactions such as title, appraisal, and credit report fees (See § 226.4(c)(7)) * * *

2. *Exclusions.* The following are examples of charges that are not "other charges": * * *

• Taxes and filing or notary fees excluded from the finance charge under § 226.4(e).

6(c) Security Interests

* * * * *

2. *Identification of property.* Identification of the collateral by type is satisfied by stating, for example, "motor vehicle" or "household appliances." (Creditors should be aware, however, that the federal credit practices rules, as well as some state laws, prohibit certain security interests in household goods.) The creditor may, at its option, provide a more specific identification (for example, a model and serial number).

* * * * *

4. *Additional collateral.* * * * (See comment 6(c)–2.)

* * * * *

Section 226.7—Periodic Statement

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7(f) Amount of Finance Charge

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8. *Start-up fees.* Points, loan fees, and similar finance charges relating to the opening of the account that are paid prior to the issuance of the first periodic statement need not be disclosed on the periodic statement. If, however, these charges are financed as part of the plan, including charges that are paid out of the first advance, the charges must be disclosed as part of the finance charge on the first periodic statement. However, they need not be factored into the annual percentage rate. (See footnote 33 in the regulation.)

* * * * *

7(h) Other Charges

1. *Identification.* In identifying any "other charges" actually imposed during the billing cycle, the type is adequately described as "late charge" or "membership fee," for example. Similarly, "closing costs" or "settlement costs," for example, may be used to describe charges imposed in connection with real estate transactions that are excluded from the finance charge under § 226.4(c)(7), if the same term (such as "closing costs") was used in the initial disclosures and if the creditor chose to itemize and individually disclose the costs included in that term. (See comment 6(b)–1 for examples of "other charges.")

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Section 226.12—Special Credit Card Provisions

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12(d) Offsets by Card Issuer Prohibited

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Paragraph 12(d)(2)

1. *Security interest—limitations.* In order to qualify for the exception stated in § 226.12(d)(2), a security interest must be affirmatively agreed to by the consumer and must be disclosed in the issuer's initial disclosures under § 226.6. The security interest must not be the functional equivalent of a right of offset; as a result, routinely including in agreements contract language indicating that consumers are giving a security interest in any deposit accounts maintained with the issuer does not result in a security interest that falls within the exception in § 226.12(d)(2). For a security interest to qualify for the exception under § 226.12(d)(2) the following conditions must be met:

• The consumer must be aware that granting a security interest is a condition for the credit card account (or for more favorable account terms) and must specifically intend to grant a security interest in a deposit account. Indicia of the consumer's awareness and intent could include, for example:

—Separate signature or initials on the agreement indicating that a security interest is being given

—Placement of the security agreement on a separate page, or otherwise separating the security interest provisions from other contract and disclosure provisions

—Reference to a specific amount of deposited funds or to a specific deposit account number

• The security interest must be obtainable and enforceable by creditors generally. If other creditors could not obtain a security interest in the consumer's deposit accounts to the same extent as the card issuer, the security interest is prohibited by § 226.12(d)(2).

* * * * *

Section 226.15—Right of Rescission

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15(c) Delay of Creditor's Performance

1. *General rule.* Until the rescission period has expired and the creditor is reasonably satisfied that the consumer has not rescinded, the creditor must not, either directly or through a third party:

• Disburse advances to the consumer.

• Begin performing services for the consumer.

• Deliver materials to the consumer.

A creditor may, however, continue to allow transactions under an existing open-end credit plan during a rescission period that results solely from the addition of a security interest in the consumer's principal dwelling. (See comment 15(c)–3 for other actions that may be taken during the delay period.)

* * * * *

3. *Actions during the delay period.* Section 226.15(c) does not prevent the creditor from taking other steps during the delay, short of beginning actual performance. Unless otherwise prohibited, such as by state law, the creditor may, for example:

• Prepare the cash advance check.

• Perfect the security interest.

• Accrue finance charges during the delay period.

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Subpart C—Closed-End Credit

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Section 226.18—Content of Disclosures

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18(g) Payment Schedule

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Paragraph 18(g)(2)

1. *Abbreviated disclosure.* The creditor may disclose an abbreviated payment schedule when the amount of each regularly scheduled payment (other than the first or last payment) includes an equal amount to be applied on principal and a finance charge computed by application of a rate to the decreasing unpaid balance. This option is also available when mortgage-guarantee insurance premiums, paid either monthly or annually, cause variations in the amount of the scheduled payments, reflecting the continual decrease or increase in the premium due. In addition, in transactions where payments vary because interest and principal are paid at different intervals, the two series of payments may be disclosed separately and the abbreviated payment schedule may be used for the interest payments. For example, in transactions with fixed quarterly principal payments and monthly interest payments based on the outstanding principal balance, the amount of

the interest payments will change quarterly as principal declines. In such cases the creditor may treat the interest and principal payments as two separate series of payments, separately disclosing the number, amount, and due dates of principal payments, and, using the abbreviated payment schedule, the number, amount, and due dates of interest payments. This option may be used when interest and principal are scheduled to be paid on the same date of the month as well as on different dates of the month. The creditor using this alternative must disclose the dollar amount of the highest and lowest payments and make reference to the variation in payments.

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18(m) Security Interest

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2. *Nonpurchase money transactions.* In nonpurchase money transactions, the property subject to the security interest must be identified by item or type. This disclosure is satisfied by a general disclosure of the category of property subject to the security interest, such as "motor vehicles," "securities," "certain household items," or "household goods." (Creditors should be aware, however, that the federal credit practices rules, as well as some state laws, prohibit certain security interests in household goods.) At the creditor's option, however, a more precise identification of the property or goods may be provided.

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Section 226.20—Subsequent Disclosure Requirements 20(a) Refinancings

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Paragraph 20(a)(2)

1. *Annual percentage rate reduction.* A reduction in the annual percentage rate with a corresponding change in the payment schedule is not a refinancing. If the annual percentage rate is subsequently increased (even though it remains below its original level) and the increase is effected in such a way that the old obligation is satisfied and replaced, new disclosures must then be made.

2. *Corresponding change.* A corresponding change in the payment schedule to implement a lower annual percentage rate would be a shortening of the maturity, or a reduction in the payment amount or the number of payments of an obligation. The exception in § 226.20(a)(2) does not apply if the maturity is lengthened, or if the payment amount or number of payments is increased beyond that remaining on the existing transaction.

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Section 226.23—Right of Rescission

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23(a) Consumer's Right to Rescind

Paragraph 23(a)(1)

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5. *Addition of a security interest.* Under footnote 47, the addition of a security interest in a consumer's principal dwelling to an existing obligation is rescindable even if the existing obligation is not satisfied and replaced by a new obligation, and even if the existing obligation was previously exempt (because it was credit over $25,000 not secured by real property or a consumer's principal dwelling). The right of rescission applies only to the added security interest, however, and not to the original obligation. In those situations, only the § 226.23(b) notice need be delivered, not new material disclosures; the rescission period will begin to run from the delivery of the notice.

* * * * *

23(c) Delay of Creditor's Performance

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3. *Actions during the delay period.* Section 226.23(c) does not prevent the creditor from taking other steps during the delay, short of beginning actual performance. Unless otherwise prohibited, such as by state law, the creditor may, for example:

- Prepare the loan check.
- Perfect the security interest.
- Prepare to discount or assign the contract to a third party.
- Accrue finance charges during the delay period.

* * * * *

23(f) Exempt Transactions

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4. *New advances.* The exemption in § 226.23(f)(2) applies only to refinancings (including consolidations) by the original creditor. If the refinancing involves a new advance of money, the amount of the new advance is rescindable. In determining whether there is a new advance, a creditor may rely on the amount financed, refinancing costs, and other figures stated in the latest Truth in Lending disclosures provided to the consumer and is not required to use, for example, more precise information that may only become available when the loan is closed. For purposes of the right of rescission, a new advance does not include amounts attributed solely to the costs of the refinancing. These amounts would include § 226.4(c)(7) charges (such as attorneys' fees and title examination and insurance fees, if bona fide and reasonable in amount), as well as insurance premiums and other charges that are not finance charges. (Finance charges on the new transaction—points, for example—would not be considered in determining whether there is a new advance of money in a refinancing since finance charges are not part of the amount financed.) To illustrate, if the sum of the outstanding principal balance plus the earned unpaid finance charge is $50,000 and the new amount financed is $51,000, then the refinancing would be exempt if the extra $1,000 is attributed solely to costs financed in connection with the refinancing that are not finance charges. Of course, if new advances of money are made (for example, to pay for home improvements) and the consumer exercises the right of rescission, the consumer must be placed in the same position as he or she was in prior to entering into the new credit transaction. Thus, all amounts of money (which would include all the costs of the refinancing) already paid by the consumer to the creditor or to a third party as part of the refinancing would have to be refunded to the consumer. (See the commentary to § 226.23(d)(2) for a discussion of refunds to consumers.) A model rescission notice applicable to transactions involving new advances appears in Appendix H.

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Appendix D—Multiple-Advance Construction Loans

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5. *Interest reserves.* In a multiple-advance construction loan, a creditor may establish an "interest reserve" to ensure that interest is paid as it accrues by designating a portion of the loan to be used for paying the interest that accrues on the loan. An interest reserve is not treated as a prepaid finance charge, whether the interest reserve is the same as or different from the estimated interest figure calculated under Appendix D.

- If a creditor permits a consumer to make interest payments as they become due, the interest reserve should be disregarded in the disclosures and calculations under Appendix D.
- If a creditor requires the establishment of an interest reserve and automatically deducts interest payments from the reserve amount rather than allow the consumer to make interest payments as they become due, the fact that interest will accrue on those interest payments as well as the other loan proceeds must be reflected in the calculations and disclosures. To reflect the effects of such compounding, a creditor should first calculate interest on the commitment amount (exclusive of the interest reserve) and then add the figure obtained by assuming that one-half of that interest is outstanding at the contract interest rate for the entire construction period. For example, using the example shown under paragraph A, part I of Appendix D, the estimated interest would be $1,117.68 ($1083.75 plus an additional $23.93 calculated by assuming half of $1093.75 is outstanding at the contract interest rate for the entire construction period), and the estimated annual percentage rate would be 21.18%.

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Board of Governors of the Federal Reserve System, March 31, 1987.

William W. Wiles,

Secretary of the Board.

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