FEDERAL RESERVE BANK
OF DALLAS

WILLIAM H. WALLACE
FIRST VICE PRESIDENT
AND CHIEF OPERATING OFFICER

DALLAS, TEXAS 75222

June 19, 1987

Circular 87-42

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

SUBJECT

Slip sheets with amendments to the Official Staff Commentaries on Regulation B (Equal Credit Opportunity), Regulation E (Electronic Fund Transfers), and Regulation Z (Truth in Lending)

DETAILS

The Board of Governors of the Federal Reserve System has published amendments in slip-sheet form to the Official Staff Commentaries on Regulations B, E, and Z effective April 1987. The new slip sheet for Regulation Z should be inserted in Volume 2 of your Regulations Binders.

If you would like copies of Regulations B and E slip sheets, please contact the Public Affairs Department at (214) 651-6289.

ENCLOSURES

The slip sheet to the Official Staff Commentary on Regulation Z is enclosed.

MORE INFORMATION

For more information, please contact 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

Board of Governors of the Federal Reserve System

Amendments to the Official Staff Commentary on Regulation B
April 1987*

The following comments were added or amended effective April 1, 1987.

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 coporation) but also to the characteristics of individuals with whom an applicant is affiliated or with whom the applicant associates. * * *

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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 section 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

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 section 202.9(c).

* The complete commentary, as amended effective April 1, 1987, consists of—

- the Regulation B commentary pamphlet dated January 1986 (see inside cover) and
- this slip sheet.

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

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SECTION 202.13—Information for Monitoring Purposes

13(a) Information to Be Requested

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5. *Transactions not covered.* The information collection requirements of section 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 section 202.13(a).

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

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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 "Information for Government Monitoring Purposes." Creditors that are governed by section 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 section 202.13(a) to ensure that they do not collect the information. Creditors that are subject to more extensive collection requirements by a substitute monitoring program under section 202.13(d) may use the form as issued, in compliance with that 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 "Information for Government Monitoring Purposes." Creditors that are governed by section 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 section 202.13(a) to ensure that they do not collect the information. Creditors that are subject to more extensive collection requirements by a substitute monitoring program under section 202.13(d) may use the form as issued, in compliance with that substitute program.

Board of Governors of the Federal Reserve System

Amendments to the Official Staff Commentary on Regulation Z Truth in Lending

April 1987*

The following comments were amended effective April 1, 1985. These amendments were included in the previous slip sheet, dated August 1986.

SUBPART A—GENERAL

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SECTION 226.2—Definitions and Rules of Construction

2(a) Definitions

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2(a)(15) "Credit Card"

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2. *Examples.* Examples of credit cards include: * * *

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

- A check-guarantee or debit card with no credit feature or agreement, even if the creditor occasionally honors an inadvertent overdraft.
- Any card, key, plate, or other device that is used in order to obtain petroleum products for business purposes from a wholesale distribution facility or to gain access to that facility, and that is required to be used without regard to payment terms.

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2(a)(17) "Creditor"

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Paragraph 2(a)(17)(i)

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

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

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

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SECTION 226.4—Finance Charge

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4(a) Definition

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* The complete Regulation Z commentary, as amended effective April 1, 1987, consists of—

- the commentary pamphlet dated November 1984 (see inside cover) and
- this slip sheet.

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

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SUBPART B—OPEN-END CREDIT

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SECTION 226.7—Periodic Statement

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7(h) Other Charges

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

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SECTION 226.9—Subsequent Disclosure Requirements

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9(d) Finance Charge Imposed at Time of Transaction

1. *Disclosure prior to imposition.* A person imposing a finance charge at the time of honoring a consumer's credit card must disclose the amount of the charge, or an explanation of how the charge will be determined, prior to its imposition. This must be disclosed before the consumer becomes obligated for property or services that may be paid for by use of a credit card. For example, disclosure must be given before the consumer has dinner at a restaurant, stays overnight at a hotel, or makes a deposit guaranteeing the purchase of property or services.

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SECTION 226.12—Special Credit Card Provisions

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12(a) Issuance of Credit Cards

Paragraph 12(a)(1)

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

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SECTION 226.15—Right of Rescission

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15(a) Consumer's Right to Rescind

Paragraph 15(a)(1)

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2. *Exceptions.* Although the consumer generally has the right to rescind with each transaction on the account, section 125(e) of the act provides an exception: the creditor need not provide the right to rescind at the time of each credit extension made under an open-end credit plan secured by the consumer's principal dwelling to the extent that the credit extended is in accordance with a previously established credit limit for the plan. This limited rescission option is available whether or not the plan existed prior to the effective date of the act.

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References

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

* * * * *

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

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SUBPART C—CLOSED-END CREDIT

SECTION 226.17—General Disclosure Requirements

17(a) Form of Disclosures

Paragraph 17 (a)(1)

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

- A statement that a due-on-sale clause or other conditions on assumption are contained in the loan document. For example, the disclosure given under section 226.18(q) may state, "Someone buying your home may, subject to conditions in the due-on-sale clause contained in the loan document, assume the remainder of the mortgage on the original terms."

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17(b) Time of Disclosures

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

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SECTION 226.18—Content of Disclosures

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18(f) Variable Rate

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5. *Other variable-rate regulations.* Transactions in which the creditor is required to comply with and has complied with variable-rate regulations of other federal agencies are exempt from the requirements of section 226.18(f), by virtue of footnote 43. Those variable-rate regulations include the adjustable mortgage loan instrument regulation issued by the Federal Home Loan Bank Board (12 CFR 545.33), the adjustable-rate mortgage regulation issued by the Comptroller of the Currency (12 CFR 29) and the adjustable-rate mortgage regulations issued by the Department of Housing and Urban Development (24 CFR 203 and 24 CFR 234). * * *

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8. *Discounted variable-rate transactions.* In some variable-rate transactions, creditors may set an initial interest rate that is not determined by the index or formula used to make

later interest rate adjustments. Typically, this initial rate charged to consumers is lower than the rate would be if it were calculated using the index or formula. However, in some cases the initial rate may be higher. In a discounted transaction, for example, a creditor may calculate interest rates according to a formula using the six-month Treasury bill rate plus a 2 percent margin. If the Treasury bill rate at consummation is 10 percent, the creditor may forgo the 2 percent spread and charge only 10 percent for a limited time, instead of setting an initial rate of 12 percent.

- When creditors use an initial interest rate that is not calculated using the index or formula for later rate adjustments, the disclosures should reflect a composite annual percentage rate based on the initial rate for as long as it is charged and, for the remainder of the term, the rate that would have been applied using the index or formula at the time of consummation. The rate at consummation need not be used if a contract provides for a delay in the implementation of changes in an index value. For example, if the contract specifies that rate changes are based on the index value in effect 45 days before the change date, creditors may use the index value in effect not more than 45 days before consummation in calculating a composite annual percentage rate.

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- Examples of discounted variable-rate transactions include:
  - —A 30-year loan for $100,000 * * *
  - —Same loan as above, except with a 2 percent rate cap * * *
  - —Same loan as above, except with a 7½ percent cap on payment adjustments. The disclosures should reflect a composite annual percentage rate of 11.64 percent, based on 9 percent for one year and 12 percent for 29 years. Because of the payment cap, five levels of payments should be reflected. The payment schedule should show 12 payments of $804.62, 12 payments of $864.97, 12 payments of $929.86, 12 payments of $999.60, and 312 payments of $1,070.03. The finance charge should be $277,037.96, and the total of payments $377,037.96.

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

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18(k) Prepayment

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

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18(q) Assumption Policy

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

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

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SECTION 226.23—Right of Rescission

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23(f) Exempt Transactions

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

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The following comments were added or amended effective April 1, 1986. These amendments were included in the previous slip sheet, dated August 1986.

SUBPART A—GENERAL

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SECTION 226.4—Finance Charge

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4(b) Examples of Finance Charges

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Paragraph 4(b)(5)

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2. *Residual-value insurance.* Where a creditor requires a consumer to maintain residual-value insurance or where the creditor is a beneficiary of a residual-value insurance policy written in connection with an extension of credit (as is the case in some forms of automobile balloon-payment financing, for example), the premiums for the insurance must be included in the finance charge for the period that the insurance is to be maintained. If a creditor pays for residual-value insurance and absorbs the payment as a cost of doing business, such costs are not considered finance charges. (See comment 4(a)-2.)

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SUBPART B—OPEN-END CREDIT

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SECTION 226.7—Periodic Statement

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7(c) Credits

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4. *Totals.* Where the creditor lists the credits made to the account during the billing cycle, the creditor need not disclose total figures for the amounts credited.

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SECTION 226.8—Identification of Transactions

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5. *Same or related persons.* For purposes of identifying transactions, the term "same or related persons" refers to, for example:

- Franchised or licensed sellers of a creditor's product or service
- Sellers who assign or sell open-end sales accounts to a creditor or arrange for such credit under a plan that allows the consumer to use the credit only in transactions with that seller

A seller is not related to the creditor merely because the seller and the creditor have an agreement authorizing the seller to honor the creditor's credit card.

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8. *Transactions involving creditors and sellers with corporate connections.* In a credit card plan established for use primarily with sellers that have no corporate connection with the creditor, the creditor may describe all transactions under the plan by using the rules in section 226.8(a)(3)—creditor and seller not same or related persons—including transactions involving a seller that has a corporate connection with the creditor. In other credit card plans, the creditor may describe transactions involving a seller that has a corporate connection with the creditor, such as subsidiary-parent, using the rules in section 226.8(a)(3) where it is unlikely that the consumer would know of the corporate connection between the creditor and the seller—for example, where the names of the creditor and the seller are not similar, and the periodic statement is issued in the name of the creditor only.

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SECTION 226.16—Advertising

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16(b) Advertisement of Terms That Require Additional Disclosures

1. *Terms requiring additional disclosures.* In section 226.16(b) the phrase "the terms required to be disclosed under section 226.6" refers to the terms in section 226.6(a) and 226.6(b).

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Comment 16(b)-1 is redesignated comment 16(b)-2.

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3. *Implicit terms.* Section 226.16(b) applies even if the triggering term is not stated explicitly, but may be readily determined from the advertisement.

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Comments 16(b)-3 through 16(b)-7 are redesignated comments 16(b)-4 through 16(b)-8.

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SUBPART C—CLOSED-END CREDIT

SECTION 226.17—General Disclosure Requirements

17(a) Form of Disclosures

Paragraph 17(a)(1)

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4. *Content of segregated disclosures.* * * * If a creditor chooses to include the security-interest charges required to be itemized under sections 226.4(e) and 226.18(o) in the amount-financed itemization, it need not list these charges elsewhere.

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

- If a state or federal law prohibits prepayment penalties and excludes the charging of interest after prepayment from coverage as a penalty, a statement that the borrower may have to pay interest for some period after prepayment in full. The disclosure given under section 226.18(k) may state, for example, "If you prepay your loan on other than the regular installment date, you may be assessed interest charges until the end of the month."

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7. *Balloon-payment financing with leasing characteristics.* In certain credit sale or loan transactions, a consumer may reduce the dollar amount of the payments to be made during the course of the transaction by agreeing to make, at the end of the loan term, a large final payment based on the expected residual value of the property. The consumer may have a number of options with respect to the final payment, including, among other things, retaining the property and making the final payment, refinancing the final payment, or transferring the property to the creditor in lieu of the final payment. Such transactions may have some of the characteristics of lease transactions subject to Regulation M but are considered credit transactions where the consumer assumes the indicia of ownership, including the risks, burdens, and benefits of ownership upon consummation. These transactions are governed by the disclosure requirements of this regulation instead of Regulation M. Creditors should not include in the segregated Truth in Lending disclosures additional information. Thus, disclosures should show the large final payment in the payment schedule and should not, for example, reflect the other options available to the consumer at maturity.

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Paragraph 17(c)(2)

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3. *Simple-interest transactions.* If consumers do not make timely payments in a simple-interest transaction, some of the amounts calculated for Truth in Lending disclosures will differ from amounts that consumers will actually pay over the term of the transaction. Creditors may label disclosures as estimates in these transactions. For example, because the finance charge and total of payments may be larger than disclosed if consumers make late payments, creditors may label the finance charge and total of payments as estimates. On the other hand, creditors may choose not to label disclosures as estimates and may base all disclosures on the assumption that payments will be made on time, disregarding any possible inaccuracies resulting from consumers' payment patterns.

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SECTION 226.18—Content of Disclosures

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18(f) Variable Rate

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2. *Basis for disclosures.* * * * (See the commentary to section 226.17(c) for a discussion of buydown transactions and the commentary to section 226.19(b) for a discussion of the redisclosure of certain residential mortgage transactions with a variable-rate feature.)

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18(k) Prepayment

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Paragraph 18(k)(1)

1. *Penalty.* This applies only to those transactions in which the interest calculation takes account of all scheduled reductions in principal, as well as transactions in which interest calculations are made daily. The term "penalty" as used here encompasses only those charges that are assessed strictly because of the prepayment in full of a simple-interest obligation, as an addition to all other amounts. Items which are penalties include, for example:

- Interest charges for any period after prepayment in full is made. (See the commentary to section 226.17(a)(1) regarding disclosure of interest charges assessed for periods after prepayment in full as directly related information.)
- A minimum finance charge in a simple-interest transaction. (See the commentary to section 226.17(a)(1) regarding the disclosure of a minimum finance charge as directly related information.) Items which are not penalties include, for example:
- Loan guarantee fees
- Interim interest on a student loan

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18(m) Security Interest

1. *Purchase-money transactions.* When the collateral is the item purchased as part of, or with the proceeds of, the credit transaction,

section 226.18(m) requires only a general identification such as "the property purchased in this transaction." However, the creditor may identify the property by item or type instead of identifying it more generally with a phrase such as "the property purchased in this transaction." For example, a creditor may identify collateral as "a motor vehicle," or as "the property purchased in this transaction." Any transaction in which the credit is being used to purchase the collateral is considered a purchase-money transaction and the abbreviated property identification may be used, whether the obligation is treated as a loan or a credit sale.

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3. *Mixed collateral.* In some transactions in which the credit is used to purchase the collateral, the creditor may also take other property of the consumer as security. In those cases, a combined disclosure must be provided, consisting of an identification of the purchase-money collateral consistent with comment 18(m)-1 and a specific identification of the other collateral consistent with comment 18(m)-2.

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SECTION 226.19—Certain Residential Mortgage Transactions

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19(b) Redisclosure Required

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4. *Basis of disclosures.* In some cases, a creditor may delay redisclosure until settlement, which may be at a time later than consummation. If a creditor chooses to redisclose at settlement, disclosures may be based on the terms in effect at settlement, rather than at consummation. For example, in a variable-rate transaction, a creditor may choose to base disclosures on the terms in effect at settlement despite the general rule in the commentary to section 18(f) that variable-rate disclosures should be based on the terms in effect at consummation.

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SECTION 226.23—Right of Rescission

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23(f) Exempt Transactions

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

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SECTION 226.24—Advertising

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24(b) Advertisement of Rate of Finance Charge

1. *Annual percentage rate.* Advertised rates must be stated in terms of an "annual percentage rate," as defined in section 226.22. Even though state or local law permits the use of add-on, discount, time-price differential, or other methods of stating rates, advertisements must state them as annual percentage rates. Unlike the transactional disclosure of an annual percentage rate under section 226.18(e), the advertised annual percentage rate need not include a descriptive explanation of the term and may be expressed using the abbreviation "APR." The advertisement must state * * *

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24(c) Advertisement of Terms That Require Additional Disclosure

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Paragraph 24(c)(2)

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3. *Annual percentage rate.* The advertised annual percentage rate may be expressed using the abbreviation "APR." The advertisement must also state, if applicable, that the annual percentage rate is subject to increase after consummation.

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The following comments were added or amended effective April 1, 1987. Reliance on the comments, as amended, is optional until October 1, 1987.

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"

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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.

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SECTION 226.3—Exempt Transactions

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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 section 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 section 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 obli-

gor. (See the commentary to section 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 section 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; one-time, nonrecurring 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 section 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 section 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). * * *

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SECTION 226.6—Initial Disclosure Statement

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6(b) Other Charges

1. *General; examples of other charges.* Under section 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 section 226.4(c)(7).)
- A tax imposed on the credit transaction by a state or other governmental body, such as a documentary stamp tax on cash advances (See the commentary to section 226.4(a).) * * *

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 section 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.)

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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 section 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 section 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 section 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 section 226.12(d)(2). For a security interest to qualify for the exception under section 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 section 226.12(d)(2).

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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. *Non-purchase-money transactions.* In non-purchase-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 section 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 section 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

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23(f) Exempt Transactions

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4. *New advances.* The exemption in section 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 section 226.4(c)(7) charges (such as attorney's 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 ($1,093.75 plus an additional $23.93 calculated by assuming half of $1,093.75 is outstanding at the contract interest rate for the entire construction period), and the estimated annual percentage rate would be 21.18 percent.

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