



FEDERAL RESERVE BANK  
OF DALLAS

WILLIAM H. WALLACE  
FIRST VICE PRESIDENT  
AND CHIEF OPERATING OFFICER

January 5, 1988

DALLAS, TEXAS 75222

Circular 88-1

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

**SUBJECT**

**Request for public comment on proposed revisions 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 requested public comment on proposed revisions to the official staff commentary for three of its consumer credit protection regulations--Regulations B, E, and Z.

Comments should be addressed to Mr. William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551. Correspondence should refer to EC-1 for Regulation B, EFT-2 for Regulation E, and TIL-1 for Regulation Z and must be received by February 12, 1988.

**ATTACHMENTS**

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

**MORE INFORMATION**

Questions regarding these proposed revisions should be directed to Dean A. Pankonien of this Bank's Legal Department at (214) 651-6228. For additional copies of this circular please contact the Public Affairs Department at (214) 651-6289.

Sincerely yours,

A handwritten signature in cursive script that reads "William H. Wallace".

# FEDERAL RESERVE press release



For immediate release

December 10, 1987

The Federal Reserve Board today issued for public comment proposed revisions to the official staff commentary for three of its consumer credit protection regulations--Regulation R (Equal Credit Opportunity), Regulation E (Electronic Fund Transfers) and Regulation Z (Truth in Lending).

The proposed revisions to the staff commentary for Regulation R address issues concerning consideration of age in evaluating creditworthiness, signature requirements, record retention and collection of monitoring information.

The proposed revisions to the staff commentary for Regulation E clarify questions that have arisen as a result of the amendments adopted by the Board in August 1987. In general, the questions pertain to point-of-sale/automated clearinghouse services, such as institutions' responsibilities concerning periodic statements, card issuance and error resolution.

Proposed revisions to the Regulation Z staff commentary address disclosure questions raised by the emergence of conversion features in adjustable-rate mortgages and the imposition of fees that are considered finance charges at the time a credit card plan is renewed. Proposed commentary is also included which interprets the Board's recent rule implementing the requirement of the Competitive Equality Banking Act that adjustable-rate mortgages contain a maximum interest rate.

The Board's notices are attached.

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Attachments

**FEDERAL RESERVE SYSTEM****12 CFR Part 202****[Reg. B; EC-1]****Equal Credit Opportunity; Proposed Update to Official Staff Commentary****AGENCY:** Board of Governors of the Federal Reserve System.**ACTION:** Proposed official staff interpretation.

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**SUMMARY:** The Board is publishing for comment proposed 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 proposed revisions address issues concerning consideration of age in evaluating creditworthiness, signature requirements, record retention and collection of monitoring information.**DATE:** Comments must be received on or before February 12, 1988.**ADDRESS:** Comments should be mailed to William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, Washington, DC 20551, or delivered to the 20th Street courtyard entrance (20th Street between C Street and Constitution Avenue NW., Washington, DC) between 8:45 a.m. and 5:15 p.m. weekdays. Comments should include a reference to EC-1. Comments may be inspected in Room B-1122 between 8:45 a.m. and 5:15 p.m. weekdays.**FOR FURTHER INFORMATION CONTACT:** Kathleen S. Brueger or Leonard N. Chanin, Staff Attorneys, or Adrienne D. Hurt, Senior Attorney, Division of Consumer and Community Affairs, at (202) 452-2412 or 452-3667; for the hearing impaired *only*, contact Earnestine Hill or Dorothea Thompson, Telecommunication Device for the Deaf

at (202) 452-3544, Board of Governors of the Federal Reserve System, Washington, DC 20551.

**SUPPLEMENTARY INFORMATION:**

**(1) General**

The Equal Credit Opportunity Act (ECOA) (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 was published to interpret the regulations, along with a final rule revising Regulation B (50 FR 48018). 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. The previous update was published in April 1987 (52 FR 10732). This notice contains the proposed second update. It is expected that it will be adopted in final form in March 1988.

**(2) Proposed Revisions**

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

*Section 202.6—Rules Concerning Evaluation of Applications*

**6(b) Specific Rules Concerning Use of Information**

*Paragraph 6(b)(2).* Comment 6(b)(2)-1 would be amended to clarify that while § 202.6(b)(2)(iv) permits favoring persons age 62 and older, that paragraph does not permit favoring a larger age group (such as persons age 55 and older). To offer a program favoring a larger age group, the creditor must rely on the special purpose credit provisions of section 202.8.

Comment 6(b)(2)-3 would be amended to clarify that age or age-related information about an applicant cannot be the sole factor in determining creditworthiness or in formulating credit terms and conditions.

*Section 202.7—Rules Concerning Extensions of Credit*

**7(d) Signature of Spouse or Other Person**

*Paragraph 7(d)(5).* Comment 7(d)(5)-2 would be revised in light of *United States v. ITT Consumer Financial Corp.*, 815 F.2d 487 (9th Cir. 1987) to clarify the rules on when a creditor may require additional signatures on a credit

obligation. In the ITT case, the U.S. Court of Appeals for the Ninth Circuit held that the future earnings of a spouse are not community property. Therefore, when an applicant relies on the spouse's future earnings to establish creditworthiness, a creditor may condition the extension of credit on the nonapplicant spouse's signing the credit obligation.

Whether an applicant is relying on the future earnings of a nonapplicant spouse is for the creditor to determine. Because § 202.5(c)(2)(iv) permits a creditor routinely to request information about a nonapplicant spouse, the mere fact that the nonapplicant spouse's income is listed on an application form is insufficient to show that the applicant is relying on the spouse's income.

A third sentence would be added to comment 7(d)(5)-2 to incorporate the holding of *ITT*. Some creditors have asked whether, given the *ITT* ruling, they are required to obtain the signature of the applicant's spouse whose future earnings are relied on for an extension of credit. Creditors have also asked whether they may differentiate on the basis of marital status when future earnings are relied on—that is, whether a creditor may follow the practice of not requiring the signature of a spouse whose earnings are relied on if it is the creditor's policy to require the signature of a person not married to the applicant whose future earnings are relied on. (In the case of a spouse, the creditor would be assuming that, under community property state law, the spouse's future earnings—unlike the future earnings of a nonspouse—will become community property.) Additional language has been added to make clear that such a practice is permissible, referencing § 202.6(c)—which allows the consideration of state property laws.

*Section 202.12—Record Retention*

**12(b) Preservation of Records**

Comment 12(b)-1 would be revised to clarify the rules for record retention of documents (for example, notifications of action taken) in computerized systems.

*Section 202.13—Information for Monitoring Purposes*

**13(a) Information to Be Requested**

Comment 13(a)-5 would be revised to clarify the monitoring information rules regarding open-end lines of credit.

**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.

Certain conventions have been used to highlight the proposed revisions. New language is shown inside bold-faced arrows, while language that would be removed is set off with brackets.

**(3) Text of Proposed Revisions**

Pursuant to authority granted in section 703 of the Equal Credit Opportunity Act (15 U.S.C. 1691b), the Board proposes to amend the official staff commentary to Regulation B (12 CFR Part 202 Supp. I) as follows:

**PART 202—[AMENDED]**

1. The authority citation for Part 202 continues to read:

*Authority:* 15 U.S.C. 1691 *et seq.*

2. The proposed revisions amend the commentary (12 CFR Part 202, Supp. I) by revising comments 6(b)(2)-1, 6(b)(2)-3, 7(d)(5)-2, 12(b)-1 and 13(a)-5 and read as follows:

**Supplement I—Official Staff Commentary**

\* \* \* \* \*

*Section 202.6—Rules Concerning Evaluation of Applications*

\* \* \* \* \*

6(b) *Specific rules concerning use of information.*

\* \* \* \* \*

**Paragraph 6(b)(2)**

1. *Favoring the elderly.* Any system of evaluating credit-worthiness may favor a credit applicant who is age 62 or older. ► A credit program offering more favorable credit terms to applicants at an age lower than 62 is permissible, however, only if the program meets the special-purpose credit requirements of § 202.8. ◀

\* \* \* \* \*

3. *Consideration of age in a judgmental system.* In a judgmental system, defined in § 202.2(t), a creditor may not take age directly into account in any aspect of the credit transaction. For example, the creditor may not reject an application or terminate an account because the applicant is 60 years old. But a creditor that uses a judgmental system may relate the applicant's age to other information about the applicant that the creditor considers in evaluating creditworthiness. For example:

• A creditor may consider the applicant's occupation and length of time to retirement to ascertain whether the applicant's income (including retirement income) will support the extension of credit to its maturity.

• A creditor may consider the adequacy of any security offered when the term of the credit extension exceeds the life expectancy of the applicant and the cost of realizing on the collateral could exceed the applicant's equity. (An elderly applicant might not

qualify for a 5 percent down, 30-year mortgage loan but might qualify with a larger downpayment or a shorter loan maturity.)

• A creditor may consider the applicant's age to assess the significance of the length of the applicant's employment (a young applicant may have just entered the job market) or length of time at an address (an elderly applicant may recently have retired and moved from a long-term residence).

► As the examples above illustrate, the evaluation must be made in an individualized, case-by-case manner; and it is impermissible for a creditor, in deciding whether to extend credit or in setting the terms and conditions, to consider age-related information solely. Age-related information may be considered only in evaluating other "pertinent elements of creditworthiness" that are drawn from the particular facts and circumstances concerning the application in question. ◀

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#### Section 202.7—Rules Concerning Extensions of Credit

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##### 7(d) Signature of spouse or other person.

\* \* \* \* \*

#### Paragraph 7(d)(5)

\* \* \* \* \*

2. ► **Reliance on** ◀ **income of another person** ►—**individual credit** ◀. An applicant who requests individual credit relying on the income of another person ([such as] ► including ◀ a spouse ► in a noncommunity property state ◀) may be required to provide the signature of the other person to make the income available to pay the debt. In community property states, the signature ► of a spouse ◀ may be required if the applicant relies on the ► spouse's ◀ separate income ►. ◀ [of another person, i.e., income] ► If the applicant relies on the spouse's future earnings ◀ that as a matter of state law ► are ◀ [is] not community property [.] ►, the creditor may but need not require the spouse's signature. The option of not requiring the spouse's signature is permissible regardless of whether the creditor requires the signature of a nonspouse whose future earnings are relied on by the applicant. (See § 202.6(c) on consideration of state property laws.) ◀

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#### Section 202.12—Record Retention

\* \* \* \* \*

##### 12(b) Preservation of records.

1. **Copies.** A copy of the original record includes carbon copies, photocopies, microfilm or microfiche copies, or copies produced by any other accurate retrieval system, such as documents stored and reproduced by computer. ► A creditor who uses a computerized or mechanized system need not keep a written copy of a document (for example, an adverse action notice) if it can regenerate all pertinent information in a timely manner for examination or other purposes. ◀

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#### Section 202.13—Information for Monitoring Purposes

13(a) Information to be requested.

\* \* \* \* \*

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). ► An application for an open-end home equity line of credit is not subject to § 202.13 unless it is readily apparent to the creditor during the application process (for example, by the documentation involved) that the purpose of the line is for the purchase or refinancing of a principal dwelling. ◀

Board of Governors of the Federal Reserve System, December 9, 1987.

**William W. Wiles,**

*Secretary of the Board.*

[FR Doc. 87-28698 Filed 12-14-87; 8:45 am]

BILLING CODE 6210-01-M

#### 12 CFR Part 205

[Reg. E; EFT-2]

#### Electronic Fund Transfer; Proposed Update to Official Staff Commentary

**AGENCY:** Board of Governors of the Federal Reserve System.

**ACTION:** Proposed official staff interpretation.

**SUMMARY:** The Board is publishing for comment proposed changes 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 proposed revisions address questions that have arisen about the regulation, including amendments adopted by the Board in August 1987 dealing with POS/ACH services. The proposed revisions deal, for example, with the responsibilities of a service-providing institution concerning periodic statements, card issuance, and error resolution.

**DATE:** Comments must be received on or before February 12, 1988.

**ADDRESS:** Comments should be mailed to William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, Washington, DC 20551, or

delivered to the 20th Street courtyard entrance (between C Street and Constitution Avenue NW.), Washington, DC between 8:45 a.m. and 5:15 p.m. weekdays. Comments should include a reference to EFT-2. Comments may be inspected in Room B-1122 between 8:45 a.m. and 5:15 p.m. weekdays.

#### FOR FURTHER INFORMATION CONTACT:

Kathleen S. Brueger, Staff Attorney, or Gerald P. Hurst or John C. Wood, Senior Attorneys, Division of Consumer and Community Affairs, at (202) 452-3667 or (202) 452-2412. For the hearing-impaired only, contact Earnestine Hill or Dorothea Thompson, Telecommunications Device for the Deaf, at (202) 452-3544, Board of Governors of the Federal Reserve System, Washington, DC 20551.

#### 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. This notice contains the proposed sixth update. It is expected that the update will be adopted in final form in March 1988. The previous updates were published on April 6, 1983 (48 FR 14880), October 18, 1984 (49 FR 40794), April 3, 1985 (50 FR 13180), April 21, 1986 (51 FR 13484), and April 3, 1987 (52 FR 10734).

##### (2) Proposed Revisions

Following is a brief description of the proposed revisions to the commentary:

#### Section 205.3—Exemptions

**Question 3-6.** Question 3-6 would be revised to make clear that section 913 of the EFT Act does not require an employer to give its employees the choice of receiving their salary by check as an alternative to direct deposit. Instead, an employer may comply with section 913 by allowing each employee to choose the institution to receive the direct deposits.

*Section 205.14—Services Offered by Financial Institutions Not Holding Consumer's Account*

**Question 14-4.** Question 14-4 would be revised to make clear that if the service provider complies with the conditions set forth in the August 1987 amendments to the regulation (52 FR 30904), it need not provide a periodic statement. The question as currently written could be viewed as requiring a service-providing institution to provide a periodic statement to consumers in all cases.

**Question 14-5.** This question is a new question. It would clarify that in any POS/ACH program where the service provider does not issue debit cards that will actually be used to initiate transfers through the system, the service provider must provide periodic statements to consumers.

**Question 14-6.** This question is also new. It deals with the responsibility of a service provider with regard to error resolution. It would clarify that the service provider must reimburse the consumer for any fees or charges incurred as a result of the error.

**Question 14-7.** This question would be added to the commentary to address an issue concerning the periodic statement provided by the account-holding institution. Specifically, the question would make clear that the statement need not show, with respect to POS/ACH transactions, information other than the transaction description set forth in § 205.9(b)(1).

**List of Subjects in 12 CFR Part 205**

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

Certain conventions have been used to highlight the revisions. New language is shown inside bold-faced arrows, while language to be removed is set off with brackets.

**(3) Text of Proposed Revisions**

Pursuant to authority granted in section 904 of the Electronic Fund Transfer Act, 15 U.S.C. 1693b, the Board proposes to amend the official staff commentary to Regulation E (12 CFR Part 205, Supp. II) as follows:

**PART 205—[AMENDED]**

1. The authority citation for Part 205 continues to read:

**Authority:** Pub. L. 95-630, 92 Stat. 3730 (15 U.S.C. 1693b).

2. The proposed revisions amend the official staff commentary on Regulation E (EFT-2, Supp. II to 12 CFR Part 205) by revising questions 3-6 and 14-4 and by

adding questions 14-5, 14-6, and 14-7, and read as follows:

**Supplement II—Official Staff Interpretations**

\* \* \* \* \*

*Section 205.3—Exemptions*

\* \* \* \* \*

**Q 3-6: Compulsory use—salary payments.** Preauthorized transfers from a financial institution to a consumer's account at the same institution are exempt from the act and regulation generally but are subject to the statutory prohibition against requiring an employee (as a condition of employment) to receive payroll deposits by electronic means at a particular institution. Does this prohibition apply to a financial institution as an employer?

**A:** Yes. The prohibition applies to all employers, including financial institutions. To comply with the law, an employer could [ , for example, ] give its employees a choice of ► institutions to receive directly deposited payments, or a choice of ◀ the method of receiving payment—such as having their pay deposited at a particular institution, or receiving payment by check or cash.

As in the case of preauthorized loan payments, the compulsory-use prohibition does not require an employer to offer alternative means of payment to employees who agreed to electronic deposits at a particular financial institution before May 10, 1980. However, if an employee asks to terminate this arrangement, the employer should honor the request. (§ 205.3(d)(2), section 913)

\* \* \* \* \*

*Section 205.14—Services Offered by Financial Institutions Not Holding Consumer's Account*

\* \* \* \* \*

**Q 14-4: Periodic statement—service-providing institution.** Does the service-providing institution have to provide to the consumer a periodic statement showing transfers other than electronic fund transfers made with the service provider's access device?

**A:** No. ► And if the service provider complies with the conditions set forth in the regulation, it need not provide any periodic statement. ◀ (§ 205.14(a)(2)►(i)-(v)◀)

► **Q 14-5: Issuance of card by service-providing institution.** May a service provider provide a POS/ACH service without sending periodic statements, if it issues its own card but then allows the consumer to use another card (such as a bank-issued debit or credit card) to initiate transfers through the POS/ACH system?

**A:** No. In order to take advantage of the exception, the debit card for initiating transfers through the system must be the one issued by the service provider. Similarly, a service provider that does not issue debit cards remains subject to the requirement to send periodic statements. (§ 205.14(a)(2)(i)◀)

► **Q 14-6: Error resolution—responsibility of service-providing institution.** In a POS/ACH transaction, the consumer properly notifies the service-providing institution of an

alleged error. What is the service provider's responsibility?

**A:** The service provider must investigate and resolve the error as set forth in the regulation. If an error in fact occurred, any fees or charges imposed as a result of the error, either by the service provider or by the account-holding institution (for example, overdraft or dishonor fees) must be reimbursed to the consumer by the service provider. (§§ 205.11 and 205.14(a)(3)-(a)(6)◀)

► **Q 14-7: Content of periodic statement.** For POS/ACH transactions, is the account-holding institution required to disclose all the items specified in § 205.9(b) on its periodic statement?

**A:** No. The periodic statement need contain only the transaction descriptive information specified in § 205.9(b)(1). (§ 205.14(b)(1)◀)

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Board of Governors of the Federal Reserve System, December 9, 1987.

William W. Wiles,

Secretary of the Board.

[FR Doc. 87-28699 Filed 12-14-87; 8:45 am]

BILLING CODE 6210-01-M

**12 CFR Part 226**

[Reg. Z; TIL-1]

**Truth in Lending; Proposed Update to Official Staff Commentary**

**AGENCY:** Board of Governors of the Federal Reserve System.

**ACTION:** Proposed official staff interpretation.

**SUMMARY:** The Board is publishing for comment proposed revisions 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 proposed revisions address a variety of questions that have arisen about the regulation, and include new material and changes in existing material. The proposed changes address, for example, disclosure questions raised by the emergence of conversion features in adjustable-rate mortgages, as well as the imposition of fees that are considered finance charges at the time a credit card plan is renewed. Proposed commentary also is included which interprets the Board's recent rule implementing the requirement of the Competitive Equality Banking Act that adjustable-rate mortgages contain a maximum interest rate.

**DATE:** Comments must be received on or before February 12, 1988.

**ADDRESS:** Comments should be mailed to William W. Wiles, Secretary, Board of Governors of the Federal Reserve

System, Washington, DC 20551, or delivered to the 20th Street courtyard entrance (20th Street, between C Street and Constitution Avenue, NW., Washington, DC) between 8:45 a.m. and 5:15 p.m. weekdays. Comments should include a reference to TIL-1. Comments may be inspected in Room B-1122 between 8:45 and 5:15 p.m. weekdays.

**FOR FURTHER INFORMATION CONTACT:**

The following attorneys in the Division of Consumer and Community Affairs, at (202) 452-3667 or (202) 452-2412:

Subparts A and B—Kathleen S. Brueger, Gerald P. Hurst, John C. Wood  
Subpart C—Michael S. Bylsma, Leonard N. Chanin, Thomas J. Noto  
Subpart D—Adrienne D. Hurt, Sharon T. Bowman

For the hearing impaired only, Telecommunication 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 and is updated periodically to address significant questions that arise. There have been six general updates so far—the first in September 1982 (47 FR 41338), the second in April 1983 (48 FR 14882), the third in April 1984 (49 FR 13482), the fourth in April 1985 (50 FR 13181), the fifth in April 1986 (51 FR 11422), and the sixth in April 1987 (52 FR 10875). There was also a limited update concerning fees for the use of automated teller machines, which was adopted in October 1984 (49 FR 40560). This notice contains the proposed seventh general update. It is expected that it will be adopted in final form in March 1988 with optional compliance until the uniform effective date of October 1 for mandatory compliance.

**(2) Proposed Revisions**

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

*Subpart A—General*

*Section 226.4—Finance Charge—4(c) Charges Excluded from the Finance Charge—Paragraph 4(c)(4).* A cross-

reference would be added to comment 4(c)(4)—participation fees. The cross-reference is to the commentary to § 226.14(c), computation of the annual percentage rate on periodic statements. Comment 14(c)-7 discusses those situations when finance charges need not be included in the annual percentage rate computed for the periodic statement. Comment 14(c)-7 currently deals with fees related to the opening of the account. In this update, the Board proposes to also exclude certain account renewal fees from the computation of the annual percentage rate on periodic statements.

*Subpart B—Open-end Credit*

*Section 226.6—Initial Disclosure Statement—6(a) Finance Charge—Paragraph 6(a)(2).* Comment 6(a)(2)-7 would be revised to include a reference to new § 226.30 and the commentary to that section. Section 226.30 requires creditors to include a provision setting a maximum interest rate in their dwelling-secured credit contracts that provide for changes in the interest rate.

*Section 226.7—Periodic Statement—7(h) Other Charges.* Comment 7(h)-1 would be revised to clarify the treatment of taxes and filing or notary fees that are excluded from the finance charge under § 226.4(e). Even though the § 226.4(e) items are not required to be disclosed as "other charges" under § 226.6(b), creditors may include such charges in a disclosure of "other charges" on the initial disclosures. Similarly, these charges may be included in the amount shown as "closing costs" or "settlement costs" on the periodic statement, if the charges were itemized and disclosed as part of the closing or settlement costs on the initial disclosure statement. The revised comment clarifies this point.

*Section 226.14—Determination of Annual Percentage Rate—14(c) Annual Percentage Rate for Periodic Statements.* Comment 14(c)-7 currently discusses the exclusion of charges related to opening an account from inclusion in the annual percentage rate computation. This comment would be revised to also exclude fees that are imposed for renewal of an account, provided the fees are not imposed as a result of specific transactions or specific account activity. This proposal is based on the idea that charges related to the renewal of an account, when they are not related to specific transactions or specific activity, result in the same problems already identified in this comment with respect to fees related to the opening of an account. Including the fees, such as charges that are only imposed on customers that do not

charge a certain amount on their credit card annually, in the computation of the annual percentage rate would, in many cases, result in significant distortions of the annual percentage rate and the delivery of possibly misleading information to consumers.

*Subpart C—Closed-end Credit*

*Section 226.18—Content of Disclosures—18(b) Amount Financed—Paragraph 18(b)(3).* Comment 18(b)(3)-1, addressing the treatment of prepaid finance charges in calculations of the amount financed, would be deleted and a new comment 18(b)(3)-1 substituted in its place. The new comment clarifies and more fully explains the treatment of prepaid finance charges, which has been the source of considerable confusion. The new comment is not intended to change the existing rules under § 226.18(b), but merely to clarify when creditors have an option to treat certain fees as prepaid finance charges and what the implications of that choice are under § 226.18(b).

*18(c) Itemization of Amount Financed—Paragraph 18(c)(1)(iv).* Comment 18(c)(1)(iv)-1, addressing the itemization of prepaid finance charges, would be supplemented by a new sentence at the beginning which clarifies that only those finance charges deducted from the principal loan amount under § 226.18(b)(3) should be itemized as prepaid finance charges under § 226.18(c)(1)(iv). The revision is made in conjunction with the clarification to comment 18(b)(3)-1 and is not intended to change the substance of existing rules.

*18(f) Variable Rate.* Comment 18(f)-9 would be added to discuss the disclosure requirements under this section for variable-rate transactions containing an option permitting consumers to convert to a fixed rate. The conversion option is a variable-rate feature that must be disclosed. The comment explains how the disclosures should be given. Consistent with the revision being made to comment 18(f)(4)-1, described below, it clarifies that only one hypothetical example should be disclosed, such as an example of payment terms resulting from changes in the index.

This comment is similar to the paragraph on conversion options proposed in the fifth commentary update in December 1985. That proposal was not adopted then because it was expected to be incorporated into a uniform adjustable-rate mortgage disclosure regulation. This regulation was proposed by the Board in November, 1986. In the likely event the

uniform disclosure regulation is adopted in the near future, comment 18(f)-9 would apply only to transactions not covered by the new requirements.

*Paragraph 18(f)(2).* Comment 18(f)(2)-1 would be revised by adding a cross-reference to the requirement in new § 226.30 that a maximum interest rate limitation be included in certain variable-rate transactions.

*Paragraph 18(f)(4).* Comment 18(f)(4)-1 would be revised to clarify that section 18(f)(4) requires only one example of the effects of a rate increase on payment terms. The comment states that in transactions with more than one variable-rate feature, only one hypothetical example may be included in the segregated disclosures.

*Subpart D—Miscellaneous*

*Section 226.28—Effect on State Laws—28(a) Inconsistent Disclosure Requirements.* Comment 28(a)-13 would be added to reflect the Board's 1985 determination of the effect of the Truth in Lending Act on a provision of the consumer credit law of Arizona. On September 4, 1987, the Board also published for public comment a proposed determination of the Federal law's effect on a provision of the consumer credit law of Indiana (52 FR 33596), and will likely make a final determination on this proposal later this year. That determination is expected to be incorporated into the final commentary update.

*Section 226.30—Limitations on Rates.* On November 9, 1987, the Board published a final rule amending Regulation Z to incorporate the substance of section 1204 of the Competitive Equality Banking Act (CEBA) into the regulation (52 FR 43178; technical corrections to original notice at 52 FR 45611 (1987)). The rule requires creditors who offer dwelling-secured loans with an adjustable interest rate to include a maximum rate ceiling in their credit agreements entered into on or after December 9, 1987. The following comments would be included as part of the commentary to § 226.30.

Comments 30-1 through 30-5 would explain the scope of the rule's coverage, including examples of what types of obligations are covered and not covered. Generally stated, the rule is that any post-effective date credit obligation is subject to the interest rate ceiling requirement if it: (1) is secured by a dwelling, (2) contractually allows for interest rate increases, and (3) requires initial Truth in Lending Act (TILA) disclosures. A credit obligation subject to the TILA may also become subject to § 226.30 in two other instances: (1) If a security interest in a dwelling is added

to an obligation that allows for interest rate increases, or (2) a variable rate feature is added to a dwelling-secured credit obligation.

The scope of the substantive law requirement of section 1204 of CEBA is limited to obligations subject to the TILA and Regulation Z. Comment 30-6 generally explains that the other provisions of the regulation relating to TILA disclosures and their corresponding commentaries apply to § 226.30 where appropriate (such as definitions and exemptions), unless otherwise specified in the commentary to § 226.30. For example, for purposes of coverage, the refinancing and assumption rules of § 226.20 (a) and (b) apply. On the other hand, for purposes of increasing a maximum interest rate originally imposed under § 226.30 only the refinancing and assumption rules in proposed comments 11 and 12 to this section would apply.

Comments 30-7 through 30-9 explain the requirement to specify the interest rate ceiling in credit contracts, including how the rate may be stated and that multiple rates may be set.

Comment 30-10 would be included to explain that the maximum rate ceiling must be applicable to increases after default. This comment applies only in situations in which a post-default agreement is still considered part of the original obligation subject to Regulation Z.

Comments 30-11 and 30-12 explain when the maximum interest rate ceiling originally set on an obligation may be increased.

Comment 30-13 further explains the relief provided in footnote 50 to § 226.30.

**List of Subjects in 12 CFR Part 226**

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

Certain conventions have been used to highlight the proposed revisions. New language is shown inside bold-faced arrows, while language that would be deleted is set off with brackets.

**(3) Text of Proposed Revisions**

Pursuant to authority granted in section 105 of the Truth in Lending Act (15 U.S.C. 1604 as amended) and section 1204 of the Competitive Equality Banking Act, Pub. L. 100-86, 101 Stat. 552, the Board proposes to amend the official staff commentary to Regulation Z (12 CFR Part 226 Supp. I) as follows:

1. 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.*); sec. 1204(c), Competitive Equality Banking Act, Pub. L. 100-86, 101 Stat. 552.

2. The proposed revisions amend the commentary (TIL-1, 12 CFR Part 226 Supp. I) by revising comments 4(c)(4)-2; amending comment 6(a)(2)-7 by adding two sentences after the second sentence; revising comment 7(h)-1, 14(c)-7, 18(b)(3)-1; amending comment 18(c)(1)(iv)-1 by adding a new first sentence; adding comment 18(f)-9; revising comments 18(f)(2)-1 and 18(f)(4)-1; and adding comments 28(a)-13 and 30-1 through 30-13 to read as follows:

**Subpart A—General**

\* \* \* \* \*

*Section 226.4—Finance Charge*

\* \* \* \* \*

*4(c) Charges Excluded from the Finance Charge*

\* \* \* \* \*

*Paragraph 4(c)(4)*

\* \* \* \* \*

2. *Participation fees—exclusions.* \* \* \* (See the commentary to § 226.4(b)(2). ► Also, see comment 14(c)-7 for treatment of certain types of fees excluded in determining the annual percentage rate for the periodic statement. ◄)

\* \* \* \* \*

**Subpart B—Open-end Credit**

\* \* \* \* \*

*Section 226.6 Initial Disclosure Statement*

\* \* \* \* \*

*6(a) Finance Charge*

\* \* \* \* \*

*Paragraph 6(a)(2)*

\* \* \* \* \*

7. *Variable-rate plan—limitations on increase.* In disclosing any limitations on rate increases, limitations such as the maximum increase per year or the maximum increase over the duration of the plan must be disclosed. When there are no limitations, the creditor may, but need not, disclose that fact. ► (A maximum interest rate must be included in dwelling-secured open-end credit plans under which the interest rate may be changed. See § 226.30 and the commentary to that section.) ◄ Legal limits such as usury or rate ceilings \* \* \*

\* \* \* \* \*

*Section 226.7—Periodic Statement*

\* \* \* \* \*

*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. ► Even though the taxes and filing or notary fees excluded from the finance charge under § 226.4(e) are not required to be disclosed as "other charges" under § 226.6(b), these charges may be included in the amount shown as "closing costs" or "settlement costs" on the periodic statement, if the charges were itemized and disclosed as part of the "closing costs" or "settlement costs" on the initial disclosure statement. ◀ (See comment 6(b)-1 for examples of "other charges.")

#### Section 226.14—Determination of Annual Percentage Rate

##### 14(c) Annual Percentage Rate for Periodic Statements

7. *Charges related to opening ► or renewing ◀ account.* Footnote 33 is applicable to § 226.14(c)(2) and (c)(3). The charges involved here do not relate to a specific transaction or to ► specific ◀ activity on the account, but relate solely to the opening ► or renewing ◀ of the account. ► As a result, a fee that is charged annually to renew a credit card account if the customer has not met certain account usage criteria—and thus may not be excluded from the finance charge under § 226.4(c)(4) (see comment 4(c)(4)-2)—would not be included in the calculation of the annual percentage rate. ◀ Inclusion of these charges in the annual percentage rate calculation results in significant distortions of the annual percentage rate and delivery of a possibly misleading disclosure to consumers. The rule in footnote 33 applies even if the loan fee, points, or similar charges are billed on a subsequent periodic statement or withheld from the proceeds of the first advance on the account.

#### Subpart C—Closed-end Credit

##### Section 226.18—Content of Disclosures

##### 18(b) Amount Financed

###### Paragraph 18(b)(3)

1. *Prepaid finance charges.* ► Prepaid finance charges that are paid separately in cash or by check should be deducted under § 226.18(b)(3) in calculating the amount financed. To illustrate:

• A consumer applies for a loan of \$2,500 with a \$40 loan fee. The face amount of the note is \$2,500 and the consumer pays the loan fee separately by cash or check at closing. The principal loan amount for purposes of § 226.18(b)(1) is \$2,500 and \$40 should be deducted under § 226.18(b)(3), thereby yielding an amount financed of \$2,460.

In some instances, as when loan fees are financed by the creditor, finance charges are incorporated in the face amount of the

obligation. Creditors have the option, when the charges are not add-on or discount charges, of either including or not including the finance charges in the principal loan amount that they determine under § 226.18(b)(1). When the finance charges are included in the principal loan amount, they should be deducted as prepaid finance charges under § 226.18(b)(3).

When the finance charges are not included in the principal loan amount, they should not be deducted under § 226.18(b)(3). The following examples illustrate the application of § 226.18(b) to this type of transaction. Each example assumes a loan request of \$2,500 with a loan fee of \$40; the creditor assesses the loan fee by increasing the face amount of the note to \$2,540.

• If the creditor determines the principal loan amount under § 226.18(b)(1) to be \$2,540, it has included the loan fee in the principal loan amount and should deduct \$40 as a prepaid finance charge under § 226.18(b)(3), thereby obtaining an amount financed of \$2,500.

• If the creditor determines the principal loan amount under § 226.18(b)(1) to be \$2,500, it has not included the loan fee in the principal loan amount and should not deduct any amount under § 226.18(b)(3), thereby obtaining an amount financed of \$2,500. ◀

##### 18(c) Itemization of Amount Financed

###### Paragraph 18(c)(1)(iv)

1. *Prepaid finance charge.* ► Prepaid finance charges that are deducted under § 226.18(b)(3) must be disclosed under this section. ◀

##### 18(f) Variable Rate

► 9. *Conversion feature.* In variable-rate transactions with an option permitting consumers to convert to a fixed-rate loan, the conversion option is a variable-rate feature that should be disclosed. In making disclosures under § 226.18(f), creditors should disclose the fact that the rate may increase upon conversion and identify the index used to set the fixed rate, any limitations on the increase resulting from conversion, and the effect of an increase. Because § 226.18(f)(4) permits only one hypothetical example in the segregated disclosures (such as an example of the effect on payments resulting from changes in the index), a second hypothetical example would not be given. ◀

###### Paragraph 18(f)(2)

1. *Limitations.* This includes any maximum imposed on the amount of an increase in the rate at any time, as well as any maximum on the total increase over the life of the transaction. When there are no limitations, the creditor may, but need not, disclose that fact. Limitations do not include legal limits in the nature of usury or rate ceilings under state or federal statutes or regulations. ► (See § 226.30 for the rule requiring that a maximum

interest rate be included in certain variable-rate transactions.) ◀

##### Paragraph 18(f)(4)

1. *Hypothetical example.* The example may, at the creditor's option, appear apart from the other disclosure. The creditor may provide either a standard example that illustrates the terms and conditions of that type of credit offered by that creditor or an example that directly reflects the terms and conditions of the particular transaction. ► In transactions with more than one variable-rate feature, only one hypothetical example should be provided in the segregated disclosures. ◀

#### Subpart D—Miscellaneous

##### Section 226.28—Effect on State Laws

###### 28(a) Inconsistent Disclosure Requirements

► 13. *Preemption determination—Arizona.* Effective October 1, 1986, the Board has determined that the following provision in the state law of Arizona is preempted by the federal law:

• Section 6-621A.2—Use of the term "the total sum of \$ \_\_\_\_" in certain notices provided to borrowers. This term describes the same item that is disclosed under federal law as the "total of payments." Since the state law requires the use of a different term than federal law to describe the same item, the state-required term is preempted. The notice itself is not preempted. ►

###### ► Section 226.30—Limitation on Rates

1. *Scope of coverage.* The requirement of this section applies to dwelling-secured consumer credit obligations—both open-end and closed-end credit—entered into on or after December 9, 1987 that are subject to the Truth in Lending Act and Regulation Z, in which the annual percentage rate may increase after consummation (or during the term of the plan, in the case of open-end credit) as a result of an increase in the interest rate component of the finance charge—whether those increases are tied to an index or formula or are within a creditor's discretion. The section applies to credit sales as well as loans. Examples of obligations subject to this section include:

• Dwelling-secured credit obligations that require variable rate disclosures under the regulation because the interest rate may increase during the term of the obligation. (See the commentaries to sections §§ 226.6(a)(2)n.12 and 226.18(f).)

• Dwelling-secured open-end credit plans that do not require variable rate disclosures under the regulation but where the creditor reserves the contractual right to increase the interest rate—periodic rate and corresponding annual percentage rate—during the term of the plan.

In contrast, the following obligations are not subject to this section, because there is

no contractual right to increase the interest rate during the term of the obligation.

- "Shared-equity" or "shared-appreciation" mortgages as described in comment 18(f)-6.

- Fixed-rate closed-end balloon payment mortgage loans and fixed-rate open-end plans with a stated term that the creditor may, but does not have a contractual legal obligation to, renew at maturity.

2. *Refinanced obligations.* On or after December 9, 1987, when a credit obligation is refinanced, as defined in § 226.20(a) the new obligation is subject to the requirement of this section if it is dwelling-secured and allows for increases in the interest rate.

3. *Assumptions.* On or after December 9, 1987, when a credit obligation is assumed, as defined in § 226.20(b), the obligation becomes subject to the requirement of this section if it is dwelling-secured and allows for increases in the interest rate.

4. *Modifications of obligations.* Modifications of agreements entered into prior to December 9, 1987 are generally not covered by this section. For example, increasing the credit limit on a dwelling-secured, open-end plan with a variable interest rate entered into before the effective date of the rule does not make the obligation subject to the requirement of this section. If, however, a security interest in a dwelling is added on or after December 9, 1987 to a pre-existing credit obligation that allows for interest rate changes, the obligation becomes subject to the requirement of this section. Similarly, if on or after December 9, 1987, a variable interest rate feature is added to a pre-existing dwelling-secured credit obligation, the obligation becomes subject to the requirement of this section.

5. *Land trusts.* In some states, a land trust is used in residential real estate transactions. (See discussion in comment 3(a)-8.) If a consumer-purpose loan that allows for interest rate changes is secured by an assignment of a beneficial interest in a land trust that holds title to a consumer's dwelling, that loan is subject to the requirement of this section.

6. *Relationship to other sections.* Unless otherwise provided for in the commentary to this section, other provisions of the regulations such as definitions, exemptions, rules and interpretations also apply to this section where appropriate. To illustrate:

- An adjustable interest rate business-purpose loan is not subject to this section even if the loan is secured by a dwelling because such credit extensions are not subject to the regulation. (See generally § 226.3(a))

- Creditors subject to the requirement of this section are only those that fall within the definition of a creditor in § 226.2(a)(17).

7. *Consumer credit contract.* Creditors are required to specify a lifetime maximum interest rate ceiling in their credit contracts—the instrument that creates personal liability and generally contains the terms and conditions of the agreement (for example, a promissory note or home-equity line of credit agreement). This requirement is subject to the general "clear and conspicuous" standard of the regulation, but no specific rule is prescribed regarding the format of the

requirement. In some states, the signing of a commitment letter may create a binding obligation, for example, constituting "consummation" as defined in § 226.2(a)(13). The maximum interest rate ceiling must be included in the credit contract, but a creditor has the option of including the rate ceiling in the commitment instrument as well.

8. *Manner of stating the rate ceiling.* The maximum interest rate must be stated either as a specified amount or in any other manner that would allow the consumer to easily ascertain, at the time of entering into the obligation, what the lifetime interest rate ceiling will be over the term of the obligation. For example, the following statements would be sufficiently specific:

- The maximum interest rate will not exceed X%.
- The interest rate will never be higher than X percentage points above the initial rate of Y%.
- The interest rate will not exceed X%, or X percentage points above [a rate to be determined at some future point in time], whichever is less.
- The maximum interest rate will not exceed X% or the state usury ceiling, whichever is less.

The following statements would not comply with this section:

- The interest rate will never be higher than X percentage points over the going market rate.
- The interest rate will never be higher than X percentage points above [a rate to be determined at some future point in time].
- The interest rate will not exceed the state usury ceiling which is currently X%.

A creditor may state the maximum rate in terms of a maximum annual percentage rate that may be imposed. Under an open-end credit plan, this would be the corresponding annual percentage rate. (See generally § 226.8(a)(2).)

9. *Multiple interest rate ceilings.* Creditors are not prohibited from setting multiple interest rate ceilings. For example, on loans with multiple variable rate features, creditors may establish a maximum interest rate for each feature. To illustrate, in a variable rate loan that has an option to convert to a fixed rate, a creditor may set one maximum interest rate for the initially imposed index-based variable rate feature and another for the conversion option. Of course, a creditor may establish one maximum interest rate applicable to all features.

10. *Interest rate charged after default.* State law may allow an interest rate after default higher than the contract rate in effect at the time of default; however, the interest rate after default must be subject to a maximum interest rate set forth in a credit obligation that is otherwise subject to the requirement of this section. This rule applies only in situations in which a post-default agreement is still considered part of the original obligation.

11. *Increasing the interest rate ceiling—general rule.* Generally, a creditor may not increase the maximum interest rate originally set on a credit obligation unless the consumer and the creditor enter into a new obligation. Therefore, under an open-end plan subject to this section, a creditor may not increase the

maximum rate ceiling imposed merely because there is an increase in the credit limit. If an open-end plan is closed and another opened, a new rate ceiling may be imposed. Furthermore, where an open-end plan subject to this section has a fixed maturity and a creditor renews the plan at maturity, or converts the plan to closed-end credit, without having a legal obligation to renew or convert, a new maximum interest rate may be set at that time. If under the initial agreement, the creditor is obligated to renew or convert the plan, the maximum interest rate originally imposed cannot be increased upon renewal or conversion. For a closed-end credit transaction, a new interest rate ceiling may be set only if the transaction is satisfied and replaced by a new obligation that is dwelling-secured and allows for increases in the interest rate. (The exceptions to the general on refinancings in § 226.20(a)(1)-(5) do not apply with respect to increases in the rate ceiling.)

12. *Increasing the interest rate ceiling—assumption of an obligation.* If an obligation subject to this section is assumed by a new obligor and the original is released from liability, the maximum interest rate set on the obligation may be increased as part of the assumption agreement. (This rule applies whether or not the transaction constitutes an assumption as defined in § 226.20(b).)

13. *Transition rules.* Under footnote 50, if creditors properly include the maximum rate ceiling in their credit contracts, creditors need not revise their Truth in Lending disclosure statement forms to add the disclosures about limitations on an increase required by §§ 226.6(a)(2) n.12 and 226.18(f)(2) until October 1, 1988. After that date, creditors are required to state the limitations on an increase as part of their Truth in Lending disclosures as well as stating the maximum interest rate ceiling in their credit contracts.

## References

*Statute:* Competitive Equality Banking Act of 1987, Pub. L. No. 100-86, 101 Stat. 552.

*Other sections:* Sections 226.6(a)(2) n.12 and 226.18(f)(2).

*Previous regulation:* None.

*1987 changes:* This section implements section 1204 of the Competitive Equality Banking Act of 1987, Pub. L. No. 100-86, 101 Stat. 552 which provides that, effective December 9, 1987, adjustable rate mortgages must include a limitation on the interest rate that may apply during the term of the mortgage loan. An adjustable rate mortgage loan is defined in section 1204 as "any loan secured by a lien on a one-to-four family dwelling unit, including a condominium unit, cooperative housing unit, or mobile home, where the loan is made pursuant to an agreement under which the creditor may, from time to time adjust the rate of interest." The rule in this section incorporates section 1204 into Regulation Z and limits the scope of section 1204 to dwelling-secured consumer credit subject to the Truth in Lending Act, in which a creditor has the contractual right to increase the interest rate during the term of the credit obligation. ◀

Board of Governors of the Federal Reserve  
System, December 9, 1987.

**William W. Wiles,**

*Secretary of the Board.*

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