FEDERAL RESERVE BANK
OF DALLAS

ROBERT D. McTEER, JR.
PRESIDENT
AND CHIEF EXECUTIVE OFFICER

August 13, 1993

DALLAS, TEXAS 75222

Notice 93-87

TO: The Chief Executive Officer of each financial institution in the Eleventh Federal Reserve District

SUBJECT

Amendments to the Official Staff Commentary on 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 Commentary on Regulation Z, effective July 1993. The new slip sheet should be inserted in your Regulations binder.

ENCLOSURE

The new slip sheet is enclosed.

MORE INFORMATION

For more information, please contact Eugene Coy at (214) 922-6201. For additional copies of this Bank's notice and the slip sheet, please contact the Public Affairs Department at (214) 922-5254.

Sincerely yours,

Robert D. McTeer, Jr.

For additional copies, bankers and others are encouraged to use one of the following toll-free numbers in contacting the Federal Reserve Bank of Dallas: Dallas Office (800) 333-4460; El Paso Branch *Intrastate* (800) 592-1631, *Interstate* (800) 351-1012; Houston Branch *Intrastate* (800) 392-4162, *Interstate* (800) 221-0363; San Antonio Branch *Intrastate* (800) 292-5810.

Board of Governors of the Federal Reserve System

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

July 1993*

The following amendments are effective April 1, 1991, or, at the creditor's option, October 1, 1991.

1. *Comments to 4(a) are amended by adding a second bulleted paragraph after the first bulleted paragraph in comment 4(a)-2, and by adding new comment 4(a)-6 to read as follows:*

4(a) Definition

* * * * *

2. *Costs of doing business.* * * *

- A tax imposed by a state or other governmental body on a creditor is not a finance charge if the creditor absorbs the tax as a cost of doing business and does not separately impose the tax on the consumer. (For additional discussion of the treatment of taxes, see other commentary to section 226.4(a).)

* * * * *

6. *Taxes.* A tax imposed by a state or other governmental body solely on a creditor is a finance charge if the creditor separately imposes the charge on the consumer. In contrast, a tax is not a finance charge (even if it is collected by the creditor) if applicable law imposes the tax:

- Solely on the consumer;
- On the creditor and the consumer jointly; or
- On the credit transaction, without indicating which party is liable for the tax.

A tax also is not a finance charge if applicable law imposes the tax solely on the creditor, but directs or authorizes the creditor to pass the tax on to the consumer. (For purposes of this section, if applicable law is silent as to such a pass-on, the law does not authorize the pass-on.) In addition, a tax is not a finance charge under this comment if it is excluded from the finance charge by any other provision of the regulation or commentary (for example, if it is imposed equally in cash and credit transactions).

2. *Comment 5a(b)(2)-2 is revised to read as follows:*

5a(b)(2) Fees for Issuance or Availability

* * * * *

2. *Enhancements.* Fees for optional services in addition to basic membership privileges in a credit or charge card account (for example, travel insurance or card-registration services) should not be disclosed in the table if the basic account may be opened without paying such fees.

3. *Comments to 5a(c) are amended by revising the second sentence in comment 5a(c)-1, and by revising the third sentence and adding a sentence and parenthetical text after the third sentence in comment 5a(c)-2 to read as follows:*

5a(c) Direct-Mail Applications and Solicitations

1. *Accuracy.* * * * (An accurate variable annual percentage rate is one in effect within 60 days before mailing.)

* The Regulation Z commentary, as amended effective April 1, 1993, consists of—

- the commentary pamphlet dated June 1990 (see inside cover) and
- this slip sheet.

Items 24 through 31 are new. Items 1 through 23 were included in the April 1991 slip sheet.

2. *Mailed publications.* * * * In addition, a card issuer may use a single application form as a "take-one" (in racks in public locations, for example) and for direct mailings, if the card issuer complies with the requirements of section 226.5a(c) · even when the form is used as a "take-one"—that is, by presenting the required section 226.5a disclosures in a tabular format. When used in a direct mailing, the credit-term disclosures must be accurate as of the mailing date whether or not the section 226.5a(e)(1)(ii) and (iii) disclosures are included; when used in a take-one, the disclosures must be accurate for as long as the take-one forms remain available to the public if the section 226.5a(e)(1)(ii) and (iii) disclosures are omitted. (If those disclosures are included in the take-one, the credit term disclosures need only be accurate as of the printing date.)

4. *Comment 5a(e)(1)-2 is revised to read as follows:*

5a(e)(1) Disclosure of Required Credit Information

* * * * *

2. *Form of disclosures.* The disclosures specified in section 226.5a(e)(1)(ii) and (iii) may appear either in or outside the table containing the required credit disclosures.

5. *Comments 5b-2 through 5b-5 are redesignated as comments 5b-3 through 5b-6, respectively, and new comment 5b-2 is added to read as follows:*

SECTION 226.5b—Requirements for Home-Equity Plans

* * * * *

2. *Changes to home-equity plans entered into on or after November 7, 1989.* Section 226.9(c) applies if, by written agreement under section 226.5b(f)(3)(iii), a creditor changes the terms of a home-equity plan—entered into on or after November 7, 1989—at or before its scheduled expiration, for example, by renewing a plan on different terms. A new plan results, however, if the plan is renewed (with or without changes to the terms) after the scheduled expiration. The new plan is subject to all open-end credit rules, including sections 226.5b, 226.6, and 226.15.

6. *Comment 5b(d)(4)(iii)-1 is amended by revising the fourth sentence to read as follows (and is amended again in April 1993, as shown in item 25 on page 7):*

Paragraph 5b(d)(4)(iii)

1. *Disclosure of conditions.* * * * As an alternative to disclosing the conditions in this manner, the creditor may simply describe the conditions using the language in section 226.5b(f)(2), 226.5b(f)(3)(i) (regarding freezing the line when the maximum annual percentage rate is reached), and 226.5b(f)(3)(vi) or language that is substantially similar. * * *

7. *Comment 5b(d)(5)(iii)-4 is amended by revising the fourth bulleted paragraph to read as follows:*

Paragraph 5b(d)(5)(iii)

* * * * *

4. *Reverse mortgages.* * * *

- Some reverse mortgages provide that some or all of the appreciation in the value of the property will be shared between the consumer and the creditor. The creditor must disclose the appreciation feature, including describing how the creditor's share will be determined, any limitations, and when the feature may be exercised.

8. *Comment 5b(d)(8)-2 is amended by revising*

the first sentence and by adding a new sentence after the fourth sentence to read as follows:

5b(d)(8) Fees Imposed by Third Parties to Open a Plan

* * * * *

2. *Itemization of third-party fees.* In all cases creditors must state the total of third-party fees as a single dollar amount or a range except that the total need not include costs for property insurance if the creditor discloses that such insurance is required. * * * Any itemization provided upon the consumer's request need not include a disclosure about property insurance.

9. *Comment 5b(f)(3)(i)-1 is amended by revising the first sentence and by adding a new sentence after the first sentence to read as follows:*

Paragraph 5b(f)(3)(i)

1. *Changes provided for in agreement.* A creditor may provide in the initial agreement that further advances will be prohibited or the credit line reduced during any period in which the maximum annual percentage rate is reached. A creditor also may provide for other specific changes to take place upon the occurrence of specific events. * * *

10. *Comment 5b(f)(3)(vi)-1 is amended by revising the first sentence and by adding a new sentence after the first sentence to read as follows:*

Paragraph 5b(f)(3)(vi)

1. Suspension of credit privileges or reduction of credit limit. A creditor may prohibit additional extensions of credit or reduce the credit limit in the circumstances specified in this section of the regulation. In addition, as discussed under section 226.5b(f)(3)(i), a creditor may contractually reserve the right to take such actions when the maximum annual percentage rate is reached. * * *

11. *Comment 6(e)-4 is amended by revising the third sentence to read as follows:*

6(e) Home-Equity Plan Information

* * * * *

4. *Disclosures for the repayment period.* * * * To the extent the corresponding annual percentage rate, the information in footnote 12, and any other required disclosures are the same for the draw and repayment phase, the creditor need not repeat such information, as long as it is clear that the information applies to both phases.

* * * * *

12. *Comment 9(c)(1)-6 is revised to read as follows:*

9(c)(1) Written Notice Required

* * * * *

6. *Changes to home-equity plans entered into on or after November 7, 1989.* Section 226.9(c) applies when, by written agreement under section 226.5b(f)(3)(iii), a creditor changes the terms of a home-equity plan—entered into on or after November 7, 1989—at or before its scheduled expiration, for example, by renewing a plan on terms different from those of the original plan. In disclosing the change:

- If the index is changed, the maximum annual percentage rate is increased (to the limited extent permitted by section 226.30), or a variable-rate feature is added to a fixed-rate plan, the creditor must include the disclosures required by section 226.5b(d)(12)(x) and (d)(12)(xi), unless these disclosures are unchanged from those given earlier.

- If the minimum-payment requirement is changed, the creditor must include the disclosures required by section 226.5b(d)(5)(iii) (and, in variable-rate plans, the disclosures required by section 226.5b(d)(12)(x) and (d)(12)(xi)) unless the disclosures given earlier contained representative examples covering the new minimum-payment requirement. (See the commentary to section 226.5b(d)(5)(iii), (d)(12)(x), and (d)(12)(xi) for a discussion of representative examples.)

When the terms are changed pursuant to a written agreement as described in section 226.5b(f)(3)(iii), the advance-notice requirement does not apply.

13. *Comment 12(a)(2)-2 is amended by revising the third bulleted paragraph to read as follows:*

Paragraph 12(a)(2)

* * * * *

2. *Substitution—examples.* * * *

- Changed the credit or other features available on the account. For example, the original card could be used to make purchases and obtain cash advances at teller windows. The substitute card might be usable, in addition, for obtaining cash advances through automated teller machines. (If the substitute card constitutes an access device, as defined in Regulation E, then the Regulation E issuance rules would have to be followed.) The "substitution" of one card with another on an unsolicited basis is not permissible, however, where in conjunction with the substitution an additional credit card account is opened and the consumer is able to make new purchases or advances under both the original and the new account with the new card. For example, if a retail card issuer replaces its credit card with a combined retailer/bank card, each of the creditors maintains a separate account, and both accounts can be accessed for new transactions by use of the new credit card, the card cannot be provided to a consumer without solicitation.

14. *Comment 16(d)-4 is amended by two sentences after the second sentence to read as follows:*

16(d) Additional Requirements for Home-Equity Plans

* * * * *

4. *Misleading terms prohibited.* * * * In the case of property insurance, however, a creditor may state, for example, "no closing costs" even if property insurance may be required, as long as the creditor also provides a statement that such insurance may be required. (See the commentary to this section regarding fees to open a plan.)

15. *Comment 17(a)(1)-5 is revised by adding a bulleted paragraph at the end to read as follows:*

Paragraph 17(a)(1)

* * * * *

5. *Directly related.* * * *

- A statement whether or not a subsequent purchaser of the property securing an obligation may be permitted to assume the remaining obligation on its original terms.

16. *Comment 17(c)(1)-1 is amended by revising the first sentence and adding a sentence after the first sentence to read as follows:*

Paragraph 17(c)(1)

1. *Legal obligation.* The disclosures shall

reflect the credit terms to which the parties are legally bound as of the outset of the transaction. In the case of disclosures required under section 226.20(c), the disclosures shall reflect the credit terms to which the parties are legally bound when the disclosures are provided. * * *

17. *Comment 17(c)(1)-11 is amended by revising the heading, the first sentence and the first bulleted paragraph to read as follows:*

Paragraph 17(c)(1)

* * * * *

11. *Examples of variable-rate transactions.* Variable-rate transactions include:

- Renewable balloon-payment instruments where the creditor is both unconditionally obligated to renew the balloon-payment loan at the consumer's option (or is obligated to renew subject to conditions within the consumer's control) and has the option of increasing the interest rate at the time of renewal. Disclosures must be based on the payment amortization (unless the specified term of the obligation with renewals is shorter) and on the rate in effect at the time of consummation of the transaction. (Examples of conditions within a consumer's control include requirements that a consumer be current in payments or continue to reside in the mortgaged property. In contrast, setting a limit on the rate at which the creditor would be obligated to renew or reserving the right to change the credit standards at the time of renewal are examples of conditions outside a consumer's control.) If, however, a creditor is not obligated to renew as described above, disclosures must be based on the term of the balloon-payment loan. Disclosures also must be based on the term of the balloon-payment loan in balloon-payment instruments in which the legal obligation provides that the loan will be renewed by a "refinancing" of the obligation, as that term is defined by section 226.20(a). If it cannot be determined from the legal obligation that the loan will be renewed by a "refinancing," disclosures must be based either on the term of the balloon-payment loan or on the payment amortization, depending on whether the creditor is unconditionally obligated to renew the loan as described above. (This discussion does not apply to construction loans subject to section 226.17(c)(6).) * * *

18. *Comment 19(b)-3 is amended by revising the third bulleted paragraph and the last paragraph to read as follows:*

19(b) Certain Variable-Rate Transactions

* * * * *

3. *Intermediary agent or broker.* * * *

- The amount of work (such as document preparation) the creditor expects to be done by the broker on an application based on the creditor's prior dealings with the broker and on the creditor's requirements for accepting applications, taking into consideration the customary practice of brokers in a particular area. The more work that the creditor expects the broker to do on an application, in excess of what is usually expected of a broker in that area, the less likely it is that the broker would be considered an "intermediary agent or broker" of the creditor.

An example of an "intermediary agent or broker" is a broker who, customarily within a brief period of time after receiving an application, inquires about the credit terms of several creditors with whom the broker does business and submits the application to one of them. The broker is responsible for only a small percentage of the applications received by that creditor. During the time the broker has the application, it might request a

credit report and an appraisal (or even prepare an entire loan package if customary in that particular area).

19. *Comment 19(b)-5 is amended by revising the first bulleted paragraph to read as follows:*

19(b) Certain Variable-Rate Transactions

* * * * *

5. *Examples of variable-rate transactions.* * * *

- Renewable balloon-payment instruments where the creditor is both unconditionally obligated to renew the balloon-payment loan at the consumer's option (or is obligated to renew subject to conditions within the consumer's control) and has the option of increasing the interest rate at the time of renewal. (See comment 17(c)(1)-11 for a discussion of conditions within a consumer's control in connection with renewable balloon-payment loans.) * * *

20. *Comment 20(a)-3 is amended by revising the second sentence to read as follows:*

20(a) Refinancings

* * * * *

3. *Variable rate.* * * * For example, a renewable balloon-payment mortgage that was disclosed as a variable-rate transaction is not subject to new disclosure requirements when the variable-rate feature is invoked. * *

21. *Comment 20(c)-3 is added to read as follows:*

20(c) Variable-Rate Adjustments

* * * * *

3. *Basis of disclosures.* The disclosures required under this section shall reflect the terms of the parties' legal obligation, as required under section 226.17(c)(1).

22. *Comment 28(a)-15 is added to read as follows:*

28(a) Inconsistent Disclosure Requirements

* * * * *

15. *Preemption determination—Wisconsin.* Effective October 1, 1991, the Board has determined that the following provisions in the state law of Wisconsin are preempted by the federal law.

- Section 422.308(1)—the disclosure of the annual percentage rate in cases where the amount of the annual percentage rate disclosed to consumers under the state law differs from the amount that would be disclosed under federal law, since in those cases the state law requires the use of the same term as the federal law to represent a different amount than the federal law.
- Section 766.565(5)—the provision permitting a creditor to include in an open-end home-equity agreement authorization to declare the account balance due and payable upon receiving notice of termination from a non-obligor spouse, since such provision is inconsistent with the purpose of the federal law.

23. *Comment 30-1 is amended by revising the parenthetical text at the end of the fourth bulleted paragraph to read as follows:*

Section 226.30—Limitation on Rates

1. *Scope of coverage.* * * * (Contrast with the renewable balloon-payment mortgage instrument described in comment 17(c)(1)-11.)

The following amendments are effective April 1, 1993, or, at the creditor's option, October 1, 1993.

24. *Comment 2(a)(25)-6 is amended by adding the following five sentences at the end of the paragraph:*

2(a) Definitions

* * * * *

6. *Specificity of disclosure.* *** In disclosing the fact that the transaction is secured by the collateral, the creditor also need not disclose how the security interest arose. For example, in a closed-end credit transaction, a rescission notice need not specifically state that a new security interest is "acquired" or an existing security interest is "retained" in the transaction. The acquisition or retention of a security interest in the consumer's principal dwelling instead may be disclosed in a rescission notice with a general statement such as the following: "Your home is the security for the new transaction." A statement such as this may be used, for example, instead of the second sentence in model form H-9 and could apply both to a refinancing in which a new security interest is taken by the original creditor to replace a preexisting security interest and one in which an existing security interest is maintained. Of course, because model form H-9 adequately discloses the fact that the home is security for the transaction, it may be used without modification in both a refinancing in which a new security interest is taken by the original creditor to replace a preexisting security interest and one in which an existing security interest is retained by that creditor.

25. *Comment 5b(d)(4)(iii)-1 is amended by revising the fourth sentence and adding a new sentence after the fourth sentence, as follows:*

*** As an alternative to disclosing the conditions in this manner, the creditor may simply describe the conditions using the language in section 226.5b(f)(2)(i)–(iii), 226.5b(f)(3)(i) (regarding freezing the line when the maximum annual percentage rate is reached), and 226.5b(f)(3)(vi) or language that is substantially similar. The condition contained in section 226.5b(f)(2)(iv) need not be stated. ***

26. *Comment 5b(f)(2)-1 is amended by changing the word "three" to "four" in the second sentence.*

27. *Comment 6(e)-1 is amended by adding the following sentence to the end of the paragraph:*

6(e) Home-Equity Plan Information

1. *Additional disclosures required.* *** (See comment 5(b)(d)(4)(iii)-1.)

28. *Comment 18(i)-2 is amended by adding the following sentence to the end of the paragraph:*

18(i) Demand Feature

* * * * *

2. *Covered demand features.* *** A creditor may, but need not, treat its contractual right to demand payment of a loan made to its executive officers as a demand feature to the extent that the contractual right is required by Regulation O (12 CFR 215.5) or other federal law.

29. *Comment 19(b)(2)(xi)-1 is revised to read as follows:*

19(b) Certain Variable-Rate Transactions

* * * * *

Paragraph 19(b)(2)(xi)

1. *Demand feature.* If a variable-rate loan subject to section 226.19(b) requirements contains a demand feature, as discussed in the commentary to section 226.18(i), this fact must be disclosed. (Pursuant to section 226.18(i), creditors would also disclose the demand feature in the standard disclosures given later.)

30. *Comment 4 in appendix G is amended by adding the following sentence at the end of the paragraph:*

APPENDIX G—Open-End Model Forms and Clauses

* * * * *

4. *Models G-5 through G-9.* * * * See the commentary to section 226.2(a)(25) regarding the specificity of the security-interest disclosure for model form G-7.

31. *Comment 11 in appendix H is amended by adding the following sentence at the end of the paragraph:*

APPENDIX H—Closed-End Model Forms and Clauses

* * * * *

11. *Models H-8 and H-9.* * * * See the commentary to section 226.2(a)(25) regarding the specificity of the security-interest disclosure for model form H-9.