



FEDERAL RESERVE BANK
OF DALLAS

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

April 21, 1995

DALLAS, TEXAS
75265-5906

Notice 95-40

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

SUBJECT

**Revisions to the
Official Staff Commentary to Regulation Z
(Truth in Lending)**

DETAILS

The Board of Governors of the Federal Reserve System has issued revisions to the official staff commentary to Regulation Z (Truth in Lending). The revisions clarify regulatory provisions and provide further guidance on issues of general interest, such as the treatment of various fees and taxes associated with real estate-secured loans, including charges by third parties, and a creditor's responsibilities when investigating a claim of unauthorized use of a credit card.

The rule became effective April 1, 1995. Compliance is optional until October 1, 1995.

ATTACHMENT

A copy of the Board's notice as it appears on pages 16771-80, Vol. 60, No. 63, of the Federal Register dated April 3, 1995, is attached.

MORE INFORMATION

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

Sincerely yours,

Robert D. McTeer, Jr.

FEDERAL RESERVE SYSTEM

12 CFR Part 226

[Regulation Z; Docket No. R-0863]

Truth in Lending

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule; official staff interpretation.

SUMMARY: The Board is publishing revisions to the official staff commentary to Regulation Z (Truth in Lending). The commentary applies and interprets the requirements of Regulation Z. The revisions clarify regulatory provisions and provide further guidance on issues of general interest, such as the treatment of various fees and taxes associated with real estate-secured loans and a creditor's

responsibilities when investigating a claim of the unauthorized use of a credit card.

DATES: This rule is effective April 1, 1995. Compliance is optional until October 1, 1995.

FOR FURTHER INFORMATION CONTACT: For Subparts A and B (open-end credit), Jane Jensen Gell or Obrea Otey Poindexter, Staff Attorneys; for Subparts A and C (closed-end credit), Kyung Cho-Miller, Sheilah A. Goodman, W. Kurt Schumacher, Natalie E. Taylor, or Manley Williams, Staff Attorneys, Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, at (202) 452-3667 or 452-2412; for the hearing impaired only, Dorothea Thompson, Telecommunications Device for the Deaf, at (202) 452-3544.

SUPPLEMENTARY INFORMATION:

I. Background

The purpose of the Truth in Lending Act (TILA; 15 U.S.C. 1601 et seq.) is to promote the informed use of consumer credit. The act requires creditors to disclose credit terms and the cost of credit as an annual percentage rate (APR). The act requires additional disclosures for loans secured by a consumer's home, and permits consumers to cancel certain transactions that involve their principal dwelling. It also imposes limitations on some credit transactions secured by a consumer's principal dwelling. The act is implemented by the Board's Regulation Z (12 CFR part 226). The regulation authorizes the issuance of official staff interpretations of the regulation. (See Appendix C to Regulation Z.) The Board has published a staff commentary to Regulation Z which clarifies existing law and provides guidance to creditors in applying the regulation to specific transactions (Supplement I of this part). The Board updates the commentary periodically as a substitute for individual staff interpretations.

In December, the Board published proposed amendments to the commentary to Regulation Z (59 FR 64351, December 14, 1994). The Board received about 150 comments. Nearly 90% were from creditors or their representatives; the remainder were from consumer advocates, government officials, and individuals. Overall, commenters generally supported the proposed amendments. Views were mixed on a number of comments, and some commenters expressed concerns about issues not addressed in the proposal. Except as discussed below, the commentary has been revised as proposed; some technical suggestions or

concerns raised by commenters are addressed. Compliance with the amendments is mandatory on October 1, 1995.

II. Commentary Revisions

Subpart A—General

Section 226.2—Definitions and Rules of Construction

2(a) Definitions

2(a)(17) Creditor

Paragraph 2(a)(17)(i)

Comment 2(a)(17)(i)–8 clarifies the identity of the creditor for participant loans from an employee savings plan, such as 401(k) plans. The proposal would have clarified that the plan (and not the plan trust or trustee) is the creditor for purposes of the TILA.

Some commenters asked for further guidance when the plan's trust or trustee provide disclosures for the plan's participant loan program. The comment is revised from the proposal for clarity. Creditors should look to the plan (not the trust or trustee) to determine whether the numerical tests for coverage have been met. The person to whom the participant's loan is initially made payable (whether the plan, the trust, or the trustee) is responsible for Regulation Z compliance for participant loans.

Section 226.4—Finance Charge

4(a) Definition

Comment 4(a)–1 is revised as proposed to indicate that section 12 of the Real Estate Settlement Procedures Act (RESPA; 12 U.S.C. 2610) prohibits creditors from charging fees for preparing TILA disclosure statements in RESPA-covered transactions. The comments generally supported the revisions.

The Board received a substantial number of comments relating to the proposed revision to comment 4(a)–3 on fees charged by third parties. While most commenters believed that the comment helped clarify the treatment of third-party fees generally, the examples of settlement agent charges, mortgage broker fees, and taxes raised a number of questions.

Creditors had expressed concern about some charges imposed by loan-closing agents being imputed to the creditor. Some had indicated that despite the fact that they require the use of a closing agent (and in limited ways the agent acts on behalf of the creditor), in the modern mortgage lending environment, creditors do not have control over certain fees that may be charged to consumers by these entities,

particularly where there is no affiliation between the creditor and the third party, as is often the case. To address this concern, the proposed revision to comment 4(a)–3 provided by example that if a particular fee imposed by a settlement agent is not required or retained by the creditor, the fee is not a finance charge, even though the creditor requires use of a third party.

Comment 4(a)–3, which applies to all types of credit extensions (not just home-purchase or other home-secured loans), is revised in the final version to clarify the general third-party rule. Upon further analysis, guidance about fees charged by settlement agents in real estate-secured transactions is provided in a separate comment 4(a)–4. This new comment gives the general rule for evaluating settlement agent fees, and is followed by an example. Comments previously numbered 4(a)–4 through –6 are now renumbered.

Many commenters also requested further clarification on the example of mortgage broker fees as a finance charge. The proposed clarification responded to questions about the existing mortgage broker fee example, which had been added to address programs offering lower rates and clearly more favorable terms to borrowers who use the creditor's affiliated mortgage broker than to borrowers who apply to the creditor directly. The particular example has been deleted; while the mortgage broker fee charged in this instance is still considered a finance charge, it is a much less common practice today, and therefore has caused confusion. The example of mortgage broker fees is amended to simply reflect the general rule that a fee is a finance charge if the creditor retains the fee.

With regard to taxes, some commenters noted that the commentary addresses in several areas the issue of whether taxes are finance charges. These commenters requested that all comments referring to taxes be consolidated into one comment. To ease compliance, the reference to taxes currently contained in comment 4(a)–3 is removed. The general rules on the treatment of taxes under the TILA are contained in renumbered and revised comment 4(a)–7, formerly comment 4(a)–6. The current reference to taxes under 4(e)–1 has been revised and the current reference to taxes under 4(a)–1 remains unaffected.

4(c) Charges Excluded From the Finance Charge

Paragraph 4(c)(7)

Comment 4(c)(7)–1 clarifies certain real-estate and residential mortgage

transaction costs that are excluded from the finance charge. In response to commenters' suggestions and upon further analysis, the comment is revised to state that fees excludable under this section include not only the cost of the charges excludable under this section, but also the cost of verifying or confirming information relating to excludable item itself. The previous language specifically stated that a credit report fee included the cost of verifying information in the report. This language was intended to be read only as an example. It is now more clearly shown as such. Verification or confirmation fees, like other excludable charges under this section, must be bona fide and reasonable in amount.

The language addressing lump sum charges has been moved to a new comment, 4(c)(7)-2. This provision has been adopted as proposed, with some revisions for clarity. The comment states that a lump sum charge for conducting or attending a closing (charged, for example, by a lawyer or a title company) is excluded from the finance charge if the charge is primarily for services related to items listed in § 226.4(c)(7) (such as reviewing or completing documents), even if other incidental services, such as explaining various documents or disbursing funds for the parties, are performed. This is an exception to the general rule on the treatment of lump sum fees. Most commenters supported the proposal as a clarification of the Board's existing position. Several, however, opposed allowing creditors to exclude fees for incidental services where the charge is primarily for services related to items listed in § 226.4(c)(7), believing that this would result in less accurate disclosures.

Comment 4(c)(7)-3 (proposed as 4(c)(7)-2) has been adopted as proposed, with minor changes for clarity. The comment states that charges excludable under § 226.4(c)(7) are those imposed in connection with the initial decision to grant credit—for example, a fee to search for tax liens on the property or to determine if flood insurance is required. The comment also clarifies that fees for services to be performed during the loan term, for example, to monitor a consumer's continued compliance with contract provisions, such as paying property taxes or purchasing flood insurance, are *not* excludable under § 226.4(c)(7), regardless of when they are paid. These recurring administrative fees, paid by the consumer to protect the creditor's security interest, are finance charges.

Commenters generally agreed with the proposed language. Many, however, had

concerns regarding the treatment of fees paid at closing for services attributable *both* to the initial credit decision and to services to be performed periodically over the term of the loan. For example, certain flood certification providers charge a consolidated fee, and it may not be clear to creditors what portion of the fee relates to the services connected with the initial credit decision. The final commentary addresses these concerns by specifying that a creditor may treat the entire charge as a finance charge if the creditor is uncertain of the portion properly attributable to the finance charge. Such sum need not be labelled as an estimate.

4(e) Certain Security Interest Charges

Comment 4(e)-1 provides examples of security interest charges that are and are not excludable as finance charges. The proposal stated that only recording fees relating to the obligation between the creditor and the consumer were excludable. Most commenters supported the proposal, although some were opposed. The comment is adopted as proposed, but indicates that fees to record documents such as an assignment between a creditor and a third party are finance charges.

In response to comments and for clarity, the portion of comment 4(e)-1 dealing with taxes has been revised. As discussed above, comment 4(a)-7 (formerly 4(a)-6) contains the general rules on the treatment of taxes.

Subpart B—Open-End Credit

Section 226.5—General Disclosure Requirements

5(b) Time of Disclosures

5(b)(1) Initial Disclosures

Comment 5(b)(1)-1 provides that initial disclosures must be provided before the consumer makes the first purchase under an open-end plan. The comment provides an example to illustrate that when a consumer makes a purchase and opens an account with a retailer contemporaneously, initial disclosures must be given to the consumer at that time.

Comment 5(b)(1)-5 addresses the general rule as it relates to the timing of initial disclosures when a creditor offers consumers an option to transfer outstanding balances with other creditors as part of a preapproval or general solicitation of an open-end credit plan. The proposal required creditors to comply with initial disclosure requirements under § 226.6 before the consumer authorized the balance transfer. The purpose of the proposal was to ensure that consumers

receive initial disclosures before the first transaction is made under the plan.

Commenters were divided on the proposal. Several commenters believed that the disclosures required under § 226.5a at the time of solicitation adequately protect and sufficiently inform the consumer about the terms of the credit plan. The initial disclosures required under § 226.6, however, contain important terms that are not included in the solicitation disclosures. For example, the initial disclosures give the cash advance APR, information that could be an important factor in a consumer's decision to authorize a balance transfer. To ease compliance, card issuers that are subject to the requirements of § 226.5a may establish procedures that comply with both sections in a single disclosure statement. Comment 5a-2 provides guidance on the appropriate format for combined disclosures. For example, a creditor could provide the § 226.5a disclosures in a tabular format, along with the additional disclosures required by § 226.6 outside the table.

Other commenters requested an "opt-out" provision that would allow card issuers to comply by establishing a procedure under which a consumer could cancel or reverse the balance transfer after receiving initial disclosures. This option raises concerns about the effect such an approach would have on a consumer whose balance with a third party would be paid by the card issuer. It could be difficult to cancel or reverse the balance transfer transaction.

Commenters suggested that a creditor could comply with the initial disclosure requirements under § 226.6 by delaying the requested transfer for a period of time after the initial disclosures are sent. The delay would ensure that the initial disclosures are received by the consumer before the transferred balance is applied to the new plan. Under the revised commentary, a creditor complies with this section if initial disclosures required under § 226.6 are furnished before a balance transfer transaction occurs.

Section 226.6—Initial Disclosure Statement

6(b) Other Charges

Comment 6(b)-1 provides guidance for disclosing a termination fee imposed in an open-end credit plan, as proposed. Commenters generally supported the disclosure of a termination fee as an "other charge." Some commenters believed disclosing the fee as a finance charge might better assist consumers in shopping for a credit plan. But this approach would not facilitate consumer

shopping based on the APR, since the APR in the initial disclosures reflects on finance charges based on periodic rates, and thus would not be affected by a termination fee. Furthermore, the consumer would gain little from receiving an APR (disproportionately high in some cases) on what might be the last periodic statement for a fee imposed when the consumer closes the plan.

Section 226.12—Special Credit Card Rules

12(b) *Liability of Cardholder for Unauthorized Use*

Comments 12(b)-2 and -3 address a card issuer's rights and responsibilities in responding to a claim of unauthorized use under § 226.12. Comment 12(b)-2 clarifies that a card issuer is not required to impose any liability. Comment 12(b)-3 clarifies that a card issuer wishing to impose liability must investigate claims in a reasonable manner.

Comment 12(b)-3 lists some of the procedures that may be involved in the investigation of a claim. The procedures involved in conducting a reasonable investigation depend on the facts of the situation; neither a minimum nor a maximum number of steps is required to deem a particular investigation "reasonable." Some commenters expressed concern about card issuers advising consumers that they may be required to appear in a court action. These commenters believed such statements would possibly be misleading and intimidating, and that in any case a court action was independent of a card issuer's investigation. The reference to court appearances has been deleted.

Commenters suggested a variety of other actions that a card issuer may take, in addition to those proposed, in a reasonable investigation of a claim of unauthorized use. The list has been expanded to clarify that a card issuer may request documentation to verify the claim and may request information regarding the cardholder's knowledge of the person who allegedly used the card or of that person's authority to do so.

Many commenters expressed concern that the proposed comment prohibited a card issuer from denying a claim because a cardholder refused to comply with any request for cooperation, such as the failure to submit a signed statement. A card issuer may not automatically deny a claim based solely on the cardholder's failure or refusal to comply with a particular request. For example, a cardholder may return an unsigned questionnaire about the claim

but may refuse to submit a sworn statement. The card issuer may not automatically deny the claim because it is unaccompanied by an affidavit. However, the comment also makes clear that the cardholder's failure to cooperate may affect the card issuer's ability to investigate the claim of unauthorized use. For example, if the cardholder fails to respond to requests for information the card issuer can reasonably obtain only from the cardholder, the comment provides that the card issuer, without further information, may reasonably terminate its investigation.

Section 226.15—Right of Rescission

15(a) *Consumer's Right To Rescind Paragraph 15(a)(1)*

Comments 15(a)(1)-5 and -6 are revised to provide further guidance on the right to rescind a transaction secured by a consumer's principal dwelling. (See also comments 23(a)(1)-3 and -4.)

15(d) *Effects of Rescission*

Comment 15(d)(2)-1 is revised to clarify that if a consumer rescinds a credit transaction, the creditor must refund any broker fee that is part of the credit transaction, even though the consumer paid the fee to the broker rather than to the creditor. (See comment 23(d)(2)-1.)

Section 226.16—Advertising

16(d) *Additional Requirements for Home Equity Plans*

Comment 16(d)-7 clarifies disclosure requirements for balloon payments in home equity plan advertisements. The commentary to § 226.5b(d)(5)(ii) provides that for plans in which a balloon payment will occur if the consumer makes only the minimum payments, the disclosure must state that fact. A comparable requirement applies to advertisements, since the regulatory provisions on treatment of balloon payments in home equity advertising and in disclosures are generally parallel.

A number of commenters thought the proposed comment would require a disclosure about balloon payments in any advertisement for a program in which a balloon payment occurs, regardless of whether the advertisement included a "trigger term." The proposed comment was not intended to impose such a requirement. The comment has been revised to clarify that disclosure is required only if the advertisement contains a statement about a minimum periodic payment. The comment also addresses questions about the required content of the disclosure, including

concerns about the effect of the cross-reference to comment 5b(d)(5)(ii)-3.

Subpart C—Closed-End Credit

Section 226.17—General Disclosures

17(a) *Form of Disclosures*

Paragraph 17(a)(1)

Comment 17(a)(1)-5 is revised to clarify that a late payment fee on a single payment loan is information directly related to the segregated disclosures. The introductory language has been revised to clarify that the list of directly related information is exhaustive.

17(c) *Basis of Disclosures and Use of Estimates*

Paragraph 17(c)(4)

Section 226.17(c)(4) allows creditors to disregard in the payment schedule and other calculations any small variations in the first payment due to a long or short first period. Comment 17(c)(4)-4 clarifies that prepaid finance charges, such as "odd-days" or "per-diem" interest paid at or prior to closing, may not be considered as the first payment on a loan. Thus, "odd-days" interest paid at or prior to closing cannot be considered a part of the payment schedule and disregarded as a irregularity in disclosing the finance charges in the payment schedule. The language has been adopted as proposed, with a minor change made to state that the comment applies to "pre-paid" and "odd-days" interest, using those terms by name.

Commenters favored treating odd-days or per-diem interest collected at closing as being the first payment for the purposes of these "minor irregularities" provisions when the consummation date is subject to change outside of the lender's control (for example, in some escrow-closing states). If interest collected at, or prior to, consummation meets the definition of a prepaid finance charge, it must be treated as such.

The regulation does not require creditors to collect odd-days or per-diem interest at, or prior to, consummation. If that interest is collected as part of the first periodic payment, instead, the minor irregularities provisions of § 226.17(c)(4) would apply to the extent the amount is within those parameters.

17(f) *Early Disclosures*

Comment 226.17(f)-1 is revised to clarify that the regulation requires redisclosure not only if the APR, at consummation, differs from the earlier disclosed APR by more than the allowable 1/8 or 1/4 of 1 percent

tolerance, but also if the early disclosures were not marked as estimates, and the terms at consummation, other than the APR, differ from the earlier disclosed terms. Language has been added to the second example to illustrate the case when terms at consummation differ from those previously disclosed, where they were not marked as estimates. To facilitate comparison of the two examples, the dates in the second example have been changed to those stated in the first example. A third example has been added to illustrate circumstances when the regulation does not require redisclosure even though the consummated terms, including the APR, differ from the disclosed terms.

Section 226.18—Content of Disclosures

18(c) Itemization of Amount Financed *Paragraph 18(c)(1)(iv)*

Comment 18(c)(1)(iv)-2 clarifies disclosure requirements under the TILA that are affected by new aggregate accounting rules under the Real Estate Settlement Procedures Act (RESPA; 12 U.S.C. 2601). The comment provides that creditors may use the amount on line 1002 of the HUD-1 or HUD-1A, without adjustment, to calculate the prepaid finance charge under the TILA.

In October 1994, the Department of Housing and Urban Development (HUD), which implements Real Estate Settlement Procedures Act (RESPA; 12 U.S.C. 2601) through Regulation X (24 CFR Part 3500), amended its regulation to implement new procedures for calculating the amount consumers must pay into escrow accounts associated with RESPA-covered home mortgage loans (59 FR 53890, October 26, 1994, and 60 FR 8812, February 15, 1995). These procedures are being phased in over time for existing escrow accounts; all new escrow accounts established on or after April 24, 1995, must comply with the new procedures. Eventually, all lenders will be required to use an aggregate accounting method instead of a single-item method for RESPA transactions. The use of the aggregate method will affect disclosure requirements under Regulation Z.

Currently, in calculating the amounts required to be paid into escrow accounts at closing, most lenders use what is referred to as the single-item analysis. (Property taxes, insurance, and mortgage insurance premiums are common examples of escrow items.) Under single-item analysis, lenders account separately for each item to be collected at closing and held in escrow.

Under the aggregate accounting method, rather than accounting for each

item separately, the amount for escrow is determined as a whole. This will make it difficult for a creditor to determine how much of the aggregate amount is actually allocated to each escrow item.

Regardless of how they collect the funds under RESPA, lenders will continue to disclose escrow items on the HUD settlement statement using the single-item analysis. If the amount actually collected at settlement is affected by the aggregate accounting method, the settlement statement will reflect the adjustment on a separate line in the 1000 series (§ 3500.8(c)(1), 60 FR 8816, February 15, 1995). Mortgage insurance premiums, one of the items typically paid at settlement and included in the escrow account, are listed on line 1002 of the HUD statement. This amount is also a prepaid finance charge under Regulation Z.

If a creditor is collecting the settlement charges using aggregate analysis the amount actually collected may be less than the amount listed on line 1002. Guidance had been requested on what amount lenders should use as the prepaid finance charge, since the amount disclosed is not precisely the amount collected. Various alternatives were considered to ensure as accurate and uniform a disclosure as possible. Comment 18(c)(1)(iv)-2 provides that creditors may use the amount on line 1002, without adjustment, to calculate the prepaid finance charge under the TILA. This approach will ease compliance and provide consumers with an easily identifiable amount for the mortgage insurance. While this method does slightly overstate the amount of the prepaid finance charge for mortgage insurance, nonetheless this method seems to provide the more accurate and equitable treatment possible given the problems associated with identifying the amount of any single item in an aggregate accounting analysis.

Commenters generally supported this approach. Several commenters requested further clarification on whether the approach is mandatory, whether the figure used is considered an estimate, and how the tolerance is applied in this situation. A sentence has been added to the comment to clarify that the Board is deeming the figure used on the HUD-1 or HUD-1A as accurate, for purposes of Regulation Z, as long as that amount is computed in accordance with RESPA. Accordingly, the figure is not considered an estimate, and the tolerance would apply as it does for all other figures disclosed under Regulation Z. As long as the figure disclosed is accurate for purposes of

RESPA, the figure is accurate to determine the finance charge tolerance. The approach is mandatory for all loans closed using the aggregate accounting method required by RESPA.

18(d) Finance Charge

Comment 18(d)-2 has been adopted as proposed, with some minor revisions for clarity. The comment states that although there is no specific tolerance for the amount financed, an error in that figure—resulting from an error in the finance charge—does not violate the act or the regulation provided the finance charge disclosed under § 226.18(d) is within the permissible tolerance provided in footnote 41 of the regulation. This same interpretation applies to other disclosures for which the regulation provides no specific tolerance, such as the total of payments.

Most commenters were in favor of the proposal. Views were split among those commenters opposing the proposal. Some suggested that a maximum tolerance of \$10 was insufficient to adequately protect lenders. Several others opposed any tolerance for errors in the amount financed or the other disclosures that was not currently addressed in the regulation.

Several commenters pointed out that the language suggested the error must result from an error in the finance charge "that constitutes a part of the amount financed." This phrase has been deleted as unnecessary.

Section 226.19—Certain Residential Mortgage and Variable-Rate Transactions

19(b) Certain Variable-Rate Transactions

Paragraph 19(b)(2)(vii)

Comment 19(b)(2)(vii)-2, with the exception of a few technical changes, is adopted as proposed. It states that loans with more than one way to trigger negative amortization are separate variable-rate loan programs requiring separate disclosures to the extent they vary from each other. For example, a loan which provides for monthly interest rate changes but only annual payment changes and an option for the borrower to cap the amount of monthly payments whenever the new payment would exceed the old payment by more than a certain margin, contains two separate variable-rate programs. Each program may trigger negative amortization requiring separate disclosures. (See comments 226.19(b)(2)-2 and -3 for a discussion on the definition of a variable-rate program and consolidation of disclosures for more than one program.)

For the program that gives the borrower an option to cap monthly payments, the creditor must fully disclose the rules relating to the payment cap option, including the effects of exercising it (such as negative amortization occurs and that the principal balance will increase), except that the disclosure in § 226.19(b)(2)(viii) need not be given for the option.

Section 226.22—Determination of the Annual Percentage Rate

22(a) Accuracy of the Annual Percentage Rate

Paragraph 22(a)(1)

Comment 22(a)(1)–5 corrects an erroneous footnote reference.

Section 226.23—Right of Rescission

23(a) Consumer's Right To Rescind
Paragraph 23(a)(1)

Comment 23(a)(1)–4, which contains an exception to the "one principal dwelling" rule in comment 23(a)(1)–3, is revised. Under the exception, a consumer may have, in effect, two principal dwellings for a time. Even if a consumer is acquiring or constructing a new principal dwelling, any loan subject to Regulation Z may be rescinded when the consumer's current principal dwelling secures the loan. A typical example is a bridge loan.

The proposed comment provided, by example, that a loan secured by the new home and the current home is a residential mortgage transaction. While many commenters agreed with the proposal, some viewed it as a change in the existing interpretation. Upon further analysis, the proposed example would negate the exception to the general rule. The existing language of comment 23(a)(1)–4 has been retained with language and examples added for clarification. Accordingly, even if a loan is a purchase-money loan secured by the new home (that is, a residential mortgage transaction) where that loan also is secured by the consumer's current home, the loan is rescindable.

23(d) Effects of Rescission
Paragraph 23(d)(2)

Comment 23(d)(2)–1 has been revised to clarify that if a consumer rescinds a credit transaction, the creditor must refund to the consumer any broker fee that is part of the credit transaction, even though the consumer paid the fee to the broker rather than to the creditor. Several commenters expressed concern that the literal language of the comment could be construed to encompass a fee paid to a broker who did not participate in the credit transaction. Some

commenters wanted broker fees covered only to the extent that the lender required the use of a broker. Creditors must refund to the consumer any broker's fee paid as part of the credit transaction, whether or not the creditor required the use of a broker.

(23)(f) Exempt Transactions
Paragraph (23)(f)(4)

Comment 23(f)–4 clarifies that § 226.23(f)(2) exempts from the right of rescission refinancings by original creditors—to whom a written agreement was originally payable. Therefore, if a consumer refinances with any other creditor, the general rescission model form (model form H–8) is the appropriate form to provide to the consumer.

Several commenters opposed the proposal, which they believe would result in an anomaly. That is, if the original creditor assigns the mortgage to a third party and the consumer returns to the original creditor to refinance (with no new advances), the original creditor would be excused from providing the consumer with the right of rescission.

In certain circumstances the application of this rule may produce an anomalous result. Nevertheless, this interpretation is required by section 103(f) of the act and § 226.2(a)(17) of the regulation, which define "creditor" as "* * * the person to whom the debt arising from the consumer credit transaction is initially payable. * * *".

The comment also clarifies that in a merger, consolidation or acquisition, the acquiring creditor would be considered the original creditor for purposes of the exemption in § 226.23(f)(2). For example, if two lending institutions merge, the resulting institution is considered the original creditor for refinancing mortgages previously originated by either of the two institutions. Accordingly, the new institution may use model form H–9 if new money is advanced. (See comment 2(a)(25)–6.)

Appendix J—Annual Percentage Rate Computations for Closed-End Credit Transactions

As proposed, the Board has revised the 1981 changes paragraph in the reference section to make a technical correction to the second sentence.

List of Subjects in 12 CFR Part 226

Advertising, Banks, banking, Consumer protection, Credit, Federal Reserve System, Mortgages, Reporting and recordkeeping requirements, Truth in lending.

For the reasons set forth in the preamble, the Board amends 12 CFR part 226 as follows:

PART 226—TRUTH IN LENDING (REGULATION Z)

1. The authority citation for part 226 continues to read as follows:

Authority: 12 U.S.C. 3806; 15 U.S.C. 1604 and 1637(c)(5).

2. In Supplement I to Part 226, under *Section 226.2—Definitions and Rules of Construction*, under *Paragraph 2(a)(17)(i)*, paragraph 8. is revised to read as follows:

Supplement I—Official Staff Interpretations

* * * * *

Subpart A—General

* * * * *

Section 226.2—Definitions and Rules of Construction

* * * * *

Paragraph 2(a)(17)(i)

* * * * *

8. *Loans from employee savings plan.* Some employee savings plans permit participants to borrow money up to a certain percentage of their account balances, and use a trust to administer the receipt and disbursement of funds. Unless each participant's account is an individual plan and trust, the creditor should apply the numerical tests to the plan as a whole rather than to the individual account, even if the loan amount is determined by reference to the balance in the individual account and the repayments are credited to the individual account. The person to whom the obligation is originally made payable (whether the plan, the trust, or the trustee) is the creditor for purposes of the act and regulation.

* * * * *

3. In Supplement I to Part 226, under *Section 226.4—Finance Charge*, the following amendments are made:

a. Under *4(a) Definition*, paragraphs 1., and 3. are revised, paragraphs 4., 5., and 6 are redesignated as paragraphs 5., 6., and 7., a new paragraph 4. is added, and newly designated paragraph 7. is revised;

b. Under *Paragraph 4(c)(7)*, paragraph 1. is revised and new paragraphs 2. and 3. are added; and

c. Under *(4)(e) Certain security interest charges*, paragraph 1. is revised.

The revisions and additions read as follows:

* * * * *

Section 226.4—Finance Charge

4(a) Definition.

1. *Charges in comparable cash transactions.* Charges imposed uniformly in cash and credit transactions are not finance charges. In determining whether an item is a

finance charge, the creditor should compare the credit transaction in question with a similar cash transaction. A creditor financing the sale of property or services may compare charges with those payable in a similar cash transaction by the seller of the property or service.

i. For example, the following items are not finance charges:

A. Taxes, license fees, or registration fees paid by both cash and credit customers.

B. Discounts that are available to cash and credit customers, such as quantity discounts.

C. Discounts available to a particular group of consumers because they meet certain criteria, such as being members of an organization or having accounts at a particular financial institution. This is the case even if an individual must pay cash to obtain the discount, provided that credit customers who are members of the group and do not qualify for the discount pay no more than the nonmember cash customers.

D. Charges for a service policy, auto club membership, or policy of insurance against latent defects offered to or required of both cash and credit customers for the same price.

ii. In contrast, the following items are finance charges:

A. Inspection and handling fees for the staged disbursement of construction loan proceeds.

B. Fees for preparing a Truth in Lending disclosure statement, if permitted by law (for example, the Real Estate Settlement Procedures Act prohibits such charges in certain transactions secured by real property).

C. Charges for a required maintenance or service contract imposed only in a credit transaction.

iii. If the charge in a credit transaction exceeds the charge imposed in a comparable cash transaction, only the difference is a finance charge. For example:

A. If an escrow agent is used in both cash and credit sales of real estate and the agent's charge is \$100 in a cash transaction and \$150 in a credit transaction, only \$50 is a finance charge.

2. Costs of doing business. * * *

3. *Charges by third parties.* Charges imposed on the consumer by someone other than the creditor are finance charges (unless otherwise excluded) if the creditor requires the use of a third party as a condition of or incident to the extension of credit, even if the consumer can choose the third party, or the creditor retains the charge. For example:

i. The cost of required mortgage insurance, even if the consumer is allowed to choose the insurer.

ii. A mortgage broker fee, to the extent that the broker shares the fee with the creditor.

4. *Charges by settlement agents.* Charges imposed on the consumer by a settlement agent (such as an attorney, escrow agent, or title company) are finance charges only if the creditor requires the particular services for which the settlement agent is charging the borrower and the charge for those services is not otherwise excluded from the finance charge. For example, a fee for courier service charged by a settlement agent to send a document to the title company or some other party is not a finance charge, provided that

the creditor has not required the use of a courier or retained the charge.

5. *Forfeitures of interest.* * * *

6. *Treatment of fees for use of automated teller machines.* * * *

7. *Taxes.* i. Generally, 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.

ii. In contrast, a tax is not a finance charge (even if the tax is collected by the creditor) if applicable law imposes the tax:

A. Solely on the consumer;

B. On the creditor and the consumer jointly;

C. On the credit transaction, without indicating which party is liable for the tax; or

D. On the creditor, if applicable law 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 passing on the tax, the law is deemed not to authorize passing it on.)

iii. For example, a stamp tax, property tax, intangible tax, or any other state or local tax imposed on the consumer, or on the credit transaction, is not a finance charge even if the tax is collected by the creditor.

iv. In addition, a tax is not a finance charge if it is excluded from the finance charge by an other provision of the regulation or commentary (for example, if the tax is imposed uniformly in cash and credit transactions).

* * * * *

Paragraph 4(c)(7).

1. *Real estate or residential mortgage transaction charges.* The list of charges in § 226.4(c)(7) applies both to residential mortgage transactions (which may include, for example, the purchase of a mobile home) and to other transactions secured by real estate. The fees are excluded from the finance charge even if the services for which the fees are imposed are performed by the creditor's employees rather than by a third party. In addition, the cost of verifying or confirming information connected to the item is also excluded. For example, credit report fees cover not only the cost of the report, but also the cost of verifying information in the report. In all cases, charges excluded under § 226.4(c)(7) must be bona fide and reasonable.

2. *Lump sum charges.* If a lump sum charged for several services includes a charge that is not excludable, a portion of the total should be allocated to that service and included in the finance charge. However, a lump sum charged for conducting or attending a closing (for example, by a lawyer or a title company) is excluded from the finance charge if the charge is primarily for services related to items listed in § 226.4(c)(7) (for example, reviewing or completing documents), even if other incidental services such as explaining various documents or disbursing funds for the parties are performed. The entire charge is excluded even if a fee for the incidental services would be a finance charge if it were imposed separately.

3. *Charges assessed during the loan term.* Real estate or residential mortgage

transaction charges excluded under § 226.4(c)(7) are those charges imposed solely in connection with the initial decision to grant credit. This would include, for example, a fee to search for tax liens on the property or to determine if flood insurance is required. The exclusion does not apply to fees for services to be performed periodically during the loan term, regardless of when the fee is collected. For example, a fee for one or more determinations during the loan term of the current tax lien status or flood insurance requirements is a finance charge, regardless of whether the fee is imposed at closing, or when the service is performed. If a creditor is uncertain about what portion of a fee to be paid at consummation or loan closing is related to the initial decision to grant credit, the entire fee may be treated as a finance charge.

* * * * *

(4)(e) Certain security interest charges.

1. Examples.

i. *Excludable charges.* Sums must be actually paid to public officials to be excluded from the finance charge under § 226.4(e)(1). Examples are charges or other fees required for filing or recording security agreements, mortgages, continuation statements, termination statements, and similar documents, and intangible property or other taxes imposed by the state solely on the creditor and payable by the consumer (if the tax must be paid to record a security agreement).

ii. *Charges not excludable.* If the obligation is between the creditor and a third party (an assignee, for example), charges or other fees for filing or recording security agreements, mortgages, continuation statements, termination statements, and similar documents relating to that obligation are not excludable from the finance charge under this section.

* * * * *

4. In Supplement I to Part 226, under Section 226.5—General Disclosure Requirements, under 5(b)(1) Initial disclosures., in paragraph 1., the first and second sentences are revised, and a new paragraph 5. is added to read as follows:

* * * * *

Subpart B—Open-End Credit

Section 226.5—General Disclosure Requirements

* * * * *

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 (such as when a consumer opens a credit plan and makes purchases contemporaneously at a retail store), receives the first advance, or pays any fees or charges under the plan other than an application fee or refundable membership fee (see below). * * *

* * * * *

5. *Balance transfers.* A creditor that solicits the transfer by a consumer of outstanding balances from an existing account to a new open-end plan must comply with § 226.6 before the balance transfer occurs. Card issuers that are subject to the requirements of § 226.5a may establish procedures that comply with both sections in a single disclosure statement.

* * * * *

5. In Supplement I to Part 226, under Section 226.6—*Initial Disclosure Statement*, under 6(b) *Other charges.*, paragraph 1. is revised to read as follows:

* * * * *

Section 226.6—*Initial Disclosure Statement*

* * * * *

6(b) *Other charges.*

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

- i. Late payment and over-the-credit-limit charges.
- ii. Fees for providing documentary evidence of transactions requested under § 226.13 (billing error resolution).
- iii. Charges imposed in connection with real estate transactions such as title, appraisal, and credit report fees (see § 226.4(c)(7)).
- iv. 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 § 226.4(a)).
- v. A membership or participation fee for a package of services that includes an open-end credit feature, unless the fee is required whether or not the open-end credit feature is included. For example, a membership fee to join a credit union is not an "other charge," even if membership is required to apply for credit.
- vi. Automated teller machine (ATM) charges described in comment 4(a)–5 that are not finance charges.
- vii. Charges imposed for the termination of an open-end credit plan.

* * * * *

6. In Supplement I to Part 226, under Section 226.12—*Special Credit Card Provisions*, under 12(b) *Liability of cardholder for unauthorized use.*, new paragraphs 2. and 3. are added to read as follows:

* * * * *

Section 226.12—*Special Credit Card Provisions*

* * * * *

12(b) *Liability of cardholder for unauthorized use.*

* * * * *

2. *Imposing liability.* A card issuer is not required to impose liability on a cardholder for the unauthorized use of a credit card; if the card issuer does not seek to impose liability, the issuer need not conduct any investigation of the cardholder's claim.

3. *Reasonable investigation.* If a card issuer seeks to impose liability when a claim of unauthorized use is made by a cardholder,

the card issuer must conduct a reasonable investigation of the claim. In conducting its investigation, the card issuer may reasonably request the cardholder's cooperation. The card issuer may not automatically deny a claim based solely on the cardholder's failure or refusal to comply with a particular request; however, if the card issuer otherwise has no knowledge of facts confirming the unauthorized use, the lack of information resulting from the cardholder's failure or refusal to comply with a particular request may lead the card issuer reasonably to terminate the investigation. The procedures involved in investigating claims may differ, but actions such as the following represent steps that a card issuer may take, as appropriate, in conducting a reasonable investigation:

- i. Reviewing the types or amounts of purchases made in relation to the cardholder's previous purchasing pattern.
- ii. Reviewing where the purchases were delivered in relation to the cardholder's residence or place of business.
- iii. Reviewing where the purchases were made in relation to where the cardholder resides or has normally shopped.
- iv. Comparing any signature on credit slips for the purchases to the signature of the cardholder or an authorized user in the card issuer's records, including other credit slips.
- v. Requesting documentation to assist in the verification of the claim.
- vi. Requesting a written, signed statement from the cardholder or authorized user.
- vii. Requesting a copy of a police report, if one was filed.
- viii. Requesting information regarding the cardholder's knowledge of the person who allegedly used the card or of that person's authority to do so.

* * * * *

7. In Supplement I to Part 226, under Section 226.15—*Right of Rescission*, the following amendments are made:

- a. Under Paragraph 15(a)(1), paragraph 5. is revised;
- b. Under Paragraph 15(a)(1), paragraph 6. is revised; and
- c. Under Paragraph 15(d)(2), in paragraph 1., the third sentence is revised.

The additions and revisions read as follows:

* * * * *

Section 226.15—*Right of Rescission*

* * * * *

Paragraph 15(a)(1).

* * * * *

5. *Principal dwelling.* A consumer can only have one principal dwelling at a time. (But see comment 15(a)(1)–6.) A vacation or other second home would not be a principal dwelling. A transaction secured by a second home (such as a vacation home) that is not currently being used as the consumer's principal dwelling is not rescindable, even if the consumer intends to reside there in the future. When a consumer buys or builds a new dwelling that will become the consumer's principal dwelling within one year or upon completion of construction, the

new dwelling is considered the principal dwelling if it secures the open-end credit line. In that case, the transaction secured by the new dwelling is a residential mortgage transaction and is not rescindable. For example, if a consumer whose principal dwelling is currently A builds B, to be occupied by the consumer upon completion of construction, an advance on an open-end line to finance B and secured by B is a residential mortgage transaction. Dwelling, as defined in § 226.2, includes structures that are classified as personalty under state law. For example, a transaction secured by a mobile home, trailer, or houseboat used as the consumer's principal dwelling may be rescindable.

6. *Special rule for principal dwelling.*

Notwithstanding the general rule that consumers may have only one principal dwelling, when the consumer is acquiring or constructing a new principal dwelling, a credit plan or extension that is subject to Regulation Z and is secured by the equity in the consumer's current principal dwelling is subject to the right of rescission regardless of the purpose of that loan (for example, an advance to be used as a bridge loan). For example, if a consumer whose principal dwelling is currently A builds B, to be occupied by the consumer upon completion of construction, a loan to finance B and secured by A is subject to the right of rescission. Moreover, a loan secured by both A and B is, likewise, rescindable.

* * * * *

Paragraph 15(d)(2).

1. *Refunds to consumer.* * * * "Any amount" includes finance charges already accrued, as well as other charges such as broker fees, application and commitment fees, or fees for a title search or appraisal, whether paid to the creditor, paid by the consumer directly to a third party, or passed on from the creditor to the third party. * * *

* * * * *

8. In Supplement I to Part 226, under Section 226.16—*Advertising*, under 16(d) *Additional Requirements for Home Equity Plans*, a new paragraph 7. is added to read as follows:

* * * * *

Section 226.16—*Advertising*

* * * * *

16(d) *Additional Requirements for Home Equity Plans.*

* * * * *

7. *Balloon payment.* In some programs, a balloon payment will occur if only the minimum payments under the plan are made. If an advertisement for such a program contains any statement about a minimum periodic payment, the advertisement must also state that a balloon payment will result (not merely that a balloon payment "may" result). (See comment 5b(d)(5)(ii)–3 for guidance on items not required to be stated in the advertisement, and on situations in which the balloon payment requirement does not apply.)

* * * * *

9. In Supplement I to Part 226, under Section 226.17—*General Disclosure*

Requirements, the following amendments are made:

- a. Under Paragraph 17(a)(1), paragraph 5. is revised;
- b. Under Paragraph 17(c)(4), a new paragraph 4. is added; and
- c. Under 17(f) *Early disclosures*, paragraph 1. is revised.

The revisions and additions read as follows:

* * * * *

Subpart C—Closed-End Credit

Section 226.17—General Disclosure Requirements

* * * * *

Paragraph 17(a)(1).

* * * * *

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

- i. A description of a grace period after which a late payment charge will be imposed. For example, the disclosure given under § 226.18(l) may state that a late charge will apply to "any payment received more than 15 days after the due date."
- ii. A statement that the transaction is not secured. For example, the creditor may add a category labelled "unsecured" or "not secured" to the security interest disclosures given under § 226.18(m).
- iii. The basis for any estimates used in making disclosures. For example, if the maturity date of a loan depends solely on the occurrence of a future event, the creditor may indicate that the disclosures assume that event will occur at a certain time.
- iv. The conditions under which a demand feature may be exercised. For example, in a loan subject to demand after five years, the disclosures may state that the loan will become payable on demand in five years.
- v. An explanation of the use of pronouns or other references to the parties to the transaction. For example, the disclosures may state, "'You' refers to the customer and 'we' refers to the creditor."
- vi. Instructions to the creditor or its employees on the use of a multiple-purpose form. For example, the disclosures may state, "Check box if applicable."
- vii. A statement that the borrower may pay a minimum finance charge upon prepayment in a simple-interest transaction. For example, when state law prohibits penalties, but would allow a minimum finance charge in the event of prepayment, the creditor may make the § 226.18(k)(1) disclosure by stating, "You may be charged a minimum finance charge."
- viii. A brief reference to negative amortization in variable-rate transactions. For example, in the variable-rate disclosure, the creditor may include a short statement such as "Unpaid interest will be added to principal." (See the commentary to § 226.18(f)(1)(iii).)
- ix. A brief caption identifying the disclosures. For example, the disclosures may bear a general title such as "Federal Truth in Lending Disclosures" or a

descriptive title such as "Real Estate Loan Disclosures."

x. 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 § 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."

xi. 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 § 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."

xii. More than one hypothetical example under § 226.18(f)(1)(iv) in transactions with more than one variable-rate feature. For example, in a variable-rate transaction with an option permitting consumers to convert to a fixed-rate transaction, the disclosures may include an example illustrating the effects on the payment terms of an increase resulting from conversion in addition to the example illustrating an increase resulting from changes in the index.

xiii. The disclosures set forth under § 226.18(f)(1) for variable-rate transactions subject to § 226.18(f)(2).

xiv. 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.

xv. A late-payment fee disclosure under § 226.18(l) on a single payment loan.

* * * * *

Paragraph 17(c)(4).

* * * * *

4. *Relation to prepaid finance charges.* Prepaid finance charges, including "odd-days" or "per-diem" interest, paid prior to or at closing may not be treated as the first payment on a loan. Thus, creditors may not disregard an irregularity in disclosing such finance charges.

* * * * *

17(f) *Early disclosures.*

1. *Change in rate or other terms.*

Redisclosure is required for changes that occur between the time disclosures are made and consummation if the annual percentage rate in the consummated transaction exceeds the limits prescribed in § 226.22(a) (1/8 of 1 percentage point in regular transactions and 1/4 of 1 percentage point in irregular transactions). Redisclosure is also required, even if the annual percentage rate is within the permitted tolerance, if the disclosures were not based on estimates in accordance with § 226.17(c)(2) and labelled as such. To illustrate:

- i. If disclosures are made in a regular transaction on July 1, the transaction is consummated on July 15, and the actual annual percentage rate varies by more than 1/8 of 1 percentage point from the disclosed annual percentage rate, the creditor must

either redisclose the changed terms or furnish a complete set of new disclosures before consummation. Redisclosure is required even if the disclosures made on July 1 are based on estimates and marked as such;

- ii. If disclosures are made on July 1, the transaction is consummated on July 15, and the finance charge increased by \$35 but the disclosed annual percentage rate is within the permitted tolerance, the creditor must at least redisclose the changed terms that were not marked as estimates. (See § 226.18(d) and footnote 41 of this part); and

- iii. If early disclosures are marked as estimates and the disclosed annual percentage rate is within tolerance at consummation, the creditor need not redisclose the changed terms (including the annual percentage rate).

* * * * *

10. In Supplement I to Part 226, under Section 226.18—*Content of Disclosures*, the following amendments are made:

- a. Under Paragraph 18(c)(1)(iv), a new paragraph 2. is added; and
- b. Under 18(d) *Finance charge*, paragraph 2. is revised.

The additions and revisions read as follows:

* * * * *

Section 226.18—Content of Disclosures

* * * * *

Paragraph 18(c)(1)(iv).

* * * * *

2. *Prepaid mortgage insurance premiums.* RESPA requires creditors to give consumers a settlement statement disclosing the costs associated with mortgage loan transactions. Included on the settlement statement are mortgage insurance premiums collected at settlement, which are prepaid finance charges. In calculating the total amount of prepaid finance charges, creditors should use the amount for mortgage insurance listed on the line for mortgage insurance on the settlement statement (line 1002 on HUD-1 or HUD 1-A), without adjustment, even if the actual amount collected at settlement may vary because of RESPA's escrow accounting rules. Figures for mortgage insurance disclosed in conformance with RESPA shall be deemed to be accurate for purposes of Regulation Z.

18(d) *Finance charge.*

* * * * *

2. *Tolerance.* A tolerance for the finance charge is provided in footnote 41 of this part. When a miscalculation of the amount financed, or of some other numerical disclosure for which the regulation provides no specific tolerance, results from an error in a finance charge, the miscalculated amount financed or other numerical disclosure does not violate the act or the regulation if the finance charge disclosed under § 226.18(d) is within the permissible tolerance under footnote 41 of this part.

* * * * *

11. In Supplement I to Part 226, under Section 226.19—*Certain Residential Mortgage and Variable-Rate Transactions*, under paragraph

19(b)(2)(vii)., paragraph 2. is revised to read as follows:

Section 226.19—Certain Residential Mortgage and Variable-Rate Transactions

Paragraph 19(b)(2)(vii).

2. Negative amortization and interest rate carryover. A creditor must disclose, where applicable, the possibility of negative amortization. For example, the disclosure might state, "If any of your payments is not sufficient to cover the interest due, the difference will be added to your loan amount." Loans that provide for more than one way to trigger negative amortization are separate variable-rate programs requiring separate disclosures. (See the commentary to § 226.19(b)(2) for a discussion on the definition of a variable-rate loan program and the format for disclosure.) If a consumer is given the option to cap monthly payments that may result in negative amortization, the creditor must fully disclose the rules relating to the option, including the effects of exercising the option (such as negative amortization will occur and the principal loan balance will increase); however, the disclosure in § 226.19(b)(2)(viii) need not be provided.

12. In Supplement I to Part 226, under Section 226.22—Determination of the Annual Percentage Rate, under Paragraph 22(a)(1)., in paragraph 5., the reference "Footnote 45a" is revised to read "Footnote 45d".

13. In Supplement I to Part 226, under Section 226.23—Right of Rescission, the following amendments are made:

- a. Under Paragraph 23(a)(1)., paragraph 3. is revised;
b. Under Paragraph 23(a)(1)., paragraph 4. is revised;
c. Under Paragraph 23(d)(2)., in paragraph 1., the third sentence is revised; and
d. Under 23(f) Exempt transactions., in paragraph 4., two new sentences are added following the first sentence, and a new sentence is added at the end of the paragraph.

The additions and revisions read as follows:

Section 226.23—Right of Rescission

Paragraph 23(a)(1).

3. Principal dwelling. A consumer can only have one principal dwelling at a time. (But see comment 23(a)(1)-4.) A vacation or other second home would not be a principal dwelling. A transaction secured by a second home (such as a vacation home) that is not currently being used as the consumer's principal dwelling is not rescindable, even if the consumer intends to reside there in the future. When a consumer buys or builds a new dwelling that will become the

consumer's principal dwelling within one year or upon completion of construction, the new dwelling is considered the principal dwelling if it secures the acquisition or construction loan. In that case, the transaction secured by the new dwelling is a residential mortgage transaction and is not rescindable. For example, if a consumer whose principal dwelling is currently A builds B, to be occupied by the consumer upon completion of construction, a construction loan to finance B and secured by B is a residential mortgage transaction. Dwelling, as defined in § 226.2, includes structures that are classified as personalty under state law. For example, a transaction secured by a mobile home, trailer, or houseboat used as the consumer's principal dwelling may be rescindable.

4. Special rule for principal dwelling. Notwithstanding the general rule that consumers may have only one principal dwelling, when the consumer is acquiring or constructing a new principal dwelling, any loan subject to Regulation Z and secured by the equity in the consumer's current principal dwelling (for example, a bridge loan) is subject to the right of rescission regardless of the purpose of that loan. For example, if a consumer whose principal dwelling is currently A builds B, to be occupied by the consumer upon completion of construction, a construction loan to finance B and secured by A is subject to the right of rescission. A loan secured by both A and B is, likewise, rescindable.

Paragraph 23(d)(2).

1. Refunds to consumer. "Any amount" includes finance charges already accrued, as well as other charges, such as broker fees, application and commitment fees, or fees for a title search or appraisal, whether paid to the creditor, paid directly to a third party, or passed on from the creditor to the third party.

23(f) Exempt transactions.

4. New advances. The original creditor is the creditor to whom the written agreement was initially made payable. In a merger, consolidation or acquisition, the successor institution is considered the original creditor for purposes of the exemption in § 226.23(f)(2). The general rescission notice (model form H-8) is the appropriate form for use by creditors not considered original creditors in refinancing transactions.

14. In Supplement I to Part 226, under Appendix J, under the heading References, under 1981 changes., the last sentence is revised to read as follows:

Appendix J—Annual Percentage Rate Computations for Closed-End Credit Transactions

References

1981 changes: Paragraph (b)(5)(vi) has been revised to permit creditors in single-advance, single-payment transactions in which the term is less than a year and is equal to a whole number of months, to use either the 12-month method or the 365-day method to compute the number of unit-periods per year.

By order of the Board of Governors of the Federal Reserve System, acting through the Secretary of the Board under delegated authority, March 28, 1995.

William W. Wiles,

Secretary of the Board.

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