FEDERAL RESERVE BANK
OF DALLAS

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

DALLAS, TEXAS
75265-5906

April 25, 1997

Notice 97-41

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

SUBJECT

Revised Pamphlets for Regulations L, M, and the Official Staff Commentary on Regulation B; Slip-sheet Amendments to Regulations K and Z

DETAILS

The Board of Governors of the Federal Reserve System has published revised pamphlets for Regulation L, effective October 1, 1996; Regulation M, effective October 31, 1996; and the Official Staff Commentary on Regulation B, effective September 30, 1996.

In addition, the Board has published slip-sheet amendments to Regulation K, effective August 28, 1996, and Regulation Z, effective October 21, 1996.

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.

ENCLOSURES

The revised pamphlets and slip-sheet amendments are enclosed. Please insert them in your Regulations binders.

MORE INFORMATION

For more information regarding Regulation L, please contact Dean Pankonien at (214) 922-6154. For more information regarding Regulation M, Regulation Z, or the Official Staff Commentary on Regulation B, please contact Eugene Coy at (214) 922-6201. For more information regarding Regulation K, please contact Susan Tetley at (214) 922-6060.

For additional copies of this Bank's notice, the revised pamphlets, or the amendment slip sheets, please contact the Public Affairs Department at (214) 922-5254.

Sincerely yours,

Robert D. McTeer, Jr.

Board of Governors of the Federal Reserve System

Regulation L
Management Official Interlocks

12 CFR 212; as amended effective October 1, 1996

Any inquiry relating to this regulation should be addressed to the Federal Reserve Bank of the District in which the inquiry arises.

September 1996

Contents

Regulation L
Management Official Interlocks

12 CFR 212; as amended effective October 1, 1996

SECTION 212.1—Authority, Purpose, and Scope

(a) *Authority.* This part is issued under the provisions of the Depository Institution Management Interlocks Act (Interlocks Act) (12 USC 3201 et seq.), as amended.

(b) *Purpose.* The purpose of the Interlocks Act and this part is to foster competition by generally prohibiting a management official from serving two nonaffiliated depository organizations in situations where the management interlock likely would have an anticompetitive effect.

(c) *Scope.* This part applies to management officials of state member banks, bank holding companies, and their affiliates.

SECTION 212.2—Definitions

For purposes of this part, the following definitions apply:

(a) *Affiliate.*

(1) The term "affiliate" has the meaning given in section 202 of the Interlocks Act (12 USC 3201). For purposes of that section 202, shares held by an individual include shares held by members of his or her immediate family. "Immediate family" means spouse, mother, father, child, grandchild, sister, brother, or any of their spouses, whether or not any of their shares are held in trust.

(2) For purposes of section 202(3)(B) of the Interlocks Act (12 USC 3201(3)(B)), an affiliate relationship based on common ownership does not exist if the Board determines, after giving the affected persons the opportunity to respond, that the asserted affiliation was established in order to avoid the prohibitions of the Interlocks Act and does not represent a true commonality of interest between the depository organizations. In making this determination, the Board considers, among other things, whether a person, including members of his or her immediate family, whose shares are necessary to constitute the group owns a nominal percentage of the shares of one of the organizations and the percentage is substantially disproportionate to that person's ownership of shares in the other organization.

(b) *Anticompetitive effect* means a monopoly or substantial lessening of competition.

(c) *Area median income* means—

(1) the median family income for the metropolitan statistical area (MSA), if a depository organization is located in an MSA; or

(2) the statewide nonmetropolitan median family income, if a depository organization is located outside an MSA.

(d) *Community* means a city, town, or village, and contiguous and adjacent cities, towns, or villages.

(e) *Contiguous or adjacent cities, towns, or villages* means cities, towns, or villages whose borders touch each other or whose borders are within 10 road miles of each other at their closest points. The property line of an office located in an unincorporated city, town, or village is the boundary line of that city, town, or village for the purpose of this definition.

(f) *Critical,* as used in section 212.5, means important to restoring or maintaining a depository organization's safe and sound operations.

(g) *Depository holding company* means a bank holding company or a savings and loan holding company (as more fully defined in section 202 of the Interlocks Act (12 USC 3201)) having its principal office located in the United States.

(h) *Depository institution* means a commercial bank (including a private bank), a savings bank, a trust company, a savings and loan association, a building and loan association, a homestead association, a cooperative bank, an industrial bank, or a credit union, chartered under the laws of the United States and having a principal office located in the United

States. Additionally, a United States office, including a branch or agency, of a foreign commercial bank is a depository institution.

(i) *Depository institution affiliate* means a depository institution that is an affiliate of a depository organization.

(j) *Depository organization* means a depository institution or a depository holding company.

(k) *Low- and moderate-income areas* means census tracts (or, if an area is not in a census tract, block-numbering areas delineated by the United States Bureau of the Census) where the median family income is less than 100 percent of the area median income.

(*l*) *Management official.*

(1) The term "management official" means—

(i) a director;

(ii) an advisory or honorary director of a depository institution with total assets of $100 million or more;

(iii) a senior executive officer as that term is defined in 12 CFR 225.71(a);

(iv) a branch manager;

(v) a trustee of a depository organization under the control of trustees; and

(vi) any person who has a representative or nominee, as defined in paragraph (p) of this section, serving in any of the above capacities in this paragraph (*l*)(1).

(2) The term "management official" does not include—

(i) a person whose management functions relate exclusively to the business of retail merchandising or manufacturing;

(ii) a person whose management functions relate principally to a foreign commercial bank's business outside the United States; or

(iii) a person described in the provisos of section 202(4) of the Interlocks Act (referring to an officer of a state-chartered savings bank, cooperative bank, or trust company that neither makes real estate mortgage loans nor accepts savings).

(m) *Office* means a principal or branch office of a depository institution located in the United States. "Office" does not include a representative office of a foreign commercial bank, an electronic terminal, a loan production office, or any office of a depository holding company.

(n) *Person* means a natural person, corporation, or other business entity.

(o) *Relevant metropolitan statistical area (RMSA)* means an MSA, a primary MSA, or a consolidated MSA that is not comprised of designated primary MSAs to the extent that these terms are defined and applied by the Office of Management and Budget.

(p) *Representative or nominee* means a natural person who serves as a management official and has an obligation to act on behalf of another person with respect to management responsibilities. The Board will find that a person has an obligation to act on behalf of another person only if the first person has an agreement, express or implied, to act on behalf of the second person with respect to management responsibilities. The Board will determine, after giving the affected persons an opportunity to respond, whether a person is a representative or nominee.

(q) *Total assets.*

(1) The term "total assets" means assets measured on a consolidated basis and reported in the most recent fiscal year-end Consolidated Report of Condition and Income.

(2) The term "total assets" does not include—

(i) assets of a diversified savings and loan holding company as defined by section 10(a)(1)(F) of the Home Owners' Loan Act (12 USC 1467a(a)(1)(F)) other than the assets of its depository institution affiliate;

(ii) assets of a bank holding company that is exempt from the prohibitions of section 4 of the Bank Holding Company Act of 1956 pursuant to an order issued under section 4(d) of that act (12 USC 1843(d)) other than the assets of its depository institution affiliate; or

(iii) assets of offices of a foreign commercial bank other than the assets of its United States branch or agency.

(r) *United States* means the United States of America, any state or territory of the United States of America, the District of Columbia, Puerto Rico, Guam, American Samoa, and the Virgin Islands.

SECTION 212.3—Prohibitions

(a) *Community.* A management official of a depository organization may not serve at the same time as a management official of an unaffiliated depository organization if the depository organizations in question (or a depository institution affiliate thereof) have offices in the same community.

(b) *RMSA.* A management official of a depository organization may not serve at the same time as a management official of an unaffiliated depository organization if the depository organizations in question (or a depository institution affiliate thereof) have offices in the same RMSA and each depository organization has total assets of $20 million or more.

(c) *Major assets.* A management official of a depository organization with total assets exceeding $1 billion (or any affiliate thereof) may not serve at the same time as a management official of an unaffiliated depository organization with total assets exceeding $500 million (or any affiliate thereof), regardless of the location of the two depository organizations.

SECTION 212.4—Interlocking Relationships Permitted by Statute

The prohibitions of section 212.3 do not apply in the case of any one or more of the following organizations or to a subsidiary thereof;

(a) a depository organization that has been placed formally in liquidation, or which is in the hands of a receiver, conservator, or other official exercising a similar function;

(b) a corporation operating under section 25 or section 25A of the Federal Reserve Act (12 USC 601 et seq. and 12 USC 611 et seq., respectively) (Edge corporations and agreement corporations);

(c) a credit union being served by a management official of another credit union;

(d) a depository organization that does not do business within the United States except as an incident to its activities outside the United States;

(e) a state-chartered savings and loan guaranty corporation;

(f) a Federal Home Loan Bank or any other bank organized solely to serve depository institutions (a bankers' bank) or solely for the purpose of providing securities clearing services and services related thereto for depository institutions and securities companies;

(g) a depository organization that is closed or is in danger of closing as determined by the appropriate federal depository institutions regulatory agency and is acquired by another depository organization. This exemption lasts for five years, beginning on the date the depository organization is acquired; and

(h) (1) a diversified savings and loan holding company (as defined in section 10(a)(1)(F) of the Home Owners' Loan Act (12 USC 1467a(a)(1)(F)) with respect to the service of a director of such company who also is a director of an unaffiliated depository organization if—

(i) both the diversified savings and loan holding company and the unaffiliated depository organization notify their appropriate federal depository institutions regulatory agency at least 60 days before the dual service is proposed to begin; and

(ii) the appropriate regulatory agency does not disapprove the dual service before the end of the 60-day period.

(2) The Board may disapprove a notice of proposed service if it finds that—

(i) the service cannot be structured or limited so as to preclude an anticompetitive effect in financial services in any part of the United States;

(ii) the service would lead to substantial conflicts of interest or unsafe or unsound practices; or

(iii) the notificant failed to furnish all the information required by the Board.

(3) The Board may require that any inter-

lock permitted under this paragraph (h) be terminated if a change in circumstances occurs with respect to one of the interlocked depository organizations that would have provided a basis for disapproval of the interlock during the notice period.

SECTION 212.5—Regulatory-Standards Exemption

(a) *Criteria.* The Board may permit an interlock that otherwise would be prohibited by the Interlocks Act and section 212.3 if—

(1) the board of directors of the depository organization (or the organizers of a depository organization being formed) that seeks the exemption provides a resolution to the Board certifying that the organization, after the exercise of reasonable efforts, is unable to locate any other candidate from the community or RMSA, as appropriate, who—

(i) possesses the level of expertise required by the depository organization and who is not prohibited from service by the Interlocks Act; and

(ii) is willing to serve as a management official; and

(2) the Board, after reviewing an application submitted by the depository organization seeking the exemption, determines that—

(i) the management official is critical to the safe and sound operations of the affected depository organization; and

(ii) service by the management official will not produce an anticompetitive effect with respect to the depository organization.

(b) *Presumptions.* The Board applies the following presumptions when reviewing any application for a regulatory-standards exemption:

(1) An interlock will not have an anticompetitive effect if it involves depository organizations that, if merged, would not cause the post-merger Herfindahl-Hirschman Index (HHI) to exceed 1800 and would not cause the HHI to increase by more than 200 points. This presumption does not apply to depository organizations subject to the major-assets prohibition of section 212.3(c).

(2) A proposed management official is critical to the safe and sound operations of a depository institution if—

(i) that official is approved by the Board to serve as a director or senior executive officer of that institution pursuant to 12 CFR 225.71; and

(ii) the institution had operated for less than two years, was not in compliance with minimum capital requirements, or otherwise was in a "troubled condition" as defined in 12 CFR 225.71 at the time the service under that section was approved.

(c) *Duration of interlock.* An interlock permitted under this section may continue until the Board notifies the affected depository organizations otherwise. The Board may require termination of any interlock permitted under this section if the Board concludes, after giving the affected persons the opportunity to respond, that the determinations under paragraph (a)(2) of this section no longer may be made. A management official may continue serving the depository organization involved in the interlock for a period of 15 months following the date of the order to terminate the interlock. The Board may shorten this period under appropriate circumstances.

SECTION 212.6—Management-Consignment Exemption

(a) *Criteria.* The Board may permit an interlock that otherwise would be prohibited by the Interlocks Act and section 212.3 if the Board, after reviewing an application submitted by the depository organization seeking an exemption, determines that the interlock would—

(1) improve the provision of credit to low- and moderate-income areas;

(2) increase the competitive position of a minority- or women-owned depository organization;

(3) strengthen the management of a depository institution that has been chartered for less than two years at the time an application is filed under this part; or

(4) strengthen the management of a depository institution that is in an unsafe or un-

sound condition as determined by the Board on a case-by-case basis.

(b) *Presumptions.* The Board applies the following presumptions in reviewing any application for a management-consignment exemption:

(1) A proposed management official is capable of strengthening the management of a depository institution described in paragraph (a)(3) of this section if that official is approved by the Board to serve as a director or senior executive officer of that institution pursuant to 12 CFR 225.71 and the institution had operated for less than two years at the time the service was approved; and

(2) A proposed management official is capable of strengthening the management of a depository institution described in paragraph (a)(4) of this section if the official is approved by the Board to serve as a director or senior executive officer of the institution pursuant to 12 CFR 225.71 and the institution was not in compliance with minimum capital requirements or otherwise was in a "troubled condition" as defined under 12 CFR 225.71 at the time service was approved.

(c) *Duration of interlock.* An interlock granted under this section may continue for a period of two years from the date of approval. The Board may extend this period for one additional two-year period if the depository organization applies for an extension at least 30 days before the current exemption expires and satisfies one of the criteria specified in paragraph (a) of this section. The provisions set forth in paragraph (b) of this section also apply to applications for extensions.

SECTION 212.7—Change in Circumstances

(a) *Termination.* A management official shall terminate his or her service or apply for an exemption to the Interlocks Act if a change in circumstances causes the service to become prohibited under that act. A change in circumstances may include, but is not limited to, an increase in asset size of an organization, a change in the delineation of the RMSA or community, the establishment of an office, an acquisition, a merger, a consolidation, or any reorganization of the ownership structure of a depository organization that causes a previously permissible interlock to become prohibited.

(b) *Transition period.* A management official described in paragraph (a) of this section may continue to serve the state member bank or bank holding company involved in the interlock for 15 months following the date of the change in circumstances. The Board may shorten this period under appropriate circumstances.

SECTION 212.8—Enforcement

Except as provided in this section, the Board administers and enforces the Interlocks Act with respect to state member banks, bank holding companies, and affiliates of either, and may refer any case of a prohibited interlocking relationship involving these entities to the attorney general of the United States to enforce compliance with the Interlocks Act and this part. If an affiliate of a state member bank or a bank holding company is subject to the primary regulation of another federal depository organization supervisory agency, then the Board does not administer and enforce the Interlocks Act with respect to that affiliate.

SECTION 212.9—Effect of Interlocks Act on Clayton Act

The Board regards the provisions of the first three paragraphs of section 8 of the Clayton Act (15 USC 19) to have been supplanted by the revised and more comprehensive prohibitions on management official interlocks between depository organizations in the Interlocks Act.

Depository Institution Management Interlocks Act

12 USC 3201 et seq.; 92 Stat. 3672; Pub. L. 95-630, Financial Institutions Regulatory and Interest Rate Control Act, Title II (November 10, 1978)

FIRA, TITLE II—Interlocking Directors

SECTION 201—Short Title

This title may be cited as the "Depository Institution Management Interlocks Act".

[12 USC 3201 note.]

SECTION 202—Definitions

As used in this title—

(1) the term "*depository institution*" means a commercial bank, a savings bank, a trust company, a savings and loan association, a building and loan association, a homestead association, a cooperative bank, an industrial bank, or a credit union;

(2) the term "*depository holding company*" means a bank holding company as defined in section 2(a) of the Bank Holding Company Act of 1956, a company which would be a bank holding company as defined in section 2(a) of the Bank Holding Company Act of 1956 but for the exemption contained in section 2(a)(5)(F) thereof, or a savings and loan holding company as defined in section 408(a)(1)(d) of the National Housing Act;

(3) the characterization of any corporation (including depository institutions and depository holding companies), as an "affiliate of," or as "affiliated" with any other corporation means that—

(A) one of the corporations is a depository holding company and the other is a subsidiary thereof, or both corporations are subsidiaries of the same depository holding company, as the term "subsidiary" is defined in either section 2(d) of the Bank Holding Company Act of 1956 in the case of a bank holding company or section 408(a)(1)(H) of the National Housing Act in the case of a savings and loan holding company; or

(B) more than 25 percent of the voting stock of one corporation is beneficially owned in the aggregate by one or more persons who also beneficially own in the aggregate more than 25 percent of the voting stock of the other corporation; or

(C) one of the corporations is a trust company all of the stock of which, except for directors qualifying shares, was owned by one or more mutual savings bank on the date of enactment of this Act, and the other corporation is a mutual savings bank; or

(D) one of the corporations is a bank, insured by the Federal Deposit Insurance Corporation and chartered under State law, and is a bankers' bank, described in Paragraph Seventh of section 5136 of the Revised Statutes; or

(E) one of the corporations is a bank, chartered under State law and insured by the Federal Deposit Insurance Corporation, the voting securities of which are held only by persons who are officers of other banks, as permitted by State law, and which bank is primarily engaged in providing banking services for other banks and not the public: *Provided, however,* That in no case shall the voting securities of such corporation be held by such officers of the other banks in excess of 6 per centum of the paid-in capital and 6 per centum of the surplus of such a bank.

(4) the term "*management official*" means an employee or officer with management functions, a director (including an advisory or honorary director except in the case of a depository institution with total assets of less than $100,000,000), a trustee of a business organization under the control of trustees, or any person who has a representative or nominee serving in any such capacity: *Provided,* That if a corporator, trustee, director, or other officer of a State-chartered savings bank or cooperative bank is specifically authorized under the laws of the State in which said institution is located to serve as a trustee, director, or other officer of a State-chartered trust company which does

not make real estate mortgage loans and does not accept savings deposits from natural persons, then, for the purposes of this title, such corporator, trustee, director, or other officer shall not be deemed to be a management official of such trust company: *And provided further,* That if a management official of a State-chartered trust company which does not make real estate mortgage loans and does not accept savings deposits from natural persons is specifically authorized under the laws of the State in which said institution is located to serve as a corporator, trustee, director, or other officer of a State-chartered savings bank or cooperative bank, then, for the purposes of this title, such management official shall not be deemed to be a management official of any such savings bank or cooperative bank;

(5) the term "*office*" used with reference to a depository institution means either a principal office or a branch; and

(6) the term "appropriate Federal depository institutions regulatory agency" means, with respect to any depository institution or depository holding company, the agency referred to in section 209 in connection with such institution or company.

[12 USC 3201. As amended by acts of Nov. 10, 1988 (102 Stat. 3819, 3820) and Sept. 23, 1994 (108 Stat. 2227).]

SECTION 203—Management Official of Unaffiliated Institution or Company in Same Area

A management official of a depository institution or a depository holding company may not serve as a management official of any other depository institution or depository holding company not affiliated therewith if an office of one of the institutions or any depository institution that is an affiliate of such institutions is located within either—

(1) the same primary metropolitan statistical area, the same metropolitan statistical area, or the same consolidated metropolitan statistical area that is not comprised of designated primary metropolitan statistical areas as defined by the Office of Management and Budget, except in the case of depository institutions with less than $20,000,000 in assets in which case the provision of paragraph (2) shall apply, as that in which an office of the other institution or any depository institution that is an affiliate of such other institution is located, or

(2) the same city, town, or village as that in which an office of the other institution or any depository institution that is an affiliate of such other institution is located, or in any city, town, or village contiguous or adjacent thereto.

[12 USC 3202. As amended by act of Nov. 30, 1983 (97 Stat. 1267).]

SECTION 204—Management Official of $1 Billion Institution or Company as Management Official of Unaffiliated Institution or Company

If a depository institution or a depository holding company has total assets exceeding $1,000,000,000, a management official of such institution or any affiliate thereof may not serve as a management official of any other nonaffiliated depository institution or depository holding company having total assets exceeding $500,000,000 or as a management official of any affiliate of such other institution.

[12 USC 3203.]

SECTION 205—Exceptions

The prohibitions contained in sections 203 and 204 shall not apply in the case of any one or more of the following or subsidiary thereof:

(1) A depository institution or depository holding company which has been placed formally in liquidation, or which is in the hands of a receiver, conservator, or other official exercising a similar function.

(2) A corporation operating under section 25 or 25(a) of the Federal Reserve Act.

(3) A credit union being served by a management official of another credit union.

(4) A depository institution or depository holding company which does not do business within any State of the United States, the District of Columbia, any territory of the United States, Puerto Rico, Guam, American Samoa, or the Virgin Islands ex-

cept as an incident to its activities outside the United States.

(5) A State-chartered savings and loan guaranty corporation.

(6) A Federal Home Loan Bank or any other bank organized specifically to serve depository institutions.

(7) A depository institution or a depository holding company which—

(A) is closed or is in danger of closing, as determined by the appropriate Federal depository institutions regulatory agency in accordance with regulations prescribed by such agency; and

(B) is acquired by another depository institution or depository holding company,

during the 5-year period beginning on the date of the acquisition of the depository institution or depository holding company described in subparagraph (A).

(8) (A) A diversified savings and loan holding company (as defined in section 408(a)(1)(F) of the National Housing Act) with respect to the service of a director of such company who is also a director of any nonaffiliated depository institution or depository holding company (including a savings and loan holding company) if—

(i) notice of the proposed dual service is given by such diversified savings and loan holding company to—

(I) the appropriate Federal depository institutions regulatory agency for such company; and

(II) the appropriate Federal depository institutions regulatory agency for the nonaffiliated depository institution or depository holding company of which such person is also a director,

not less than 60 days before such dual service is proposed to begin; and

(ii) the proposed dual service is not disapproved by any such appropriate Federal depository institutions regulatory agency before the end of such 60-day period.

(B) Any appropriate Federal depository institutions regulatory agency may disapprove, under subparagraph (A)(ii), a notice of proposed dual service by any individual if such agency finds that—

(i) the dual service cannot be structured or limited so as to preclude the dual service's resulting in a monopoly or substantial lessening of competition in financial services in any part of the United States;

(ii) the dual service would lead to substantial conflicts of interest or unsafe or unsound practices; or

(iii) the diversified savings and loan holding company has neglected, failed, or refused to furnish all the information required by such agency.

(C) Any appropriate Federal depository institutions regulatory agency may, at any time after the end of the 60-day period referred to in subparagraph (A), require that any dual service by any individual which was not disapproved by such agency during such period be terminated if a change in circumstances occurs with respect to any depository institution or depository holding company of which such individual is a director that would have provided a basis for disapproval of the dual service during such period.

(9) Any savings association (as defined in section 10(a)(1)(A) of the Home Owners' Loan Act or any savings and loan holding company (as defined in section 10(a)(1)(D) of such Act) which has issued stock in connection with a qualified stock issuance pursuant to section 10(q) of such Act, except that this paragraph shall apply only with respect to service as a single management official of such savings association or holding company, or any subsidiary of such savings association or holding company, by a single management official of the savings and loan holding company which purchased the stock issued in connection with such qualified stock issuance, and shall apply only when the Director of the Office of Thrift Supervision has determined that such service is consistent with the purposes of this Act and the Home Owners' Loan Act.

[12 USC 3204. As amended by acts of Oct. 15, 1982 (96 Stat. 1524); Nov. 10, 1988 (102 Stat. 3819); and Aug. 9, 1989 (103 Stat. 410).]

SECTION 206—Management Official in Position Prior to November 10, 1978

(a) A person whose service in a position as a management official began prior to the date of enactment of this title and who was not immediately prior to the date of enactment of this title in violation of section 8 of the Clayton Act is not prohibited by section 203 or section 204 of this title from continuing to serve in that position for a period of, subject to the requirements of subsection (c), 20 years after the date of enactment of this title. The appropriate Federal depository institutions regulatory agency may provide a reasonable period of time for compliance with this title, not exceeding fifteen months, after any change in circumstances which makes service described in the preceding sentence prohibited by this title, except that a merger, acquisition, increase in total assets, establishment of one or more offices, or change in management responsibilities shall not constitute changes in circumstances which would make such service prohibited by section 203 or section 204 of this title.

(b) Effective on the date of enactment of this title, a person who serves as a management official of a company which is not a depository institution or a depository holding company and as a management official of a depository institution or a depository holding company is not prohibited from continuing to serve as a management official of that depository institution or depository holding company as a result of that company which is not a depository institution or depository holding company becoming a diversified savings and loan holding company as that term is defined in section 408(a) of the National Housing Act. This subsection shall expire, subject to the requirements of subsection (c), 20 years after the date of enactment of this title.

(c) *Review of existing management interlocks.* Upon the timely filing of a submission by a person petitioning to serve as a management official in more than 1 position pursuant to subsection (a) or (b), each appropriate Federal depository institutions regulatory agency shall, not later than 6 months after the date of enactment of this Act—

(1) review, on a case-by-case basis, the circumstances under which such person has served as a management official under the provisions of subsection (a) or (b); and

(2) permit the management official to continue to serve in such position only if—

(A) such person has provided a resolution from the boards of directors of each affected depository institution, depository holding company, or company described in subsection (b), certifying to the appropriate Federal depository institutions regulatory agency for each of the institutions involved that there is no other qualified candidate from the community described in paragraph (1) or (2) of section 203 who—

(i) possesses the level of expertise necessary for such service with respect to the affected depository institution, depository holding company, or company described in subsection (b); and

(ii) is willing to serve as a management official at the affected depository institution, depository holding company, or company described in subsection (b); and

(B) the appropriate Federal depository institutions regulatory agency determines that continuation of service by the management official does not produce an anti-competitive effect with respect to each affected depository institution, depository holding company, or company described in subsection (b).

[12 USC 3205. As amended by acts of Dec. 26, 1981 (95 Stat. 1515); Nov. 10, 1988 (102 Stat. 3820, 3821); and Sept. 23, 1994 (108 Stat. 2235).]

SECTION 207—Administration and Enforcement

This title shall be administered and enforced by—

(1) the Comptroller of the Currency with respect to national banks and banks located in the District of Columbia,

(2) the Board of Governors of the Federal Reserve System with respect to State banks which are members of the Federal Reserve System, and bank holding companies,

(3) the Board of Directors of the Federal Deposit Insurance Corporation with respect to State banks which are not members of the Federal Reserve System but the deposits of which are insured by the Federal Deposit Insurance Corporation,

(4) the Director of the Office of Thrift Supervision with respect to a savings association (the deposits of which are insured by the Federal Deposit Insurance Corporation) and savings and loan holding companies,

(5) the National Credit Union Administration with respect to credit unions the accounts of which are insured by the National Credit Union Administration, and

(6) upon referral by the agencies named in the foregoing paragraphs (1) through (5), the Attorney General shall have the authority to enforce compliance by any person with this title.

[12 USC 3206. As amended by act of Aug. 9, 1989 (103 Stat. 440).]

* * * * *

SECTION 209—Rules and Regulations

(a) Rules and regulations to carry out this title may be prescribed by—

(1) the Comptroller of the Currency with respect to national banks and banks located in the District of Columbia.

(2) the Board of Governors of the Federal Reserve System with respect to State banks which are members of the Federal Reserve System, and bank holding companies.

(3) the Board of Directors of the Federal Deposit Insurance Corporation with respect to State banks which are not members of the Federal Reserve System but the deposits of which are insured by the Federal Deposit Insurance Corporation.

(4) the Federal Home Loan Bank Board with respect to institutions the accounts of which are insured by the Federal Savings and Loan Insurance Corporation, and savings and loan holding companies, and

(5) the National Credit Union Administration with respect to credit unions the accounts of which are insured by the National Credit Union Administration.

(b) *Regulatory standards.* An appropriate Federal depository institution regulatory agency may permit, on a case-by-case basis, service by a management official which would otherwise be prohibited by section 203 or 204 only if—

(1) the board of directors of the affected depository institution, depository institution holding company, or company described in section 206(b), provides a resolution to the appropriate Federal depository institutions regulatory agency certifying that there is no other candidate from the community described in paragraph (1) or (2) of section 203 who—

(A) possesses the level of expertise necessary for such service with respect to the affected depository institution, depository institution holding company, or company described in section 206(b) and is not prohibited from service under section 203 or 204; and

(B) is willing to serve as a management official at the affected depository institution, depository institution holding company, or company described in section 206(b); and

(2) the appropriate Federal depository institutions regulatory agency determines that—

(A) the management official is critical to the safe and sound operations of the affected depository institution, depository institution holding company, or company described in section 206(b);

(B) continuation of service by the management official does not produce an anticompetitive effect with respect to the affected depository institution, depository institution holding company, or company described in section 206(b); and

(C) the management official meets such additional requirements as the agency may impose.

(c) *Limited exception for management official consignment program.*

(1) Notwithstanding the requirements of subsection (b), an appropriate Federal depository institutions regulatory agency may establish a program to permit, on a case-by-

case basis, service by a management official which would otherwise be prohibited by section 203 or 204, for a period of not more than 2 years, if the agency determines that such service would—

(A) improve the provision of credit to low- and moderate-income areas;

(B) increase the competitive position of minority- and woman-owned institutions; or

(C) strengthen the management of newly chartered institutions that are in an unsafe or unsound condition.

(2) The appropriate Federal depository institutions regulatory agency may extend the 2-year period referred to in paragraph (1) for one additional period of not more than 2 years, subject to making a new determination described in subparagraphs (A) through (C) of paragraph (1).

[12 USC 3207. As amended by act of Sept. 23, 1994 (108 Stat. 2236).]

SECTION 210—Functions and Powers of Attorney General and Assistant Attorney General

(a) For the purpose of the exercise by the Attorney General of his enforcement functions under section 207(6) of this title, all of the functions and powers of the Attorney General under the Clayton Act are available to the Attorney General, irrespective of any jurisdictional tests in the Clayton Act, including the power to take enforcement actions in the same manner as if the violation has been a violation of the Clayton Act.

(b) All of the functions and powers of the Attorney General or the Assistant Attorney General in charge of the Antitrust Division of the Department of Justice are available to the Attorney General or to such Assistant Attorney General to investigate possible violations under section 207(6) of the title in the same manner as if such possible violations were possible violations of the Clayton Act.

[12 USC 3208. As added by act of Oct. 15, 1982 (96 Stat. 1524).]

Board of Governors of the Federal Reserve System

Regulation M
Consumer Leasing

12 CFR 213, as amended effective October 31, 1996

Any inquiry relating to Regulation M should be addressed to the Federal Reserve Bank of the District in which the inquiry arises.

November 1996

Contents

Regulation M
Consumer Leasing

12 CFR 213; as amended effective October 31, 1996*

SECTION 213.1—Authority, Scope, Purpose, and Enforcement

(a) *Authority.* The regulation in this part, known as Regulation M, is issued by the Board of Governors of the Federal Reserve System to implement the consumer leasing provisions of the Truth in Lending Act, which is title I of the Consumer Credit Protection Act, as amended (15 USC 1601 et seq.).

(b) *Scope and purpose.* This part applies to all persons that are lessors of personal property under consumer leases as those terms are defined in section 213.2(e)(1) and (h). The purpose of this part is—

(1) to ensure that lessees of personal property receive meaningful disclosures that enable them to compare lease terms with other leases and, where appropriate, with credit transactions;

(2) to limit the amount of balloon payments in consumer lease transactions; and

(3) to provide for the accurate disclosure of lease terms in advertising.

(c) *Enforcement and liability.* Section 108 of the act contains the administrative enforcement provisions. Sections 112, 130, 131, and 185 of the act contain the liability provisions for failing to comply with the requirements of the act and this part.

SECTION 213.2—Definitions

For the purposes of this part the following definitions apply:

(a) *Act* means the Truth in Lending Act (15 USC 1601 et seq.) and the Consumer Leasing Act is chapter 5 of the Truth In Lending Act.

(b) *Advertisement* means a commercial message in any medium that directly or indirectly promotes a consumer lease transaction.

(c) *Board* refers to the Board of Governors of the Federal Reserve System.

(d) *Closed-end lease* means a consumer lease other than an open-end lease as defined in this section.

(e) (1) *Consumer lease* means a contract in the form of a bailment or lease for the use of personal property by a natural person primarily for personal, family, or household purposes, for a period exceeding four months and for a total contractual obligation not exceeding $25,000, whether or not the lessee has the option to purchase or otherwise become the owner of the property at the expiration of the lease. Unless the context indicates otherwise, in this part "lease" means "consumer lease."

(2) The term does not include a lease that meets the definition of a credit sale in Regulation Z (12 CFR 226.2(a)). It also does not include a lease for agricultural, business, or commercial purposes or a lease made to an organization.

(3) This part does not apply to a lease transaction of personal property which is incident to the lease of real property and which provides that—

(i) the lessee has no liability for the value of the personal property at the end of the lease term except for abnormal wear and tear, and

(ii) the lessee has no option to purchase the leased property.

(f) *Gross capitalized cost* means the amount agreed upon by the lessor and lessee as the value of the leased property and any items that are capitalized or amortized during the lease term, including but not limited to taxes, insurance, service agreements, and any outstanding balance from a prior loan or lease. *Capitalized cost reduction* means the total amount of any rebate, cash payment, net trade-in allowance, and noncash credit that reduces the gross capitalized cost. The *adjusted capitalized cost* equals the gross capitalized cost less the capitalized cost reduction, and is the amount used by the lessor in calculating the base periodic payment.

* Compliance with the revised version is optional until October 1, 1997.

(g) *Lessee* means a natural person who enters into or is offered a consumer lease.

(h) *Lessor* means a person who regularly leases, offers to lease, or arranges for the lease of personal property under a consumer lease. A person who has leased, offered, or arranged to lease personal property more than five times in the preceding calendar year or more than five times in the current calendar year is subject to the act and this part.

(i) *Open-end lease* means a consumer lease in which the lessee's liability at the end of the lease term is based on the difference between the residual value of the leased property and its realized value.

(j) *Organization* means a corporation, trust, estate, partnership, cooperative, association, or government entity or instrumentality.

(k) *Person* means a natural person or an organization.

(*l*) *Personal property* means any property that is not real property under the law of the state where the property is located at the time it is offered or made available for lease.

(m) *Realized value* means—

(1) the price received by the lessor for the leased property at disposition;

(2) the highest offer for disposition of the leased property; or

(3) the fair market value of the leased property at the end of the lease term.

(n) *Residual value* means the value of the leased property at the end of the lease term, as estimated or assigned at consummation by the lessor, used in calculating the base periodic payment.

(o) *Security interest* and *security* mean any interest in property that secures the payment or performance of an obligation.

(p) *State* means any state, the District of Columbia, the Commonwealth of Puerto Rico, and any territory or possession of the United States.

SECTION 213.3—General Disclosure Requirements

(a) *General requirements.* A lessor shall make the disclosures required by section 213.4, as applicable. The disclosures shall be made clearly and conspicuously in writing in a form the consumer may keep, in accordance with this section.

(1) *Form of disclosures.* The disclosures required by section 213.4 shall be given to the lessee together in a dated statement that identifies the lessor and the lessee; the disclosures may be made either in a separate statement that identifies the consumer lease transaction or in the contract or other document evidencing the lease. Alternatively, the disclosures required to be segregated from other information under paragraph (a)(2) of this section may be provided in a separate dated statement that identifies the lease, and the other required disclosures may be provided in the lease contract or other document evidencing the lease. In a lease of multiple items, the property description required by section 213.4(a) may be given in a separate statement that is incorporated by reference in the disclosure statement required by this paragraph.

(2) *Segregation of certain disclosures.* The following disclosures shall be segregated from other information and shall contain only directly related information: section 213.4(b) through (f), (g)(2), (h)(3), (i)(1), (j), and (m)(1). The headings, content, and format for the disclosures referred to in this paragraph (a)(2) shall be provided in a manner substantially similar to the applicable model form in appendix A of this part.

(3) *Timing of disclosures.* A lessor shall provide the disclosures to the lessee prior to the consummation of a consumer lease.

(4) *Language of disclosures.* The disclosures required by section 213.4 may be made in a language other than English provided that they are made available in English upon the lessee's request.

(b) *Additional information; nonsegregated disclosures.* Additional information may be provided with any disclosure not listed in paragraph (a)(2) of this section, but it shall not be stated, used, or placed so as to mislead

or confuse the lessee or contradict, obscure, or detract attention from any disclosure required by this part.

(c) *Multiple lessors or lessees.* When a transaction involves more than one lessor, the disclosures required by this part may be made by one lessor on behalf of all the lessors. When a lease involves more than one lessee, the lessor may provide the disclosures to any lessee who is primarily liable on the lease.

(d) *Use of estimates.* If an amount or other item needed to comply with a required disclosure is unknown or unavailable after reasonable efforts have been made to ascertain the information, the lessor may use a reasonable estimate that is based on the best information available to the lessor, is clearly identified as an estimate, and is not used to circumvent or evade any disclosures required by this part.

(e) *Effect of subsequent occurrence.* If a required disclosure becomes inaccurate because of an event occurring after consummation, the inaccuracy is not a violation of this part.

(f) *Minor variations.* A lessor may disregard the effects of the following in making disclosures:

(1) that payments must be collected in whole cents;

(2) that dates of scheduled payments may be different because a scheduled date is not a business day;

(3) that months have different numbers of days; and

(4) that February 29 occurs in a leap year.

SECTION 213.4—Content of Disclosures

For any consumer lease subject to this part, the lessor shall disclose the following information, as applicable:

(a) *Description of property.* A brief description of the leased property sufficient to identify the property to the lessee and lessor.

(b) *Amount due at lease signing.* The total amount to be paid prior to or at consummation, using the term "amount due at lease signing." The lessor shall itemize each component by type and amount, including any refundable security deposit, advance monthly or other periodic payment, and capitalized cost reduction; and in motor vehicle leases, shall itemize how the amount due will be paid, by type and amount, including any net trade-in allowance, rebates, noncash credits, and cash payments in a format substantially similar to the model forms in appendix A of this part.

(c) *Payment schedule and total amount of periodic payments.* The number, amount, and due dates or periods of payments scheduled under the lease, and the total amount of the periodic payments.

(d) *Other charges.* The total amount of other charges payable to the lessor, itemized by type and amount, that are not included in the periodic payments. Such charges include the amount of any liability the lease imposes upon the lessee at the end of the lease term; the potential difference between the residual and realized values referred to in paragraph (k) of this section is excluded.

(e) *Total of payments.* The total of payments, with a description such as "the amount you will have paid by the end of the lease." This amount is the sum of the amount due at lease signing (less any refundable amounts), the total amount of periodic payments (less any portion of the periodic payment paid at lease signing), and other charges under paragraphs (b), (c), and (d) of this section. In an open-end lease, a description such as "you will owe an additional amount if the actual value of the vehicle is less than the residual value" shall accompany the disclosure.

(f) *Payment calculation.* In a motor-vehicle lease, a mathematical progression of how the scheduled periodic payment is derived, in a format substantially similar to the applicable model form in appendix A of this part, which shall contain the following:

(1) *Gross capitalized cost.* The gross capitalized cost, including a disclosure of the agreed-upon value of the vehicle, a description such as "the agreed-upon value of the vehicle [state the amount] and any items you pay for over the lease term (such as service contracts, insurance, and any outstanding prior loan or lease balance)," and

a statement of the lessee's option to receive a separate written itemization of the gross capitalized cost. If requested by the lessee, the itemization shall be provided before consummation.

(2) *Capitalized cost reduction.* The capitalized cost reduction, with a description such as "the amount of any net trade-in allowance, rebate, noncash credit, or cash you pay that reduces the gross capitalized cost."

(3) *Adjusted capitalized cost.* The adjusted capitalized cost, with a description such as "the amount used in calculating your base [periodic] payment."

(4) *Residual value.* The residual value, with a description such as "the value of the vehicle at the end of the lease used in calculating your base [periodic] payment."

(5) *Depreciation and any amortized amounts.* The depreciation and any amortized amounts, which is the difference between the adjusted capitalized cost and the residual value, with a description such as "the amount charged for the vehicle's decline in value through normal use and for any other items paid over the lease term."

(6) *Rent charge.* The rent charge, with a description such as "the amount charged in addition to the depreciation and any amortized amounts." This amount is the difference between the total of the base periodic payments over the lease term minus the depreciation and any amortized amounts.

(7) *Total of base periodic payments.* The total of base periodic payments with a description such as "depreciation and any amortized amounts plus the rent charge."

(8) *Lease term.* The lease term with a description such as "the number of [periods of repayment] in your lease."

(9) *Base periodic payment.* The total of the base periodic payments divided by the number of payment periods in the lease.

(10) *Itemization of other charges.* An itemization of any other charges that are part of the periodic payment.

(11) *Total periodic payment.* The sum of the base periodic payment and any other charges that are part of the periodic payment.

(g) *Early termination.*

(1) *Conditions and disclosure of charges.* A statement of the conditions under which the lessee or lessor may terminate the lease prior to the end of the lease term; and the amount or a description of the method for determining the amount of any penalty or other charge for early termination, which must be reasonable.

(2) *Early-termination notice.* In a motor-vehicle lease, a notice substantially similar to the following: "Early Termination. You may have to pay a substantial charge if you end this lease early. *The charge may be up to several thousand dollars.* The actual charge will depend on when the lease is terminated. The earlier you end the lease, the greater this charge is likely to be."

(h) *Maintenance responsibilities.* The following provisions are required:

(1) *Statement of responsibilities.* A statement specifying whether the lessor or the lessee is responsible for maintaining or servicing the leased property, together with a brief description of the responsibility;

(2) *Wear-and-use standard.* A statement of the lessor's standards for wear and use (if any), which must be reasonable; and

(3) *Notice of wear-and-use standard.* In a motor vehicle lease, a notice regarding wear and use substantially similar to the following: "Excessive Wear and Use. You may be charged for excessive wear based on our standards for normal use." The notice shall also specify the amount or method for determining any charge for excess mileage.

(i) *Purchase option.* A statement of whether or not the lessee has the option to purchase the leased property, and:

(1) *End of lease term.* If at the end of the lease term, the purchase price; and

(2) *During lease term.* If prior to the end of the lease term, the purchase price or the method for determining the price and when the lessee may exercise this option.

(j) *Statement referencing nonsegregated disclosures.* A statement that the lessee should refer to the lease documents for additional information on early termination, purchase options and maintenance responsibilities, warran-

ties, late and default charges, insurance, and any security interests, if applicable.

(k) *Liability between residual and realized values.* A statement of the lessee's liability, if any, at early termination or at the end of the lease term for the difference between the residual value of the leased property and its realized value.

(*l*) *Right of appraisal.* If the lessee's liability at early termination or at the end of the lease term is based on the realized value of the leased property, a statement that the lessee may obtain, at the lessee's expense, a professional appraisal by an independent third party (agreed to by the lessee and the lessor) of the value that could be realized at sale of the leased property. The appraisal shall be final and binding on the parties.

(m) *Liability at end of lease term based on residual value.* If the lessee is liable at the end of the lease term for the difference between the residual value of the leased property and its realized value:

(1) *Rent and other charges.* The rent and other charges, paid by the lessee and required by the lessor as an incident to the lease transaction, with a description such as "the total amount of rent and other charges imposed in connection with your lease [state the amount]."

(2) *Excess liability.* A statement about a rebuttable presumption that, at the end of the lease term, the residual value of the leased property is unreasonable and not in good faith to the extent that the residual value exceeds the realized value by more than three times the base monthly payment (or more than three times the average payment allocable to a monthly period, if the lease calls for periodic payments other than monthly); and that the lessor cannot collect the excess amount unless the lessor brings a successful court action and pays the lessee's reasonable attorney's fees, or unless the excess of the residual value over the realized value is due to unreasonable or excessive wear or use of the leased property (in which case the rebuttable presumption does not apply).

(3) *Mutually agreeable final adjustment.* A statement that the lessee and lessor are permitted, after termination of the lease, to make any mutually agreeable final adjustment regarding excess liability.

(n) *Fees and taxes.* The total dollar amount for all official and license fees, registration, title, or taxes required to be paid to the lessor in connection with the lease.

(o) *Insurance.* A brief identification of insurance in connection with the lease including:

(1) *Voluntary insurance.* If the insurance is provided by or paid through the lessor, the types and amounts of coverage and the cost to the lessee; or

(2) *Required insurance.* If the lessee must obtain the insurance, the types and amounts of coverage required of the lessee.

(p) *Warranties or guarantees.* A statement identifying all express warranties and guarantees from the manufacturer or lessor with respect to the leased property that apply to the lessee.

(q) *Penalties and other charges for delinquency.* The amount or the method of determining the amount of any penalty or other charge for delinquency, default, or late payments, which must be reasonable.

(r) *Security interest.* A description of any security interest, other than a security deposit disclosed under paragraph (b) of this section, held or to be retained by the lessor; and a clear identification of the property to which the security interest relates.

(s) *Limitations on rate information.* If a lessor provides a percentage rate in an advertisement or in documents evidencing the lease transaction, a notice stating that "this percentage may not measure the overall cost of financing this lease" shall accompany the rate disclosure. The lessor shall not use the term "annual percentage rate," "annual lease rate," or any equivalent term.

SECTION 213.5—Renegotiations, Extensions, and Assumptions

(a) *Renegotiation.* A renegotiation occurs when a consumer lease subject to this part is

satisfied and replaced by a new lease undertaken by the same consumer. A renegotiation requires new disclosures, except as provided in paragraph (d) of this section.

(b) *Extension.* An extension is a continuation, agreed to by the lessor and the lessee, of an existing consumer lease beyond the originally scheduled end of the lease term, except when the continuation is the result of a renegotiation. An extension that exceeds six months requires new disclosures, except as provided in paragraph (d) of this section.

(c) *Assumption.* New disclosures are not required when a consumer lease is assumed by another person, whether or not the lessor charges an assumption fee.

(d) *Exceptions.* New disclosures are not required for the following, even if they meet the definition of a renegotiation or an extension:

(1) a reduction in the lease charge;

(2) the deferment of one or more payments, whether or not a fee is charged;

(3) the extension of a lease for not more than six months on a month-to-month basis or otherwise;

(4) a substitution of leased property with property that has a substantially equivalent or greater economic value, provided no other lease terms are changed;

(5) the addition, deletion, or substitution of leased property in a multiple-item lease, provided the average periodic payment does not change by more than 25 percent; or

(6) an agreement resulting from a court proceeding.

SECTION 213.6

[Reserved]

SECTION 213.7—Advertising

(a) *General rule.* An advertisement for a consumer lease may state that a specific lease of property at specific amounts or terms is available only if the lessor usually and customarily leases or will lease the property at those amounts or terms.

(b) *Clear-and-conspicuous standard.* Disclosures required by this section shall be made clearly and conspicuously.

(1) *Amount due at lease signing.* Except for the statement of a periodic payment, any affirmative or negative reference to a charge that is a part of the total amount due at lease signing under paragraph (d)(2)(ii) of this section, such as the amount of any capitalized cost reduction (or no capitalized cost reduction is required), shall not be more prominent than the disclosure of the total amount due at lease signing.

(2) *Advertisement of a lease rate.* If a lessor provides a percentage rate in an advertisement, the rate shall not be more prominent than any of the disclosures in section 213.4, with the exception of the notice in section 213.4(s) required to accompany the rate; and lessor shall not use the term "annual percentage rate," "annual lease rate," or equivalent term.

(c) *Catalogs and multipage advertisements.* A catalog or other multipage advertisement that provides a table or schedule of the required disclosures shall be considered a single advertisement if, for lease terms that appear without all the required disclosures, the advertisement refers to the page or pages on which the table or schedule appears.

(d) *Advertisement of terms that require additional disclosure.*

(1) *Triggering terms.* An advertisement that states any of the following items shall contain the disclosures required by paragraph (d)(2) of this section, except as provided in paragraphs (e) and (f) of this section:

(i) the amount of any payment;

(ii) the number of required payments; or

(iii) a statement of any capitalized cost reduction or other payment required prior to or at consummation, or that no payment is required.

(2) *Additional terms.* An advertisement stating any item listed in paragraph (d)(1) of this section shall also state the following items:

(i) that the transaction advertised is a lease;

(ii) the total amount due at lease signing, or that no payment is required;

(iii) the number, amounts, due dates or

periods of scheduled payments, and total of such payments under the lease;

(iv) a statement of whether or not the lessee has the option to purchase the leased property, and where the lessee has the option to purchase at the end of the lease term, the purchase-option price. The method of determining the purchase-option price may be substituted in disclosing the lessee's option to purchase the leased property prior to the end of the lease term;

(v) a statement of the amount, or the method for determining the amount, of the lessee's liability (if any) at the end of the lease term; and

(vi) a statement of the lessee's liability (if any) for the difference between the residual value of the leased property and its realized value at the end of the lease term.

(e) *Alternative disclosures—merchandise tags.* A merchandise tag stating any item listed in paragraph (d)(1) of this section may comply with paragraph (d)(2) of this section by referring to a sign or display prominently posted in the lessor's place of business that contains a table or schedule of the required disclosures.

(f) *Alternative disclosures—television or radio advertisements.*

(1) *Toll-free number or print advertisement.* An advertisement made through television or radio stating any item listed in paragraph (d)(1) of this section complies with paragraph (d)(2) of this section if the advertisement states the items listed in paragraphs (d)(2)(i) through (iii) of this section, and—

(i) lists a toll-free telephone number along with a reference that such number may be used by consumers to obtain the information required by paragraph (d)(2) of this section; or

(ii) directs the consumer to a written advertisement in a publication of general circulation in the community served by the media station, including the name and the date of the publication, with a statement that information required by paragraph (d)(2) of this section is included in the advertisement. The written advertisement shall be published beginning at least three days before and ending at least ten days after the broadcast.

(2) *Establishment of toll-free number.*

(i) The toll-free telephone number shall be available for no fewer than ten days, beginning on the date of the broadcast.

(ii) The lessor shall provide the information required by paragraph (d)(2) of this section orally, or in writing upon request.

SECTION 213.8—Record Retention

A lessor shall retain evidence of compliance with the requirements imposed by this part, other than the advertising requirements under section 213.7, for a period of not less than two years after the date the disclosures are required to be made or an action is required to be taken.

SECTION 213.9—Relation to State Laws

(a) *Inconsistent state law.* A state law that is inconsistent with the requirements of the act and this part is preempted to the extent of the inconsistency. If a lessor cannot comply with a state law without violating a provision of this part, the state law is inconsistent within the meaning of section 186(a) of the act and is preempted, unless the state law gives greater protection and benefit to the consumer. A state, through an official having primary enforcement or interpretative responsibilities for the state consumer leasing law, may apply to the Board for a preemption determination.

(b) *Exemptions.*

(1) *Application.* A state may apply to the Board for an exemption from the requirements of the act and this part for any class of lease transactions within the state. The Board will grant such an exemption if the Board determines that —

(i) the class of leasing transactions is subject to state-law requirements substantially similar to the act and this part or that lessees are afforded greater protection under state law; and

(ii) there is adequate provision for state enforcement.

(2) *Enforcement and liability.* After an exemption has been granted, the requirements of the applicable state law (except for additional requirements not imposed by federal law) will constitute the requirements of the act and this part. No exemption will extend to the civil liability provisions of sections 130, 131, and 185 of the act.

APPENDIX A—Model Forms

A-1—Model Open-End or Finance Vehicle Lease Disclosures

Appendix A-1 Model Open-End or Finance Vehicle Lease Disclosures

Federal Consumer Leasing Act Disclosures

Date _____

Lessor(s) _____ Lessee(s) _____

Amount Due at Lease Signing	Monthly Payments	Other Charges (not part of your monthly payment)	Total of Payments (The amount you will have paid by the end of the lease)
(Itemized below)*	Your first monthly payment of $ _____ is due on _____, followed by _____ payments of $ _____ due on the _____ of each month. The total of your monthly payments is $ _____.	Disposition fee (if you do not purchase the vehicle) $_____ [Annual tax] _____ _____ _____ Total $_____	$ _____ You will owe an additional amount if the actual value of the vehicle is less than the residual value.
$ _____			

*** Itemization of Amount Due at Lease Signing**

Amount Due At Lease Signing:		How the Amount Due at Lease Signing will be paid:	
Capitalized cost reduction	$ _____	Net trade-in allowance	$ _____
First monthly payment	_____	Rebates and noncash credits	_____
Refundable security deposit	_____	Amount to be paid in cash	_____
Title fees	_____		
Registration fees	_____		
_____	_____		
Total	$ _____	Total	$ _____

Your monthly payment is determined as shown below:

Gross capitalized cost. The agreed upon value of the vehicle ($_____) and any items you pay over the lease term (such as service contracts, insurance, and any outstanding prior loan or lease balance) ..... $ _____

If you want an itemization of this amount, please check this box. ☐

Capitalized cost reduction. The amount of any net trade-in allowance, rebate, noncash credit, or cash you pay that reduces the gross capitalized cost ..... – _____

Adjusted capitalized cost. The amount used in calculating your base monthly payment ..... = _____

Residual value. The value of the vehicle at the end of the lease used in calculating your base monthly payment ..... – _____

Depreciation and any amortized amounts. The amount charged for the vehicle's decline in value through normal use and for other items paid over the lease term ..... = _____

Rent charge. The amount charged in addition to the depreciation and any amortized amounts ..... + _____

Total of base monthly payments. The depreciation and any amortized amounts plus the rent charge ..... = _____

Lease term. The number of months in your lease ..... + _____

Base monthly payment ..... = _____

Monthly sales/use tax ..... + _____

_____ ..... + _____

Total monthly payment ..... =$ _____

Rent and other charges. The total amount of rent and other charges imposed in connection with your lease $ _____ .

Early Termination. You may have to pay a substantial charge if you end this lease early. The charge may be up to several thousand dollars. The actual charge will depend on when the lease is terminated. The earlier you end the lease, the greater this charge is likely to be.

Excessive Wear and Use. You may be charged for excessive wear based on our standards for normal use [and for mileage in excess of _____ miles per year at the rate of _____ per mile].

Purchase Option at End of Lease Term. [You have an option to purchase the vehicle at the end of the lease term for $ _____ [and a purchase option fee of $ _____].] [You do not have an option to purchase the vehicle at the end of the lease term.]

Other Important Terms. See your lease documents for additional information on early termination, purchase options and maintenance responsibilities, warranties, late and default charges, insurance, and any security interest, if applicable.

Appendix A-1 Model Open-End or Finance Vehicle Lease Disclosures

[The following provisions are the nonsegregated disclosures required under Regulation M.]

Official Fees and Taxes. The total amount you will pay for official and license fees, registration, title, and taxes over the term of your lease, whether included with your monthly payments or assessed otherwise: $ _____ .

Insurance. The following types and amounts of insurance will be acquired in connection with this lease:

_____ .

_____ We (lessor) will provide the insurance coverage quoted above for a total premium cost of $ _____ .

_____ You (lessee) agree to provide insurance coverage in the amount and types indicated above.

End of Term Liability. (a) The residual value ($ _____) of the vehicle is based on a reasonable, good faith estimate of the value of the vehicle at the end of the lease term. If the actual value of the vehicle at that time is greater than the residual value, you will have no further liability under this lease, except for other charges already incurred [and are entitled to a credit or refund of any surplus.] If the actual value of the vehicle is less than the residual value, you will be liable for any difference up to $ _____ (3 times the monthly payment). For any difference in excess of that amount, you will be liable only if:
1. Excessive use or damage [as described in paragraph ____] [representing more than normal wear and use] resulted in an unusually low value at the end of the term.
2. The matter is not otherwise resolved and we win a lawsuit against you seeking a higher payment.
3. You voluntarily agree with us after the end of the lease term to make a higher payment.
Should we bring a lawsuit against you, we must prove that our original estimate of the value of the leased property at the end of the lease term was reasonable and was made in good faith. For example, we might prove that the actual was less than the original estimated value, although the original estimate was reasonable, because of an unanticipated decline in value for that type of vehicle. We must also pay your attorney's fees.
(b) If you disagree with the value we assign to the vehicle, you may obtain, at your own expense, from an independent third party agreeable to both of us, a professional appraisal of the _____ value of the leased vehicle which could be realized at sale. The appraised value shall then be used as the actual value.

Standards for Wear and Use. The following standards are applicable for determining unreasonable or excess wear and use of the leased vehicle:

_____ .

Maintenance.
[You are responsible for the following maintenance and servicing of the leased vehicle:

_____].

[We are responsible for the following maintenance and servicing of the leased vehicle:

_____].

Warranties. The leased vehicle is subject to the following express warranties:

_____ .

Early Termination and Default. (a) You may terminate this lease before the end of the lease term under the following conditions:

_____ .

The charge for such early termination is:

_____ .

(b) We may terminate this lease before the end of the lease term under the following conditions:

_____ .

Upon such termination we shall be entitled to the following charge(s) for:

_____ .

(c) To the extent these charges take into account the value of the vehicle at termination, if you disagree with the value we assign to the vehicle, you may obtain, at your own expense, from an independent third party agreeable to both of us, a professional appraisal of the _____ value of the leased vehicle which could be realized at sale. The appraised value shall then be used as the actual value.

Security Interest. We reserve a security interest of the following type in the property listed below to secure performance of your obligations under this lease:

_____ .

Late Payments. The charge for late payments is: _____ .

Option to Purchase Leased Property Prior to the End of the Lease. [You have an option to purchase the leased vehicle prior to the end of the term. The price will be [$ _____ /[the method of determining the price].] [You do not have an option to purchase the leased vehicle.]

A-2—Model Closed-End or Net Vehicle Lease Disclosures

Appendix A-2 Model Closed-End or Net Vehicle Lease Disclosures

Federal Consumer Leasing Act Disclosures

Date _____

Lessor(s) _____ Lessee(s) _____

Amount Due at Lease Signing	Monthly Payments	Other Charges (not part of your monthly payment)	Total of Payments (The amount you will have paid by the end of the lease)
(Itemized below)*	Your first monthly payment of $ _____ is due on _____, followed by _____ payments of $ _____ due on the _____ of each month. The total of your monthly payments is $ _____.	Disposition fee (if you do not purchase the vehicle) $_____ [Annual tax] _____ _____ Total $_____	$ _____
$ _____			

*** Itemization of Amount Due at Lease Signing**

Amount Due At Lease Signing:		How the Amount Due at Lease Signing will be paid:	
Capitalized cost reduction	$ _____	Net trade-in allowance	$ _____
First monthly payment	_____	Rebates and noncash credits	_____
Refundable security deposit	_____	Amount to be paid in cash	_____
Title fees	_____		
Registration fees	_____		
_____	_____		
Total	$ _____	Total	$ _____

Your monthly payment is determined as shown below:

Gross capitalized cost. The agreed upon value of the vehicle ($_____) and any items you pay over the lease term (such as service contracts, insurance, and any outstanding prior loan or lease balance) ..... $ _____

If you want an itemization of this amount, please check this box. ☐

Capitalized cost reduction. The amount of any net trade-in allowance, rebate, noncash credit, or cash you pay that reduces the gross capitalized cost ..... – _____

Adjusted capitalized cost. The amount used in calculating your base monthly payment ..... = _____

Residual value. The value of the vehicle at the end of the lease used in calculating your base monthly payment ..... – _____

Depreciation and any amortized amounts. The amount charged for the vehicle's decline in value through normal use and for other items paid over the lease term ..... = _____

Rent charge. The amount charged in addition to the depreciation and any amortized amounts ..... + _____

Total of base monthly payments. The depreciation and any amortized amounts plus the rent charge ..... = _____

Lease term. The number of months in your lease ..... + _____

Base monthly payment ..... = _____

Monthly sales/use tax ..... + _____

_____ ..... + _____

Total monthly payment ..... =$ _____

Early Termination. You may have to pay a substantial charge if you end this lease early. The charge may be up to several thousand dollars. The actual charge will depend on when the lease is terminated. The earlier you end the lease, the greater this charge is likely to be.

Excessive Wear and Use. You may be charged for excessive wear based on our standards for normal use [and for mileage in excess of _____ miles per year at the rate of _____ per mile].

Purchase Option at End of Lease Term. [You have an option to purchase the vehicle at the end of the lease term for $ _____ [and a purchase option fee of $ _____].] [You do not have an option to purchase the vehicle at the end of the lease term.]

Other Important Terms. See your lease documents for additional information on early termination, purchase options and maintenance responsibilities, warranties, late and default charges, insurance, and any security interest, if applicable.

Appendix A-2 Model Closed-End or Net Vehicle Lease Disclosures

[The following provisions are the nonsegregated disclosures required under Regulation M.]

Official Fees and Taxes. The total amount you will pay for official and license fees, registration, title, and taxes over the term of your lease, whether included with your monthly payments or assessed otherwise: $ _____ .

Insurance. The following types and amounts of insurance will be acquired in connection with this lease:

_____ .

_____ We (lessor) will provide the insurance coverage quoted above for a total premium cost of $ _____ .

_____ You (lessee) agree to provide insurance coverage in the amount and types indicated above.

Standards for Wear and Use. The following standards are applicable for determining unreasonable or excess wear and use of the leased vehicle:

_____ .

Maintenance.
[You are responsible for the following maintenance and servicing of the leased vehicle:

_____].

[We are responsible for the following maintenance and servicing of the leased vehicle:

_____].

Warranties. The leased vehicle is subject to the following express warranties:

_____ .

Early Termination and Default. (a) You may terminate this lease before the end of the lease term under the following conditions:

_____ .

The charge for such early termination is:

_____ .

(b) We may terminate this lease before the end of the lease term under the following conditions:

_____ .

Upon such termination we shall be entitled to the following charge(s) for:

_____ .

(c) To the extent these charges take into account the value of the vehicle at termination, if you disagree with the value we assign to the vehicle, you may obtain, at your own expense, from an independent third party agreeable to both of us, a professional appraisal of the _____ value of the leased vehicle which could be realized at sale. The appraised value shall then be used as the actual value.

Security Interest. We reserve a security interest of the following type in the property listed below to secure performance of your obligations under this lease:

_____ .

Late Payments. The charge for late payments is: _____ .

Option to Purchase Leased Property Prior to the End of the Lease. [You have an option to purchase the leased vehicle prior to the end of the term. The price will be [$ _____ /[the method of determining the price].] [You do not have an option to purchase the leased vehicle.]

A-3—Model Furniture Lease Disclosures

Appendix A-3 Model Furniture Lease Disclosures

Federal Consumer Leasing Act Disclosures

Date _____

Lessor(s) _____ **Lessee(s)** _____

Description of Leased Property

Item	Color	Stock #	Mfg.	Quantity

Amount Due at Lease Signing	**Monthly Payments**	**Other Charges** (not part of your monthly payment)	**Total of Payments** (The amount you will have paid by the end of the lease)
First monthly payment $ _____	Your first monthly payment of $ _____	Pick-up fee $ _____	
Refundable security deposit $ _____	is due on _____, followed by	_____ $ _____	
Delivery/Installation fee $ _____	_____ payments of $ _____ due on	Total $ _____	$ _____
_____ $ _____	the _____ of each month. The total of your		
Total $ _____	monthly payments is $ _____.		

Purchase Option at End of Lease Term. [You have an option to purchase the leased property at the end of the lease term for $ _____ [and a purchase option fee of $ _____].] [You do not have an option to purchase the leased property at the end of the lease term.]

Other Important Terms. See your lease documents for additional information on early termination, purchase options and maintenance responsibilities, warranties, late and default charges, insurance, and any security interest, if applicable.

[The following provisions are the nonsegregated disclosures required under Regulation M.]

Official Fees and Taxes. The total amount you will pay for official fees, and taxes over the term of your lease, whether included with your monthly payments or assessed otherwise: $ _____ .

Insurance. The following types and amounts of insurance will be acquired in connection with this lease: _____ .

_____ We (lessor) will provide the insurance coverage quoted above for a total premium cost of $ _____ .

_____ You (lessee) agree to provide insurance coverage in the amount and types indicated above.

Standards for Wear and Use. The following standards are applicable for determining unreasonable or excess wear and use of the leased property: _____

Maintenance.

[You are responsible for the following maintenance and servicing of the leased property: _____.]

[We are responsible for the following maintenance and servicing of the leased property: _____.]

Warranties. The leased property is subject to the following express warranties: _____ .

Early Termination and Default. (a) You may terminate this lease before the end of the lease term under the following conditions: _____ .

The charge for such early termination is: _____ .

(b) We may terminate this lease before the end of the lease term under the following conditions: _____ .

Upon such termination we shall be entitled to the following charge(s) for: _____ .

Appendix A-3 Model Furniture Lease Disclosures

Early Termination and Default. (continued)

(c) To the extent these charges take into account the value of the leased property at termination, if you disagree with the value we assign to the property, you may obtain, at your own expense, from an independent third party agreeable to both of us, a professional appraisal of the _____ value of the property which could be realized at sale. The appraised value shall then be used as the actual value.

Security Interest. We reserve a security interest of the following type in the property listed below to secure performance of your obligations under this lease: _____.

Late Payments. The charge for late payments is: _____.

Purchase Option Prior to the End of the Lease Term.

[You have an option to purchase the leased property prior to the end of the term. The price will be [$ _____]/the method of determining the price].]

[You do not have an option to purchase the leased property.]

APPENDIX B—Federal Enforcement Agencies

The following list indicates which federal agency enforces Regulation M (12 CFR 213) for particular classes of business. Any questions concerning compliance by a particular business should be directed to the appropriate enforcement agency. Terms that are not defined in the Federal Deposit Insurance Act (12 USC 1813(s)) shall have the meaning given to them in the International Banking Act of 1978 (12 USC 3101).

1. *National banks and federal branches and federal agencies of foreign banks*
District office of the Office of the Comptroller of the Currency for the district in which the institution is located.

2. *State member banks, branches and agencies of foreign banks (other than federal branches, federal agencies, and insured state branches of foreign banks), commercial lending companies owned or controlled by foreign banks, and organizations operating under section 25 or 25A of the Federal Reserve Act*
Federal Reserve Bank serving the District in which the institution is located.

3. *Nonmember insured banks and insured state branches of foreign banks*
Federal Deposit Insurance Corporation Regional Director for the region in which the institution is located.

4. *Savings institutions insured under the Savings Association Insurance Fund of the FDIC and federally chartered savings banks insured under the Bank Insurance Fund of the FDIC (but not including state-chartered savings banks insured under the Bank Insurance Fund)*
Office of Thrift Supervision regional director for the region in which the institution is located.

5. *Federal credit unions*
Regional office of the National Credit Union Administration serving the area in which the federal credit union is located.

6. *Air carriers*
Assistant General Counsel for
Aviation Enforcement and Proceedings
Department of Transportation
400 Seventh Street, S.W.
Washington, D.C. 20590

7. *Those subject to Packers and Stockyards Act*
Nearest Packers and Stockyards Administration area supervisor.

8. *Federal Land Banks, Federal Land Bank Associations, Federal Intermediate Credit Banks, and Production Credit Associations*
Farm Credit Administration
490 L'Enfant Plaza, S.W.
Washington, D.C. 20578

9. *All other lessors (lessors operating on a local or regional basis should use the address of the FTC regional office in which they operate)*
Division of Credit Practices
Bureau of Consumer Protection
Federal Trade Commission
Washington, D.C. 20580

APPENDIX C—Issuance of Staff Interpretations

Officials in the Board's Division of Consumer and Community Affairs are authorized to issue official staff interpretations of this Regulation M (12 CFR 213). These interpretations provide the formal protection afforded under section 130(f) of the act. Except in unusual circumstances, interpretations will not be issued separately but will be incorporated in an official commentary to Regulation M (supplement I of this part), which will be amended periodically. No staff interpretations will be issued approving lessor's forms, statements, or calculation tools or methods.

Truth in Lending Act

15 USC 1601 et seq.; 82 Stat. 146; Pub. L. 90-321 (May 29, 1968)

Public Law 90-321 (as amended), Title I (Chapters 1, 2, and 5)

CHAPTER 5—CONSUMER LEASES

Section

SECTION 181—Definitions

For purposes of this chapter—

(1) The term *"consumer lease"* means a contract in the form of a lease or bailment for the use of personal property by a natural person for a period of time exceeding four months, and for a total contractual obligation not exceeding $25,000, primarily for personal, family, or household purposes, whether or not the lessee has the option to purchase or otherwise become the owner of the property at the expiration of the lease, except that such term shall not include any credit sale as defined in section 103(g). Such term does not include a lease for agricultural, business, or commercial purposes, or to a government or governmental agency or instrumentality, or to an organization.

(2) The term *"lessee"* means a natural person who leases or is offered a consumer lease.

(3) The term *"lessor"* means a person who is regularly engaged in leasing, offering to lease, or arranging to lease under a consumer lease.

(4) The term *"personal property"* means any property which is not real property under the laws of the State where situated at the time offered or otherwise made available for lease.

(5) The terms *"security"* and *"security interest"* mean any interest in property which secures payment or performance of an obligation.

[15 USC 1667. As added by act of March 23, 1976 (90 Stat. 257).]

SECTION 182—Consumer Lease Disclosures

Each lessor shall give a lessee prior to the consummation of the lease a dated written statement on which the lessor and lessee are identified setting out accurately and in a clear and conspicuous manner the following information with respect to that lease, as applicable:

(1) A brief description or identification of the leased property;

(2) The amount of any payment by the lessee required at the inception of the lease;

(3) The amount paid or payable by the lessee for official fees, registration, certificate of title, or license fees or taxes;

(4) The amount of other charges payable by the lessee not included in the periodic payments, a description of the charges and that the lessee shall be liable for the differential, if any, between the anticipated fair market value of the leased property and its appraised actual value at the termination of the lease, if the lessee has such liability;

(5) A statement of the amount or method of determining the amount of any liabilities the lease imposes upon the lessee at the end of the term and whether or not the lessee has the option to purchase the leased property and at what price and time;

(6) A statement identifying all express warranties and guarantees made by the manufacturer or lessor with respect to the leased property, and identifying the party responsible for maintaining or servicing the leased property together with a description of the responsibility;

(7) A brief description of insurance provided or paid for by the lessor or required of the lessee, including the types and amounts of the coverages and costs;

(8) A description of any security interest held or to be retained by the lessor in connection with the lease and a clear identification of the property to which the security interest relates;

(9) The number, amount, and due dates or periods of payments under the lease and the total amount of such periodic payments;

(10) Where the lease provides that the lessee shall be liable for the anticipated fair market value of the property on expiration of the lease, the fair market value of the property at the inception of the lease, the aggregate cost of the lease on expiration, and the differential between them; and

(11) A statement of the conditions under which the lessee or lessor may terminate the lease prior to the end of the term and the amount or method of determining any penalty or other charge for delinquency, default, late payments, or early termination.

The disclosures required under this section may be made in the lease contract to be signed by the lessee. The Board may provide by regulation that any portion of the information required to be disclosed under this section may be given in the form of estimates where the lessor is not in a position to know exact information.

[15 USC 1667a. As added by act of March 23, 1976 (90 Stat. 258).]

SECTION 183—Lessee's Liability on Expiration or Termination of Lease

(a) Where the lessee's liability on expiration of a consumer lease is based on the estimated residual value of the property such estimated residual value shall be a reasonable approximation of the anticipated actual fair market value of the property on lease expiration. There shall be a rebuttable presumption that the estimated residual value is unreasonable to the extent that the estimated residual value exceeds the actual residual value by more than three times the average payment allocable to a monthly period under the lease. In addition, where the lessee has such liability on expiration of a consumer lease there shall be a rebuttable presumption that the lessor's estimated residual value is not in good faith to the extent that the estimated residual value exceeds the actual residual value by more than three times the average payment allocable to a monthly period under the lease and such lessor shall not collect from the lessee the amount of such excess liability on expiration of a consumer lease unless the lessor brings a successful action with respect to such excess liability. In all actions, the lessor shall pay the lessee's reasonable attorney's fees. The presumptions stated in this section shall not apply to the extent the excess of estimated over actual residual value is due to physical damage to the property beyond reasonable wear and use, or to excessive use, and the lease may set standards for such wear and use if such standards are not unreasonable. Nothing in this subsection shall preclude the right of a willing lessee to make any mutually agreeable final adjustment with respect to such excess residual liability, provided such an agreement is reached after termination of the lease.

(b) Penalties or other charges for delinquency, default, or early termination may be specified in the lease but only at an amount which is reasonable in the light of the anticipated or actual harm caused by the delinquency, default, or early termination, the difficulties of proof of loss, and the inconvenience or nonfeasibility of otherwise obtaining an adequate remedy.

(c) If a lease has a residual value provision at the termination of the lease, the lessee may obtain at his expense, a professional appraisal of the leased property by an independent third party agreed to by both parties. Such appraisal shall be final and binding on the parties.

[15 USC 1667b. As added by act of March 23, 1976 (90 Stat. 259).]

SECTION 184—Consumer Lease Advertising

(a) No advertisement to aid, promote, or assist directly or indirectly any consumer lease shall state the amount of any payment, the number of required payments, or that any or no downpayment or other payment is required at inception of the lease unless the advertisement also states clearly and conspicuously and

in accordance with regulations issued by the Board each of the following items of information which is applicable:

(1) That the transaction advertised is a lease.

(2) The amount of any payment required at the inception of the lease or that no such payment is required if that is the case.

(3) The number, amounts, due dates or periods of scheduled payments, and the total of payments under the lease.

(4) That the lessee shall be liable for the differential, if any, between the anticipated fair market value of the leased property and its appraised actual value at the termination of the lease, if the lessee has such liability.

(5) A statement of the amount or method of determining the amount of any liabilities the lease imposes upon the lessee at the end of the term and whether or not the lessee has the option to purchase the leased property and at what price and time.

(b) *Radio advertisements.*

(1) An advertisement by radio broadcast to aid, promote, or assist, directly or indirectly, any consumer lease shall be deemed to be in compliance with the requirements of subsection (a) if such advertisement clearly and conspicuously—

(A) states the information required by paragraphs (1) and (2) of subsection (a);

(B) states the number, amounts, due dates or periods of scheduled payments, and the total of such payments under the lease;

(C) includes—

(i) a referral to—

(I) a toll-free telephone number established in accordance with paragraph (2) that may be used by consumers to obtain the information required under subsection (a); or

(II) a written advertisement that—

(aa) appears in a publication in general circulation in the community served by the radio station on which such advertisement is broadcast during the period beginning 3 days before any such broadcast and ending 10 days after such broadcast; and

(bb) includes the information required to be disclosed under subsection (a); and

(ii) the name and dates of any publication referred to in clause (i)(II); and

(D) includes any other information which the Board determines necessary to carry out this chapter.

(2) (A) In the case of a radio broadcast advertisement described in paragraph (1) that includes a referral to a toll-free telephone number, the lessor who offers the consumer lease shall—

(i) establish such a toll-free telephone number not later than the date on which the advertisement including the referral is broadcast;

(ii) maintain such telephone number for a period of not less than 10 days, beginning on the date of any such broadcast; and

(iii) provide the information required under subsection (a) with respect to the lease to any person who calls such number.

(B) The information required to be provided under subparagraph (A)(iii) shall be provided verbally or, if requested by the consumer, in written form.

(3) Nothing in this subsection shall affect the requirements of Federal law as such requirements apply to advertisement by any medium other than radio broadcast.

(c) There is no liability under this section on the part of any owner or personnel, as such, of any medium in which an advertisement appears or through which it is disseminated.

[15 USC 1667c. As added by act of March 23, 1976 (90 Stat. 259) and amended by act of Sept. 23, 1994 (108 Stat. 2234).]

SECTION 185—Civil Liability

(a) Any lessor who fails to comply with any requirement imposed under section 182 or 183 of this chapter with respect to any person is liable to such person as provided in section 130.

(b) Any lessor who fails to comply with any requirement imposed under section 184 of this

chapter with respect to any person who suffers actual damage from the violation is liable to such person as provided in section 130. For the purposes of this section, the term "creditor" as used in sections 130 and 131 shall include a lessor as defined in this chapter.

(c) Notwithstanding section 130(e), any action under this section may be brought in any United States district court or in any other court of competent jurisdiction. Such actions alleging a failure to disclose or otherwise comply with the requirements of this chapter shall be brought within one year of the termination of the lease agreement.

[15 USC 1667d. As added by act of March 23, 1976 (90 Stat. 260).]

SECTION 186—Relation to State Laws

(a) This chapter does not annul, alter, or affect, or exempt any person subject to the provisions of this chapter from complying with, the laws of any State with respect to consumer leases, except to the extent that those laws are inconsistent with any provision of this chapter, and then only to the extent of the inconsistency. The Board is authorized to determine whether such inconsistencies exist. The Board may not determine that any State law is inconsistent with any provision of this chapter if the Board determines that such law gives greater protection and benefit to the consumer.

(b) The Board shall by regulation exempt from the requirements of this chapter any class of lease transactions within any State if it determines that under the law of that State that class of transactions is subject to requirements substantially similar to those imposed under this chapter or that such law gives greater protection and benefit to the consumer, and that there is adequate provision for enforcement.

[15 USC 1667e. As added by act of March 23, 1976 (90 Stat. 260).]

Board of Governors of the Federal Reserve System

Official Staff Commentary on Regulation B Equal Credit Opportunity

As amended effective September 30, 1996

Any inquiry relating to Regulation B should be addressed to the Federal Reserve Bank of the District in which the inquiry arises.

November 1996

Contents

Official Staff Commentary on Regulation B

As amended effective September 30, 1996

Following is an official staff interpretation of Regulation B issued under authority delegated by the Federal Reserve Board to officials in the Division of Consumer and Community Affairs. References are to sections of the regulation or the Equal Credit Opportunity Act (15 USC 1601 et seq.).

INTRODUCTION

1. *Official status.* Section 706(e) of the Equal Credit Opportunity Act protects a creditor from civil liability for any act done or omitted in good faith in conformity with an interpretation issued by a duly authorized official of the Federal Reserve Board. This commentary is the means by which the Division of Consumer and Community Affairs of the Federal Reserve Board issues official staff interpretations of Regulation B. Good faith compliance with this commentary affords a creditor protection under section 706(e) of the act.

2. *Issuance of interpretations.* Under appendix D to the regulation, any person may request an official staff interpretation. Interpretations will be issued at the discretion of designated officials and incorporated in this commentary following publication for comment in the *Federal Register.* Except in unusual circumstances, official staff interpretations will be issued only by means of this commentary.

3. *Status of previous interpretations.* Interpretations of Regulation B previously issued by the Federal Reserve Board and its staff have been incorporated into this commentary as appropriate. All other previous Board and staff interpretations, official and unofficial, are superseded by this commentary.

4. *Footnotes.* Footnotes in the regulation have the same legal effect as the text of the regulation, whether they are explanatory or illustrative in nature.

5. *Comment designations.* The comments are designated with as much specificity as possible according to the particular regulatory provision addressed. Each comment in the commentary is identified by a number and the regulatory section or paragraph that it interprets. For example, comments to section 202.2(c) are further divided by subparagraph, such as comment 2(c)(1)(ii)-1 and comment 2(c)(2)(ii)-1.

SECTION 202.1—Authority, Scope, and Purpose

1(a) Authority and Scope

1. *Scope.* The Equal Credit Opportunity Act and Regulation B apply to all credit—commercial as well as personal—without regard to the nature or type of the credit or the creditor. If a transaction provides for the deferral of the payment of a debt, it is credit covered by Regulation B even though it may not be a credit transaction covered by Regulation Z (Truth in Lending). Further, the definition of creditor is not restricted to the party or person to whom the obligation is initially payable, as is the case under Regulation Z. Moreover, the act and regulation apply to all methods of credit evaluation, whether performed judgmentally or by use of a credit scoring system.

2. *Foreign applicability.* Regulation B generally does not apply to lending activities that occur outside the United States. The regulation does apply to lending activities that take place within the United States (as well as the Commonwealth of Puerto Rico and any territory or possession of the United States), whether or not the applicant is a citizen.

3. *Board.* The term "Board," as used in this regulation, means the Board of Governors of the Federal Reserve System.

SECTION 202.2—Definitions

2(c) Adverse Action

Paragraph 2(c)(1)(i)

1. *Application for credit.* A refusal to refi-

nance or extend the term of a business or other loan is adverse action if the applicant applied in accordance with the creditor's procedures.

Paragraph 2(c)(1)(ii)

1. *Move from service area.* If a credit card issuer terminates the open-end account of a customer because the customer has moved out of the card issuer's service area, the termination is "adverse action" for purposes of the regulation unless termination on this ground was explicitly provided for in the credit agreement between the parties. In cases where termination is adverse action, notification is required under section 202.9.

2. *Termination based on credit limit.* If a creditor terminates credit accounts that have low credit limits (for example, under $400) but keeps open accounts with higher credit limits, the termination is adverse action and notification is required under section 202.9.

Paragraph 2(c)(2)(ii)

1. *Default—exercise of due-on-sale clause.* If a mortgagor sells or transfers mortgaged property without the consent of the mortgagee, and the mortgagee exercises its contractual right to accelerate the mortgage loan, the mortgagee may treat the mortgagor as being in default. An adverse-action notice need not be given to the mortgagor or the transferee. (See comment 2(e)-1 for treatment of a purchaser who requests to assume the loan.)

2. *Current delinquency or default.* The term "adverse action" does not include a creditor's termination of an account when the accountholder is currently in default or delinquent on that account. Notification in accordance with section 202.9 of the regulation generally is required, however, if the creditor's action is based on a past delinquency or default on the account.

Paragraph 2(c)(2)(iii)

1. *Point-of-sale transactions.* Denial of credit at point of sale is not adverse action except under those circumstances specified in the regulation. For example, denial at point of sale is not adverse action in the following situations:

- A credit cardholder presents an expired card or a card that has been reported to the card issuer as lost or stolen.
- The amount of a transaction exceeds a cash advance or credit limit.
- The circumstances (such as excessive use of a credit card in a short period of time) suggest that fraud is involved.
- The authorization facilities are not functioning.
- Billing statements have been returned to the creditor for lack of a forwarding address.

2. *Application for increase in available credit.* A refusal or failure to authorize an account transaction at the point of sale or loan is not adverse action, except when the refusal is a denial of an application, submitted in accordance with the creditor's procedures, for an increase in the amount of credit.

Paragraph 2(c)(2)(v)

1. *Terms of credit versus type of credit offered.* When an applicant applies for credit and the creditor does not offer the credit terms requested by the applicant (for example, the interest rate, length of maturity, collateral, or amount of downpayment), a denial of the application for that reason is adverse action (unless the creditor makes a counteroffer that is accepted by the applicant) and the applicant is entitled to notification under section 202.9.

2(e) Applicant

1. *Request to assume loan.* If a mortgagor sells or transfers the mortgaged property and the buyer makes an application to the creditor to assume the mortgage loan, the mortgagee must treat the buyer as an applicant unless its policy is not to permit assumptions.

2(f) Application

1. *General.* A creditor has the latitude under the regulation to establish its own application process and to decide the type and amount of information it will require from credit applicants.

2. *"Procedures established."* The term refers to the actual practices followed by a creditor for making credit decisions as well as its stated application procedures. For example, if a creditor's stated policy is to require all applications to be in writing on the creditor's application form, but the creditor also makes credit decisions based on oral requests, the creditor's established procedures are to accept both oral and written applications.

3. *When an inquiry becomes an application.* A creditor is encouraged to provide consumers with information about loan terms. However, if in giving information to the consumer the creditor also evaluates information about the applicant, decides to decline the request, and communicates this to the applicant, the creditor has treated the inquiry as an application and must then comply with the notification requirements under section 202.9. Whether the inquiry becomes an application depends on how the creditor responds to the applicant, not on what the applicant says or asks.

4. *Examples of inquiries that are not applications.* The following examples illustrate situations in which only an inquiry has taken place:

- When a consumer calls to ask about loan terms and an employee explains the creditor's basic loan terms, such as interest rates, loan-to-value ratio, and debt-to-income ratio.
- When a consumer calls to ask about interest rates for car loans, and, in order to quote the appropriate rate, the loan officer asks for the make and sales price of the car and the amount of the downpayment, then gives the consumer the rate.
- When a consumer asks about terms for a loan to purchase a home and tells the loan officer her income and intended downpayment, but the loan officer only explains the creditor's loan-to-value ratio policy and other basic lending policies, without telling the consumer whether she qualifies for the loan.
- When a consumer calls to ask about terms for a loan to purchase vacant land and states his income and the sale price of the property to be financed, and asks whether he qualifies for a loan, and the employee responds by describing the general lending policies, explaining that he would need to look at all of the applicant's qualifications before making a decision, and offering to send an application form to the consumer.

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

2(g) Business Credit

1. *Definition.* The test for deciding whether a transaction qualifies as business credit is one of primary purpose. For example, an open-end credit account used for both personal and business purposes is not business credit unless the primary purpose of the account is business-related. A creditor may rely on an applicant's statement of the purpose for the credit requested.

2(j) Credit

1. *General.* Regulation B covers a wider range of credit transactions than Regulation Z (Truth in Lending). For purposes of Regulation B, a transaction is credit if there is a right to defer payment of a debt—regardless of whether the credit is for personal or commercial purposes, the number of installments required for repayment, or whether the transaction is subject to a finance charge.

2(l) Creditor

1. *Assignees.* The term "creditor" includes all persons participating in the credit decision. This may include an assignee or a potential

purchaser of the obligation who influences the credit decision by indicating whether or not it will purchase the obligation if the transaction is consummated.

2. *Referrals to creditors.* For certain purposes, the term "creditor" includes persons such as real estate brokers who do not participate in credit decisions but who regularly refer applicants to creditors or who select or offer to select creditors to whom credit requests can be made. These persons must comply with section 202.4, the general rule prohibiting discrimination, and with section 202.5(a), on discouraging applications.

2(p) Empirically Derived and Other Credit Scoring Systems

1. *Purpose of definition.* The definition under section 202.2(p)(l)(i) through (iv) sets the criteria that a credit system must meet in order for the system to use age as a predictive factor. Credit systems that do not meet these criteria are judgmental systems and may consider age only for the purpose of determining a "pertinent element of creditworthiness." (Both types of systems may favor an elderly applicant. See section 202.6(b)(2).)

2. *Periodic revalidation.* The regulation does not specify how often credit scoring systems must be revalidated. To meet the requirements for statistical soundness, the credit scoring system must be revalidated frequently enough to ensure that it continues to meet recognized professional statistical standards. To ensure that predictive ability is being maintained, creditors must periodically review the performance of the system. This could be done, for example, by analyzing the loan portfolio to determine the delinquency rate for each score interval, or by analyzing population stability over time to detect deviations of recent applications from the applicant population used to validate the system. If this analysis indicates that the system no longer predicts risk with statistical soundness, the system must be adjusted as necessary to reestablish its predictive ability. A creditor is responsible for ensuring its system is validated and revalidated based on the creditor's own data when it becomes available.

3. *Pooled-data scoring systems.* A scoring system or the data from which to develop such a system may be obtained from either a single credit grantor or multiple credit grantors. The resulting system will qualify as an empirically derived, demonstrably and statistically sound, credit scoring system provided the criteria set forth in paragraph (p)(1)(i) through (iv) of this section are met.

4. *Effects test and disparate treatment.* An empirically derived, demonstrably and statistically sound, credit scoring system may include age as a predictive factor (provided that the age of an elderly applicant is not assigned a negative factor or value). Besides age, no other prohibited basis may be used as a variable. Generally, credit scoring systems treat all applicants objectively and thus avoid problems of disparate treatment. In cases where a credit scoring system is used in conjunction with individual discretion, disparate treatment could conceivably occur in the evaluation process. In addition, neutral factors used in credit scoring systems could nonetheless be subject to challenge under the effects test. (See comment 6(a)-2 for a discussion of the effects test).

2(w) Open-End Credit

1. *Open-end real estate mortgages.* The term "open-end credit" does not include negotiated advances under an open-end real estate mortgage or a letter of credit.

2(z) Prohibited Basis

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

complex being financed), or because of the race of other residents in the neighborhood where the property offered as collateral is located.

2. *National origin.* A creditor may not refuse to grant credit because an applicant comes from a particular country but may take the applicant's immigration status into account. A creditor may also take into account any applicable law, regulation, or executive order restricting dealings with citizens (or the government) of a particular country or imposing limitations regarding credit extended for their use.

3. *Public assistance program.* Any federal, state, or local governmental assistance program that provides a continuing, periodic income supplement, whether premised on entitlement or need, is "public assistance" for purposes of the regulation. The term includes (but is not limited to) Aid to Families with Dependent Children, food stamps, rent and mortgage supplement or assistance programs, Social Security and Supplemental Security Income, and unemployment compensation. Only physicians, hospitals, and others to whom the benefits are payable need consider Medicare and Medicaid as public assistance.

SECTION 202.3—Limited Exceptions for Certain Classes of Transactions

1. *Scope.* This section relieves burdens with regard to certain types of credit for which full application of the procedural requirements of the regulation is not needed. All classes of transactions remain subject to the general rule given in section 202.4, barring discrimination on a prohibited basis, and to any other provision not specifically excepted.

3(a) Public-Utilities Credit

1. *Definition.* This definition applies only to credit for the purchase of a utility service, such as electricity, gas, or telephone service. Credit provided or offered by a public utility for some other purpose—such as for financing the purchase of a gas dryer, telephone equipment, or other durable goods, or for insulation or other home improvements—is not excepted.

2. *Security deposits.* A utility company is a creditor when it supplies utility service and bills the user after the service has been provided. Thus, any credit term (such as a requirement for a security deposit) is subject to the regulation.

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

3(c) Incidental Credit

1. *Examples.* If a service provider (such as a hospital, doctor, lawyer or retailer) allows the client or customer to defer the payment of a bill, this deferral of a debt is credit for purposes of the regulation, even though there is no finance charge and no agreement for payment in installments. Because of the exceptions provided by this section, however, these particular credit extensions are excepted from compliance with certain procedural requirements as specified in the regulation.

3(d) Government Credit

1. *Credit to governments.* The exception relates to credit extended to (not by) governmental entities. For example, credit extended to a local government by a creditor in the private sector is covered by this exception, but credit extended to consumers by a federal or state housing agency does not qualify for special treatment under this category.

SECTION 202.4—General Rule Prohibiting Discrimination

1. *Scope of section.* The general rule stated in section 202.4 covers all dealings, without exception, between an applicant and a creditor, whether or not addressed by other provisions of the regulation. Other sections of the regulation identify specific practices that the Board has decided are impermissible because they could result in credit discrimination on a basis prohibited by the act. The general rule covers, for example, application procedures, criteria

used to evaluate creditworthiness, administration of accounts, and treatment of delinquent or slow accounts. Thus, whether or not specifically prohibited elsewhere in the regulation, a credit practice that treats applicants differently on a prohibited basis violates the law because it violates the general rule. Disparate treatment on a prohibited basis is illegal whether or not it results from a conscious intent to discriminate. Disparate treatment would be found, for example, where a creditor requires a minority applicant to provide greater documentation to obtain a loan than a similarly situated nonminority applicant. Disparate treatment also would be found where a creditor waives or relaxes credit standards for a nonminority applicant but not for a similarly situated minority applicant. Treating applicants differently on a prohibited basis is unlawful if the creditor lacks a legitimate nondiscriminatory reason for its action, or if the asserted reason is found to be a pretext for discrimination.

SECTION 202.5—Rules Concerning Taking of Applications

5(a) Discouraging Applications

1. *Potential applicants.* Generally, the regulation's protections apply only to persons who have requested or received an extension of credit. In keeping with the purpose of the act—to promote the availability of credit on a nondiscriminatory basis—section 202.5(a) covers acts or practices directed at potential applicants. Practices prohibited by this section include—

- a statement that the applicant should not bother to apply, after the applicant states that he is retired
- use of words, symbols, models or other forms of communication in advertising that express, imply, or suggest a discriminatory preference or a policy of exclusion in violation of the act
- use of interview scripts that discourage applications on a prohibited basis.

2. *Affirmative advertising.* A creditor may affirmatively solicit or encourage members of traditionally disadvantaged groups to apply for credit, especially groups that might not normally seek credit from that creditor.

5(b) General Rules Concerning Requests for Information

1. *Requests for information.* This section governs the types of information that a creditor may gather. Section 202.6 governs how information may be used.

Paragraph 5(b)(2)

1. *Local laws.* Information that a creditor is allowed to collect pursuant to a "state" statute or regulation includes information required by a local statute, regulation, or ordinance.

2. *Information required by Regulation C.* Regulation C generally requires creditors covered by the Home Mortgage Disclosure Act (HMDA) to collect and report information about the race or national origin and sex of applicants for home-improvement loans and home-purchase loans, including some types of loans not covered by section 202.13. Certain creditors with assets under $30 million, though covered by HMDA, are not required to collect and report these data; but they may do so at their option under HMDA, without violating the ECOA or Regulation B.

3. *Collecting information on behalf of creditors.* Loan brokers, correspondents, or other persons do not violate the ECOA or Regulation B if they collect information that they are otherwise prohibited from collecting, where the purpose of collecting the information is to provide it to a creditor that is subject to the Home Mortgage Disclosure Act or another federal or state statute or regulation requiring data collection.

5(d) Other Limitations on Information Requests

Paragraph 5(d)(1)

1. *Indirect disclosure of prohibited information.* The fact that certain credit-related information may indirectly disclose marital status does not bar a creditor from seeking such in-

formation. For example, the creditor may ask about—

- the applicant's obligation to pay alimony, child support, or separate maintenance
- the source of income to be used as the basis for repaying the credit requested, which could disclose that it is the income of a spouse
- whether any obligation disclosed by the applicant has a co-obligor, which could disclose that the co-obligor is a spouse or former spouse
- the ownership of assets, which could disclose the interest of a spouse

Paragraph 5(d)(2)

1. *Disclosure about income.* The sample application forms in appendix B to the regulation illustrate how a creditor may inform an applicant of the right not to disclose alimony, child support, or separate maintenance income.

2. *General inquiry about source of income.* Since a general inquiry about the source of income may lead an applicant to disclose alimony, child support, or separate maintenance, a creditor may not make such an inquiry on an application form without prefacing the request with the disclosure required by this paragraph.

3. *Specific inquiry about sources of income.* A creditor need not give the disclosure if the inquiry about income is specific and worded in a way that is unlikely to lead the applicant to disclose the fact that income is derived from alimony, child support, or separate maintenance payments. For example, an application form that asks about specific types of income such as salary, wages, or investment income need not include the disclosure.

5(e) Written Applications

1. *Requirement for written applications.* The requirement of written applications for certain types of dwelling-related loans is intended to assist the federal supervisory agencies in monitoring compliance with the ECOA and the Fair Housing Act. Model application forms are provided in appendix B to the regulation, although use of a printed form of any kind is not required. A creditor will satisfy the requirement by writing down the information that it normally considers in making a credit decision. The creditor may complete the application on behalf of an applicant and need not require the applicant to sign the application.

2. *Telephone applications.* A creditor that accepts applications by telephone for dwelling-related credit covered by section 202.13 can meet the requirements for written applications by writing down pertinent information that is provided by the applicant(s).

3. *Computerized entry.* Information entered directly into and retained by a computerized system qualifies as a written application under this paragraph. (See the commentary to section 202.13(b), *Applications through electronic media* and *Applications through video.*)

SECTION 202.5a—Rules on Providing Appraisal Reports

5a(a) Providing Appraisals

1. *Coverage.* This section covers applications for credit to be secured by a lien on a dwelling, as that term is defined in section 202.5a(c), whether the credit is for a business purpose (for example, a loan to start a business) or a consumer purpose (for example, a loan to finance a child's education).

2. *Renewals.* If an applicant requests that a creditor renew an existing extension of credit, and the creditor obtains a new appraisal report to evaluate the request, this section applies. This section does not apply to a renewal request if the creditor uses the appraisal report previously obtained in connection with the decision to grant credit.

Paragraph 5a(a)(2)(i) Notice

1. *Multiple applicants.* When an application that is subject to this section involves more than one applicant, the notice about the appraisal report need only be given to one appli-

cant, but it must be given to the primary applicant where one is readily apparent.

Paragraph 5a(a)(2)(ii) Delivery

1. *Reimbursement.* Creditors may charge for photocopy and postage costs incurred in providing a copy of the appraisal report, unless prohibited by state or other law. If the consumer has already paid for the report—for example, as part of an application fee—the creditor may not require additional fees for the appraisal (other than photocopy and postage costs).

5a(c) Definitions

1. *Appraisal reports.* Examples of appraisal reports are—

i. a report prepared by an appraiser (whether or not licensed or certified), including written comments and other documents submitted to the creditor in support of the appraiser's estimate or opinion of value
ii. a document prepared by the creditor's staff which assigns value to the property, if a third-party appraisal report has not been used
iii. an internal review document reflecting that the creditor's valuation is different from a valuation in a third party's appraisal report (or different from valuations that are publicly available or valuations such as manufacturers' invoices for mobile homes)

2. *Other reports.* The term "appraisal report" does not cover all documents relating to the value of the applicant's property. Examples of reports not covered are—

i. internal documents, if a third-party appraisal report was used to establish the value of the property
ii. governmental-agency statements of appraised value
iii. valuations lists that are publicly available (such as published sales prices or mortgage amounts, tax assessments, and retail price ranges) and valuations such as manufacturers' invoices for mobile homes

SECTION 202.6—Rules Concerning Evaluation of Applications

6(a) General Rule Concerning Use of Information

1. *General.* When evaluating an application for credit, a creditor generally may consider any information obtained. However, a creditor may not consider in its evaluation of creditworthiness any information that it is barred by section 202.5 from obtaining.

2. *Effects test.* The effects test is a judicial doctrine that was developed in a series of employment cases decided by the Supreme Court under title VII of the Civil Rights Act of 1964 (42 USC 2000e et seq.), and the burdens of proof for such employment cases were codified by Congress in the Civil Rights Act of 1991 (42 USC 2000e-2). Congressional intent that this doctrine apply to the credit area is documented in the Senate Report that accompanied H.R. 6516, No. 94-589, pp. 4–5; and in the House Report that accompanied H.R. 6516, No. 94-210, p. 5. The act and regulation may prohibit a creditor practice that is discriminatory in effect because it has a disproportionately negative impact on a prohibited basis, even though the creditor has no intent to discriminate and the practice appears neutral on its face, unless the creditor practice meets a legitimate business need that cannot reasonably be achieved as well by means that are less disparate in their impact. For example, requiring that applicants have incomes in excess of a certain amount to qualify for an overdraft line of credit could mean that women and minority applicants will be rejected at a higher rate than men and nonminority applicants. If there is a demonstrable relationship between the income requirement and creditworthiness for the level of credit involved, however, use of the income standard would likely be permissible.

6(b) Specific Rules Concerning Use of Information

Paragraph 6(b)(1)

1. *Prohibited basis—marital status.* A creditor may not use marital status as a basis for de-

termining the applicant's creditworthiness. However, a creditor may consider an applicant's marital status for the purpose of ascertaining the creditor's rights and remedies applicable to the particular extension of credit. For example, in a secured transaction involving real property, a creditor could take into account whether state law gives the applicant's spouse an interest in the property being offered as collateral. Except to the extent necessary to determine rights and remedies for a specific credit transaction, a creditor that offers joint credit may not take the applicants' marital status into account in credit evaluations. Because it is unlawful for creditors to take marital status into account, creditors are barred from applying different standards in evaluating married and unmarried applicants. In making credit decisions, creditors may not treat joint applicants differently based on the existence, the absence, or the likelihood of a marital relationship between the parties.

2. *Prohibited basis—special-purpose credit.* In a special-purpose credit program, a creditor may consider a prohibited basis to determine whether the applicant possesses a characteristic needed for eligibility. (See section 202.8.)

Paragraph 6(b)(2)

1. *Favoring the elderly.* Any system of evaluating creditworthiness may favor a credit applicant who is age 62 or older. A credit program that offers more favorable credit terms to applicants age 62 or older is also permissible; a program that offers more favorable credit terms to applicants at an age lower than 62 is permissible only if it meets the special-purpose credit requirements of section 202.8.

2. *Consideration of age in a credit scoring system.* Age may be taken directly into account in a credit scoring system that is "demonstrably and statistically sound," as defined in section 202.2(p), with one limitation: applicants 62 years old or older must be treated at least as favorably as applicants who are under age 62. If age is scored by assigning points to an applicant's age category, elderly applicants must receive the same or a greater number of points as the most favored class of nonelderly applicants.

i. *Age-split scorecards.* A creditor may segment the population into scorecards based on the age of an applicant. In such a system, one card covers a narrow age range (for example, applicants in their twenties or younger) who are evaluated under attributes predictive for that age group. A second card covers all other applicants who are evaluated under the attributes predictive for that broad class. When a system uses a card covering a wide age range that encompasses elderly applicants, the credit scoring system does not score age. Thus, the system does not raise the issue of assigning a negative factor or value to the age of elderly applicants. But if a system segments the population by age into multiple scorecards, and includes elderly applicants in a narrower age range, the credit scoring system does score age. To comply with the act and regulation in such a case, the creditor must ensure that the system does not assign a negative factor or value to the age of elderly applicants as a class.

3. *Consideration of age in a judgmental system.* In a judgmental system, defined in section 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 base its decision on age or information related exclusively to age. Age or 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 applicant.

4. *Consideration of age in a reverse mortgage.* A reverse mortgage is a home-secured loan in which the borrower receives payments from the creditor and does not become obligated to repay these amounts (other than in the case of default) until the borrower dies, moves permanently from the home, or transfers title to the home, or upon a specified maturity date. Disbursements to the borrower under a reverse mortgage typically are determined by considering the value of the borrower's home, the current interest rate, and the borrower's life expectancy. A reverse mortgage program that requires borrowers to be age 62 or older is permissible under section 202.6(b)(2)(iv). In addition, under section 202.6(b)(2)(iii), a creditor may consider a borrower's age to evaluate a pertinent element of creditworthiness, such as the amount of the credit or monthly payments that the borrower will receive, or the estimated repayment date.

5. *Consideration of age in a combined system.* A creditor using a credit scoring system that qualifies as "empirically derived" under section 202.2(p) may consider other factors (such as a credit report or the applicant's cash flow) on a judgmental basis. Doing so will not negate the classification of the credit scoring component of the combined system as "demonstrably and statistically sound." While age could be used in the credit scoring portion, however, in the judgmental portion age may not be considered directly. It may be used only for the purpose of determining a "pertinent element of creditworthiness." (See comment 6(b)(2)-3.)

6. *Consideration of public assistance.* When considering income derived from a public assistance program, a creditor may take into account, for example—

- the length of time an applicant will likely remain eligible to receive such income
- whether the applicant will continue to qualify for benefits based on the status of the applicant's dependents (such as Aid to Families with Dependent Children or Social Security payments to a minor)
- whether the creditor can attach or garnish the income to assure payment of the debt in the event of default

Paragraph 6(b)(5)

1. *Consideration of an individual applicant.* A creditor must evaluate income derived from part-time employment, alimony, child support, separate maintenance, retirement benefits, or public assistance (all referred to as "protected income") on an individual basis, not on the basis of aggregate statistics, and must assess its reliability or unreliability by analyzing the applicant's actual circumstances, not by analyzing statistical measures derived from a group.

2. *Payments consistently made.* In determining the likelihood of consistent payments of alimony, child support, or separate maintenance, a creditor may consider factors such as whether payments are received pursuant to a written agreement or court decree; the length of time that the payments have been received; whether the payments are regularly received by the applicant; the availability of court or other procedures to compel payment; and the creditworthiness of the payor, including the credit history of the payor when it is available to the creditor.

3. *Consideration of income.* A creditor need not consider income at all in evaluating creditworthiness. If a creditor does consider income, there are several acceptable methods, whether in a credit scoring or a judgmental system:

- A creditor may score or take into account

the total sum of all income stated by the applicant without taking steps to evaluate the income.

- A creditor may evaluate each component of the applicant's income, and then score or take into account reliable income separately from income that is not reliable, or the creditor may disregard that portion of income that is not reliable before aggregating it with reliable income.
- A creditor that does not evaluate all income components for reliability must treat as reliable any component of protected income that is not evaluated.

In considering the separate components of an applicant's income, the creditor may not automatically discount or exclude from consideration any protected income. Any discounting or exclusion must be based on the applicant's actual circumstances.

4. *Part-time employment, sources of income.* A creditor may score or take into account the fact that an individual applicant has more than one source of earned income—a full-time and a part-time job or two part-time jobs. A creditor may also score or treat earned income from a secondary source differently than earned income from a primary source. However, the creditor may not score or otherwise take into account the number of sources for protected income—for example, retirement income, Social Security, alimony. Nor may the creditor treat negatively the fact that an applicant's only earned income is derived from a part-time job.

Paragraph 6(b)(6)

1. *Types of credit references.* A creditor may restrict the types of credit history and credit references that it will consider, provided that the restrictions are applied to all credit applicants without regard to sex, marital status, or any other prohibited basis. However, on the applicant's request, a creditor must consider credit information not reported through a credit bureau when the information relates to the same types of credit references and history that the creditor would consider if reported through a credit bureau.

Paragraph 6(b)(7)

1. *National origin—immigration status.* The applicant's immigration status and ties to the community (such as employment and continued residence in the area) could have a bearing on a creditor's ability to obtain repayment.

Accordingly, the creditor may consider and differentiate, for example, between a nonciti zen who is a long-time resident with permanent resident status and a noncitizen who is temporarily in this country on a student visa.

2. *National origin—citizenship.* Under the regulation, a denial of credit on the ground that an applicant is not a United States citizen is not per se discrimination based on national origin.

SECTION 202.7—Rules Concerning Extensions of Credit

7(a) Individual Accounts

1. *Open-end credit—authorized user.* A creditor may not require a creditworthy applicant seeking an individual credit account to provide additional signatures. However, the creditor may condition the designation of an authorized user by the account holder on the authorized user's becoming contractually liable for the account, as long as the creditor does not differentiate on any prohibited basis in imposing this requirement.

2. *Open-end credit—choice of authorized user.* A creditor that permits an account holder to designate an authorized user may not restrict this designation on a prohibited basis. For example, if the creditor allows the designation of spouses as authorized users, the creditor may not refuse to accept a nonspouse as an authorized user.

3. *Overdraft authority on transaction accounts.* If a transaction account (such as a checking account or NOW account) includes an overdraft line of credit, the creditor may require that all persons authorized to draw on the transaction account assume liability for any overdraft.

7(b) Designation of Name

1. *Single name on account.* A creditor may require that joint applicants on an account designate a single name for purposes of administering the account and that a single name be embossed on any credit card(s) issued on the account. But the creditor may not require that the name be the husband's name. (See section 202.10 for rules governing the furnishing of credit history on accounts held by spouses.)

7(c) Action Concerning Existing Open-End Accounts

Paragraph 7(c)(1)

1. *Termination coincidental with marital status change.* When an account holder's marital status changes, a creditor generally may not terminate the account unless it has evidence that the account holder is unable or unwilling to repay. But the creditor may terminate an account on which both spouses are jointly liable, even if the action coincides with a change in marital status, when one or both spouses—

- repudiate responsibility for future charges on the joint account
- request separate accounts in their own names
- request that the joint account be closed

2. *Updating information.* A creditor may periodically request updated information from applicants but may not use events related to a prohibited basis—such as an applicant's retirement, reaching a particular age, or change in name or marital status—to trigger such a request.

Paragraph 7(c)(2)

1. *Procedure pending reapplication.* A creditor may require a reapplication from a contractually liable party, even when there is no evidence of unwillingness or inability to repay, if (1) the credit was based on the qualifications of a person who is no longer available to support the credit and (2) the creditor has information indicating that the account holder's income by itself may be insufficient to support the credit. While a reapplication is pending, the creditor must allow the account holder full access to the account under the existing contract terms. The creditor may specify a reasonable time period within which the account holder must submit the required information.

7(d) Signature of Spouse or Other Person

1. *Qualified applicant.* The signature rules ensure that qualified applicants are able to obtain credit in their own names. Thus, when an applicant requests individual credit, a creditor generally may not require the signature of another person unless the creditor has first determined that the applicant alone does not qualify for the credit requested.

2. *Unqualified applicant.* When an applicant applies for individual credit but does not alone meet a creditor's standards, the creditor may require a cosigner, guarantor or the like—but cannot require that it be the spouse. (See commentary to section 202.7(d)(5) and (6).)

Paragraph 7(d)(1)

1. *Joint applicant.* The term "joint applicant" refers to someone who applies contemporaneously with the applicant for shared or joint credit. It does not refer to someone whose signature is required by the creditor as a condition for granting the credit requested.

Paragraph 7(d)(2)

1. *Jointly owned property.* If an applicant requests unsecured credit, does not own sufficient separate property, and relies on joint property to establish creditworthiness, the creditor must value the applicant's interest in the jointly owned property. A creditor may not request that a nonapplicant joint owner sign any instrument as a condition of the credit extension unless the applicant's interest does not support the amount and terms of the credit sought.

i. *Valuation of applicant's interest.* In determining the value of an applicant's interest in jointly owned property, a creditor may consider factors such as the form of ownership

and the property's susceptibility to attachment, execution, severance, or partition; the value of the applicant's interest after such action; and the cost associated with the action. This determination must be based on the form of ownership prior to or at consummation, and not on the possibility of a subsequent change. For example, in determining whether a married applicant's interest in jointly owned property is sufficient to satisfy the creditor's standards of creditworthiness for individual credit, a creditor may not consider that the applicant's separate property may be transferred into tenancy by the entirety after consummation. Similarly, a creditor may not consider the possibility that the couple may divorce. Accordingly, a creditor may not require the signature of the nonapplicant spouse in these or similar circumstances.

ii. *Other options to support credit.* If the applicant's interest in jointly owned property does not support the amount and terms of credit sought, the creditor may offer the applicant other options to provide additional support for the extension of credit. For example—

A. requesting an additional party (see section 202.7(d)(5));
B. offering to grant the applicant's request on a secured basis (see section 202.7(d)(4)); or
C. asking for the signature of the joint owner on an instrument that ensures access to the property in the event of the applicant's death or default, but does not impose personal liability unless necessary under state law (e.g., a limited guarantee). A creditor may not routinely require, however, that a joint owner sign an instrument (such as a quitclaim deed) that would result in the forfeiture of the joint owner's interest in the property.

2. *Need for signature—reasonable belief.* A creditor's reasonable belief as to what instruments need to be signed by a person other than the applicant should be supported by a thorough review of pertinent statutory and decisional law or an opinion of the state attorney general.

Paragraph 7(d)(3)

1. *Residency.* In assessing the creditworthiness of a person who applies for credit in a community property state, a creditor may assume that the applicant is a resident of the state unless the applicant indicates otherwise.

Paragraph 7(d)(4)

1. *Creation of enforceable lien.* Some state laws require that both spouses join in executing any instrument by which real property is encumbered. If an applicant offers such property as security for credit, a creditor may require the applicant's spouse to sign the instruments necessary to create a valid security interest in the property. The creditor may not require the spouse to sign the note evidencing the credit obligation if signing only the mortgage or other security agreement is sufficient to make the property available to satisfy the debt in the event of default. However, if under state law both spouses must sign the note to create an enforceable lien, the creditor may require them to do so.

2. *Need for signature—reasonable belief.* Generally, a signature to make the secured property available will only be needed on a security agreement. A creditor's reasonable belief that, to ensure access to the property, the spouse's signature is needed on an instrument that imposes personal liability should be supported by a thorough review of pertinent statutory and decisional law or an opinion of the state attorney general.

3. *Integrated instruments.* When a creditor uses an integrated instrument that combines the note and the security agreement, the spouse cannot be required to sign the integrated instrument if the signature is only needed to grant a security interest. But the spouse could be asked to sign an integrated instrument that makes clear—for example, by a legend placed next to the spouse's signature—that the spouse's signature is only to grant a security interest and that signing the instrument does not impose personal liability.

Paragraph 7(d)(5)

1. *Qualifications of additional parties.* In es-

tablishing guidelines for eligibility of guarantors, cosigners, or similar additional parties, a creditor may restrict the applicant's choice of additional parties buy may not discriminate on the basis of sex, marital status or any other prohibited basis. For example, the creditor could require that the additional party live in the creditor's market area.

2. *Reliance on income of another person—individual credit.* An applicant who requests individual credit relying on the income of another person (including a spouse in a non-community 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. If the applicant relies on the spouse's future earnings that as a matter of state law cannot be characterized as community property until earned, the creditor may require the spouse's signature, but need not do so—even if it is the creditor's practice to require the signature when an applicant relies on the future earnings of a person other than a spouse. (See section 202.6(c) on consideration of state property laws.)

3. *Renewals.* If the borrower's creditworthiness is reevaluated when a credit obligation is renewed, the creditor must determine whether an additional party is still warranted and, if not, release the additional party.

Paragraph 7(d)(6)

1. *Guarantees.* A guarantee on an extension of credit is part of a credit transaction and therefore subject to the regulation. A creditor may require the personal guarantee of the partners, directors, or officers of a business, and the shareholders of a closely held corporation, even if the business or corporation is creditworthy. The requirement must be based on the guarantor's relationship with the business or corporation, however, and not on a prohibited basis. For example, a creditor may not require guarantees only for women-owned or minority-owned businesses. Similarly, a creditor may not require guarantees only from the married officers of a business or married shareholders of a closely held corporation.

2. *Spousal guarantees.* The rules in section 202.7(d) bar a creditor from requiring a signature of a *guarantor's spouse* just as they bar the creditor from requiring the signature of an *applicant's spouse*. For example, although a creditor may require all officers of a closely held corporation to personally guarantee a corporate loan, the creditor may not automatically require that spouses of married officers also sign the guarantee. If an evaluation of the financial circumstances of an officer indicates that an additional signature is necessary, however, the creditor may require the signature of a spouse in appropriate circumstances in accordance with section 202.7(d)(2).

7(e) Insurance

1. *Differences in terms.* Differences in the availability, rates, and other terms on which credit-related casualty insurance or credit life, health, accident, or disability insurance is offered or provided to an applicant does not violate Regulation B.

2. *Insurance information.* A creditor may obtain information about an applicant's age, sex, or marital status for insurance purposes. The information may only be used, however, for determining eligibility and premium rates for insurance, and not in making the credit decision.

SECTION 202.8—Special-Purpose Credit Programs

8(a) Standards for Programs

1. *Determining qualified programs.* The Board does not determine whether individual programs qualify for special-purpose credit status, or whether a particular program benefits an "economically disadvantaged class of persons." The agency or creditor administering or offering the loan program must make these decisions regarding the status of its program.

2. *Compliance with a program authorized by federal or state law.* A creditor does not violate Regulation B when it complies in good

faith with a regulation promulgated by a government agency implementing a special-purpose credit program under section 202.8(a)(1). It is the agency's responsibility to promulgate a regulation that is consistent with federal and state law.

3. *Expressly authorized.* Credit programs authorized by federal or state law include programs offered pursuant to federal, state, or local statute, regulation or ordinance, or by judicial or administrative order.

4. *Creditor liability.* A refusal to grant credit to an applicant is not a violation of the act or regulation if the applicant does not meet the eligibility requirements under a special-purpose credit program.

5. *Determining need.* In designing a special-purpose program under section 202.8(a), a for-profit organization must determine that the program will benefit a class of people who would otherwise be denied credit or would receive it on less favorable terms. This determination can be based on a broad analysis using the organization's own research or data from outside sources, including governmental reports and studies. For example, a bank could review Home Mortgage Disclosure Act data along with demographic data for its assessment area and conclude that there is a need for a special-purpose credit program for low-income minority borrowers.

6. *Elements of the program.* The written plan must contain information that supports the need for the particular program. The plan also must either state a specific period of time for which the program will last, or contain a statement regarding when the program will be reevaluated to determine if there is a continuing need for it.

8(b) Rules in Other Sections

1. *Applicability of rules.* A creditor that rejects an application because the applicant does not meet the eligibility requirements (common characteristic or financial need, for example) must nevertheless notify the applicant of action taken as required by section 202.9.

8(c) Special Rule Concerning Requests and Use of Information

1. *Request of prohibited information.* This section permits a creditor to request and consider certain information that would otherwise be prohibited by sections 202.5 and 202.6 to determine an applicant's eligibility for a particular program.

2. *Examples.* Examples of programs under which the creditor can ask for and consider information related to a prohibited basis are—

- energy conservation programs to assist the elderly, for which the creditor must consider the applicant's age
- programs under a Minority Enterprise Small Business Investment Corporation, for which a creditor must consider the applicant's minority status

8(d) Special Rule in the Case of Financial Need

1. *Request of prohibited information.* This section permits a creditor to request and consider certain information that would otherwise be prohibited by sections 202.5 and 202.6, and to require signatures that would otherwise be prohibited by section 202.7(d).

2. *Examples.* Examples of programs in which financial need is a criterion are—

- subsidized housing programs for low- to moderate-income households, for which a creditor may have to consider the applicant's receipt of alimony or child support, the spouse's or parents' income, etc.
- student loan programs based on the family's financial need, for which a creditor may have to consider the spouse's or parents' financial resources

3. *Student loans.* In a guaranteed student loan program, a creditor may obtain the signature of a parent as a guarantor when required by federal or state law or agency regulation, or when the student does not meet the creditor's standards of creditworthiness. (See sections 202.7(d)(1) and (5).) The creditor may not require an additional signature when a student has a work or credit history that satisfies the creditor's standards.

SECTION 202.9—Notifications

1. *Use of the term "adverse action."* The regulation does not require that a creditor use the term "adverse action" in communicating to an applicant that a request for an extension of credit has not been approved. In notifying an applicant of adverse action as defined by section 202.2(c)(1), a creditor may use any words or phrases that describe the action taken on the application.

2. *Expressly withdrawn applications.* When an applicant expressly withdraws a credit application, the creditor is not required to comply with the notification requirements under section 202.9. (The creditor must, however, comply with the record-retention requirements of the regulation. See section 202.12(b)(3).)

3. *When notification occurs.* Notification occurs when a creditor delivers or mails a notice to the applicant's last known address or, in the case of an oral notification, when the creditor communicates the credit decision to the applicant.

4. *Location of notice.* The notifications required under section 202.9 may appear on either or both sides of a form or letter.

5. *Prequalification and preapproval programs.* Whether a creditor must provide a notice of action taken for a prequalification or preapproval request depends on the creditor's response to the request, as discussed in the commentary to section 202.2(f). For instance, a creditor may treat the request as an inquiry if the creditor provides general information such as loan terms and the maximum amount a consumer could borrow under various loan programs, explaining the process the consumer must follow to submit a mortgage application and the information the creditor will analyze in reaching a credit decision. On the other hand, a creditor has treated a request as an application, and is subject to the adverse-action notice requirements of section 202.9 if, after evaluating information, the creditor decides that it will not approve the request and communicates that decision to the consumer. For example, if in reviewing a request for prequalification, a creditor tells the consumer that it would not approve an application for a mortgage because of a bankruptcy in the consumer's record, the creditor has denied an application for credit.

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

Paragraph 9(a)(1)

1. *Timing of notice—when an application is complete.* Once a creditor has obtained all the information it normally considers in making a credit decision, the application is complete and the creditor has 30 days in which to notify the applicant of the credit decision. (See also comment 2(f)-5.)

2. *Notification of approval.* Notification of approval may be express or by implication. For example, the creditor will satisfy the notification requirement when it gives the applicant the credit card, money, property, or services requested.

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

4. *Incomplete application—denial for reasons other than incompleteness.* When an application is missing information but provides sufficient data for a credit decision, the creditor may evaluate the application and notify the applicant under this section as appropriate. If credit is denied, the applicant must be given the specific reasons for the credit denial (or notice of the right to receive the reasons); in this instance the incompleteness of the application cannot be given as the reason for the denial.

5. *Length of counteroffer.* Section 202.9(a)(1)(iv) does not require a creditor to hold a counteroffer open for 90 days or any other particular length of time.

6. *Counteroffer combined with adverse-action*

notice. A creditor that gives the applicant a combined counteroffer and adverse-action notice that complies with section 202.9(a)(2) need not send a second adverse-action notice if the applicant does not accept the counter offer. A sample of a combined notice is contained in form C-4 of appendix C to the regulation.

7. *Denial of a telephone application.* When an application is conveyed by means of telephone and adverse action is taken, the creditor must request the applicant's name and address in order to provide written notification under this section. If the applicant declines to provide that information, then the creditor has no further notification responsibility.

Paragraph 9(a)(3)

1. *Coverage.* In determining the rules in this paragraph that apply to a given business-credit application, a creditor may rely on the applicant's assertion about the revenue size of the business. (Applications to start a business are governed by the rules in section 202.9(a)(3)(i).) If an applicant applies for credit as a sole proprietor, the revenues of the sole proprietorship will determine which rules in the paragraph govern the application. However, if an applicant applies for business-purpose credit as an individual, the rules in paragraph 9(a)(3)(i) apply unless the application is for trade or similar credit.

2. *Trade credit.* The term "trade credit" generally is limited to a financing arrangement that involves a buyer and a seller—such as a supplier who finances the sale of equipment, supplies, or inventory; it does not apply to an extension of credit by a bank or other financial institution for the financing of such items.

3. *Factoring.* Factoring refers to a purchase of accounts receivable and thus is not subject to the act or regulation. If there is a credit extension incident to the factoring arrangement, the notification rules in section 202.9(a)(3)(ii) apply, as do other relevant sections of the act and regulation.

4. *Manner of compliance.* In complying with the notice provisions of the act and regulation, creditors offering business credit may follow the rules governing consumer credit. Similarly, creditors may elect to treat all business credit the same (irrespective of revenue size) by providing notice in accordance with section 202.9(a)(3)(i).

5. *Timing of notification.* A creditor subject to section 202.9(a)(3)(ii)(A) is required to notify a business credit applicant, orally or in writing, of action taken on an application within a reasonable time of receiving a completed application. Notice provided in accordance with the timing requirements of section 202.9(a)(1) is deemed reasonable in all instances.

9(b) Form of ECOA Notice and Statement of Specific Reasons

Paragraph 9(b)(1)

1. *Substantially similar notice.* The ECOA notice sent with a notification of a credit denial or other adverse action will comply with the regulation if it is "substantially similar" to the notice contained in section 202.9(b)(1). For example, a creditor may add a reference to the fact that the ECOA permits age to be considered in certain credit scoring systems, or add a reference to a similar state statute or regulation and to a state enforcement agency.

Paragraph 9(b)(2)

1. *Number of specific reasons.* A creditor must disclose the principal reasons for denying an application or taking other adverse action. The regulation does not mandate that a specific number of reasons be disclosed, but disclosure of more than four reasons is not likely to be helpful to the applicant.

2. *Source of specific reasons.* The specific reasons disclosed under section 202.9(a)(2) and (b)(2) must relate to and accurately describe the factors actually considered or scored by a creditor.

3. *Description of reasons.* A creditor need not describe how or why a factor adversely affected an applicant. For example, the notice may say "length of residence" rather than "too short a period of residence."

4. *Credit scoring system.* If a creditor bases the denial or other adverse action on a credit

scoring system, the reasons disclosed must relate only to those factors actually scored in the system. Moreover, no factor that was a principal reason for adverse action may be excluded from disclosure. The creditor must disclose the actual reasons for denial (for example, "age of automobile") even if the relationship of that factor to predicting creditworthiness may not be clear to the applicant.

5. *Credit scoring—method for selecting reasons.* The regulation does not require that any one method be used for selecting reasons for a credit denial or other adverse action that is based on a credit scoring system. Various methods will meet the requirements of the regulation. One method is to identify the factors for which the applicant's score fell furthest below the average score for each of those factors achieved by applicants whose total score was at or slightly above the minimum passing score. Another method is to identify the factors for which the applicant's score fell furthest below the average score for each of those factors achieved by all applicants. These average scores could be calculated during the development or use of the system. Any other method that produces results substantially similar to either of these methods is also acceptable under the regulation.

6. *Judgmental system.* If a creditor uses a judgmental system, the reasons for the denial or other adverse action must relate to those factors in the applicant's record actually reviewed by the person making the decision.

7. *Combined credit scoring and judgmental system.* If a creditor denies an application based on a credit evaluation system that employs both credit scoring and judgmental components, the reasons for the denial must come from the component of the system that the applicant failed. For example, if a creditor initially credit scores an application and denies the credit request as a result of that scoring, the reasons disclosed to the applicant must relate to the factors scored in the system. If the application passes the credit scoring stage but the creditor then denies the credit request based on a judgmental assessment of the applicant's record, the reasons disclosed must relate to the factors reviewed judgmentally, even if the factors were also considered in the credit scoring component.

8. *Automatic denial.* Some credit-decision methods contain features that call for automatic denial because of one or more negative factors in the applicant's record (such as the applicant's previous bad credit history with that creditor, the applicant's declaration of bankruptcy, or the fact that the applicant is a minor). When a creditor denies the credit request because of an automatic-denial factor, the creditor must disclose that specific factor.

9. *Combined ECOA-FCRA disclosures.* The ECOA requires disclosure of the principal reasons for denying or taking other adverse action on an application for an extension of credit. The Fair Credit Reporting Act requires a creditor to disclose when it has based its decision in whole or in part on information from a source other than the applicant or from its own files. Disclosing that a credit report was obtained and used to deny the application, as the FCRA requires, does not satisfy the ECOA requirement to disclose specific reasons. For example, if the applicant's credit history reveals delinquent credit obligations and the application is denied for that reason, to satisfy section 202.9(b)(2) the creditor must disclose that the application was denied because of the applicant's delinquent credit obligations. To satisfy the FCRA requirement, the creditor must also disclose that a credit report was obtained and used to deny credit. Sample forms C-1 through C-5 of appendix C of the regulation provide for the two disclosures.

9(c) Incomplete Applications

Paragraph 9(c)(2)

1. *Reapplication.* If information requested by a creditor is submitted by an applicant after the expiration of the time period designated by the creditor, the creditor may require the applicant to make a new application.

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Paragraph 9(c)(3)

1. *Oral inquiries for additional information.*

If the applicant fails to provide the information in response to an oral request, a creditor must send a written notice to the applicant within the 30-day period specified in section 202.9(c)(1) and (c)(2). If the applicant does provide the information, the creditor shall take action on the application and notify the applicant in accordance with section 202.9(a).

9(g) Applications Submitted Through a Third Party

1. *Third parties.* The notification of adverse action may be given by one of the creditors to whom an application was submitted. Alternatively, the third party may be a noncreditor.

2. *Third-party notice—enforcement agency.* If a single adverse action notice is being provided to an applicant on behalf of several creditors and they are under the jurisdiction of different federal enforcement agencies, the notice need not name each agency; disclosure of any one of them will suffice.

3. *Third-party notice—liability.* When a notice is to be provided through a third party, a creditor is not liable for an act or omission of the third party that constitutes a violation of the regulation if the creditor accurately and in a timely manner provided the third party with the information necessary for the notification and maintains reasonable procedures adapted to prevent such violations.

SECTION 202.10—Furnishing of Credit Information

1. *Scope.* The requirements of section 202.10 for designating and reporting credit information apply only to creditors that furnish credit information to credit bureaus or to other creditors. There is no requirement that a creditor furnish credit information on its accounts.

2. *Reporting on all accounts.* The requirements of section 202.10 apply only to accounts held or used by spouses. However, a creditor has the option to designate all joint accounts (or all accounts with an authorized user) to reflect the participation of both parties, whether or not the accounts are held by persons married to each other.

3. *Designating accounts.* In designating accounts and reporting credit information, a creditor need not distinguish between accounts on which the spouse is an authorized user and accounts on which the spouse is a contractually liable party.

4. *File and index systems.* The regulation does not require the creation or maintenance of separate files in the name of each participant on a joint or user account, or require any other particular system of recordkeeping or indexing. It requires only that a creditor be able to report information in the name of each spouse on accounts covered by section 202.10. Thus, if a creditor receives a credit inquiry about the wife, it should be able to locate her credit file without asking the husband's name.

10(a) Designation of Accounts

1. *New parties.* When new parties who are spouses undertake a legal obligation on an account, as in the case of a mortgage-loan assumption, the creditor should change the designation on the account to reflect the new parties and should furnish subsequent credit information on the account in the new names.

2. *Request to change designation of account.* A request to change the manner in which information concerning an account is furnished does not alter the legal liability of either spouse upon the account and does not require a creditor to change the name in which the account is maintained.

SECTION 202.11—Relation to State Law

11(a) Inconsistent State Laws

1. *Preemption determination—New York.* Effective November 11, 1988, the Board has determined that the following provisions in the state law of New York are preempted by the federal law:

- Article 15, Section 296a(1)(b)—Unlawful discriminatory practices in relation to credit on the basis of race, creed, color, national

origin, age, sex, marital status, or disability. This provision is preempted to the extent that it bars taking a prohibited basis into account when establishing eligibility for certain special-purpose credit programs.

- Article 15, Section 296a(1)(c)—Unlawful discriminatory practice to make any record or inquiry based on race, creed, color, national origin, age, sex, marital status, or disability. This provision is preempted to the extent that it bars a creditor from requesting and considering information regarding the particular characteristics (for example, race, national origin, or sex) required for eligibility for special-purpose credit programs.

2. *Preemption determination—Ohio.* Effective July 23, 1990, the Board has determined that the following provision in the state law of Ohio is preempted by the federal law:

- Section 4112.021(B)(1)—Unlawful discriminatory practices in credit transactions. This provision is preempted to the extent that it bars asking or favorably considering the age of an elderly applicant; prohibits the consideration of age in a credit scoring system; permits without limitation the consideration of age in real estate transactions; and limits the consideration of age in special-purpose credit programs to certain government-sponsored programs identified in the state law.

SECTION 202.12—Record Retention

12(a) Retention of Prohibited Information

1. *Receipt of prohibited information.* Unless the creditor specifically requested such information, a creditor does not violate this section when it receives prohibited information from a consumer reporting agency.

2. *Use of retained information.* Although a creditor may keep in its files prohibited information as provided in section 202.12(a), the creditor may use the information in evaluating credit applications only if permitted to do so by section 202.6.

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 that 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.

2. *Computerized decisions.* A creditor that enters information items from a written application into a computerized or mechanized system and makes the credit decision mechanically, based only on the items of information entered into the system, may comply with section 202.12(b) by retaining the information actually entered. It is not required to store the complete written application, nor is it required to enter the remaining items of information into the system. If the transaction is subject to section 202.13, however, the creditor is required to enter and retain the data on personal characteristics in order to comply with the requirements of that section.

Paragraph 12(b)(3)

1. *Withdrawn and brokered applications.* In most cases, the 25-month retention period for applications runs from the date a notification is sent to the applicant granting or denying the credit requested. In certain transactions, a creditor is not obligated to provide a notice of the action taken. (See, for example, comment 9-2.) In such cases, the 25-month requirement runs from the date of application, as when—

- an application is withdrawn by the applicant
- an application is submitted to more than one creditor on behalf of the applicant, and the application is approved by one of the other creditors

SECTION 202.13—Information for Monitoring Purposes

13(a) Information to Be Requested

1. *Natural person.* Section 202.13 applies only to applications from natural persons.

2. *Principal residence.* The requirements of section 202.13 apply only if an application relates to a dwelling that is or will be occupied by the applicant as the principal residence. A credit application related to a vacation home or a rental unit is not covered. In the case of a two- to four-unit dwelling, the application is covered if the applicant intends to occupy one of the units as a principal residence.

3. *Temporary financing.* An application for temporary financing to construct a dwelling is not subject to section 202.13. But an application for both a temporary loan to finance construction of a dwelling and a permanent mortgage loan to take effect upon the completion of construction is subject to section 202.13.

4. *New principal residence.* A person can have only one principal residence at a time. However, if a person buys or builds a new dwelling that will become that person's principal residence within a year or upon completion of construction, the new dwelling is considered the principal residence for purposes of section 202.13.

5. *Transactions not covered.* The information-collection requirements of this section 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 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. An application for an open-end home equity line of credit is not subject to this section unless it is readily apparent to the creditor when the application is taken that the primary purpose of the line is for the purchase or refinancing of a principal dwelling.

6. *Refinancings.* A refinancing occurs when an existing obligation is satisfied and replaced by a new obligation undertaken by the same borrower. A creditor that receives an application to refinance an existing extension of credit made by that creditor for the purchase of the applicant's dwelling may request the monitoring information again but is not required to do so if it was obtained in the earlier transaction.

7. *Data collection under Regulation C.* See comment 5(b)(2)-2.

13(b) Obtaining of Information

1. *Forms for collecting data.* A creditor may collect the information specified in section 202.13(a) either on an application form or on a separate form referring to the application.

2. *Written applications.* The regulation requires written applications for the types of credit covered by section 202.13. A creditor can satisfy this requirement by recording in writing or by means of computer the information that the applicant provides orally and that the creditor normally considers in a credit decision.

3. *Telephone, mail applications.* If an applicant does not apply in person for the credit requested, a creditor does not have to complete the monitoring information. For example:

- When a creditor accepts an application by telephone, it does not have to request the monitoring information.
- When a creditor accepts an application by mail, it does not have to make a special request to the applicant if the applicant fails to complete the monitoring information on the application form sent to the creditor.

If it is not evident on the face of the application that it was received by mail or telephone, the creditor should indicate on the form or other application record how the application was received.

4. *Applications through electronic media.* If an applicant applies through an electronic medium (for example, the Internet or a facsimile) without video capability that allows the credi-

tor to see the applicant, the creditor may treat the application as if it were received by mail or telephone.

5. *Applications through video.* If a creditor takes an application through a medium that allows the creditor to see the applicant, the creditor treats the application as taken in person and must note the monitoring information on the basis of visual observation or surname, if the applicant chooses not to provide the information.

6. *Applications through loan-shopping services.* When a creditor receives an application through an unaffiliated loan-shopping service, it does not have to request the monitoring information for purposes of the ECOA or Regulation B. Creditors subject to the Home Mortgage Disclosure Act should be aware, however, that data collection may be called for under Regulation C, which generally requires creditors to report, among other things, the sex and race or national origin of an applicant on brokered applications or applications received through a correspondent.

7. *Inadvertent notation.* If a creditor inadvertently obtains the monitoring information in a dwelling-related transaction not covered by section 202.13, the creditor may process and retain the application without violating the regulation.

13(c) Disclosure to Applicant(s)

1. *Procedures for providing disclosures.* The disclosures to an applicant regarding the monitoring information may be provided in writing. Appendix B contains a sample disclosure. A creditor may devise its own disclosure so long as it is substantially similar. The creditor need not orally request the applicant to provide the monitoring information if it is requested in writing.

13(d) Substitute Monitoring Program

1. *Substitute program.* An enforcement agency may adopt, under its established rulemaking or enforcement procedures, a program requiring creditors under its jurisdiction to collect information in addition to that required by this section.

SECTION 202.14—Enforcement, Penalties, and Liabilities

14(c) Failure of Compliance

1. *Inadvertent errors.* Inadvertent errors include, but are not limited to, clerical mistake, calculation error, computer malfunction, and printing error. An error of legal judgment is not an inadvertent error under the regulation.

2. *Correction of error.* For inadvertent errors that occur under sections 202.12 and 202.13, this section requires that they be corrected prospectively only.

APPENDIX B—Model Application Forms

1. *FHLMC/FNMA form—residential loan application.* The uniform residential loan application form (FHLMC 65/FNMA 1003), including supplemental form (FHLMC 65A/FNMA 1003A), prepared by the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association and dated May 1991 may be used by creditors without violating this regulation even though the form's listing of race or national origin categories in the "Information for Government Monitoring Purposes" section differs from the classifications currently specified in section 202.13(a)(1). The classifications used on the FNMA-FHLMC form are those required by the U.S. Office of Management and Budget for notation of race and ethnicity by federal programs in their administrative reporting and statistical activities. Creditors that are governed by the monitoring requirements of Regulation B (which limits collection to applications primarily for the purchase or refinancing of the applicant's principal residence) should delete, strike, or modify the data-collection section on the form when using it for transactions not covered by section 202.13(a) to ensure that they do not collect the information. Creditors that are subject to more extensive collection requirements by a substitute monitoring program under section 202.13(d) or by the Home Mortgage Disclosure Act (HMDA) may use the form as issued, in compliance with that substitute program or HMDA.

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

APPENDIX C—Sample Notification Forms

Form C-9

Creditors may design their own form, add to, or modify the model form to reflect their indi vidual policies and procedures. For example, a creditor may want to add—

i. a telephone number that applicants may call to leave their name and the address to which an appraisal report should be sent
ii. a notice of the cost the applicant will be required to pay the creditor for the appraisal or a copy of the report

Board of Governors of the Federal Reserve System

Amendments to Regulation K International Banking Operations October 1996*

1. *Effective December 21, 1995, section 211.2 is amended by redesignating paragraphs (u) and (v) as paragraphs (v) and (w), respectively, and by adding new paragraphs (u) and (x) to read as follows:*

(u) *Strongly capitalized* means—

(1) in relation to a parent member bank, that the standards set out in 12 CFR 208.33(b)(1) are satisfied; and

(2) in relation to an Edge or agreement corporation or a bank holding company, that it has a total risk-based capital ratio of 10.0 percent or greater.

* * * * *

(x) *Well managed* means that the Edge or agreement corporation, its parent member bank, if any, and the bank holding company have each received a composite rating of 1 or 2 at its most recent examination or review and are not subject to any supervisory enforcement action.

2. *Effective December 21, 1995, section 211.5 is amended by redesignating paragraphs (c)(2) and (c)(3) as paragraphs (c)(3) and (c)(4), respectively. In the third sentence of newly designated paragraph (c)(3), the word "accepted" is replaced with the word "received." A new paragraph (c)(2) is added to read as follows:*

(2) (i) *Expanded general consent for de novo investments.* Notwithstanding the amount limitations of paragraph (c)(1) of this section, but subject to the other limitations of this section, the Board grants expanded general consent authority for investments in an organization by an investor that is strongly capitalized and well managed if—

(A) the activities of the organization are limited to activities in which a national bank may engage directly or in which a subsidiary may engage under section 211.5(d);

(B) in the case of an investor that is an Edge corporation that is not engaged in banking or an agreement corporation, the total amount invested in such organization (in one transaction or a series of transactions) does not exceed the lesser of 20 percent of the investor's tier 1 capital or 2 percent of the tier 1 capital of the parent member bank;

(C) in the case of a bank holding company or member bank investor, the total amount invested in such organization (in one transaction or a series of transactions) directly or indirectly does not exceed 2 percent of the investor's tier 1 capital;

(D) all investments made, directly or indirectly, by an Edge corporation not engaged in banking or an agreement corporation during the previous 12-month period under paragraph (c)(2) of this section, when aggregated with the proposed investment, would not exceed the lesser of 50 percent of the total capital of the Edge or agreement corporation, or 5 percent of the total capital of the parent member bank;

(E) all investments made, directly or indirectly, by a member bank or a bank holding company during the previous 12-month period under paragraph (c)(2) of this section, when

* A complete Regulation K, as amended effective August 28, 1996, consists of—

- the regulation pamphlet dated January 1994 (see inside cover) and
- this slip sheet.

Items 4 and 10 are new. The other items were included in the July 1996 slip sheet.

aggregated with the proposed investment, would not exceed 5 percent of its total capital; and

(F) both before and immediately after the proposed investment the investor, its parent member bank, if any, and any parent bank holding company are strongly capitalized and well managed.

(ii) *Determining aggregate investment limits.* For purposes of determining compliance with the aggregate investment limits set out in paragraphs (c)(2)(i)(D) and (E) of this section, an investment by an investor in a subsidiary shall be counted only once notwithstanding that such subsidiary may, within 12 months of the date of making the investment, downstream all or any part of such investment to another subsidiary.

(iii) *Additional investments.* An investor that makes investments under paragraph (c)(2)(i) of this section may also make additional investments in an organization under the standards set forth in paragraphs (c)(1)(ii), (c)(1)(iii) and (c)(1)(iv) of this section.

(iv) *Ineligible investments.* The following investments are not eligible for the general consent under paragraph (c)(2)(i) of this section:

(A) an investment in a foreign country where the investor does not have an affiliate or a branch;

(B) the establishment or acquisition of an initial subsidiary bank in a foreign country;

(C) investments in general partnerships or unlimited liability companies; and

(D) an acquisition of shares or assets of an organization that is not an affiliate or joint venture of the investor.

(v) *Post-investment notice.* By the end of the month following the month in which the investment is made, the investor shall provide the Board with the following information relating to the investment:

(A) if the investment is in a joint venture, the respective responsibilities of the parties to the joint venture;

(B) projections for the organization in which the investment is made for the first year following the investment; and

(C) where the investment is made in an organization that incurred a loss in the last year, a description of the reasons for the loss and the steps taken to address the problem.

3. *Effective April 1, 1996, section 211.8 is amended by replacing the words "criminal referral form" with the words "suspicious-activity report."*

4. *Effective August 28, 1996, section 211.20(b)(10) is added to read as follows:*

* * * * *

(10) the management of shell branches (12 USC 3105(k)).

5. *Effective January 1, 1995, section 211.21(e) is amended to read as follows:*

(e) *Change the status* of an office means convert a representative office into a branch or agency, or an agency into a branch, but does not include renewal of the license of an existing office.

6. *Effective May 9, 1996, section 211.22(a) is amended to read as follows. Section 211.22(c) is deleted, and section 211.22(d) is redesignated as 211.22(c).*

(a) *Determination of home state.*

(1) A foreign bank (except a foreign bank to which paragraph (a)(2) of this section applies) that has any combination of domestic agencies or subsidiary commercial lending companies that were established before September 29, 1994, in more than one state and have been continuously operated shall select its home state from those states in which such offices or subsidiaries are

located. A foreign bank shall do so by filing with the Board a declaration of home state by June 30, 1996. In the absence of such selection, the Board shall designate the home state for such foreign banks.

(2) A foreign bank that, as of September 29, 1994, had declared a home state or had a home state determined pursuant to the law and regulations in effect prior to that date shall have that state as its home state.

(3) A foreign bank that has any branches, agencies, subsidiary commercial lending companies, or subsidiary banks in one state, and has no such offices or subsidiaries in any other states, shall have as its home state the state in which such offices or subsidiaries are located.

7. *Effective January 24, 1996, section 211.24 is amended by revising paragraphs (a)(2)(i) and (ii) to read as follows:*

(i) *Prior notice for certain representative offices.* After providing 45 days' prior written notice to the Board, a foreign bank that is subject to the BHC Act, either directly or through section 8(a) of the IBA (12 USC 3106(a)), may establish—

(A) a regional administrative office; or

(B) a representative office, but only if the Board has previously determined that the foreign bank proposing to establish a representative office is subject to comprehensive supervision or regulation on a consolidated basis by its home-country supervisor, or previously has been approved for a representative office by Board order. The Board may waive the 45-day period if it finds that immediate action is required by the circumstances presented. The notice period shall commence at the time the notice is received by the appropriate Reserve Bank. The Board may suspend the period or require Board approval prior to the establishment of such an office if the notification raises significant policy, prudential, or supervisory concerns.

(ii) *General consent for representative offices.* The Board grants its general consent for a foreign bank that is subject to section 8(a) of the IBA (12 USC 3106(a)) to establish a representative office that solely engages in limited administrative functions (such as separately maintaining back-office support systems) that are clearly defined, are performed in connection with the United States banking activities of the foreign bank, and do not involve contact or liaison with customers or potential customers beyond incidental contact with existing customers relating to administrative matters (such as verification or correction of account information), provided that the foreign bank notifies the Board in writing within 30 days of the establishment of the representative office.

8. *Effective January 24, 1996, section 211.24 is amended by redesignating paragraph (d)(3) as (d)(4) and adding a new paragraph (d)(3) to read as follows:*

(3) *Special-purpose foreign-government banks.* A foreign government–owned organization engaged in banking activities in its home country that are not commercial in nature may apply to the Board for determination that the organization is not a *foreign bank* for purposes of this section. A written request setting forth the basis for such a determination may be submitted to the Reserve Bank of the District in which the foreign organization's representative office is located in the United States or to the Board in the case of a proposed establishment of a representative office. The Board will review and act upon each such request on a case-by-case basis.

9. *Effective April 1, 1996, section 211.24(f) is amended by replacing the words "criminal referral form" with the words "suspicious-activity report."*

10. *Effective August 28, 1996, section 211.24(g) is added to read as follows:*

(g) *Management of shell branches.*

(1) A state-licensed branch or agency shall not manage, through an office of the foreign bank which is located outside the United States and is managed or controlled by such state-licensed branch or agency, any type of activity that a bank organized under the laws of the United States or any state is not permitted to manage at any branch or subsidiary of such bank which is located outside the United States.

(2) For purposes of this subsection, an office of a foreign bank located outside the United States is "managed or controlled" by a state-licensed branch or agency if a majority of the responsibility for business decisions, including but not limited to decisions with regard to lending or asset management or funding or liability management, or the responsibility for recordkeeping in respect of assets or liabilities for that non-U.S. office, resides at the state-licensed branch or agency.

(3) The types of activities that a state-licensed branch or agency may manage through an office located outside the United States that it manages or controls include the types of activities authorized to a U.S. bank by state or federal charters, regulations issued by chartering or regulatory authorities, and other U.S. banking laws, including the Federal Reserve Act, and the implementing regulations, but U.S. procedural or quantitative requirements that may be applicable to the conduct of such activities by U.S. banks shall not apply.

11. *Effective January 1, 1995, section 211.29 is added to read as follows:*

SECTION 211.29—Applications by State-Licensed Branches and Agencies to Conduct Activities Not Permissible for Federal Branches

(a) *Scope.* A state-licensed branch or agency shall file with the Board a prior written application for permission to engage in or continue to engage in any type of activity that—

(1) is not permissible for a federal branch, pursuant to statute, regulation, official bulletin or circular, or order or interpretation issued in writing by the Office of the Comptroller of the Currency; or

(2) is rendered impermissible due to a subsequent change in statute, regulation, official bulletin or circular, written order or interpretation, or decision of a court of competent jurisdiction.

(b) *Exceptions.* No application shall be required by a state-licensed branch or agency to conduct any activity that is otherwise permissible under applicable state and federal law or regulation and that—

(1) has been determined by the FDIC pursuant to 12 CFR 362.4(c)(i)–(ii)(A) not to present a significant risk to the affected deposit insurance fund;

(2) is permissible for a federally licensed branch but the OCC imposes a quantitative limitation on the conduct of such activity by the federal branch;

(3) is conducted as agent rather than as principal, provided that the activity is one that could be conducted by a state-chartered bank headquartered in the same state in which the branch or agency is licensed; or

(4) any other activity that the Board has determined may be conducted by any state-licensed branch or agency of a foreign bank without further application to the Board.

(c) *Contents of application.* An application submitted pursuant to paragraph (a) of this section shall be in letter form and shall contain the following information:

(1) a brief description of the activity, including the manner in which it will be conducted and an estimate of the expected dollar volume associated with the activity;

(2) an analysis of the impact of the proposed activity on the condition of the U.S. operations of the foreign bank in general and of the branch or agency in particular, including a copy, if avail-

able, of any feasibility study, management plan, financial projections, business plan, or similar document concerning the conduct of the activity;

(3) a resolution by the applicant's board of directors or, if a resolution is not required pursuant to the applicant's organizational documents, evidence of approval by senior management, authorizing the conduct of such activity and the filing of this application;

(4) if the activity is to be conducted by a state-licensed insured branch, a statement by the applicant of whether or not it is in compliance with 12 CFR 346.19 and 346.20, Pledge of Assets, and Asset Maintenance, respectively;

(5) if the activity is to be conducted by a state-licensed insured branch, statements by the applicant—

(i) that it has complied with all requirements of the Federal Deposit Insurance Corporation concerning an application to conduct the activity and the status of the application, including a copy of the FDIC's disposition of such application, if available, and

(ii) explaining why the activity will pose no significant risk to the deposit insurance fund; and

(6) any other information that the Reserve Bank deems appropriate.

(d) *Factors considered in determination.*

(1) The Board shall consider the following factors in determining whether a proposed activity is consistent with sound banking practice:

(A) the types of risks, if any, the activity poses to the U.S. operations of the foreign banking organization in general and the branch or agency in particular;

(B) if the activity poses any such risks, the magnitude of each risk; and

(C) if a risk is not de minimis, the actual or proposed procedures to control and minimize the risk.

(2) Each of the factors set forth in paragraph (d)(1) of this section shall be evaluated in light of the financial condition of the foreign bank in general and the branch or agency in particular and the volume of the activity.

(e) *Application procedures.* Applications pursuant to this section shall be filed with the responsible Reserve Bank for the foreign bank. An application shall not be deemed complete until it contains all the information requested by the Reserve Bank and has been accepted. Approval of such an application may be conditioned on the applicant's agreement to conduct the activity subject to specific conditions or limitations.

(f) *Divestiture or cessation.*

(1) In the event that an applicant's application for permission to continue to conduct an activity is not approved by the Board or, if applicable, the FDIC, the applicant shall submit a detailed written plan of divestiture or cessation of the activity to the responsible Reserve Bank within 60 days of the disapproval. The divestiture or cessation plan shall describe in detail the manner in which the applicant will divest itself of or cease the activity and shall include a projected timetable describing how long the divestiture or cessation is expected to take. Divestitures or cessation shall be complete within one year from the date of the disapproval, or within such shorter period of time as the Board shall direct.

(2) In the event that a foreign bank operating a state branch or agency chooses not to apply to the Board for permission to continue to conduct an activity that is not permissible for a federal branch or which is rendered impermissible due to a subsequent change in statute, regulation, official bulletin or circular, written order or interpretation, or decision of a court of competent jurisdiction, the foreign bank shall submit a written plan of divestiture or cessation, in conformance with section 211.29(f)(1), of this part within 60 days of the effective date of this part or of such change or decision.

12. *Effective March 25, 1996, section 211.30 is added to read as follows:*

SECTION 211.30—Criteria for Evaluating the U.S. Operations of Foreign Banks Not Subject to Consolidated Supervision

(a) *General.* Pursuant to the Foreign Bank Supervision Enhancement Act, Pub.L. 102-242, 105 Stat. 2286 (1991), the Board shall develop and publish criteria to be used in evaluating the operations of any foreign bank in the United States that the Board has determined is not subject to comprehensive supervision or regulation on a consolidated basis.

(b) *Criteria.* Following a determination by the Board that, having taken into account the standards set forth in section 211.24(c)(1) of this subpart, a foreign bank is not subject to comprehensive, consolidated supervision by its home-country supervisor, the Board shall consider the following criteria in determining whether the foreign bank's U.S. operations should be permitted to continue and, if so, whether any supervisory constraints should be placed upon the bank in connection with those operations:

(1) the proportion of the foreign bank's total assets and total liabilities that are located or booked in its home country, as well as the distribution and location of its assets and liabilities that are located or booked elsewhere;

(2) the extent to which the operations and assets of the foreign bank and any affiliates are subject to supervision by its home-country supervisor;

(3) whether the appropriate authorities in the home country of such foreign bank are actively working to establish arrangements for the comprehensive, consolidated supervision of such bank and whether demonstrable progress is being made;

(4) whether the foreign bank has effective and reliable systems of internal controls and management information and reporting, which enable its management properly to oversee its worldwide operations;

(5) whether the foreign bank's home-country supervisor has any objection to the bank continuing to operate in the United States;

(6) whether the foreign bank's home-country supervisor and the home-country supervisor of any parent of the foreign bank share material information regarding the operations of the foreign bank with other supervisory authorities;

(7) the relationship of the U.S. operations to the other operations of the foreign bank, including whether the foreign bank maintains funds in its U.S. offices that are in excess of amounts due to its U.S. offices from the foreign bank's non-U.S. offices;

(8) the soundness of the foreign bank's overall financial condition;

(9) the managerial resources of the foreign bank, including the competence, experience, and integrity of the officers and directors and the integrity of its principal shareholders;

(10) the scope and frequency of external audits of the foreign bank;

(11) the operating record of the foreign bank generally and its role in the banking system in its home country;

(12) the foreign bank's record of compliance with relevant laws, as well as the adequacy of its money-laundering controls and procedures, in respect of its worldwide operations;

(13) the operating record of the U.S. offices of the foreign bank;

(14) the views and recommendations of the Office of the Comptroller of the Currency or the state banking regulators in those states in which the foreign bank has operations, as appropriate;

(15) whether the foreign bank, if requested, has provided the Board with adequate assurances that such information will be made available on the operations or activities of the foreign bank and any of its affiliates as the Board deems necessary to determine and enforce compliance with the International Banking Act, the Bank Hold-

ing Company Act, and other applicable federal banking statutes; and

(16) any other information relevant to the safety and soundness of the U.S. operations of the foreign bank.

(c) *Restrictions on U.S. operations.*

(1) *Terms of agreement.* Any foreign bank that the Board determines is not subject to comprehensive supervision or regulation on a consolidated basis by its home-country supervisor may be required to enter into an agreement to conduct its U.S. operations subject to such restrictions as the Board, having considered the criteria set forth in paragraph (b) of this section, determines to be appropriate in order to ensure the safety and soundness of its U.S. operations.

(2) *Failure to enter into or comply with agreement.* A foreign bank that is required by the Board to enter into an agreement pursuant to paragraph (c)(1) of this section and either fails to do so or fails to comply with the terms of such agreement may be subject to enforcement action in order to ensure safe and sound banking operations under 12 USC 1818, or to termination or a recommendation for termination of its U.S. operations under section 211.25(a) and (e) of this subpart and section (7)(e) of the IBA (12 USC 3105(e)).

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

November 1996*

1. *Effective October 21, 1996, comment 4(a)-3 is amended by deleting paragraph ii.*

2. *Effective April 1, 1996, comment 4(d)-5 is amended to read as follows:*

5. *Required credit life insurance.* Credit life, accident, health, or loss-of-income insurance must be voluntary in order for the premium or charges to be excluded from the finance charge. Whether the insurance is in fact required or optional is a factual question. If the insurance is required, the premiums must be included in the finance charge, whether the insurance is purchased from the creditor or from a third party. If the consumer is required to elect one of several options—such as to purchase credit life insurance, or to assign an existing life insurance policy, or to pledge security such as a certificate of deposit—and the consumer purchases the credit life insurance policy, the premium must be included in the finance charge. (If the consumer assigns a preexisting policy or pledges security instead, no premium is included in the finance charge. The security interest would be disclosed under section 226.6(c) or section 226.18(m). See the commentary to section 226.4(b)(7) and (8).)

3. *Effective April 1, 1996, a sentence is added at the end of comment 6(b)-1, item v., to read as follows:*

* * * For example, if the primary benefit of membership in an organization is the opportunity to apply for a credit card, and the other benefits offered (such as a newsletter or a member information hotline) are merely incidental to the credit feature, the membership fee would be disclosed as an "other charge."

4. *Effective April 1, 1996, the last sentence of comment 12(c)(2)-1 is amended and comment 12(c)(2)-2 is added to read as follows:*

* * * * *

- Nothing in this provision prohibits the card issuer from undertaking its normal collection activities for the delinquent and undisputed portion of the account.

2. *Settlement of dispute.* A card issuer may not consider a dispute settled and report an amount disputed as delinquent or begin collection of the disputed amount until it has completed a reasonable investigation of the cardholder's claim. A reasonable investigation requires an independent assessment of the cardholder's claim based on information obtained from both the cardholder and the merchant, if possible. In conducting an investigation, the card issuer may request the cardholder's reasonable cooperation. The card issuer may not automatically consider a dispute settled if the cardholder fails or refuses to comply with a particular request. However, if the card issuer otherwise has no means of obtaining information necessary to resolve the dispute, 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.

5. *Effective April 1, 1996, comment 14(c)-10 is added to read as follows:*

10. *Transactions at end of billing cycle.* The annual percentage rate reflects trans-

* A complete commentary pamphlet, as amended effective October 21, 1996, consists of—
- the commentary pamphlet dated July 1995 (see inside front cover) and
- this slip sheet.

Items 1, 8, 10, and 12 are new. The other items were included in the June 1996 slip sheet.

actions and charges imposed during the billing cycle. However, it may be impracticable to post a transaction that occurs at the end of a billing cycle until the following cycle, such as a cash advance that occurs on the last day of a billing cycle and is posted to the account in the following cycle. A card issuer that uses the date of the transaction to figure finance charges shall calculate the annual percentage rate as follows for the billing cycle in which the transaction and charges are posted:

i. The denominator shall be calculated as if the transaction occurred on the first day of the billing cycle; and
ii. The numerator shall include the amount of the transaction charge plus all finance charges derived from the application of the periodic rate to the amount of the transaction (including all charges from a prior cycle).

6. *Effective April 1, 1996, the first and last paragraphs of comment 17(c)(1)-10 are amended to read as follows:*

10. *Discounted and premium variable-rate transactions.* In some variable-rate transactions, creditors may set an initial interest rate that is not determined by the index or formula used to make later interest-rate adjustments. Typically, this initial rate charged to consumers is lower than the rate would be if it were calculated using the index or formula. However, in some cases the initial rate may be higher. In a discounted transaction, for example, a creditor may calculate interest rates according to a formula using the six-month Treasury bill rate plus a 2 percent margin. If the Treasury bill rate at consummation is 10 percent, the creditor may forgo the 2 percent spread and charge only 10 percent for a limited time, instead of setting an initial rate of 12 percent.

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

* * * * *

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

7. *Effective April 1, 1996, comment 17(c)(1)-18 is added to read as follows:*

18. *Pawn Transactions.* When, in connection with an extension of credit, a consumer pledges or sells an item to a pawnbroker creditor in return for a sum of money and retains the right to redeem the item for a greater sum (the redemption price) within a specified period of time, disclosures are required. In addition to other disclosure requirements that may be applicable under section 226.18, for purposes of pawn transactions:

i. The amount financed is the initial sum paid to the consumer. The pawnbroker creditor need not provide a separate itemization of the amount financed if that entire amount is paid

directly to the consumer and the disclosed description of the amount financed is "the amount of cash given directly to you" or a similar phrase.

ii. The finance charge is the difference between the initial sum paid to the consumer and the redemption price plus any other finance charges paid in connection with the transaction. (See section 226.4.)

iii. The term of the transaction, for calculating the annual percentage rate, is the period of time agreed to by the pawnbroker creditor and the consumer. The term of the transaction does not include a grace period (including any statutory grace period) after the agreed redemption date.

8. *Effective October 21, 1996, paragraph 17(c)(2) is redesignated as 17(c)(2)(i).*

9. *Effective April 1, 1996, comment 18(c)(1)(iii)-2 is added to read as follows:*

2. *Charges added to amounts paid to others.* A sum is sometimes added to the amount of a fee charged to a consumer for a service provided by a third party (such as for an extended warranty or a service contract) that is payable in the same amount in comparable cash and credit transactions. In the credit transaction, the amount is retained by the creditor. Given the flexibility permitted in meeting the requirements of the amount financed itemization (see the commentary to section 226.18(c)), the creditor in such cases may reflect that the creditor has retained a portion of the amount paid to others. For example, the creditor could add to the category "amount paid to others" language such as "(we may be retaining a portion of this amount)."

10. *Effective October 21, 1996, comment 18(d)-2 is deleted.*

11. *Effective April 1, 1996, comment 20(a)-3 is amended to read as follows:*

3. *Variable rate.*

i. If a variable-rate feature was properly disclosed under the regulation, a rate change in accord with those disclosures is not a refinancing. For example, no new disclosures are required when the variable-rate feature is invoked on a renewable balloon-payment mortgage that was previously disclosed as a variable-rate transaction.

ii. Even if it is not accomplished by the cancellation of the old obligation and substitution of a new one, a new transaction subject to new disclosures results if the creditor either:

A. Increases the rate based on a variable-rate feature that was not previously disclosed; or

B. Adds a variable-rate feature to the obligation. A creditor does not add a variable-rate feature by changing the index of a variable-rate transaction to a comparable index, whether the change replaces the existing index or substitutes an index for one that no longer exists.

iii. If either of the events in paragraph 20(a)(iii) ii.A. or ii.B. occurs in a transaction secured by a principal dwelling with a term longer than one year, the disclosures required under section 226.19(b) also must be given at that time.

12. *Effective October 21, 1996, the first sentence of comment 23(b)-3 is amended to read as follows:*

3. *Content.* The notice must include all of the information outlined in section 226.23(b)(1)(i) through (v). * * *

13. *Effective April 1, 1996, comments on subpart E are added to read as follows:*

SUBPART E—SPECIAL RULES FOR CERTAIN HOME MORTGAGE TRANSACTIONS

SECTION 226.31—General Rules

31(c) Timing of Disclosure

31(c)(1) Disclosures for Certain Closed-End Home Mortgages

1. *Furnishing disclosures.* Disclosures are considered furnished when received by the consumer.

2. *Pre-consummation waiting period.* A creditor must furnish section 226.32 disclosures at least three business days prior to consummation. Under section 226.32, "business day" has the same meaning as the rescission rule in comment 2(a)(6)-2—all calendar days except Sundays and the federal legal holidays listed in 5 USC 6103(a). However, while the disclosure rule under sections 226.15 and 226.23 extends to midnight of the third business day, the rule under section 226.32 does not. For example, under section 226.32, if disclosures were provided on a Friday, consummation could occur any time on Tuesday, the third business day following receipt of the disclosures. If the timing of the rescission rule were to be used, consummation could not occur until after midnight on Tuesday.

31(c)(1)(i) Change in Terms

1. *Redisclosure required.* Creditors must provide new disclosures when a change in terms makes disclosures previously provided under section 226.32(c) inaccurate, including disclosures based on and labeled as an estimate. A change in terms may result from a formal written agreement or otherwise.

31(c)(1)(ii) Telephone Disclosures

1. *Telephone disclosures.* Disclosures by telephone must be furnished at least three business days prior to consummation, calculated in accord with the timing rules under section 226.31(c)(1).

31(c)(1)(iii) Consumer's Waiver of Waiting Period before Consummation

1. *Modification or waiver.* A consumer may modify or waive the right to the three-day waiting period only after receiving the disclosures required by section 226.32 and only if the circumstances meet the criteria for establishing a bona fide personal financial emergency under section 226.23(e). Whether these criteria are met is determined by the facts surrounding individual situations. The imminent sale of the consumer's home at foreclosure during the three-day period is one example of a bona fide personal financial emergency. Each consumer entitled to the three-day waiting period must sign the handwritten statement for the waiver to be effective.

31(c)(2) Disclosures for Reverse Mortgages

1. *Business days.* For purposes of providing reverse-mortgage disclosures, "business day" has the same meaning as in comment 31(c)(1)-2—all calendar days except Sundays and the federal legal holidays listed in 5 USC 6103(a). This means if disclosures are provided on a Friday, consummation could occur any time on Tuesday, the third business day following receipt of the disclosures.

2. *Open-end plans.* Disclosures for open-end reverse mortgages must be provided three business days before the first transaction under the plan (see section 226.5(b)(1)).

31(d) Basis of Disclosures and Use of Estimates

1. *Redisclosure.* Section 226.31(d) allows the use of estimates when information necessary for an accurate disclosure is unknown to the creditor, provided that the disclosure is clearly identified as an estimate. For purposes of subpart E, the rule in section 226.31(c)(1)(i) requiring new disclosures when the creditor changes terms also applies to disclosures labeled as estimates.

SECTION 226.32—Requirements for Certain Closed-End Home Mortgages

32(a) Coverage

Paragraph 32(a)(1)(i)

1. *Application date.* An application is deemed received when it reaches the creditor in any of the ways applications are normally transmitted. (See section 226.19(a).) For example, if a borrower applies for a 10-year loan on September 30 and the creditor counteroffers with a 7-year loan on October 10, the application is deemed received in September and the creditor must measure the annual percentage rate against the appropriate Treasury security yield as of August 15. An application transmitted through an intermediary agent or broker is received when it reaches the creditor, rather than when it reaches the agent or broker. (See comment 19(b)-3 to determine whether a transaction involves an intermediary agent or broker.)

2. *When fifteenth not a business day.* If the 15th day of the month immediately preceding the application date is not a business day, the creditor must use the yield as of the business day immediately preceding the 15th.

3. *Calculating annual percentage rates for variable-rate loans and discount loans.* Creditors must use the rules set out in the commentary to section 226.17(c)(1) in calculating the annual percentage rate for variable-rate loans (assume the rate in effect at the time of disclosure remains unchanged) and for discount, premium, and stepped-rate transactions (which must reflect composite annual percentage rates).

4. *Treasury securities.* To determine the yield on a Treasury security for the annual percentage rate test, creditors may use the Board's "Selected Interest Rates" (statistical release H-15) or the actual auction results. Treasury auctions are held at regular intervals for the different types of securities. These figures are published by major financial and metropolitan newspapers and are also available from Federal Reserve Banks. Creditors must use the yield on the security that has the nearest maturity at issuance to the loan's maturity. For example, if a creditor must compare the annual percentage rate to Treasury securities with either 7-year or 10-year maturities, the annual percentage rate for an 8-year loan is compared with securities that have a 7-year maturity; the annual percentage rate for a 9-year loan is compared with securities that have a 10-year maturity. If the loan maturity is exactly halfway between, the annual percentage rate is compared with the Treasury security that has the lower yield. For example, if the loan has a maturity of 20 years and comparable securities have maturities of 10 years with a yield of 6.501 percent and 30 years with a yield of 6.906 percent, the annual percentage rate is compared with 10 percentage points over the yield of 6.501 percent, the lower of the two yields.

Paragraph 32(a)(1)(ii)

1. *Total loan amount.* For purposes of the "points and fees" test, the total loan amount is calculated by taking the amount financed, as determined according to section 226.18(b), and deducting any cost listed in section 226.32(b)(1)(iii) that is both included as points and fees under section 226.32(b)(1) and financed by the creditor. Some examples follow, each using a $10,000 amount borrowed, a $300 appraisal fee, and $400 in points:

i. If the consumer finances a $300 fee for a creditor-conducted appraisal and pays $400 in points at closing, the amount financed under section 226.18(b) is $9,900 ($10,000 plus the $300 appraisal fee that is paid to and financed by the creditor, less $400 in prepaid finance charges). The $300 appraisal fee paid to the creditor is added to other points and fees under section 226.32(b)(1)(iii). It is deducted from the amount financed ($9,900) to derive a total loan amount of $9,600.

ii. If the consumer pays the $300 fee for

the creditor-conducted appraisal in cash at closing, the $300 is included in the points and fees calculation because it is paid to the creditor. However, because the $300 is not financed by the creditor, the fee is not part of the amount financed under section 226.18(b) ($10,000, in this case). The total loan amount is $9,600 ($10,000, less $400 in prepaid finance charges).

iii. If the consumer finances a $300 fee for an appraisal conducted by someone other than the creditor or an affiliate, the $300 fee is not included with other points and fees under section 226.32(b)(1)(iii). The amount financed under section 226.18(b) is $9,900 ($10,000 plus the $300 fee for an independently conducted appraisal that is financed by the creditor, less the $400 paid in cash and deducted as prepaid finance charges).

2. *Annual adjustment of $400 amount.* A mortgage loan is covered by section 226.32 if the total points and fees payable by the consumer at or before loan consummation exceed the greater of $400 or 8 percent of the total loan amount. The $400 figure is adjusted annually by the Board; the adjusted figure becomes effective on January 1 of the following year. The adjusted figure for 1996 is $412, reflecting a 3.00 percent increase in the CPI-U from June 1994 to June 1995, rounded to the nearest whole dollar. The Board will publish adjustments after the June figures become available each year. The adjustment for the upcoming year will be included in any proposed commentary published in the fall, and incorporated into the commentary the following spring.

32(b) Definitions

Paragraph 32(b)(1)(i)

1. *General.* Items defined as finance charges under section 226.4(a) and 226.4(b) are included under this paragraph as a component of the total "points and fees." Items excluded from the finance charge under other provisions of section 226.4 are not included under paragraph 32(b)(1)(i), although a fee may be included in "points and fees" under paragraphs 32(b)(1)(ii) and 32(b)(1)(iii).

Paragraph 32(b)(1)(ii)

1. *Mortgage broker fees.* In determining "points and fees" for purposes of this section, compensation paid by a consumer to a mortgage broker (directly or through the creditor for delivery to the broker) is included in the calculation whether or not the amount is disclosed as a finance charge. Mortgage broker fees that are not paid by the consumer are not included. Mortgage broker fees already included in the calculation as finance charges under section 226.32(b)(1)(i) need not be counted again under section 226.32(b)(1)(ii).

2. *Example.* Section 226.32(b)(1)(iii) defines "points and fees" to include all items listed in section 226.4(c)(7), other than amounts held for the future payment of taxes. An item listed in section 226.4(c)(7) may be excluded from the "points and fees" calculation, however, if the charge is reasonable, the creditor receives no direct or indirect compensation from the charge, and the charge is not paid to an affiliate of the creditor. For example, a reasonable fee paid by the consumer to an independent, third-party appraiser may be excluded from the "points and fees" calculation (assuming no compensation is paid to the creditor). A fee paid by the consumer for an appraisal performed by the creditor must be included in the calculation, even though the fee may be excluded from the finance charge if it is bona fide and reasonable in amount.

32(c) Disclosures

1. *Format.* The disclosures must be clear and conspicuous but need not be in any particular type size or typeface, nor presented in any particular manner. The disclosures need not be a part of the note or mortgage document.

32(c)(3) Regular Payment

1. *General.* The regular payment is the amount due from the borrower at regular intervals, such as monthly, bimonthly, quarterly, or annually. There must be at least two payments, and the payments must be in an amount and at such intervals that they fully amortize the amount owed. In disclosing the regular payment, creditors may rely on the rules set forth in section 226.18(g); however, the amounts for voluntary items not agreed to by the consumer such as credit life insurance may not be included in the regular payment.

i. If the loan has more than one payment level, the regular payment for each level must be disclosed. For example:

A. In a 30-year graduated payment mortgage where there will be payments of $300 for the first 120 months, $400 for the next 120 months, and $500 for the last 120 months, each payment amount must be disclosed, along with the length of time that the payment will be in effect.
B. If interest and principal are paid at different times, the regular amount for each must be disclosed.
C. In discounted or premium variable-rate transactions where the creditor sets the initial interest rate and later rate adjustments are determined by an index or formula, the creditor must disclose both the initial payment based on the discount or premium and the payment that will be in effect thereafter. Additional explanatory material which does not detract from the required disclosures may accompany the disclosed amounts. For example, if a monthly payment is $250 for the first six months and then increases based on an index and margin, the creditor could use language such as the following: "Your regular monthly payment will be $250 for six months. After six months your regular monthly payment will be based on an index and margin, which currently would make your payment $350. Your actual payment at that time may be higher or lower."

32(c)(4) Variable Rate

1. *Calculating "worst-case" payment example.* Creditors may rely on instructions in section 226.19(b)(2)(x) for calculating the maximum possible increases in rates in the shortest possible timeframe, based on the face amount of the note (not the hypothetical loan amount of $10,000 required by section 226.19(b)(2)(x)). The creditor must provide a maximum payment for each payment level, where a payment schedule provides for more than one payment level and more than one maximum payment amount is possible.

32(d) Limitations

32(d)(1)(i) Balloon Payment

1. *Regular periodic payments.* The repayment schedule for a section 226.32 mortgage loan with a term of less than five years must fully amortize the outstanding principal balance through "regular periodic payments." A payment is a "regular periodic payment" if it is not more than twice the amount of other payments.

32(d)(2) Negative Amortization

1. *Negative amortization.* The prohibition against negative amortization in a mortgage covered by section 226.32 does not preclude reasonable increases in the principal balance that result from events permitted by the legal obligation unrelated to the payment schedule. For example, when a consumer fails to obtain property insurance and the creditor purchases insurance, the creditor may add a reasonable premium to the consumer's principal balance, to the extent permitted by the legal obligation.

32(d)(4) Increased Interest Rate

1. *Variable-rate transactions.* The limitation on interest-rate increases does not ap-

ply to rate increases resulting from changes in accordance with the legal obligation in a variable-rate transaction, even if the increase occurs after default by the consumer.

32(d)(5) Rebates

1. *Calculation of refunds.* The limitation applies only to refunds of precomputed (such as add-on) interest and not to any other charges that are considered finance charges under section 226.4 (for example, points and fees paid at closing). The calculation of the refund of interest includes odd-days interest, whether paid at or after consummation.

32(d)(6) Prepayment Penalties

1. *State law.* For purposes of computing a refund of unearned interest, if using the actuarial method defined by applicable state law results in a refund that is greater than the refund calculated by using the method described in section 933(d) of the Housing and Community Development Act of 1992, creditors should use the state law definition in determining if a refund is a prepayment penalty.

32(d)(7) Prepayment-Penalty Exception

Paragraph 32(d)(7)(iii)

1. *Calculating debt-to-income ratio.* "Debt" does not include amounts paid by the borrower in cash at closing or amounts from the loan proceeds that directly repay an existing debt. Creditors may consider combined debt-to-income ratios for transactions involving joint applicants.

2. *Verification.* Verification of employment satisfies the requirement for payment records for employment income.

32(e) Prohibited Acts and Practices

32(e)(1) Repayment Ability

1. *Determining repayment ability.* The information provided to the creditor in connection with section 226.32(d)(7) may be used to show that the creditor considered the consumer's income and obligations before extending the credit. Any expected income can be considered by the creditor, except equity income that the consumer would obtain through the foreclosure of a mortgage covered by section 226.32. For example, a creditor may use information about income other than regular salary or wages such as gifts, expected retirement payments, or income from housecleaning or childcare. The creditor also may use unverified income, as long as the creditor has a reasonable basis for believing that the income exists and will support the loan.

32(e)(2) Home-Improvement Contracts

Paragraph 32(e)(2)(i)

1. *Joint payees.* If a creditor pays a contractor with an instrument jointly payable to the contractor and the consumer, the instrument must name as payee each consumer who is primarily obligated on the note.

32(e)(3) Notice to Assignee

1. *Subsequent sellers or assignors.* Any person, whether or not the original creditor, that sells or assigns a mortgage subject to this section must furnish the notice of potential liability to the purchaser or assignee.

2. *Format.* While the notice of potential liability need not be in any particular format, the notice must be prominent. Placing it on the face of the note, such as with a stamp, is one means of satisfying the prominence requirement.

SECTION 226.33—Requirements for Reverse Mortgages

33(a) Definition

1. *Nonrecourse transaction.* A nonrecourse reverse-mortgage transaction limits the homeowner's liability to the proceeds of the sale of the home (or any lesser amount specified in the credit obligation).

If a transaction structured as a closed-end reverse-mortgage transaction allows recourse against the consumer, and the annual percentage rate or the points and fees exceed those specified under section 226.32(a)(1), the transaction is subject to all the requirements of section 226.32, including the limitations concerning balloon payments and negative amortization.

Paragraph 33(a)(2)

1. *Default.* Default is not defined by the statute or regulation, but rather by the legal obligation between the parties and state or other law.

2. *Definite term or maturity date.* To meet the definition of a reverse-mortgage transaction, a creditor cannot require any principal, interest, or shared appreciation or equity to be due and payable (other than in the case of default) until after the consumer's death, transfer of the dwelling, or the consumer ceases to occupy the dwelling as a principal dwelling. Some state laws require legal obligations secured by a mortgage to specify a definite maturity date or term of repayment in the instrument. Stating a definite maturity date or term of repayment in an obligation does not violate the definition of a reverse-mortgage transaction if the maturity date or term of repayment used would in no case operate to cause maturity prior to the occurrence of any of the events recognized in the regulation. For example, a provision that allows a reverse-mortgage loan to become due and payable only after the consumer's death, transfer, or cessation of occupancy, *or* after a specified term, but which automatically extends the term for consecutive periods as long as none of the events specified in this section had yet occurred.

33(c) Projected Total Cost of Credit

33(c)(1) Costs to Consumer

1. *Costs and charges to consumer—relation to finance charge.* All costs and charges to the consumer that are incurred in a reverse-mortgage transaction are included in the projected total cost of credit, and thus in the total-annual-loan-cost rates, whether or not the cost or charge is a finance charge under section 226.4.

2. *Annuity costs.* As part of the credit transaction, some creditors require or permit a consumer to purchase an annuity that immediately—or at some future time—supplements or replaces the creditor's payments. The amount paid by the consumer for the annuity is a cost to the consumer under this section, regardless of whether the annuity is purchased through the creditor or a third party, or whether the purchase is mandatory or voluntary.

3. *Disposition costs excluded.* Disposition costs incurred in connection with the sale or transfer of the property subject to the reverse mortgage are not included in the costs to the consumer under this paragraph. (However, see the definition of Val_n in appendix K to the regulation to determine the effect certain disposition costs may have on the total-annual-loan-cost rates.)

33(c)(2) Payments to Consumer

1. *Payments upon a specified event.* The projected total cost of credit should not reflect contingent payments in which a credit to the outstanding loan balance or a payment to the consumer's estate is made upon the occurrence of an event (for example, a "death benefit" payable if the consumer's death occurs within a certain period of time). Thus, the table of total-annual-loan-cost rates required under section 226.33(b)(2) would not reflect such payments. At its option, however, a creditor may put an asterisk, footnote, or similar type of notation in the table next to the applicable total-annual-loan-cost rate, and state in the body of the note, apart from the table, the assumption upon which the total-annual-loan-cost is made and any different rate that would apply if the contingent benefit were paid.

33(c)(3) Additional Creditor Compensation

1. *Shared appreciation or equity.* Any shared appreciation or equity that the creditor is entitled to receive pursuant to the legal obligation must be included in the total cost of a reverse-mortgage loan. For example, if a creditor agrees to a reduced interest rate on the transaction in exchange for a portion of the appreciation or equity that may be realized when the dwelling is sold, that portion is included in the projected total cost of credit.

33(c)(4) Limitations on Consumer Liability

1. *In general.* Creditors must include any limitation on the consumer's liability (such as a nonrecourse limit or an equity-conservation agreement) in the projected total cost of credit. These limits and agreements protect a portion of the equity in the dwelling for the consumer or the consumer's estate. For example, the following are limitations on the consumer's liability that must be included in the projected total cost of credit:

i. A limit on the consumer's liability to a certain percentage of the projected value of the home.
ii. A limit on the consumer's liability to the net proceeds from the sale of the property subject to the reverse mortgage.

2. *Uniform assumption for "net proceeds" recourse limitations.* If the legal obligation between the parties does not specify a percentage for the "net proceeds" liability of the consumer, for purposes of the disclosures required by section 226.33, a creditor must assume that the costs associated with selling the property will equal 7 percent of the projected sale price (see the definition of the Val_n symbol under appendix K(b)(6)).

14. *Effective April 1, 1996, comments on appendixes K and L are added to read as follows:*

APPENDIX K—Total-Annual-Loan-Cost Rate Computations for Reverse-Mortgage Transactions

1. *General.* The calculation of total-annual-loan-cost rates under appendix K is based on the principles set forth and the estimation or "iteration" procedure used to compute annual percentage rates under appendix J. Rather than restate this iteration process in full, the regulation cross-references the procedures found in appendix J. In other aspects the appendix reflects the special nature of reverse-mortgage transactions. Special definitions and instructions are included where appropriate.

(b) Instructions and Equations for the Total-Annual-Loan-Cost Rate

(b)(5) Number of Unit Periods between Two Given Dates

1. *Assumption as to when transaction begins.* The computation of the total-annual-loan-cost rate is based on the assumption that the reverse-mortgage transaction begins on the first day of the month in which consummation is estimated to occur. Therefore, fractional unit periods (used under appendix J for calculating annual percentage rates) are not used.

(b)(9) Assumption for Discretionary Cash Advances

1. *Amount of credit.* Creditors should compute the total-annual-loan-cost rates for transactions involving discretionary cash advances by assuming that 50 percent of the initial amount of the credit available under the transaction is advanced at closing or, in an open-end transaction, when the consumer becomes obligated under the plan. (For the purposes of this assumption, the initial amount of the credit is the principal loan

amount less any costs to the consumer under section 226.33(c)(1).)

(b)(10) Assumption for Variable-Rate Reverse-Mortgage Transactions

1. *Initial discount or premium rate.* Where a variable-rate reverse-mortgage transaction includes an initial discount or premium rate, the credit should apply the same rules for calculating the total-annual-loan-cost rate as are applied when calculating the annual percentage rate for a loan with an initial discount or premium rate (see the commentary to section 226.17(c)).

(d) Reverse Mortgage Model Form and Sample Form

(d)(2) Sample Form

1. *General.* The "clear and conspicuous" standard for reverse-mortgage disclosures does not require disclosures to be printed in any particular type size. Disclosures may be made on more than one page, and use both the front and the reverse sides, as long as the pages constitute an integrated document and the table disclosing the total-annual-loan-cost rates is on a single page.

APPENDIX L—Assumed Loan Periods for Computations of Total-Annual-Loan-Cost Rates

1. *General.* The life expectancy figures used in appendix L are those found in the U.S. Decennial Life Tables for women, as rounded to the nearest whole year and as published by the U.S. Department of Health and Human Services. The figures contained in appendix L must be used by creditors for all consumers (men and women). Appendix L will be revised periodically by the Board to incorporate revisions to the figures made in the decennial tables.